

# Raffles Medical Group – ADD

26 July 2011

Result review



## In line results; expansion on track

Raffles Medical delivered strong 2Q11 results, in line with our estimates. 1H11 revenue grew 14.5% YoY and earnings rose 12.6% YoY to S\$22.1m, with revenue and net profit achieving 48% and 43% of our full-year 2011 estimates, respectively. The group is on track to build a new extension to its hospital and set up a large specialist medical clinic on Orchard Road by end-2013. We have adjusted our 2011-13 estimates marginally lower for higher assumed debt and capex. Current valuation of 22x 1-year forward EPS is still at a discount to recent Parkway and Thomson Medical acquisitions. We value the stock at 23x FY12ii EPS and adjust our TP to S\$2.62 from S\$2.65. Our revised DCF estimate of S\$3.42 (earlier S\$3.37) offers 46% upside. Reiterate ADD.

### Well-rounded growth; China operations remains a drag

- Rising volume of patients and revenue per patient (ASP) equally contributed towards 2Q11 revenue growth. We believe there is further potential for rise in ASP as the average bill rate now is comparable to some public hospitals and lower than other private hospitals.
- Excluding losses from China, profit in 2Q11 would have grown by 14.6% against reported 10.1%. Management expects losses from China to reduce gradually with likely breakeven in 2 years.

### Expansion on track; inorganic growth potential:

- The group is on track to complete the hospital extension by end-2013. Although operations will commence at the specialist centre at Orchard Road in 2012, we expect it to attain full operations by end-2013.
- The group is open to M&A opportunities. Management is studying the feasibility of expanding into Japan, but has not identified a clear timeline for the expansion.

### Margin expansion potential; reiterate ADD; adjust TP to S\$2.62:

- During 2010-13, we estimate profit to grow at 19% CAGR with 140bps expansion in operating margin. Margins would improve as the group adds more hospital beds, increases revenue per bed and hikes specialist service fees with relatively less rise in overall staff costs.
- On a going-concern basis, 1-year forward P/E of 22x fails to capture the group's long-term growth potential. We value the stock at 23x FY12ii EPS and adjust our TP to S\$2.62 from S\$2.65.

## Result update

CMP	S\$2.35
12-mth TP (S\$)	2.62 (11%)
Market cap (US\$ m)	1,028.3
Bloomberg	RFMD SP
Sector	Healthcare

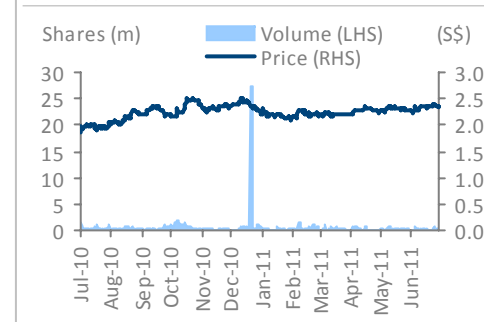
### Shareholding pattern (%)

Raffles Medical Hldg	39.2
Choon Yong Loo	10.3
S&D Holdings Pte	5.0
Others	45.5
52Wk High/Low (S\$)	2.52/1.83
Shares o/s (m)	533.4
Daily volume (US\$ m)	.5
Dividend yield FY11ii (%)	1.5
Free float (%)	46.7

### Price performance (%)

	1M	3M	1Y
Raffles Medical	4.0	6.3	28.4
Rel. to ST Index	0.6	6.8	21.8
KPJ Healthcare	0.7	13.1	24.1
Bangkok D. Med.	15.0	15.6	106.1

### Stock performance



### Financial summary (S\$)

Y/e 31 Dec	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Revenue (m)	219	239	277	316	357
EBITDA margin (%)	23.9	25.1	25.2	26.5	27.5
Net profit (m)	37	42	52	60	71
EPS (cents)	7.2	8.1	9.8	11.4	13.5
Growth (%)	18.6	12.4	21.3	16.3	18.2
IIFL vs consensus (%)			2.1	6.5	3.6
PER (x)	32.7	29.1	24.0	20.6	17.4
ROE (%)	15.8	15.8	17.0	17.6	18.4
Net debt / equity (%)	-19.9	-29.6	-0.8	-2.2	-7.9
EV / EBITDA (x)	22.7	19.4	18.4	15.3	12.8
Price / book (x)	4.9	4.3	3.8	3.4	3.0
Dividend yield (%)	1.3	1.5	1.5	1.8	2.1

Source: Company, IIFL Research. Priced as on 25 July 2011

**Figure 1: 2Q11 result summary**

Income Statement (\$\$ m)	2QFY11	2QFY10	YoY (%)	1HFY11	1HFY10	YoY (%)	FY11ii	% of FY11ii
<b>Revenue</b>	<b>67.0</b>	<b>58.6</b>	<b>14.3</b>	<b>131.4</b>	<b>114.8</b>	<b>14.5</b>	<b>277.5</b>	<b>47.4</b>
Inventories and consumables	7.6	6.7	15.0	15.1	13.0	15.7	30.5	49.4
Purchased & contracted services	5.3	4.3	21.6	10.1	8.2	23.6	19.4	52.0
Staff costs	31.7	27.8	14.1	63.4	55.4	14.4	133.2	47.6
Depreciation of PP&E	2.0	1.7	16.4	3.8	3.4	13.6	9.0	42.6
Operating lease expenses	1.5	1.3	8.3	2.9	2.7	7.6	6.4	45.1
Other operating expenses	4.6	4.0	14.4	9.0	8.2	9.4	19.7	45.6
Other operating income	(0.0)	(0.2)	(95.7)	(0.0)	(0.2)	(95.7)	(1.7)	0.4
<b>Operating income</b>	<b>14.3</b>	<b>12.9</b>	<b>11.0</b>	<b>27.1</b>	<b>24.0</b>	<b>12.9</b>	<b>60.9</b>	<b>44.6</b>
Interest income	(0.0)	(0.1)	(61.6)	(0.2)	(0.2)	5.5	(0.5)	32.4
Interest expense	0.1	0.1	11.1	0.1	0.1	(16.4)	0.4	27.1
<b>Pretax profit</b>	<b>14.3</b>	<b>12.9</b>	<b>10.4</b>	<b>27.2</b>	<b>24.1</b>	<b>13.0</b>	<b>61.0</b>	<b>44.6</b>
Income tax	2.6	2.3	11.3	5.0	4.3	14.2	8.7	57.1
<b>Reported net income</b>	<b>11.7</b>	<b>10.6</b>	<b>10.2</b>	<b>22.2</b>	<b>19.7</b>	<b>12.8</b>	<b>52.3</b>	<b>42.5</b>
Minority	0.1	0.0	51.4	0.1	0.1	47.8	0.2	54.5
<b>Income accruing to shareholders</b>	<b>11.6</b>	<b>10.6</b>	<b>10.1</b>	<b>22.1</b>	<b>19.6</b>	<b>12.6</b>	<b>52.1</b>	<b>42.5</b>
Post-tax exceptionals	0.0	0.0	-	0.0	0.0	-	0.0	-
<b>Recurring net income</b>	<b>11.6</b>	<b>10.6</b>	<b>10.1</b>	<b>22.1</b>	<b>19.6</b>	<b>12.6</b>	<b>52.1</b>	<b>42.5</b>
<b>EBITDA</b>	<b>16.3</b>	<b>14.6</b>	<b>11.6</b>	<b>31.0</b>	<b>27.4</b>	<b>13.0</b>	<b>69.9</b>	<b>44.3</b>
<b>Ratio analysis (%)</b>	<b>2QFY11</b>	<b>2QFY10</b>	<b>YoY (%)</b>	<b>1HFY11</b>	<b>1HFY10</b>	<b>YoY (%)</b>	<b>FY11ii</b>	
Operating margin	21.4	22.0	-64 bps	20.7	20.9	-29 bps	21.9	
EBITDA margin	24.3	24.9	-59 bps	23.6	23.9	-31 bps	25.2	
Net profit margin	17.4	18.0	-67 bps	16.8	17.1	-28 bps	18.8	

Source: Company, IIFL Research

**Figure 2: Average hospital's inpatient bill size (Jan 10 - Jun 10)**

(S\$)	Average Per Day	Average Total Bill
<b>Private Hospitals</b>		
Parkway East Hospital	2,652	6,746
Gleneagles Hospital	3,824	9,609
Mt Alvernia Hospital	2,400	7,249
Mt Elizabeth Hospital	4,141	12,237
<b>Raffles Hospital</b>	<b>3,686</b>	<b>8,123</b>
Thomson Medical Centre	2,014	5,159
<b>Simple average for private hospitals</b>	<b>3,120</b>	<b>8,187</b>
<b>Class A (1-bedded) in Public Hospitals</b>		
Alexandra Hospital	906	3,968
Changi General Hospital	1,103	4,539
KK Women's & Children's Hospital	1,756	3,970
National University Hospital,	1,946	7,684
Singapore General Hospital	2,106	8,128
Tan Tock Seng Hospital	1,837	5,601
National Heart Centre	2,434	20,738
<b>Simple average for public hospitals</b>	<b>1,727</b>	<b>7,804</b>

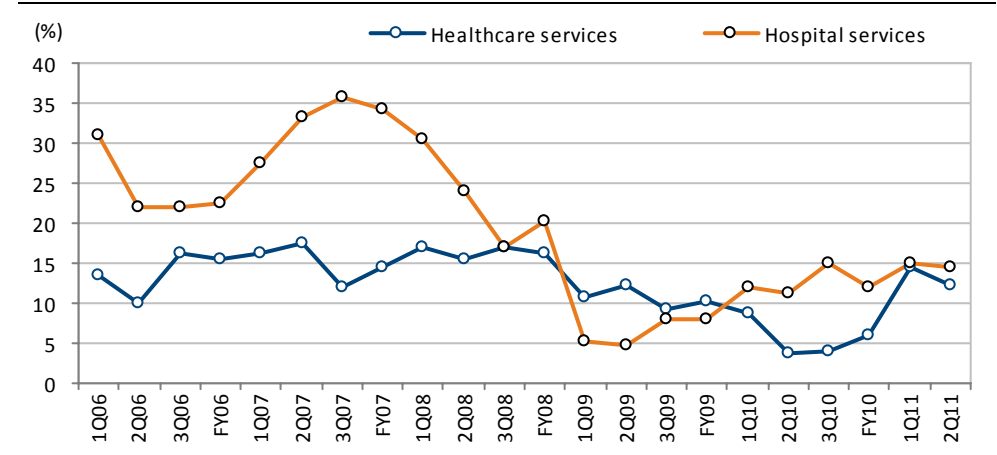
Source: Ministry of Health, IIFL Research

**Figure 3: 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.
<b>FY10 (reported)</b>			
48.41	25.1	42.3	
<b>FY11ii (estimate)</b>			
<b>48.00 (current estimate)</b>	<b>25.2</b>	<b>51.7</b>	
47.50	25.7	52.8	2.3
<b>47.00</b>	<b>26.2</b>	<b>54.0</b>	<b>4.6</b>
46.50	26.7	55.2	6.9

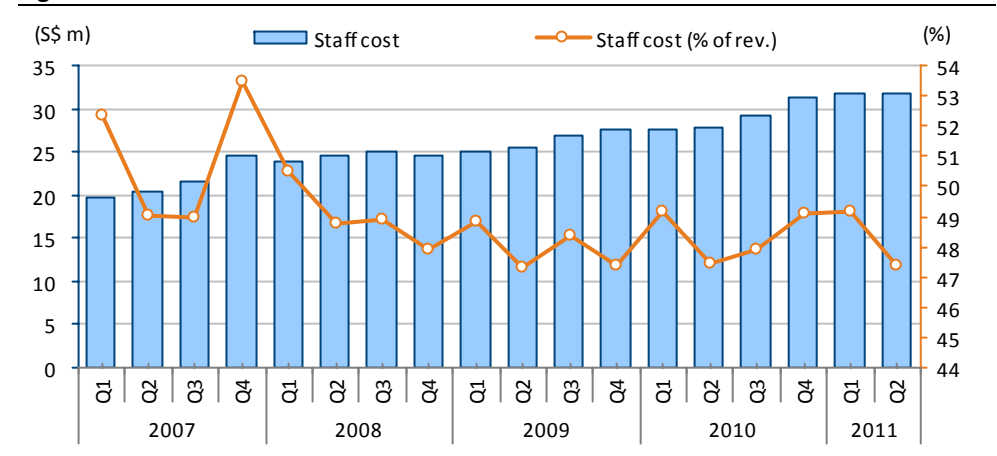
Source: Company, IIFL Research

**Figure 4: QoQ growth in healthcare and hospital services revenue**



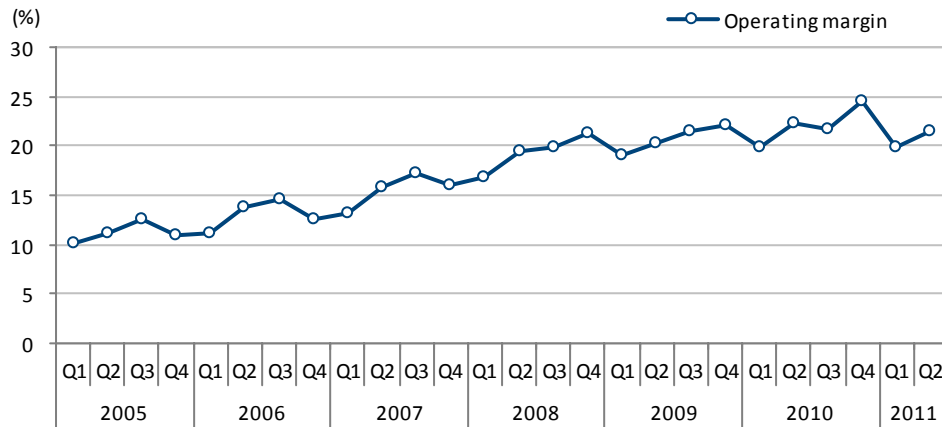
Source: Company, IIFL Research

**Figure 5: Staff cost as % of revenue has been on a decline...**



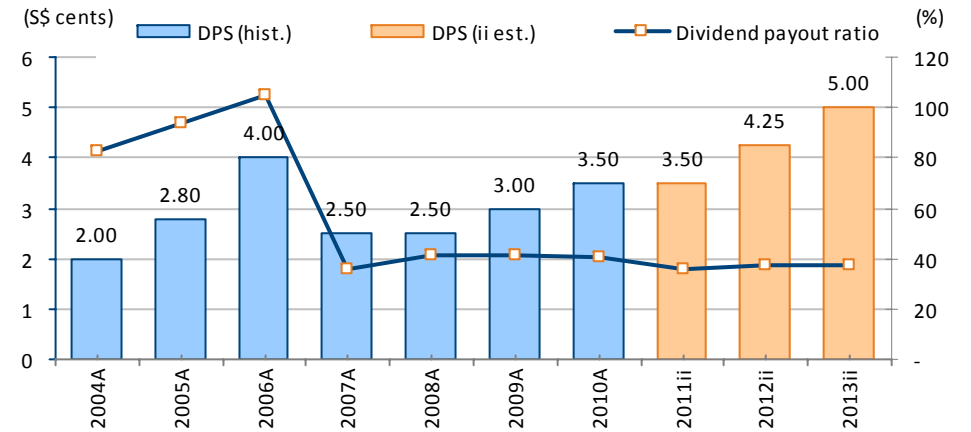
Source: Company, IIFL Research

**Figure 6: ...leading to consistent improvement in operating margins**



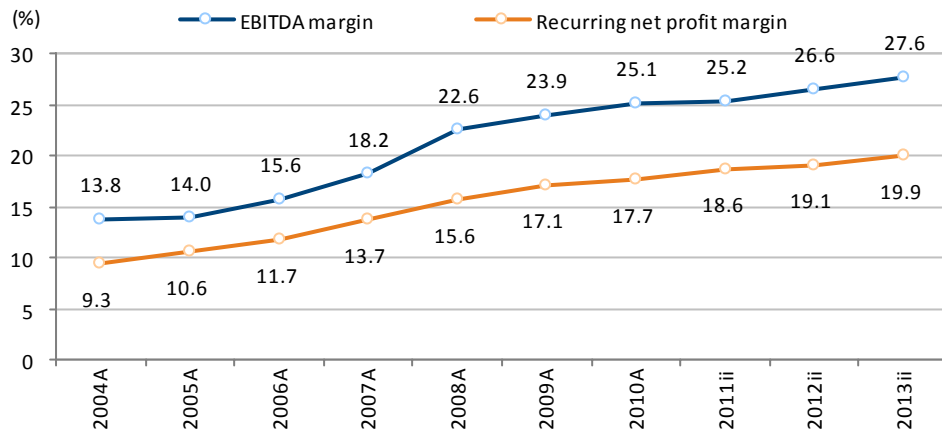
Source: Company, IIFL Research

**Figure 8: We expect Raffles Medical's to maintain above 35% dividend payout ratio**



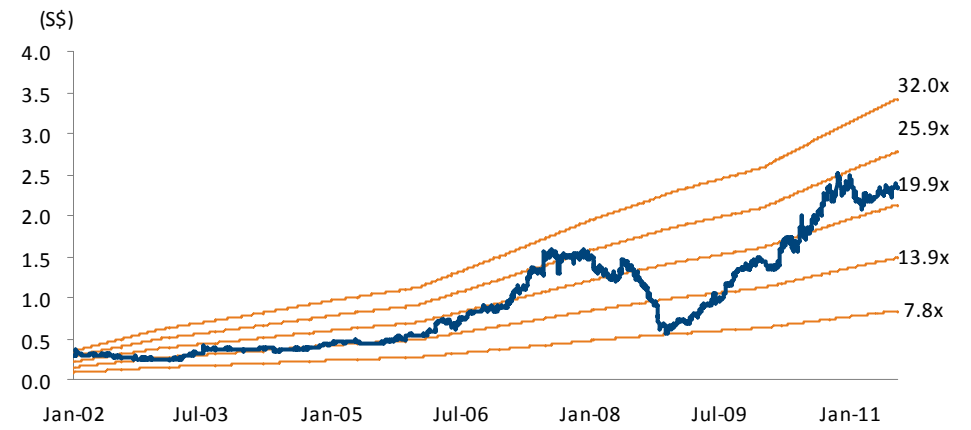
Source: Company, IIFL Research

**Figure 7: EBITDA and net profit margin outlook**



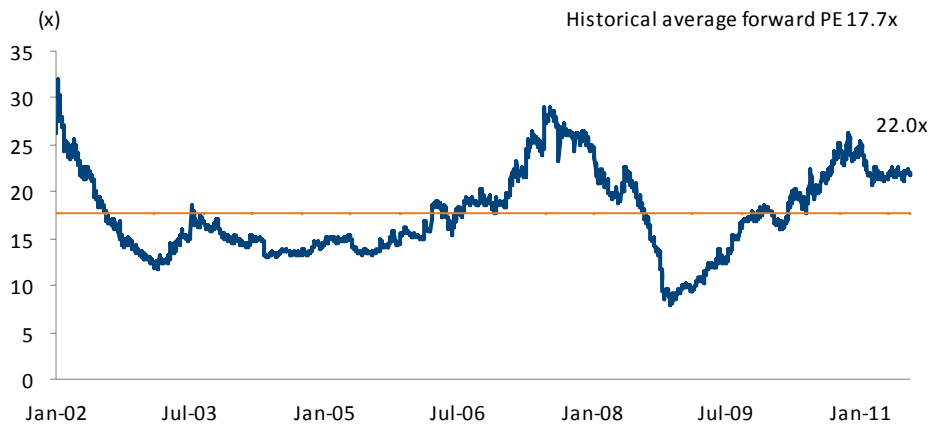
Source: Company, IIFL Research

**Figure 9: PE bands based on 1-year forward earnings**



Source: Company, IIFL Research

**Figure 10: 1-year forward price earnings multiple**



Source: Company, IIFL Research

**Figure 11: Historical acquisition valuations**

Acquirer	Price on Announcement date (S\$)	Price paid (S\$)	Premium (%)	Trailing valuations		
				P/E	P/B	EV/EBITDA
<b>Parkway</b>						
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
<b>Thomson Med.</b>						
Peter Lim	1.08	1.75	62.0	40.0	3.8	20.2
<b>Raffles Med.</b>						
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 12: We value Raffles Medical based on FY12ii earning multiple**

Valuation	
FY12ii earnings per share (S\$ cents)	11.4
1-year PE for comparable peers (x)	25.0
Target FY12 earnings multiple (x)	23.0
Implied FY12 price target (S\$)	2.62
<b>Raffles Medical price target (S\$)</b>	
	2.62

Source: Company, IIFL Research

**Figure 13: DCF assumptions**

DCF assumptions	
Target equity (%)	100.0
Tax rate (%)	15.0
Risk-free rate (%)	3.0
Market risk premium (%)	6.0
Equity beta	0.80
Terminal growth rate (%)	2.00
<b>Weighted average cost of capital</b>	<b>7.80</b>

Source: Company, IIFL Research

**Figure 14: DCF valuation**

WACC	7.30			7.80			8.30		
	1.50	2.00	2.50	1.50	2.00	2.50	1.50	2.00	2.50
Perp. FCF Growth (%)									
PV FCFF (\$\$ m)	797.3	797.3	797.3	773.0	773.0	773.0	749.7	749.7	749.7
PV of Terminal Value (\$\$ m)	1,161.1	1,276.9	1,416.8	979.1	1,068.7	1,175.3	831.2	901.6	984.1
% of Agg. Value	59%	62%	64%	56%	58%	60%	53%	55%	57%
Aggregate Value (\$\$ m)	1,958.4	2,074.2	2,214.1	1,752.1	1,841.8	1,948.3	1,580.9	1,651.3	1,733.8
Less Net Debt (\$\$ m)	31.8	31.8	31.8	31.8	31.8	31.8	31.8	31.8	31.8
Less Minority Interest (\$\$ m)	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Equity Value (\$\$ m)	1,925.9	2,041.7	2,181.7	1,719.7	1,809.4	1,915.9	1,548.5	1,618.9	1,701.4
Shares Outstanding (m)	528.3	528.3	528.3	528.3	528.3	528.3	528.3	528.3	528.3
Equity Value per Share (\$\$)	3.65	3.86	4.13	3.26	3.42	3.63	2.93	3.06	3.22

Source: Company, IIFL Research

**Figure 15: Peer comparison**

	Price (LCY)	Market cap (US\$)	FV/ EBITDA		Price / earnings			2-year EPS CAGR	N. margin CY11	ROE CY11	Div. Yield CY11
			CY11	CY12	CY10	CY11	CY12				
<b>Thailand</b>											
Bangkok Dusit Medical	59.3	3,078	12.7	10.5	31.5	25.1	20.8	23.0	10.6	15.8	1.9
Bumrungrad Hospital	37.5	918	11.7	10.8	21.7	19.3	17.8	10.4	14.1	23.7	2.7
Bangkok Chain Hospital	6.3	419	9.3	8.1	19.7	17.2	15.6	12.4	16.1	19.6	3.5
<b>India</b>											
Apollo Hospitals	509.1	1,506	15.3	12.5	45.7	29.8	24.2	37.5	7.7	11.1	1.1
Fortis Healthcare	167.9	1,532	41.2	26.4	64.1	45.8	32.5	40.5	7.0	5.0	-
<b>Malaysia</b>											
KPJ Healthcare	4.6	876	12.0	10.4	20.3	19.1	16.5	11.0	7.3	16.0	2.3
<b>Average (ex RFMD)</b>		<b>8,330</b>	<b>18.1</b>	<b>13.7</b>	<b>37.2</b>	<b>28.1</b>	<b>22.5</b>	<b>25.6</b>	<b>9.7</b>	<b>14.1</b>	<b>1.6</b>
Raffles Medical	2.4	1,039	18.0	15.0	29.1	24.0	20.6	18.8	18.6	17.0	1.5
<b>Average (with RFMD)</b>		<b>9,369</b>	<b>18.1</b>	<b>13.8</b>	<b>36.3</b>	<b>27.6</b>	<b>22.3</b>	<b>24.9</b>	<b>10.7</b>	<b>14.4</b>	<b>1.6</b>

Source: Company, IIFL Research

## Financial summary

### Income statement summary (\$\$ m)

Y/e 31 Dec	FY09A	FY10A	FY11ii	FY12ii	FY13ii
<b>Revenue</b>	<b>219</b>	<b>239</b>	<b>277</b>	<b>316</b>	<b>357</b>
EBITDA	52	60	70	84	98
EBIT	45	53	61	71	84
Net interest (exp) / inc.	0	0	0	0	0
Exceptional items	0	0	0	0	0
Others items	0	0	0	0	0
<b>Profit before tax</b>	<b>45</b>	<b>53</b>	<b>61</b>	<b>71</b>	<b>84</b>
Tax expense	-7	-8	-9	-10	-12
Extraordinary items	-1	-3	0	0	0
<b>Net Profit</b>	<b>37</b>	<b>42</b>	<b>52</b>	<b>60</b>	<b>71</b>

### Cash flow summary (\$\$ m)

Y/e 31 Dec	FY09A	FY10A	FY11ii	FY12ii	FY13ii
EBIT	45	53	61	71	84
Depreciation & amortization	7	7	9	13	15
Tax paid	-8	-7	-9	-10	-12
Working capital change	0	-2	1	1	1
Other operating items	0	0	0	0	0
<b>Operating cash-flow</b>	<b>45</b>	<b>51</b>	<b>62</b>	<b>74</b>	<b>88</b>
Capital expenditure	-3	-5	-128	-51	-41
<b>Free cash flow</b>	<b>42</b>	<b>46</b>	<b>-66</b>	<b>24</b>	<b>47</b>
Equity raised	4	10	2	1	0
Investments	0	0	0	0	0
Debt financing / disposal	-2	-2	15	10	0
Dividends paid	-13	-16	-18	-18	-22
Other items	0	-6	0	0	0
<b>Net change in cash</b>	<b>30</b>	<b>33</b>	<b>-67</b>	<b>15</b>	<b>25</b>

Source: Company data, IIFL Research

### Balance sheet summary (\$\$ m)

Y/e 31 Dec	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Cash & cash equivalents	74	107	40	55	80
Other current assets	30	31	37	41	47
Fixed assets	146	144	263	301	327
Intangible assets	0	0	0	0	0
Other assets	86	89	89	89	89
<b>Total assets</b>	<b>337</b>	<b>372</b>	<b>429</b>	<b>487</b>	<b>543</b>
Short-term debt	5	5	5	5	5
Other current liabilities	61	61	67	72	79
Long-term debt	20	18	33	43	43
Other long-term liabilities	1	2	2	2	2
Minority	0	1	1	1	1
Net worth	250	286	322	364	413
<b>Total liabilities &amp; equity</b>	<b>337</b>	<b>372</b>	<b>429</b>	<b>487</b>	<b>543</b>

### Ratio analysis

Y/e 31 Dec	FY09A	FY10A	FY11ii	FY12ii	FY13ii
<b>Growth ratios (%)</b>					
Sales growth	8.9	9.4	16.0	13.8	13.2
EBITDA growth	15.1	14.8	16.6	19.9	17.4
EBIT growth	16.9	17.0	14.2	17.4	18.1
<b>Margins (%)</b>					
EBITDA margin	23.9	25.1	25.2	26.5	27.5
EBIT margin	20.7	22.2	21.8	22.5	23.5
Net profit margin	17.1	17.7	18.6	19.1	19.9
<b>Return ratios (%)</b>					
Return on assets	11.5	11.9	12.9	13.2	13.8
Return on equity	15.8	15.8	17.0	17.6	18.4
<b>Other key ratios (%)</b>					
Dividend payout ratio	41.1	40.5	35.7	37.3	37.1
Tax rate	15.6	14.3	14.3	14.3	14.2
Net debt / equity	-19.9	-29.6	-0.8	-2.2	-7.9

Source: Company data, IIFL Research

## 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%.

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MICA (P) 125/10/2010

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