Raffles Medical Group – ADD

01 November 2011

Result review

IIFL Institutional Equities

Growth slows, expansion delayed

Raffles Medical's (RFMD) 9M11 revenue grew 14.2% YoY and earnings rose 11.8% YoY to S$33.9m, with revenue and net profit achieving 72% and 65% of our 2011 estimates, respectively. 9M11 operating margin declined 40bps YoY as losses from China and insurance business continue to drag earnings. The group indicated delays in its plan to build a new extension to its hospital (completion by end-2014 instead of end-2013 earlier) and to set up a large specialist medical clinic on Orchard Road (operations to start in 1H2013 instead of 2H212 earlier). Accordingly, we lower our 2011-13 estimates by 2.5%-3%. Current valuation of 20x 1-year forward EPS is still at a discount to recent Parkway and Thomson Medical acquisitions. We value the stock at 23x 2012ii EPS and adjust our TP to S$2.55 from S$2.62. Reiterate ADD.

Expansion delayed: RFMD will commence construction of the hospital extension in 2H'2012 and expects the construction to be completed in 18-24 months. 2015 will be the first full year of operation for the hospital extension, against earlier guidance of 2014. The specialist centre at Thong Sia building (Orchard, Singapore) is now expected to commence operations in 1H'2013 as compared to earlier estimate of 2H'2012.

Healthcare growth lower than expected; rising costs and losses from China operations to restrict margin expansion: Healthcare continued to show weak growth with sequential drop in 3Q11 revenue growth to 8.4% from 12.2% in 2Q11. We lower our 2011-13 revenue per clinic growth from 8% to 5%. Continuing losses from China, rising insurance claims and higher staff costs dragged RFMD's 3Q11 earnings, resulting in lower earnings growth compared to revenue growth for second successive quarter. Despite an expected seasonally strong fourth quarter, we estimate rising costs to result in 48bps YoY decline in 2011 operating margin.

Reiterate ADD; adjust TP to S$2.55: During 2010-13, we estimate profit to grow at 18% CAGR with 140bps expansion in operating margin. Margin expansion will be driven by greater specialist service offering, higher specialist service fees with relatively lesser increase in overall staff and other non-operating costs. We value the stock at 23x 2012ii EPS and adjust our TP to S$2.55 from S$2.62.

Result update

CMP	**S$2.25**
12-mth TP (S$)	***2.55 (13%)***
Market cap (US$ m)	**951.7**
Bloomberg	**RFMD SP**
Sector	**Health Care**

Price performance (%)

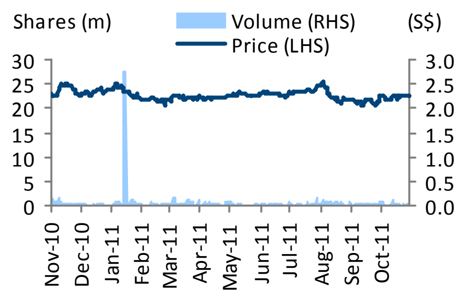
	1M	3M	1Y
Raffles Medical	0.4	-8.5	3.2
Rel. to ST Index	**-6.3**	**1.9**	**12.3**
KPJ Healthcare	5.0	-8.7	13.2
Bangkok D. Med.	5.5	16.9	67.7

Shareholding pattern (%)

Raffles Medical Hldg	39.2
Choon Yong Loo	10.3
Fidelity Management	5.0
Others	45.5

52Wk High/Low (S$)	2.53/2.02
Shares o/s (m)	533.9
Daily volume (US$ m)	.7
Dividend yield FY11ii (%)	1.6
Free float (%)	46.6

Stock performance



Financial summary (S$)

Y/e 31 Dec	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Revenue (m)	**219**	**239**	**274**	**310**	**349**
EBITDA margin (%)	23.9	25.1	25.0	26.2	27.3
Net profit (m)	**37**	**42**	**51**	**59**	**70**
EPS (cents)	**7.2**	**8.1**	**9.6**	**11.1**	**13.1**
Growth (%)	18.6	12.4	18.8	15.7	18.0
IIFL vs consensus (%)			0.0	1.9	0.8
PER (x)	**31.3**	**27.8**	**23.4**	**20.3**	**17.2**
ROE (%)	15.8	15.8	16.8	17.5	18.3
Net debt / equity (%)	-19.9	-29.6	-4.5	-11.4	-14.2
EV / EBITDA (x)	21.6	18.6	17.9	14.8	12.5
Price / book (x)	4.7	4.1	3.7	3.3	3.0
Dividend yield (%)	1.3	1.6	1.6	1.9	2.2

Source: Company, IIFL Research. Priced as on 31 October 2011

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Figure 1: 3Q11 results summary

Income statement (S$ m)	3Q10	4Q10	1Q11	2Q11	3Q11	YoY (%)	9M10	9M11	YoY (%)	Old 2011	9M11 % of 2011
Revenue	**60.9**	**63.5**	**64.4**	**67.0**	**69.1**	**13.5**	**175.6**	**200.5**	**14.2**	**277.5**	**72.3**
Inventories and consumables	7.0	6.6	7.4	7.6	8.3	18.9	20.0	23.4	16.8	30.5	76.7
Purchased & contracted services	4.2	5.1	4.8	5.3	5.0	20.3	12.3	15.1	22.5	19.4	77.8
Staff costs	**29.2**	**31.2**	**31.7**	**31.7**	**33.4**	**14.4**	**84.6**	**96.7**	**14.4**	**133.2**	**72.6**
Depreciation	1.7	1.9	1.9	2.0	1.8	7.3	5.1	5.7	11.9	9.4	60.3
Operating lease expenses	1.5	1.4	1.4	1.5	1.4	(4.7)	4.2	4.3	3.2	6.4	67.2
Other operating expenses	4.2	4.8	4.4	4.6	4.7	10.7	12.5	13.7	9.7	19.7	69.4
Other operating income	-	(3.3)	-	(0.0)	-	-	(0.2)	(0.0)	(95.7)	(1.7)	0.4
Operating income	**13.1**	**15.8**	**12.8**	**14.3**	**14.5**	**10.3**	**37.1**	**41.6**	**12.0**	**60.5**	**68.8**
Interest income	(0.1)	(0.1)	(0.1)	(0.0)	-	(100.0)	(0.3)	(0.2)	(33.1)	(0.5)	32.4
Interest expense	0.1	0.0	0.0	0.1	0.1	5.6	0.2	0.2	(8.7)	0.3	71.5
Pretax profit	**13.1**	**15.9**	**12.9**	**14.3**	**14.4**	**9.6**	**37.2**	**41.6**	**11.8**	**60.8**	**68.4**
Income tax	2.4	0.9	2.4	2.6	2.5	6.4	6.7	7.5	11.4	8.7	86.7
Reported net income	**10.7**	**15.0**	**10.6**	**11.7**	**11.8**	**10.3**	**30.5**	**34.1**	**11.9**	**52.1**	**65.4**
Minority	0.1	0.1	0.1	0.1	0.0	(25.5)	0.1	0.2	20.4	0.2	71.2
PATMI	**10.7**	**15.0**	**10.5**	**11.6**	**11.8**	**10.4**	**30.3**	**33.9**	**11.8**	**51.9**	**65.3**
Exceptional	-	3.0	-	-	-	-	-	-	-	-	-
Recurring PATMI	**10.7**	**12.0**	**10.5**	**11.6**	**11.8**	**10.4**	**30.3**	**33.9**	**11.8**	**51.9**	**65.3**
EBITDA	**14.8**	**17.7**	**14.7**	**16.3**	**16.3**	**10.0**	**42.2**	**47.3**	**12.0**	**69.9**	**67.6**
Ratio analysis (%)	**3Q10**	**4Q10**	**1Q11**	**2Q11**	**3Q11**	**YoY (bps)**	**9M10**	**9M11**	**YoY (bps)**	**2011**	
Operating profit margin	**21.5**	**24.9**	**19.9**	**21.4**	**20.9**	**(60.8)**	**21.1**	**20.8**	**(39.8)**	**21.8**	
EBITDA margin	24.3	27.9	22.8	24.3	23.6	(76.1)	24.0	23.6	(45.5)	25.2	
Net profit margin	17.5	18.8	16.3	17.4	17.1	(47.9)	17.3	16.9	(34.9)	18.7	
Additional information	**3Q10**	**4Q10**	**1Q11**	**2Q11**	**3Q11**	**YoY (bps)**	**9M10**	**9M11**	**YoY (bps)**	**2011**	
(as % of sales)											
Staff costs	**47.9**	**49.1**	**49.1**	**47.3**	**48.3**	**37.5**	**48.2**	**48.2**	**9.7**	**48.0**	

Source: Company, IIFL Research

Key takeaways from the analyst meet

3Q'11 results

- **Hospital segment:** 14.1% growth in segment revenue was driven by 4% increase in patient volume and 10% increase in prices. **Healthcare segment:** most of the growth in segment revenue was driven by volume growth.
- Losses incurred at the Raffles Medical, China continue drag earnings. RFMD expects Chinese operations to breakeven in two years. The total accumulated loss from Chinese operations, which had commenced operations in 3Q'10, is less than S$2m (S$1.6m-S$1.8m).
- Overseas patient growth (~10%) continues to surpass the local patient growth, with Indonesia accounting for the largest number of overseas patients.

Healthcare business outlook

- RFMD operates 74+ general practice (GP) clinics in Singapore and plans to add 4-5 clinics each year going forward. The Group opened a new clinic in Asia Square (Singapore) in 3Q11 and plans to open two more clinics in Singapore by end-2011.
- The Group expects to benefit from government initiatives such as the expanded Primary Care Partnership Scheme (PCPS), which enables subsidised patients to be treated at private general practitioners. Ministry of Health (MoH) recently announced changes to the eligibility criteria of the PCPS, which will be implemented from 1Q'12. The age criteria was lowered from the current 65 years to 40 years and the qualifying income criteria was raised from the current S$800 to S$1,500 per capita monthly household income. These changes will enable additional 710,000 Singaporeans to receive subsidised care at participating PCPS GP clinics.

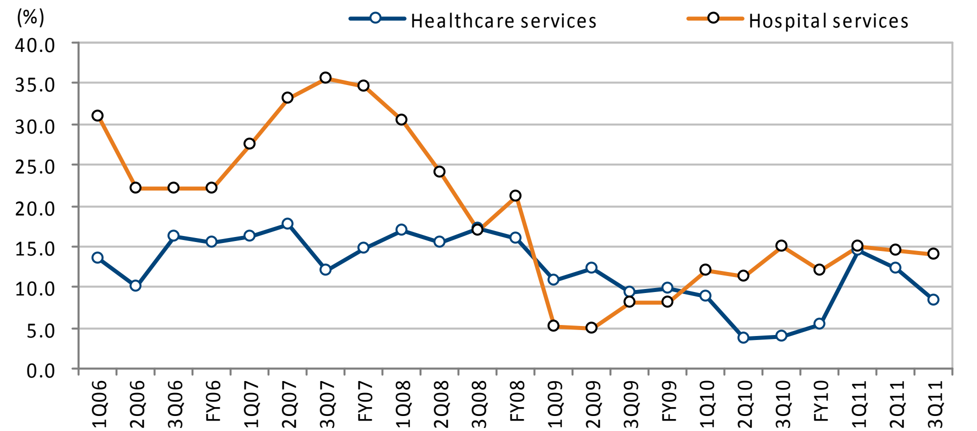
Hospital: making more space available for specialist centres; building extension to be delayed

- RFMD will vacate 15,000 square feet (sq. ft.) of space in the current hospital building by moving administrative/back office operations out of the hospital premises. The space will be made available in 1Q'12 and will be used to open new/expand existing specialist service offerings. The total space occupied by back office operations in the current hospital is less than 30,000 sq. ft.
- As of 3Q'11, Raffles Hospital operates 200 beds (licensed to operate 380 beds). In 2011, the Group intends to satisfy rising patient load by improving the utilisation of existing beds instead of increasing the number of operational beds. The current utilisation of operational beds at Raffles Hospital varies between 40%-55%.
- RFMD will commence construction of the hospital extension in 2H'2012 and expects the construction to be completed in 18-24 months. First full year of operations for the hospital extension is now expected to be 2015, against earlier guidance of 2014. RFMD reiterated that the hospital extension will be used for setting up new specialist centres.

Thong Sia specialist centre to commence operations in 1H'13

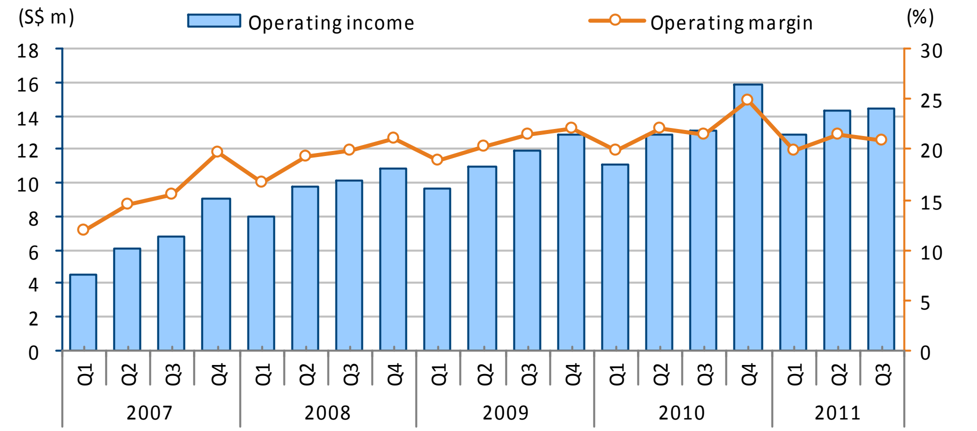
- The specialist centre at Thong Sia building (Orchard, Singapore) is now expected to commence operations in 1H'2013 as compared to earlier estimate of 2H'2012.
- RFMD will hire about 100 non-doctor staff and 30 full-time equivalent (FTE) doctors to run the specialist medical centre. The FTE doctors will also practice at RFMD's other specialist centres.
- RFMD highlighted that Singapore continues to face shortage of doctors. Earlier, foreign doctors/returning doctors had to practise in a public hospital for one year before being eligible to work for a private hospital. Now, with approval from MOH, RFMD can directly hire foreign doctors. RFMD currently has 220 doctors on its payroll, of which less than 10% are foreigners. Going forward, RFMD expects the proportion of foreign doctors to increase to 20%.

Figure 2: YoY growth in healthcare and hospital services revenue



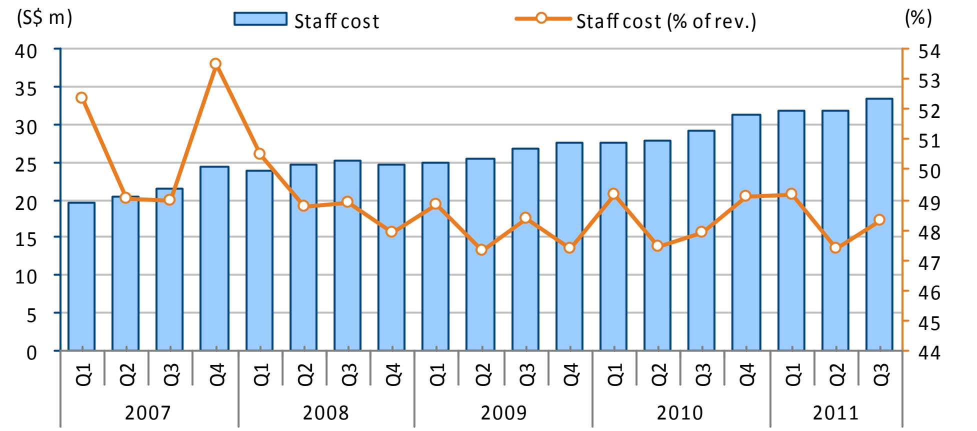
Source: Company, IIFL Research

Figure 4: Rising costs have kept the operating margins depressed



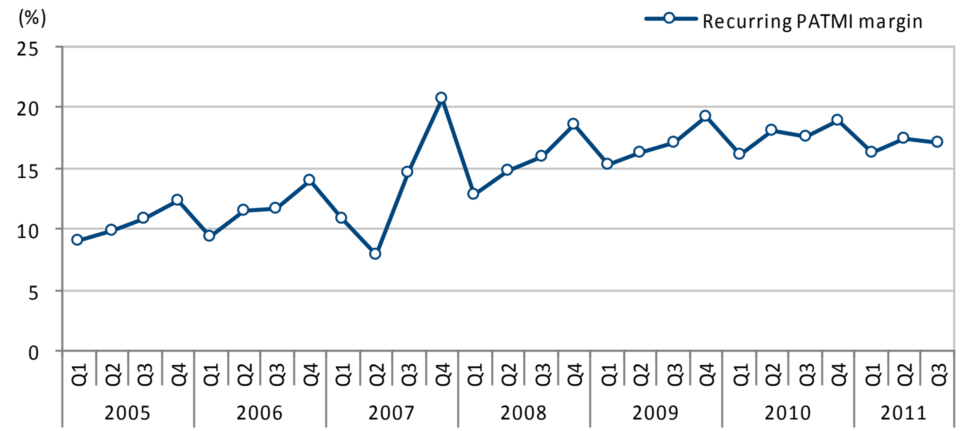
Source: Company, IIFL Research

Figure 3: Staff cost is the key cost component for Raffles Medical



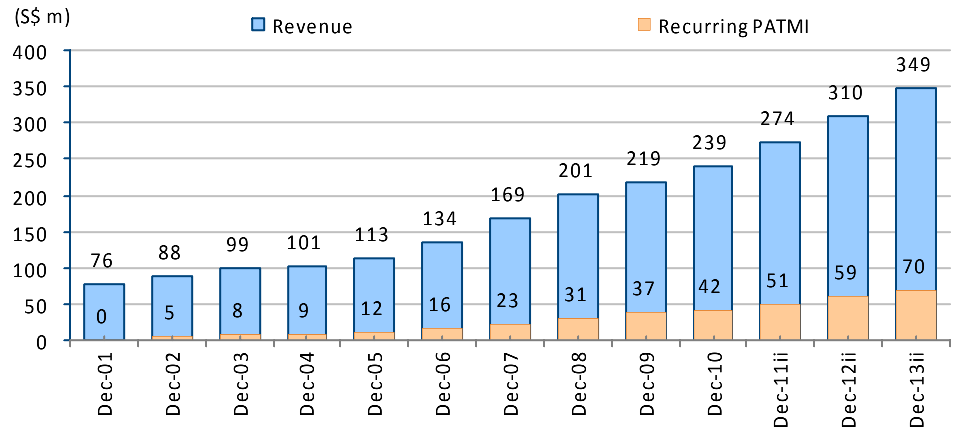
Source: Company, IIFL Research

Figure 5: Recurring net profit margin continues to remain flat



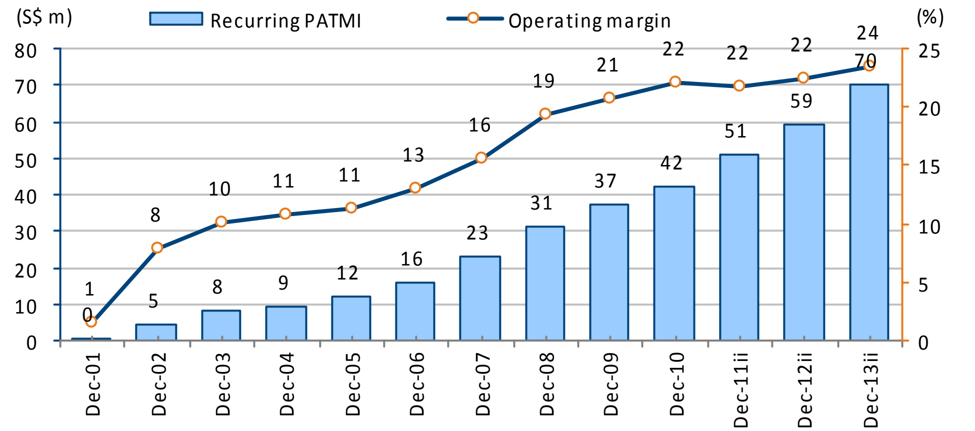
Source: Company, IIFL Research

Figure 6: Revenue to increase 13%; earnings to increase 18% annually over 2010-13



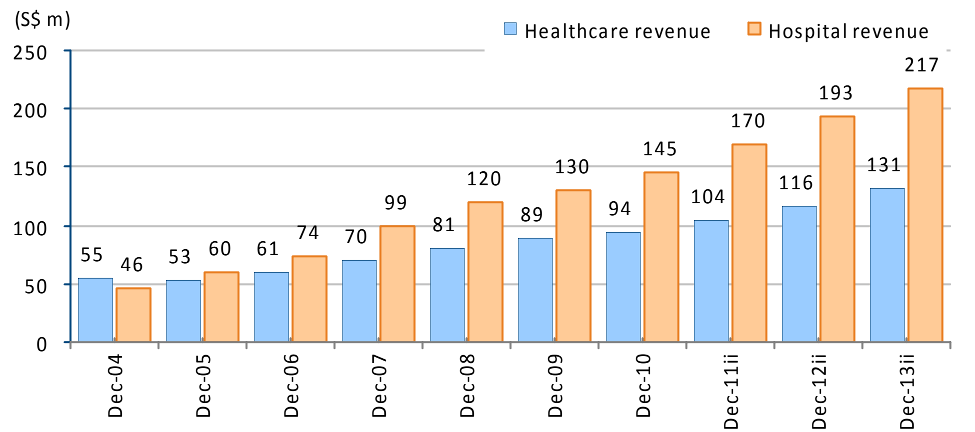
Source: Company, IIFL Research

Figure 8: Rising costs to restrict the expansion of operating margins



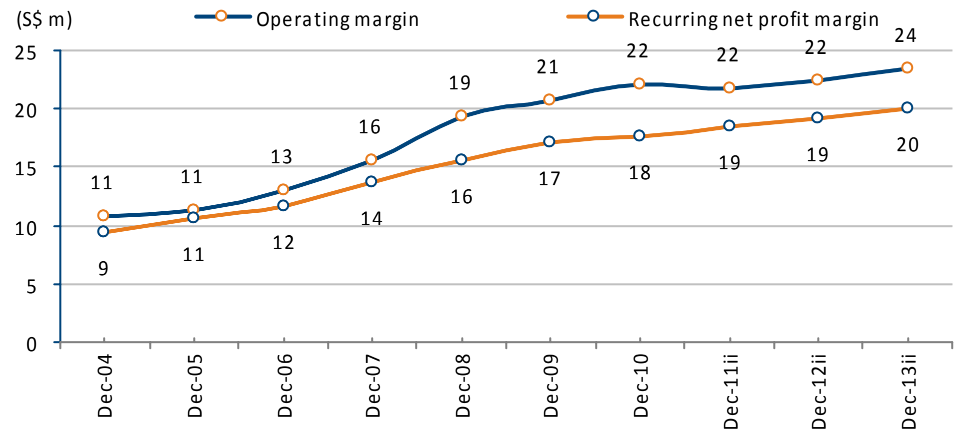
Source: Company, IIFL Research

Figure 7: Revenue contribution from Healthcare and Hospital segment



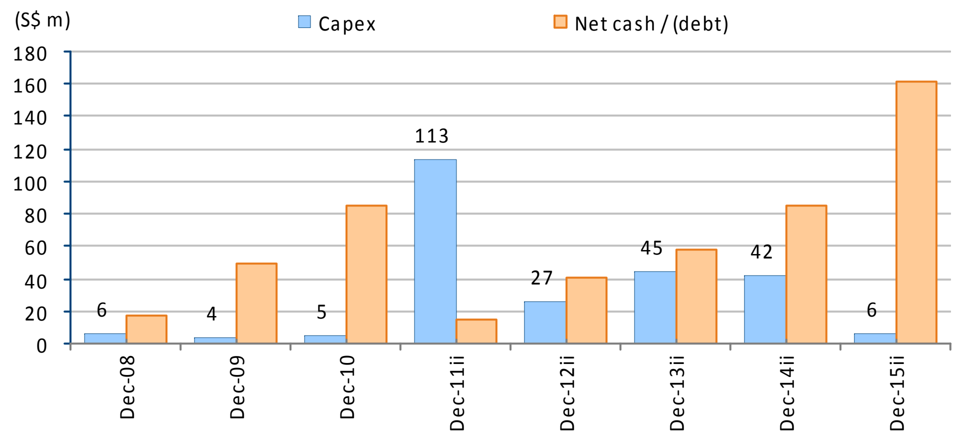
Source: Company, IIFL Research

Figure 9: Operating and recurring net margins



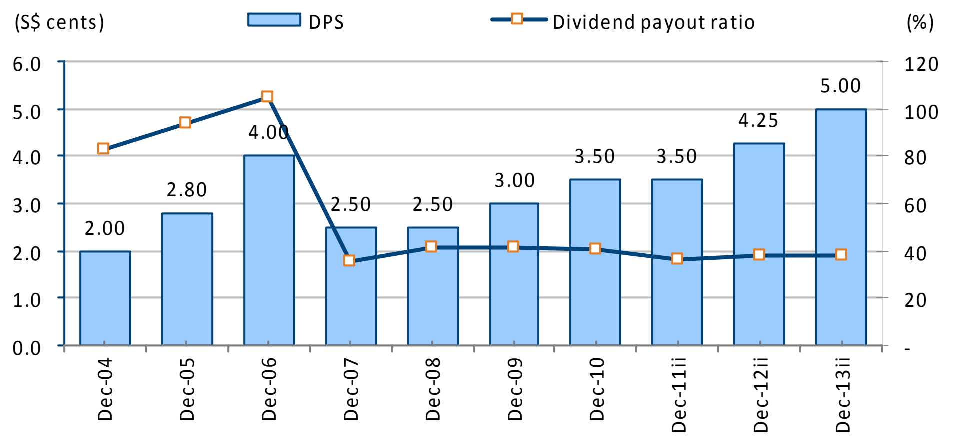
Source: Company, IIFL Research

Figure 10: RFMD's net cash to double in 2015 as compared its net cash position in 2010



Source: Company, IIFL Research

Figure 11: We expect Raffles Medical's to maintain above 35% dividend payout ratio



Source: Company, IIFL Research

Figure 12:Earnings sensitivity to changes in staff cost and EBITDA margin

Staff cost (% of rev.)	Implied EBITDA margin (%)	Net profit (S$ m)	% change from current est.
2010 (reported)			
48.41	25.1	42.3	
2012ii (estimate)			
47.75 (current estimate)	26.3	59.3	
47.25	26.8	60.7	2.2
46.75	27.3	62.0	4.5
46.25	27.8	63.3	6.7

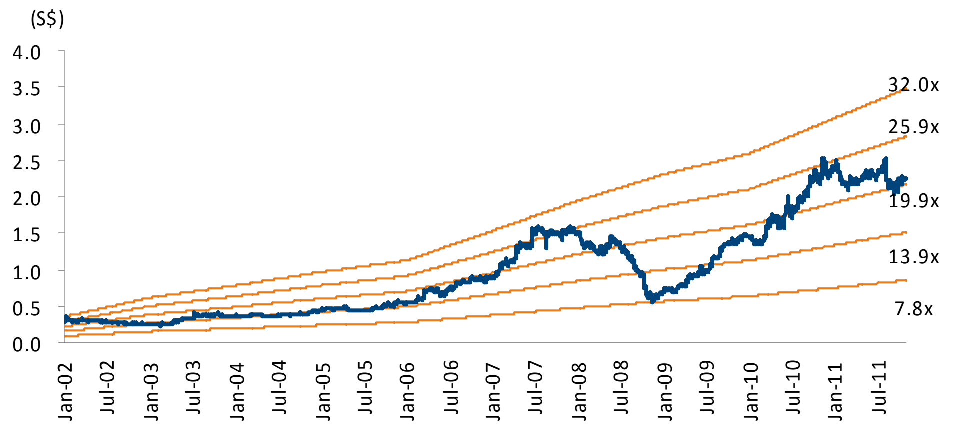
Source: Company, IIFL Research

Figure 13: Key changes to our estimates

Change (paste values)	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13
Revenues OLD (S$ m)	218.6	239.1	277.5	315.8	357.4
Revenues NEW (S$ m)	218.6	239.1	273.7	310.0	348.7
Change (%)	-	-	*(1.3)*	*(1.8)*	*(2.5)*
Net profit OLD (S$ m)	37.3	42.3	51.9	60.5	71.6
Net profit NEW (S$ m)	37.3	42.3	50.8	59.3	70.1
Change (%)	-	-	*(2.0)*	*(2.0)*	*(2.0)*
EPS OLD (S$ cents)	7.2	8.1	9.8	11.4	13.5
EPS NEW (S$ cents)	7.2	8.1	9.6	11.1	13.1
Change (%)	-	-	*(2.5)*	*(2.9)*	*(3.0)*

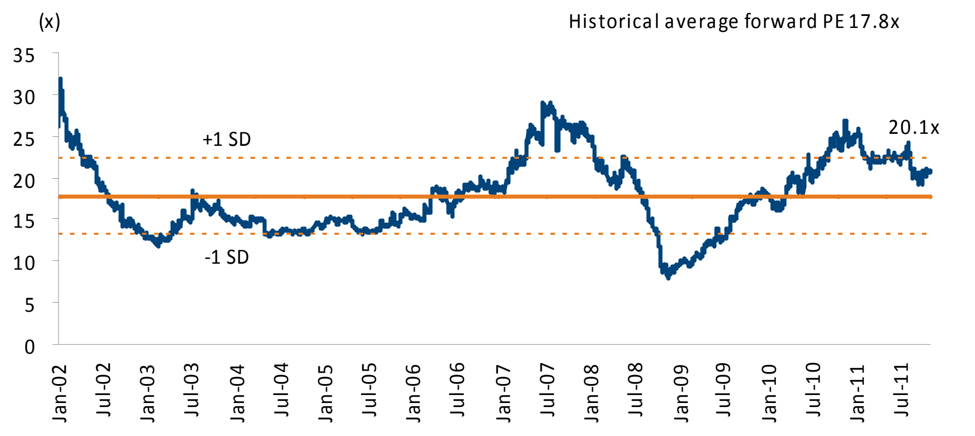
Source: Company, IIFL Research

Figure 14: PE bands based on 1-year forward earnings



Source: Bloomberg, Company, IIFL Research

Figure 15: 1-year forward price earnings multiple



Source: Bloomberg, Company, IIFL Research

Figure 16: Historical acquisition valuations

	Acquirer	Price on Announcement date (S$)	Price paid (S$)	Premium (%)	Trailing valuations P/E	P/B	EV/ EBITDA
Parkway							
	TPG	1.38	1.69	22.5	19.0	3.4	14.0
	Khazanah	3.09	4.11	33.0	43.4	3.6	22.0
	Fortis	3.12	3.56	14.1	34.5	2.8	23.0
	Khazanah	3.02	3.78	25.2	36.7	2.9	25.0
	Fortis	3.57	3.80	6.4	36.9	2.9	25.0
	Khazanah	3.88	3.95	1.8	38.3	3.1	26.0
Thomson Med.							
	Peter Lim	1.08	1.75	62.0	40.0	3.8	20.2
Raffles Med.							
	Temasek	1.30	1.30	-	37.2	3.9	26.1
	Qatar Invest.	1.30	1.30	-	37.2	3.9	26.1

Source: Company, IIFL Research

Figure 17: We value Raffles Medical based on 2012ii earning multiple

Valuation	
2012ii earnings per share (S$ cents)	11.1
Target 2012 earnings multiple (x)	23.0
Implied 2012 price target (S$)	2.55
Raffles Medical price target (S$)	2.55

Source: Company, IIFL Research

Figure 18: Peer comparison

	Price	Market cap	FV/ EBITDA		Price / earnings		2010-13	N. margin	ROE	Div. Yield
	(LCY)	(US$)	CY11	CY12	CY11	CY12	EPS CAGR	CY12	CY12	CY12
Thailand										
Bangkok Dusit Medical	67.5	3,397	14.3	11.9	25.1	21.8	25.3	11.6	15.6	2.1
Bumrungrad Hospital	39.8	943	11.2	10.3	20.3	18.8	10.5	14.8	24.2	2.7
Bangkok Chain Hospital	6.3	409	9.5	8.4	17.8	15.7	13.5	15.5	20.2	3.8
India										
Apollo Hospitals	519.8	1,402	15.4	12.7	29.8	24.6	34.9	7.7	11.5	1.0
Fortis Healthcare	124.5	1,036	21.6	14.0	35.2	24.9	38.9	7.3	5.2	-
Malaysia										
KPJ Healthcare	4.2	795	11.6	9.9	18.8	15.3	10.9	7.5	18.5	3.2
Average (ex RFMD)		**7,982**	**14.6**	**11.7**	**25.7**	**21.4**	**25.0**	**10.5**	**15.1**	**1.9**
Raffles Medical	2.3	958	17.6	14.8	23.4	20.3	17.5	19.1	17.5	1.9
Average (with RFMD)		**8,940**	**14.9**	**12.1**	**25.4**	**21.3**	**24.2**	**11.4**	**15.3**	**1.9**

Source: Bloomberg, Company, IIFL Research

Financial summary

Income statement summary (S$ m)

Y/e 31 Dec	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Revenue	**219**	**239**	**274**	**310**	**349**
EBITDA	52	60	68	81	95
EBIT	45	53	59	70	82
Net interest (exp) / inc.	0	0	0	0	0
Exceptional items	0	0	0	0	0
Others items	0	0	0	0	0
Profit before tax	**45**	**53**	**60**	**70**	**82**
Tax expense	-7	-8	-8	-10	-12
Extraordinary items	-1	-3	0	0	0
Net Profit	**37**	**42**	**51**	**59**	**70**

Cash flow summary (S$ m)

Y/e 31 Dec	FY09A	FY10A	FY11ii	FY12ii	FY13ii
EBIT	45	53	59	70	82
Depreciation & amortization	7	7	9	12	13
Tax paid	-8	-7	-8	-10	-12
Working capital change	0	-2	1	0	0
Other operating items	0	0	0	0	0
Operating cash-flow	**45**	**51**	**60**	**72**	**84**
Capital expenditure	-3	-5	-113	-27	-45
Free cash flow	**42**	**46**	**-53**	**45**	**39**
Equity raised	4	10	0	0	0
Investments	0	0	0	0	0
Debt financing / disposal	-2	-2	9	5	0
Dividends paid	-13	-16	-18	-19	-23
Other items	0	-6	0	0	0
Net change in cash	30	33	-62	31	17

Source: Company data, IIFL Research

Balance sheet summary (S$ m)

Y/e 31 Dec	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Cash & cash equivalents	74	107	45	77	94
Other current assets	30	31	36	41	46
Fixed assets	146	144	248	263	294
Intangible assets	0	0	0	0	0
Other assets	86	89	89	89	89
Total assets	**337**	**372**	**419**	**470**	**523**
Short-term debt	5	5	5	5	5
Other current liabilities	61	61	66	71	77
Long-term debt	20	18	27	32	32
Other long-term liabilities	1	2	2	2	2
Minority	0	1	1	1	1
Net worth	250	286	319	359	407
Total liabilities & equity	**337**	**372**	**419**	**470**	**523**

Ratio analysis

Y/e 31 Dec	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Growth ratios (%)					
Sales growth	8.9	9.4	14.5	13.3	12.5
EBITDA growth	15.1	14.8	14.1	18.9	16.9
EBIT growth	16.9	17.0	12.0	17.4	17.9
Margins (%)					
EBITDA margin	23.9	25.1	25.0	26.2	27.3
EBIT margin	20.7	22.2	21.7	22.5	23.5
Net profit margin	17.1	17.7	18.6	19.1	20.1
Return ratios (%)					
Return on assets	11.5	11.9	12.9	13.4	14.1
Return on equity	15.8	15.8	16.8	17.5	18.3
Other key ratios (%)					
Dividend payout ratio	41.1	40.5	36.5	38.3	38.1
Tax rate	15.6	14.3	14.2	14.3	14.2
Net debt / equity	-19.9	-29.6	-4.5	-11.4	-14.2

Source: Company data, IIFL Research

Institutional Equities

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the risk-free rate of return + equity risk premium.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

MICA (P) 013/10/2011