

RESULTS FIRST LOOK

Raffles Medical's 2Q10 results are in-line with our estimates – 2Q net profit grew 20% (vs. full year forecast of 19%) and seasonally-weak 1H10 net profit met 44% of FY10F forecast. The group announced that it is adding an additional ~100,000 sq ft of space (+33% of existing) at its flagship hospital at a cost of S\$80-100mn. We view this expansion positively as it allows the group to expand its outpatient services, positioning it to meet the growing demand from foreign patients going forward. Maintain BUY.

Price target: SGD 1.95

Price (23 Jul 2010): SGD 1.83

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2Q results in-line, hospital expansion underway

- Earnings vs. our Forecast: **IN LINE**

Likely Impact:

- Earnings Estimates: **NO CHANGE**
- Dividend Estimates: **NO CHANGE**
- Price Target: **NO CHANGE**
- Long-term View: **CONFIRMED**

2Q10 results in-line. While 2Q revenue growth of 8.7% did not outperform our expectations, continued operating efficiencies ensured strong earnings growth of 20% y-y. In particular, staff cost escalation has been contained – 2Q staff cost accounts for 47.4% of revenue (vs. 49.2% in 1Q). Foreign patient growth has not been as strong compared to pre-crisis but management expects stronger growth at its primary network in the next six months, with increased corporate contract volume in step with the economic recovery in Singapore.

Hospital expansion to grow outpatient services. The group has received URA approval to build an additional 102,408 sq ft (+33% of existing) of space at its flagship hospital at a total cost of S\$80–100mn, fully funded by net cash of S\$62mn and operating cashflow of S\$10m/quarter. Detailed construction plans and use of space have not been finalized. Management's priority is to add more sub-specialties to offer a wider range of outpatient services, rather than to boost inpatient beds. We view this positively as we believe there is more scope to increase revenue intensity by targeting the higher-end of the medical tourism market as compared to playing the volume game when there is additional capacity of private beds coming on stream in 2011/12.

New Medical Centre in Shanghai. The group has also opened its first medical centre in Xuhui District, Shanghai in June on a management contract. Occupying 30,000 sq ft of space, the medical centre offers GP, dental services, Japanese clinic, among others. The target market is largely the expat population, including Singaporeans working in Shanghai. While it is unlikely to contribute significantly to the bottom-line given the nature of management contracts, we view it as a brand-building effort which could be a start to a hospital project in the future.

Maintain BUY. While Raffles is now trading at 21x/18x FY10/11F P/E (above historical mean), we believe the valuation premium is justified in view of its strong growth potential underscored by the recent hospital buyout activities and its EPS CAGR of 18.5% over 2009-12F. Management maintains its annual dividend guidance of 3 cents despite the incremental capex given its strong balance sheet.

| 2Q09 | 1Q10 | 2Q10 | 2010E |
|------|------|------|-------|
|------|------|------|-------|

| | | | | |
|---|--------------|--------------|--------------|--------------|
| Revenue | 54 | 56 | 59 | 248 |
| Operating Cost | (43) | (45) | (46) | (194) |
| Inventories + consumables used | (6.4) | (6) | (7) | (28) |
| <i>% Revenue</i> | 11.9% | 11.4% | 11.4% | 11.2% |
| Staff costs | (25.5) | (28) | (28) | (117) |
| <i>% Revenue</i> | 47.3% | 49.2% | 47.4% | 47.3% |
| Operating lease expenses | (1.4) | (1) | (1) | (5) |
| <i>% Revenue</i> | 2.6% | 2.4% | 2.3% | 2.2% |
| Purchased & contracted services | (4.2) | (4) | (4) | (18) |
| <i>% Revenue</i> | 7.8% | 6.8% | 7.4% | 7.3% |
| Other operating expenses excluding bad debt | (3.4) | (4) | (4) | (17) |
| <i>% Revenue</i> | 6.4% | 6.9% | 6.1% | 7.0% |
| Allowance for doubtful receivable | (0.3) | (0) | (0) | (1) |
| <i>% Revenue</i> | 0.58% | 0.60% | 0.75% | 0.51% |
| Depreciation/amortization | (2) | (2) | (2) | (7) |
| Core EBIT | 11 | 11 | 13 | 54 |
| Core EBIT margin | 20.3% | 19.8% | 21.8% | 21.7% |
| Core EBITDA | 13 | 13 | 14 | 61 |
| Core EBITDA margin | 23.5% | 22.8% | 24.7% | 24.5% |
| Net earnings | 8.8 | 9.1 | 10.6 | 44.9 |
| y-y% | | 16.4 | 20.3 | 18.6 |

Source: Company data, Nomura estimates

Valuation Methodology and Investment Risks: We value Raffles Medical based on 21x FY10F P/E, which is at a mean relative P/E discount to Parkway's core P/E of 25x. Our price target of S\$1.95 is derived after adding an estimated net cash/share of S\$0.15 (Dec 10F). We believe an earnings-based methodology reflects the company's strong growth profile, backed by our estimated DCF-based intrinsic value range of S\$1.89~2.89/share. Key risks to our call: 1) the group's ability to attract and retain medical professionals; 2) regulatory risks in Singapore

Note: Ratings and Price Targets are as of the date of the most recently published report (<http://www.nomura.com/research>) rather than the date of this email.

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Mentioned Stocks:

| Mentioned Company | Ticker | Price | Price Date | Stock Rating | Disclosures |
|-------------------------|---------|----------|-------------|--------------|-------------|
| Parkway Hdgs | PWAY SP | SGD 3.88 | 23 Jul 2010 | Neutral | |
| Raffles Medical Sgd0.10 | RFMD SP | SGD 1.83 | 23 Jul 2010 | Buy | |

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- A rating of "1", or "**Strong buy**" recommendation indicates that upside is more than 20%.
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- A rating of "5", or "**Sell**" recommendation indicates that downside is more than 20%.

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