

Raffles Medical Group

Double booster from MediSave and MediShield

| | |
|----------------|-----------------|
| OUTPERFORM | Maintained |
| S\$0.98 | @15/01/07 |
| | Target: S\$1.18 |
| | Healthcare |

RFMD SP / RAFG SI

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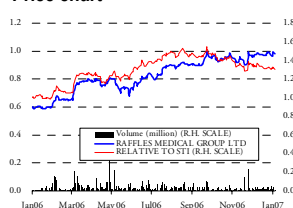
- Medisave changes benefit private oncology healthcare players.** The government's recent move to increase the daily withdrawal limit for in-patient medical treatment from Medisave (from S\$400 to S\$450) and the extension of Medisave coverage to cancer scans is a boon to private healthcare operators. Raffles Medical Group (RMG) is one of them.
- Additional boost from reduction of deductibles for private insurance plans.** The government intends to further reduce the co-payment, in particular deductibles, for Medisave-approved private insurance plans in 2007. With the proposed reduction of deductibles in these plans, we predict that RMG will be able to develop its medical insurance business to 4% of its revenue and operating profit in 2H07, ahead of the group's target of FY08.
- Slow overseas expansion strategy gives rise to higher dividend payout.** With no huge capex related to overseas expansion, our payout assumption has been raised to 85% from 80%, implying yields of 5.1-5.9% for FY07-08.
- Maintain Outperform, target price upgraded to S\$1.18 (from S\$1.09).** Keeping our earnings estimates intact for FY06, we raise our FY07-08 estimates by 9% and 2% respectively, to reflect insurance contributions, operating efficiencies from all divisions and a higher outpatient load from chronic illness treatment. Consequently, our target price, still set at 20x CY07 P/E, has been raised to S\$1.18 from S\$1.09. RMG remains our top pick in Singapore's healthcare sector on the back of its strong earnings prospects, improving ROEs and respectable dividend yield. Maintain Outperform.

Financial summary

| FYE Dec | 2004 | 2005 | 2006F | 2007F | 2008F |
|---------------------------|--------|--------|--------|--------|--------|
| Revenue (S\$ m) | 101.5 | 112.9 | 131.8 | 157.0 | 183.0 |
| EBITDA (S\$ m) | 14.3 | 16.6 | 22.7 | 32.2 | 35.7 |
| EBITDA margins (%) | 14.1 | 14.7 | 17.3 | 20.5 | 19.5 |
| Pretax profit (S\$ m) | 12.4 | 14.8 | 20.2 | 29.7 | 34.3 |
| Net profit (S\$ m) | 9.5 | 12.0 | 16.2 | 23.7 | 27.4 |
| EPS (cts) | 2.4 | 3.0 | 4.0 | 5.9 | 6.8 |
| EPS growth (%) | 17% | 24% | 34% | 47% | 15% |
| P/E (x) | 40.3 | 32.6 | 24.3 | 16.6 | 14.3 |
| Gross DPS (cts) | 2.5 | 2.5 | 3.3 | 5.0 | 5.8 |
| Dividend yield (%) | 2.6 | 2.6 | 3.4 | 5.1 | 5.9 |
| P/NTA (x) | 3.8 | 3.7 | 3.7 | 3.7 | 3.7 |
| ROE (%) | 9.7 | 11.5 | 15.1 | 22.4 | 25.7 |
| Net gearing (%) | (29.9) | (30.4) | (32.9) | (37.1) | (38.6) |
| Net cash per share (S\$) | 0.08 | 0.08 | 0.09 | 0.10 | 0.10 |
| P/CF (x) | 30.6 | 25.9 | 19.5 | 14.2 | 12.5 |
| EV/EBITDA (x) | 25.4 | 21.9 | 16.0 | 11.3 | 10.2 |
| % change in EPS estimates | - | - | - | 9% | 2% |
| CIMB-GK/Consensus (x) | - | - | 1.02 | 1.09 | 1.02 |

Source: Company, CIMB-GK estimates, Reuters Estimates

Price chart



Source: Bloomberg

Market capitalisation & share price info

| | | | | | |
|------------------------|-----------------|------------------------------|-----------|-----------|---------------|
| Market cap | 393.1 | Share price perf. (%) | 1M | 3M | 12M |
| 12-mth price range | S\$0.59/S\$1.00 | Relative | (1.1) | (9.1) | 34.2 |
| 3-mth avg daily volume | S\$0.25m | Absolute | 1.5 | 2.6 | 67.8 |
| # of shares (m) | 401.1 | Major shareholders | | | % held |
| Est. free float (%) | 35% | Dr Loo Choon Yong | | | 57% |
| Wrts/ICULS o/s (m) | None | | | | |
| Conv. price (S\$) | None | | | | |

Source: Company, CIMB-GK estimates / Research, Bloomberg, Reuters Estimates

Please read carefully the important disclosures at the end of this publication.

Update

Medisave changes benefit private oncology healthcare players. The government's recent decision to increase the daily withdrawal limit for in-patient medical treatment from Medisave (from S\$400 to S\$450) came as a mild surprise. As part of its review of Medisave and MediShield policies, the Ministry of Health also extended Medisave coverage to cancer scans such as computerised tomography (CT scan) and magnetic resonance imaging (MRI).

We believe this landmark change will benefit more than 25,000 patients, but it seems unlikely to affect subsidised patients much, since about 95% of their average bills are already covered by Medisave. We think non-subsidised private patients who have Medisave accounts would be the most direct beneficiaries. MOH data showed that with the withdrawal limit increase in Apr06 (from S\$300 to S\$400), the increase helped patients cover 57% of the average A/private ward class bill (up from 52% previously). We estimated with daily withdrawal limit to S\$450, coverage of that same class bill will be increase to approximately 64%. This is a boon for private healthcare operators who treat oncology patients. RMG is one of these.

Already, the extension of Medisave coverage to chronic illnesses has provided immense opportunities for the group to offer integrated disease management programmes. With S\$250m slated for withdrawal annually according to the Ministry of Health, we believe RMG could leverage its extensive clinic network in Singapore to enjoy a larger share of the healthcare market going forward.

Additional boost from reduction of deductibles for private insurance plans. With healthcare expenditure on the rise, the government will be placing greater emphasis on national and private healthcare insurance. It recently announced that preliminary feedback suggests that Singaporeans are prepared to pay higher premiums for greater MediShield payouts, provided the premium increase is not too big. The Ministry of Health intends to further reduce the co-payment, in particular deductibles, of Medisave-approved private insurance plans in 2007.

RMG has been tapping the medical insurance market, which has vast potential for growth, after converting its general insurer's licence to a life insurer's licence. With the scheme to reduce deductibles for Medisave-approved private insurance plans, we predict that RMG would be able to increase contributions from its medical insurance business to 4% of group revenue and operating profit in 2H07, ahead of the group's target of FY08, as more patients sign up Medisave-approved insurance plans to enjoy the lower deductibles. Conservatively, we estimate only S\$3m in insurance revenue. This would lift our FY07 operating profit estimate for the healthcare services division to S\$11m, a 7% increase from our previous forecast.

Spillover benefits for hospital, with non-bed-related rate hike imminent. We believe that this surge in patient load from the insurance business would cause inpatient and outpatient occupancy rates to climb above 60%. We believe higher non-bed-related fee income, partly related to rate adjustments for procedures and synergies from the insurance business, could boost hospital services revenue to S\$87m (+20% yoy) in FY07.

Slow overseas expansion strategy gives rise to higher dividend payout. The group has indicated that its China operation may take a longer time to break even given the vague regulatory changes pertaining to medical practices in the PRC. In the absence of any huge capex related to overseas expansion (a low probability at this time), we have raised our dividend payout assumption to 85% from 80%. With no Section 44 tax credits to back up its dividend stream, we project yields of 5.1-5.9% for FY07-08.

Valuation and recommendation

Maintain Outperform, target price upgraded to S\$1.18 (from S\$1.09). We are keeping our earnings estimates intact for FY06, but have raised FY07-08 estimates by 9% and 2% respectively to reflect: 1) insurance contributions; 2) operating efficiencies from hospital and healthcare services; 3) added specialist healthcare services in and outside the hospital; and 4) a higher outpatient load from chronic illness treatment.

Consequently, our target price, still set at 20x CY07 P/E, has been raised to S\$1.18 from S\$1.09. RMG remains our top pick in Singapore's healthcare sector on the back of its strong earnings prospects, improving ROEs and respectable dividend yield. Maintain Outperform.

| Financial tables | | | | | |
|---|--------------|--------------|---------------|---------------|---------------|
| PROFIT & LOSS (RMB m, FYE Dec) | 2004 | 2005 | 2006F | 2007F | 2008F |
| Revenue | 101.5 | 112.9 | 131.8 | 157.0 | 183.0 |
| Operating expenses | (87.1) | (96.3) | (109.1) | (124.8) | (147.4) |
| EBITDA | 14.3 | 16.6 | 22.7 | 32.2 | 35.7 |
| Depreciation & amortisation | (3.0) | (3.1) | (4.0) | (4.0) | (4.0) |
| EBIT | 11.3 | 13.5 | 18.7 | 28.2 | 31.7 |
| Net interest & invt income | (0.1) | (0.1) | (0.1) | (0.1) | 0.9 |
| Associates' contribution | 1.2 | 1.4 | 1.5 | 1.6 | 1.7 |
| Exceptional items | - | - | - | - | - |
| Pretax profit | 12.4 | 14.8 | 20.2 | 29.7 | 34.3 |
| Tax | (3.0) | (2.8) | (4.0) | (5.9) | (6.9) |
| Minority interests | (0.0) | (0.1) | - | - | - |
| Net profit | 9.5 | 12.0 | 16.2 | 23.7 | 27.4 |
| Wt. shares (m) | 390.0 | 397.4 | 400.3 | 401.1 | 401.1 |
| Shares at year-end (m) | 391.7 | 400.3 | 401.1 | 401.1 | 401.1 |
| BALANCE SHEET (RMB m, 31 Dec) | 2004 | 2005 | 2006F | 2007F | 2008F |
| Fixed assets | 19.4 | 21.4 | 22.4 | 22.9 | 22.9 |
| Intangible assets | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Other long-term assets | 52.8 | 53.9 | 54.5 | 55.1 | 55.6 |
| Total non-current assets | 72.4 | 75.6 | 77.2 | 78.3 | 78.8 |
| Cash and equivalents | 32.2 | 35.1 | 37.5 | 42.0 | 45.1 |
| Stocks | 2.6 | 2.9 | 2.8 | 2.7 | 2.5 |
| Trade debtors | 11.0 | 12.3 | 13.5 | 14.8 | 16.3 |
| Other current assets | 9.5 | 13.0 | 11.8 | 9.5 | 10.9 |
| Total current assets | 55.3 | 63.3 | 65.6 | 69.0 | 74.8 |
| Trade creditors | 22.0 | 24.4 | 29.0 | 31.9 | 35.1 |
| Short-term borrowings | 2.1 | 2.3 | 2.4 | 2.4 | 2.4 |
| Other current liabilities | 2.6 | 3.8 | 4.0 | 5.9 | 6.9 |
| Total current liabilities | 26.7 | 30.5 | 35.5 | 40.3 | 44.4 |
| Long-term borrowings | - | - | - | - | - |
| Other long-term liabilities | 0.7 | 0.7 | 0.7 | 0.7 | - |
| Total long-term liabilities | 0.7 | 0.7 | 0.7 | 0.7 | - |
| Shareholders' funds | 100.2 | 107.5 | 106.4 | 105.6 | 108.9 |
| Minority interests | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| NTA/share (RMB) | 0.25 | 0.27 | 0.26 | 0.26 | 0.27 |
| CASH FLOW (RMB m, FYE Dec) | 2004 | 2005 | 2006F | 2007F | 2008F |
| Pretax profit | 12.4 | 14.8 | 20.2 | 29.7 | 34.3 |
| Depreciation & non-cash adjustments | 3.0 | 3.1 | 4.0 | 4.0 | 4.0 |
| Working capital changes | 3.3 | 0.8 | 3.5 | 1.7 | 1.8 |
| Cash tax paid | (2.1) | (3.0) | (2.8) | (4.0) | (5.9) |
| Others | (1.1) | (1.7) | (4.6) | (4.6) | (4.6) |
| Cash flow from operations | 15.4 | 15.6 | 20.6 | 28.6 | 30.4 |
| Capex | (1.6) | (5.8) | (5.0) | (4.5) | (4.0) |
| Net investments & sale of FA | 13.5 | (2.9) | 0.1 | - | - |
| Others | - | - | - | - | - |
| Cash flow from investing | 12.4 | (7.9) | (4.9) | (4.5) | (4.0) |
| Debt raised/(repaid) | - | - | - | - | - |
| Equity raised/(repaid) | 1.4 | 3.0 | - | - | - |
| Dividends paid | (7.8) | (8.0) | (13.3) | (19.6) | (22.6) |
| Cash interest & others | (0.1) | (0.1) | (0.0) | - | (0.7) |
| Cash flow from financing | (6.4) | (5.0) | (13.3) | (19.6) | (23.3) |
| Change in cash | 21.3 | 2.7 | 2.4 | 4.5 | 3.1 |
| Change in net cash/(debt) | 21.3 | 2.7 | 2.4 | 4.5 | 3.1 |
| Ending net cash/(debt) | 30.0 | 32.7 | 35.1 | 39.5 | 42.7 |
| KEY RATIOS (FYE Dec) | 2004 | 2005 | 2006F | 2007F | 2008F |
| Revenue growth (%) | 2.4 | 11.3 | 16.7 | 19.1 | 16.6 |
| EBITDA growth (%) | 8.8 | 15.6 | 37.3 | 41.5 | 10.9 |
| Pretax margins (%) | 12.3 | 13.1 | 15.3 | 18.9 | 18.7 |
| Net profit margins (%) | 9.3 | 10.6 | 12.3 | 15.1 | 15.0 |
| Interest cover (x) | 186.9 | 148.5 | 163.4 | 179.1 | 180.1 |
| Effective tax rates (%) | 23.8 | 18.6 | 20.0 | 20.0 | 20.0 |
| Net dividend payout (%) | 102.8 | 83.1 | 82.3 | 82.5 | 82.5 |
| Debtors turnover (days) | 47.6 | 37.6 | 35.7 | 33.0 | 31.1 |
| Stock turnover (days) | 9.7 | 8.9 | 7.9 | 6.3 | 5.2 |
| Creditors turnover (days) | 81.5 | 74.9 | 73.9 | 70.8 | 66.8 |

Source: Company, CIMB-GK estimates

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UNDERPERFORM: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.

TRADING BUY: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 months.

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OVERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

NEUTRAL: The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.

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