

Raffles Medical Group

Hitting a duller tone

NEUTRAL

Downgraded

S\$1.52

@18/06/07

Target: S\$1.54

Mkt. Cap: S\$770.9m

Healthcare

RFMD SP / RAFG SI

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MICA (P) 156/03/2007

Acquisition of Raffles Hospital through placement

RFMD has entered into a conditional sale and purchase agreement with CapitaLand to acquire the remaining 50% of Raffles Hospital (RH) for a total consideration of S\$66.86m. To fund this purchase, RFMD is placing out 50m new shares to raise net proceeds of S\$63m. The new shares represent about 9.9% of the group's enlarged share capital.

Comments

Defensive measure in view of escalating rentals. In our healthcare sector report dated 12 Jun, we highlighted that the main risk to RFMD would actually come from the cost side. We believe possible rental escalation could be behind the group's move, given that RH's rental renewal with the old JV is due this year. We estimate that rentals could amount to S\$12m (vs. about S\$7m FY06) in FY07. With full ownership of RH, the group would effectively cease paying rents.

Better ability to configure RH. We also think that full control of RH would increase the group's flexibility to configure usage of the hospital without the need to obtain consent from the JV partner on the deployment of floors and space.

Moving into net gearing. We do not think dividend yields would be affected as proceeds from the placement will go to fund the purchase. Hence, RFMD is likely to retain its 85% payout ratio. That said, we expect the group to go into a net gearing position of 11% at end FY07, as it will assume more debt from full ownership of the building. We deem such gearing levels as low and not a major concern.

Could stifle ability to expand overseas. Should the group need to fund its overseas expansion, further borrowing would be needed. Given the group's normally conservative stance on gearing, we believe such expansion programmes could be deferred.

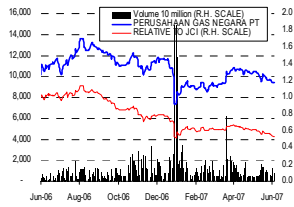
Valuation and recommendation

Estimates slashed by 10-17%. We have slashed our FY07-09 EPS estimates by 10-17% to reflect: 1) higher net interest from full ownership of RH that would offset rental savings; 2) higher depreciation charges; and 3) earnings dilution from the placement.

Raised target price to S\$1.54 from S\$1.49. Given the group's full control of its core healthcare asset, we have raised our CY08 target multiple for RFMD from 23x to 27x. This still represents a 15% discount to our target multiple for Parkway (previously 20% discount), given that RFMD only has Singapore exposure. Consequently, our target price has been raised to S\$1.54 from S\$1.49.

Downgrade to NEUTRAL from Outperform. However, with limited upside from current levels, we downgrade our rating from Outperform to NEUTRAL. Risks to our call would be the scalability of RFMD's business overseas in the next 6-12 months, should the group be willing to take on higher gearing in favour of regional opportunities.

Price chart



Source: Bloomberg

Financial summary

FYE Dec	2005	2006	2007F	2008F	2009F
Revenue (S\$ m)	112.9	134.2	157.0	183.7	213.4
EBITDA (S\$ m)	17.1	22.4	34.3	40.8	47.6
EBITDA margins (%)	15.2	16.7	21.8	22.2	22.3
Pretax profit (S\$ m)	14.8	20.0	29.3	35.3	42.6
Net profit (S\$ m)	12.0	15.8	23.6	29.0	34.9
EPS (cts)	2.6	3.4	4.7	5.7	6.9
EPS growth (%)	26%	31%	36%	23%	20%
P/E (x)	58.1	44.2	32.6	26.6	22.1
Gross DPS (cts)	2.5	4.0	4.0	4.9	5.9
Dividend yield (%)	1.6	2.6	2.6	3.2	3.8
P/NTA (x)	6.5	6.2	3.4	3.3	3.3
ROE (%)	11.5	14.3	13.8	12.5	14.8
Net cash per share (S\$)	0.07	0.09	(0.05)	(0.05)	(0.03)
P/CF (x)	45.4	35.2	25.1	23.0	19.3
EV/EBITDA (x)	43.3	33.0	21.6	18.1	15.6
% change in EPS estimates	-	-	-10%	-11%	-17%
CIMB-GK/Consensus (x)	-	-	1.06	1.00	0.97

Source: Company, CIMB-GK estimates, Reuters Estimates

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