

Raffles Medical Group

Nothing exciting yet

NEUTRAL	Maintained
S\$1.51	@24/09/07
	Target: S\$1.51
	Healthcare

RFMD SP / RAFG.SI

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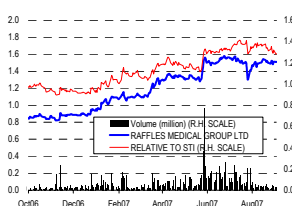
- Minimal benefits from recent changes.** We do not expect immediate price hikes from the recent removal of consultation-fee guidelines, as fee adjustments tend to be gradual and market forces may keep prices competitive. The extended use of Medisave for the outpatient treatment of chronic diseases is also not likely to have much impact given the long-dated costs of treatment involved.
- Overseas expansion unlikely in next 6-12 months.** While the group has not disclosed the timeline for its expansion in China, we doubt that expansion would take place next year, given its cautious approach. Its foray into China is likely to commence with medical centres, rather than full-fledged hospitals.
- Maintain Neutral, with a slightly lower target price.** We have shaved our earnings estimates by 2-4% for FY07-08 on higher operating-cost assumptions as YTD operating costs have been higher than expected. Following this, we have trimmed our target price to S\$1.51 from S\$1.54, still based on 27x CY08 P/E, or a 10% discount to our target P/E for Parkway, given that RFMD only has Singapore exposure. Although fundamentals remain very much intact, we do not see significant catalysts in the next 6-12 months. Maintain Neutral.

Financial summary

FYE Dec	2005	2006	2007F	2008F	2009F
Revenue (S\$ m)	112.9	134.2	159.3	186.0	214.7
EBITDA (S\$ m)	16.6	22.6	32.4	42.6	49.2
EBITDA margins (%)	14.7	16.8	20.3	22.9	22.9
Pretax profit (S\$ m)	14.8	20.0	40.2	35.0	43.7
Net profit (S\$ m)	12.0	15.7	32.9	28.6	35.7
EPS (S cts)	3.0	3.9	7.1	5.6	6.9
EPS growth (%)	+24%	+28%	+84%	-22%	+25%
P/E (x)	50.2	39.2	21.3	27.2	21.7
Core EPS (S cts)	3.0	3.9	4.3	5.6	6.9
Core EPS growth (%)	+24%	+28%	+12%	+29%	+25%
Core P/E (x)	50.2	39.2	35.0	27.2	21.7
FD EPS (S cts)	3.0	3.8	7.0	5.6	6.9
FD P/E (x)	50.9	39.9	21.7	27.2	21.7
Gross DPS (S cts)	3.0	4.0	6.0	4.7	5.9
Dividend yield (%)	2.0	2.6	4.0	3.1	3.9
P/NTA (x)	5.6	5.5	4.4	4.3	4.1
ROE (%)	11.5	14.3	22.6	15.9	19.4
Net gearing (%)	(30.4)	(35.3)	31.0	23.2	14.9
P/CF (x)	38.4	31.3	18.5	19.3	16.3
EV/EBITDA (x)	34.3	25.5	23.3	19.2	16.4
% change in EPS estimates	-	-	(4.2)	(1.5)	2.4
CIMB/Consensus (x)	-	-	0.95	0.90	0.89

Source: Company, CIMB-GK Research

Price chart



Source: Bloomberg

Market capitalisation & share price info

Market cap	S\$777.3m	Share price perf. (%)	1M	3M	12M
12-mth price range	S\$0.81/S\$1.61	Relative	(1.6)	2.7	31.3
3-mth avg daily volume	S\$0.94m	Absolute	3.4	0.7	84.6
# of shares (m)	514.8	Major shareholders			% held
Est. free float (%)	35	Raffles Medical Holding			0.4
Wrts/ICULS o/s (m)	None	Dr Loo Choon Yong			0.1
Conv. price (S\$)	None				

Source: Company, CIMB-GK Research, Bloomberg

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

Regulatory update

Removal of consultation-fee guidelines unlikely to raise prices in the short term. In April this year, the Singapore Medical Association withdrew its decades-old guidelines on medical fees as the guide may contravene the recently-enacted Competition Act. The withdrawal has allowed private doctors to set their fees without caps. While RFMD may benefit as the group would now be able to set fees in line with its operating costs and not be subjected to artificial price caps, we believe upward price revisions may not occur in the short term as fee adjustments tend to be gradual and market forces may keep prices competitive.

No significant benefit from higher daily hospital limit for Medisave claims. Inpatient withdrawal limits have been increased from S\$400 to S\$450, effectively covering 66% of an A-ward bill in a private hospital, up from 57% previously. We do not envisage that private hospitals such as RFMD would significantly benefit from this, as the quantum increase may not be sufficiently attractive for middle-income earners to opt for private tertiary healthcare instead of government hospitals.

Minimal impact of extended use of Medisave. The use of Medisave has also been extended to diagnostic scans such as MRI, CT and PET scans in outpatient oncology treatment. In addition, Medisave can be used to cover outpatient treatment of the following chronic diseases: diabetes, high blood pressure, lipid disorders and stroke, all of which affect an estimated 1m Singaporeans. We expect these changes in government policy to have a minimal impact on private healthcare given the chronic nature of these diseases and the long-dated costs of treatment involved.

Other updates

New specialist clinics. The group has moved its administrative offices to unoccupied wards to make way for new and expanded specialist clinics. The Raffles Fertility Centre has been formed within the Raffles Women's Clinic, to offer treatments such as super-ovulation & intrauterine insemination, in-vitro fertilisation and intra cytoplasmic sperm Injection. This centre is helmed by Dr Sheila Loh, the former Head & Senior Consultant of the Reproductive Medicine Unit and former Director of KK IVF Centre at the KK Women's & Children's Hospital. Although we have factored in revenue contributions from the new specialist clinics, we think that revenue growth may trail operating costs in the short term due to start-up costs and promotional expenses.

Higher growth from foreign patients. Improvements in regional economies, coupled with greater marketing efforts through representative clinics in new markets such as Vietnam, Mongolia and Russia, have been attracting more foreign patients. Foreigners now account for more than a third of all hospital attendances, up from 20% six years ago. The group expects the number to reach 50% within the next two years. Foreign patients drive greater growth as their diagnosis is often more complex and treatment more intensive, resulting in a greater utilisation of higher-value services.

Room to enhance operating efficiencies. With occupancy rates at 40-60% and only 175 beds out of the 380 licensed beds occupied, there remains room for further enhancement of operating efficiencies and margins. New beds are added when occupancy reaches more than 70%, so as to maintain an exclusive feel for the hospital. The group thinks that there is sufficient capacity in its hospital to serve its needs for the next 2-3 years. As such, it does not anticipate significant capex for its local operations. When the existing hospital becomes fully occupied, the group will assess its expansion plans, which may include building extensions or a second greenfield hospital.

Overseas expansion unlikely in the next 6-12 months. The group wants to expand into fast-growing cities in China such as Shanghai and Beijing. Its foray into China is likely to commence with medical centres, rather than full-fledged hospitals, to enable it to test out the market. RFMD is less keen on hospital management contracts, as it is not prepared to mortgage its brand name if it cannot influence the quality of healthcare. While it is not disclosing the timeline for its expansion, we doubt that such moves would materialise within the next year, given its cautious approach and low risk appetite.

Risks

Economic downturn. Healthcare is a cyclical business. During economic downturns, patients may postpone non-emergency elective medical procedures.

Pandemics and natural disasters. During SARS and the avian flu outbreak, foreign patients cut back on their travel and postponed their non-emergency treatments.

Similarly, local patients stayed away from hospitals and postponed their treatments.

Shortage of medical professionals. As a service company, the group depends on its doctors and specialist medical staff for the quality of medical services rendered. The group believes the risk of a shortage of doctors is low as their doctors are paid within the top quartile of the profession and it has a waiting list of doctors keen to join the company. We are more concerned that the continuous worldwide shortage of nurses may limit RFMD's growth.

Valuation and recommendation

Forecasts and target price trimmed; maintain Neutral. We have shaved our earnings estimates by 2-4% for FY07-08 as we have raised our operating-cost assumptions to bring them in line with recent cost trends. Following our earnings adjustments, we have trimmed our target price to S\$1.51 from S\$1.54, still based on 27x CY08 P/E, or a 10% discount to our target P/E for Parkway, given that RFMD only has Singapore exposure.

Although industry and company fundamentals remain very much intact, we do not see significant catalysts happening in the next 6-12 months. Maintain Neutral. Stock catalysts could come from: 1) overseas expansion; and 2) policy changes such as means testing which may result in more middle-income patients seeking private healthcare as they will no longer enjoy subsidies under the government healthcare system.

Figure 1: Sector comparisons

	Bloomberg ticker	Recom.	Price	Mkt cap (US\$ m)	Core P/E (x)		3-yr EPS CAGR (%)	P/NTA (x)	ROE (%)		Div yield (%)
					CY07	CY08		CY07	CY07	CY08	CY07
Parkway Holdings	PWAY SP	O	S\$4.26	2,163.2	33.5	26.7	24.6	7.0	22.0	24.8	1.6
Raffles Medical	RFMD SP	N	S\$1.51	512.2	35.0	27.2	20.9	4.4	22.6	15.9	4.0
Thomson Medical	THOM SP	O	S\$0.68	130.8	19.3	15.4	22.7	2.3	20.3	23.3	2.9
Bangkok Dusit Medic	BGH TB	NR	38.75 THB	1,495.8	32.4	25.9	31.5	4.5	15.0	17.4	1.5
Bumrungrad Hospital	BH TB	U	42.75 THB	965.3	27.5	23.2	18.2	9.2	36.6	36.2	1.8
Bangkok Chain Hosp	KH TB	NR	9 THB	260.1	17.6	15.7	15.4	2.9	16.6	16.8	3.1
Simple average (including Raffles Medical)					27.6	22.4	22.2	5.0	22.2	22.4	2.5
Simple average (excluding Raffles Medical)					26.1	21.4	22.5	5.2	22.1	23.7	2.2

O = Outperform, N = Neutral, U = Underperform, NR = Not Rated, TB = Trading Buy and TS = Trading Sell
Source: CIMB-GK Research, Bloomberg

Financial tables

PROFIT & LOSS (\$\$ m, FYE Dec)	2005	2006	2007F	2008F	2009F
Revenue	112.9	134.2	159.3	186.0	214.7
Operating expenses	(96.3)	(111.7)	(126.9)	(143.4)	(165.5)
EBITDA	16.6	22.6	32.4	42.6	49.2
Depreciation & amortisation	(3.1)	(3.4)	(3.2)	(5.4)	(5.4)
EBIT	13.5	19.2	29.2	37.2	43.8
Net interest & invt income	(0.1)	(0.1)	(2.2)	(2.2)	(0.1)
Associates' contribution	1.4	0.9	13.3	-	-
Exceptional items	-	-	-	-	-
Pretax profit	14.8	20.0	40.2	35.0	43.7
Tax	(2.8)	(4.3)	(7.2)	(6.3)	(7.9)
Minority interests	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Net profit	12.0	15.7	32.9	28.6	35.7
Wt. shares (m)	397.4	407.7	463.1	514.7	514.7
Shares at year-end (m)	400.3	412.5	514.7	514.7	514.7
BALANCE SHEET (\$\$ m, 31 Dec)	2005	2006	2007F	2008F	2009F
Fixed assets	21.4	20.2	236.0	229.3	222.7
Intangible assets	0.3	0.2	0.2	0.1	0.1
Other long-term assets	53.9	55.1	1.1	1.1	1.1
Total non-current assets	75.6	75.5	237.2	230.5	223.9
Cash and equivalents	35.1	41.9	31.5	(40.2)	(26.0)
Stocks	2.9	3.4	3.8	4.4	5.1
Trade debtors	12.3	16.8	17.0	19.9	22.9
Other current assets	13.0	14.3	14.3	14.3	14.3
Total current assets	63.3	76.4	66.5	(1.7)	16.3
Trade creditors	24.4	30.0	32.3	37.7	43.5
Short-term borrowings	2.3	2.0	86.7	2.0	2.0
Other current liabilities	3.8	5.9	5.9	5.9	5.9
Total current liabilities	30.5	37.9	124.9	45.6	51.5
Long-term borrowings	-	-	-	-	-
Other long-term liabilities	0.7	0.7	0.7	0.7	0.7
Total long-term liabilities	0.7	0.7	0.7	0.7	0.7
Shareholders' funds	107.5	112.9	177.7	182.0	187.3
Minority interests	0.2	0.3	0.4	0.5	0.6
NTA/share (US\$)	0.30	0.30	0.30	0.40	0.40
CASH FLOW (\$\$ m, FYE Dec)	2005	2006	2007F	2008F	2009F
Pretax profit	14.8	20.0	40.2	35.0	43.7
Depreciation & non-cash adjustments	2.3	1.7	3.2	9.7	9.7
Working capital changes	0.9	0.7	1.6	1.9	2.1
Cash tax paid	(1.4)	(2.3)	(7.2)	(6.3)	(7.9)
Others	(1.0)	(0.5)	-	-	-
Cash flow from operations	15.6	19.7	37.8	40.3	47.6
Capex	(5.8)	(2.3)	(219.0)	(3.0)	(3.0)
Net investments & sale of FA	(3.5)	(1.3)	-	-	-
Others	1.3	1.7	54.0	-	-
Cash flow from investing	(7.9)	(1.9)	(165.0)	(3.0)	(3.0)
Debt raised/(repaid)	3.9	-	84.7	(84.7)	-
Equity raised/(repaid)	3.0	4.8	63.0	-	-
Dividends paid	(8.0)	(15.5)	(31.0)	(24.3)	(30.4)
Cash interest & others	(3.9)	0.1	-	-	-
Cash flow from financing	(4.9)	(10.6)	116.7	(109.0)	(30.4)
Change in cash	2.7	7.2	(10.5)	(71.7)	14.2
Change in net cash/(debt)	(1.2)	7.2	(95.2)	13.0	14.2
Ending net cash/(debt)	32.8	40.0	(55.3)	(42.2)	(28.0)
KEY RATIOS (FYE Dec)	2005	2006	2007F	2008F	2009F
Revenue growth (%)	11.3	18.9	18.6	16.8	15.4
EBITDA growth (%)	15.6	36.4	43.5	31.5	15.4
Pretax margins (%)	13.1	14.9	25.2	18.8	20.4
Net profit margins (%)	10.6	11.7	20.6	15.4	16.6
Interest cover (x)	183.7	184.9	19.1	16.8	439.4
Effective tax rates (%)	18.6	21.3	18.0	18.0	18.0
Net dividend payout (%)	66.7	98.7	94.5	85.0	85.0
Debtors turnover (days)	37.6	39.5	38.7	36.2	36.4
Stock turnover (days)	8.9	8.7	8.3	8.1	8.1
Creditors turnover (days)	74.9	74.0	71.4	68.7	69.1

Source: CIMB-GK Research

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