

\$1.32 - OUTPERFORM

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Singapore Miscellaneous

Reuters RAFG.SI
Bloomberg RFMD SP

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STI @ 3,477.6

12M price target S\$1.41

±% up/downside +7%

Target set on 8 May 07

Market cap US\$403m

Shares in issue 462.8m

Free float (est.) 100.0%

3M average daily volume

S\$0.5m (US\$0.3m)

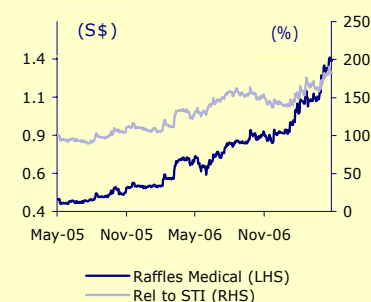
12M high/low

S\$1.43/0.60

Major shareholders

Stock performance (%)

	1M	3M	12M
Absolute	15.2	28.5	88.6
Relative	10.9	19.6	42.7
Abs (US\$)	15.1	30.0	96.2



Source: Bloomberg

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The Unique Model

Hot on the heels of our Red Dot story and the medical tourism theme, Raffles Medical looks set to capitalise on the booming industry as a natural beneficiary. The group subscribes to the unique Group Practice Model, where doctors are employees of the group. Volume growth and operating leverage on excess capacity should drive earnings growth in excess of 20% for the next 3 years. We initiate coverage on Raffles Medical with an O-PF, based on 23x FY08 PE and TP of S\$1.41.

Medical tourism and Volume Growth

We are very positive on the medical tourism story and RMG will be a key beneficiary as one of the largest integrated healthcare providers in Singapore. Various government initiatives should attract more foreign patients to Singapore to seek medical treatment. As RMG focuses on volume growth, this should drive earnings growth in excess of 20% for the next three years. With excess capacity to tap on, RMG has operating leverage to improve its profitability and margins.

Group Practice Model / Growth Drivers

Raffles Medical subscribes to the Group Practice Model, a unique model, which has proven to be successful and profitable for the group. RMG has not had any problems attracting doctors under this model (they have 170 under their books), which is one of the key drivers of profitability. Other growth drivers include the policy changes for the usage of Medisave funds, increasing take-ups in health insurance, and lifting of the cap on consultation fees.

Risks

As with any healthcare provider, the greatest risk is the potential loss of doctors, and failure to attract or retain top specialists to join RMG would have adverse effects on the group. Other risks include the intense competition in the primary healthcare segment, and lack of current plans to expand the franchise further and drive earnings growth. Transparency can be improved, though this is a smaller concern.

Valuations

We value RMG at 23x FY08 PE, slight discount to a larger listed peer like Parkway (25x) and slight premium to a smaller niche outfit like Thomson (20x). Valuing RMG on an ex-cash PE basis brings the multiple lower as RMG sits on healthy cash levels. We forecast dividend payout to be ~4% for FY08. Our TP of \$1.41 gives us 7% upside. We initiate with an OUTPERFORM.

Financials

Year to 31 Dec	05A	06A	07CL	08CL	09CL
Revenue (\$m)	112.9	134.3	162.7	195.3	234.3
Net profit (\$m)	12.0	15.7	20.5	28.1	36.8
EPS (\$¢)	3.0	3.9	4.7	6.1	8.0
CLSA/consensus(4) (%)	-	-	103.0	102.0	98.0
EPS (% YoY)	24.5	28.2	21.2	29.8	30.2
PEX (@S\$1.32)	43.4	33.8	27.9	21.5	16.5
DPS (\$¢)	2.8	4.0	4.3	5.5	6.5
Dividend yield (%)	2.1	3.0	3.2	4.2	4.9
ROAE (%)	11.50	14.20	18.00	24.40	30.80
Price/book (x)	4.9	4.8	5.3	5.2	5.0
Net gearing (%)	(32.61)	(37.07)	(33.14)	(34.76)	(36.34)

Source: CLSA Asia-Pacific Markets

RMG serves 1million patients and 5,000 corporate clients...

RMG has 60 primary care clinics in Singapore, 4 in HK, and a 380-bed tertiary hospital...

The 2 main business segments are Healthcare Services and Hospital Services...

The Integrated Healthcare Player

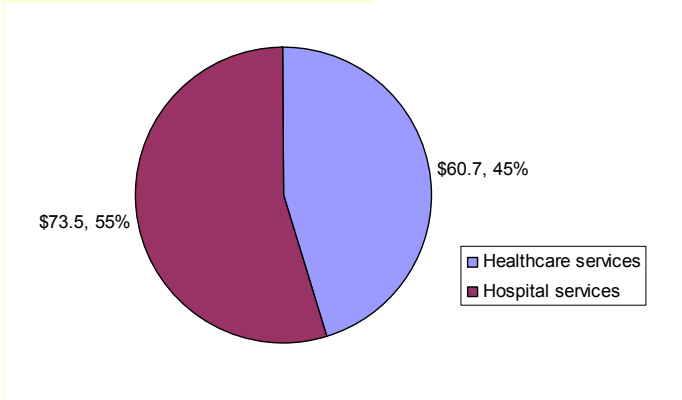
Raffles Medical Group (RMG) is one of the largest integrated healthcare organisations in Singapore and the region, serving about one million patients and 5,000 corporate clients. Its offerings span across basic complaints to chronic conditions to specialist treatment and complex surgery.

RMG operates a network of 60 primary care clinics in Singapore and 4 in HK. Its flagship hospital Raffles Hospital is a 380-bed tertiary hospital. Other services along the healthcare value chain include insurance and consumer healthcare.

Under the healthcare side, the two main business segments are Healthcare Services and Hospital Services. Another segment, relatively smaller, is the Investment Holdings segment, which forms less than 1% of total revenues.

Figure 1

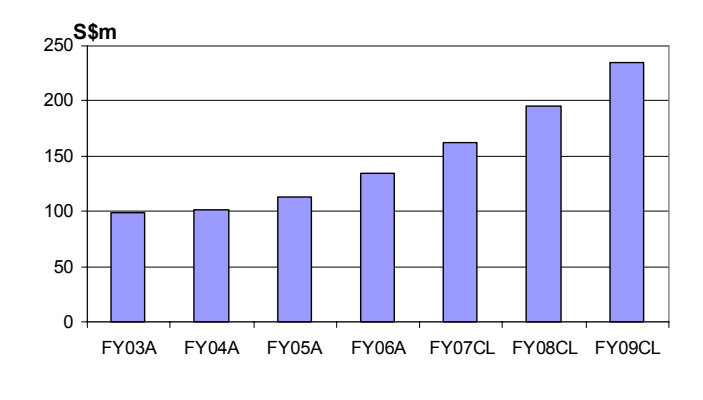
FY06 Revenues (in S\$m)



Source: CLSA Asia-Pacific Markets

Figure 2

Revenue trend



Source: CLSA Asia-Pacific Markets

RMB has largest network of GP and dental clinics in Singapore.... Corporate clients account for 70%...

Private patients more profitable, but RMG seeks to grow the corporate segment via volume growth...

Growth drivers – S’pore’s growing population, usage of Medisave, increased patient load...

RH operating 150 out of 380 licensed beds... intends to open up to 200 by end of year...

Current occupancy is about 50-60%... will stagger increase 150-175-200 beds...

Healthcare Services

RMG has the largest island-wide network of GP and dental clinics, strategically located in CBD, HDB neighbourhoods and airports. Corporate clients contribute about 70% of the revenues, with private patients accounting for the rest.

While the latter is marginally more profitable than the former, RMG seeks to grow the corporate client segment by increasing volume growth (i.e. by aiming to sign up more corporate clients). Going forward, RMG also intends to improve revenues within the same clinic by introducing a wider variety of services into existing ones, and will be looking to open 4-5 clinics yearly.

The key demand growth drivers to this segment would be Singapore’s growing population, the usage of Medisave to be pay for chronic illnesses, increased insurance coverage and corporate contracts, which churn patient load, as well as increase in consultation fees.

Hospital Services

Raffles Hospital is licensed to operate 380 beds, but currently only 150 are in operation. RMG intends to open up to 200 beds by the end of the year to cater to an expected increase in demand.

At 150 beds, the occupancy rate is at about 50-60%. It is important to note that hospitals cannot achieve 100% occupancy rate due to the nature of the service, hence at about 70% occupancy rate, the hospital will look at opening more beds to maintain a spacious feel within the hospital. Additional costs

Growth drivers – increased demand for quality healthcare, excess capacity and medical tourism...

We assume 20% revenue growth for the next 3 years...

Operating margins should improve...

RMG could enjoy a 10% concessionary tax rate...

RMG subscribes to the Group Practice Model...

All medical professionals are employees of the Group and work together to serve patients...

No hard and fast rule to determine which model is superior...

include staff and extra beds, and would not require much expenditure as the existing infrastructure is there. The increase is likely to be staggered 150-175-200 by the end of the year.

Key demand growth drivers to this segment would be the increased demand for quality tertiary healthcare, the ability to increase capacity without incurring much additional costs and capex, medical tourism attracting foreign patients to seek medical treatment in Singapore, and increase in fees.

Forecasts and Assumptions

Fig 3 below shows our growth forecasts and revenue/net profit assumptions for RMG.

We are very positive on the medical tourism story and we believe that RMG will be a key beneficiary of the booming industry. With RMG very much focused on growth by volume, we have assumed a 20% revenue growth for the next 3 years.

We expect operating margins to improve as RMG capitalises on its operating leverage and taps on its excess capacity. We believe staff costs and operating expenses will continue to grow, albeit at a slower rate relative to revenues.

Under an EDB initiative, we understand that RMG is in line to enjoy a concessionary tax status for subscribing to the Group Practice Model. Upon the finalisation of the administrative process, RMG will enjoy a tax rate of 10% with immediate effect. For the time being, we have conservatively assumed a tax rate of 18%, with upside to our net profit assumptions once the process is completed.

Figure 3

	FY05A	FY06A	FY07CL	FY08CL	FY09CL
Revenues (S\$m)	112.9	134.2	162.7	195.3	234.3
Revenue growth (%)	11.3	18.9	21.2	20.0	20.0
Operating profit (S\$m)	13.5	19.2	24.6	33.9	44.5
Operating margins (%)	12.0	14.3	15.1	17.4	19.0
Net profit (S\$m)	12.0	15.8	20.5	28.2	36.9
Net margins (%)	10.7	11.7	12.6	14.4	15.8
Net profit growth (%)	26.1	31.0	30.2	37.4	30.9

Source: CLSA Asia-Pacific Markets

The Unique Model - Group Practice

As mentioned earlier, RMG subscribes to the Group Practice Model (GPM). The unique aspect of this model is that all specialists and medical professionals work as a team to serve patients and provide the quality of healthcare that is integrated, peer reviewed and medically audited. Every single inpatient case is being audited by a panel to ensure quality.

This also means that the doctors and specialists are employees of the Group and work together to serve the patients. Currently there are 170 GP/specialists/dentists under RMG’s books, with another 300 accredited to refer patients to RMG.

Traditionally, there has been a long debate over whether the GPM serves as a good model for integrated healthcare providers. There has been no hard and fast rule. The other 2 hospital operators – Parkway (PWAY SP) and Thomson Medical (THOM SP) operate on a different model, but each of the 3 have been

We analyse and compare the pros and cons of GPM...

successful in their own right, hence it is not possible to gauge which model is superior.

It has been argued that under the GPM, there will be difficulty attracting the top medical professionals to be recruited under the group as an employee. Hence, to understand the GPM better, we do an analysis to compare the pros and cons of the GPM from the perspectives of the doctors and the group.

Figure 4

Group Practice Model (Pros & Cons)

	Pros	Cons
Doctors	<ul style="list-style-type: none"> - No capital raising needed to start practice - No marketing required, do not have to find their own patients - Business aspect left to group, able to focus on practise - Able to exchange info, share expertise and handle more complex cases - Able to upgrade knowledge consistently - Can take breaks / holidays or upgrading courses without fear of income loss 	<ul style="list-style-type: none"> - No ownership of own practice - Private practitioners have greater control over practice, career direction and interest. - As a paid employee, there is a limitation to upside in remuneration
Group (RMG)	<ul style="list-style-type: none"> - Totally integrated, extends along the whole value chain - Able to choose their employees - Greater control over costs - Economies of scale with operating leverage, and enhanced presence - Covers available in the absence of doctors - Quality of healthcare, audit of every inpatient case 	<ul style="list-style-type: none"> - Difficult for a newcomer start a Group Practice - May have problems attracting top specialists who want to start own practice

Source: CLSA Asia-Pacific Markets

Successful doctors have no problems... but some will run the risk...

From the doctors' point of view, a successful solo practice will reap monetary rewards. Eminent doctors who are at the pinnacle of their practice will have no problems attracting their own patients, but there are some that run the risk of not being able to generate patient load to sustain their practice.

RMG's GPM allows doctors to focus on their practice and leave the business aspects to the management...

Hence, by joining a GPM outfit like RMG, the medical professionals will be able to focus solely on their practice and leave the business and marketing aspects to management of the group. The doctors will also be able to go for breaks and upgrading courses without fear of any potential income loss.

For a newcomer, difficult to start a GPM, and may even struggle to attract top specialists...

From a group's point of view, it is difficult for any newcomer to start a Group Practice as the group needs to find a starting point and slowly grow the business. It can be argued that GPM outfits may struggle to attract top specialists, but for the case of RMG, they are still able to attract top specialists from the restructured hospitals. In fact, they have a steady stream of doctors and specialists who are keen to join the group as its employees.

Staff costs account for significant portion of costs... bulk of it attributable to medical professionals...

One unique aspect of the GPM is that staff costs account for a significant portion of costs. For RMG, staff costs typically account for over half of its revenues, with the bulk of the staff costs attributable directly to the medical professionals.

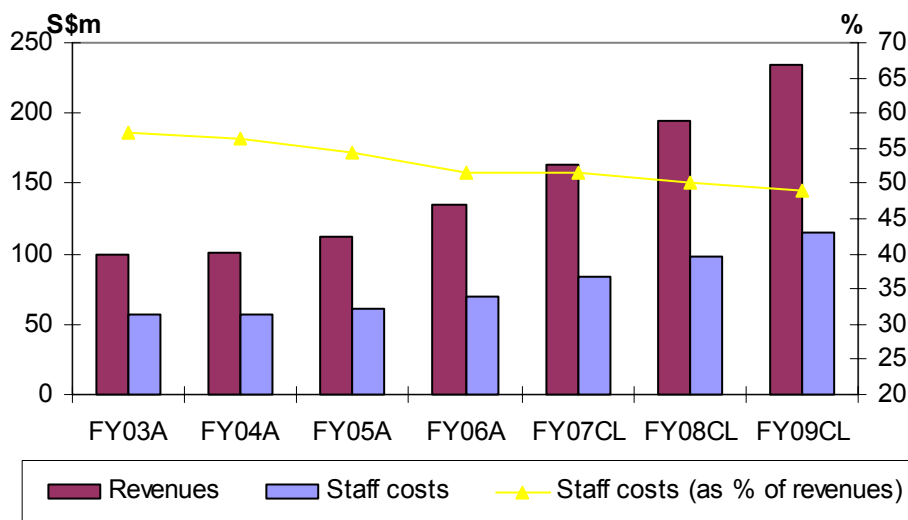
Staff costs declining as a percentage of revenues...

Over the last three years, staff costs have continued to increase, but have been declining as a percentage of total revenues. We believe this trend is

likely to continue, as the group enhances its operating leverage and improves its operating margins. (Refer to Fig 5)

Figure 5

Staff Costs



Source: CLSA Asia-Pacific Markets

Growth Drivers
Government initiatives

RMG is a natural beneficiary of government initiatives to promote medical tourism...

Hot on the heels of our 'Red Dot gets bigger' report, we believe the medical tourism industry in Singapore is booming. RMG stands to benefit as a natural beneficiary of various government initiatives to attract foreign patients to seek medical treatment in Singapore.

Multi-agency government initiative to promote medical tourism...

The SingaporeMedicine initiative was launched in Oct 2003. It is a multi-agency government initiative aimed at developing Singapore into one of Asia's leading destination for medical treatment. The Ministry of Health (MOH), Singapore Tourism Board (STB), Economic Development Board (EDB) and International Enterprise Singapore (IES) are part of this initiative.

Target of 1 million foreign patients by 2012...

The initiative has set a target of attracting at least 1,000,000 foreign patients by 2012. In 2005, Singapore attracted a total of 400,000 foreign patients. Though the 2012 target seems very ambitious, RMG will benefit from a larger pool of foreign patients coming to Singapore, even if the target of 1 million cannot be reached.

Usage of Medisave funds for hospital bills...

More recently, the government has announced a number of changes relating to the usage of Medisave in the Central Provident Fund (CPF) accounts. There has been an upward revision of the daily hospital limit for Medisave. This means that patients can withdraw a higher amount from their Medisave accounts to offset hospital bills.

As well as treatment for chronic diseases....

Further to that, the usage of Medisave funds has been extended to cover chronic diseases like diabetes and hypertension. These changes are positive for RMG as patients have greater flexibility over the use of funds to seek quality healthcare.

Removal of consultation fee cap

Removal of consultation fee cap allows healthcare providers to pass on costs and charge at discretion...

In Apr this year, the Singapore Medical Association (SMA) announced that it would be withdrawing its Guidelines on Fees (GOF) as it was deemed to be

The GPM means all contributions flow straight to RMG...

Rising healthcare costs will cause more people to take up health insurance...

Singapore ranks one of the world's best in terms of healthcare quality...

Attracting rich patients from neighbouring countries where quality medical service is not available...

Niche offerings such as the Japanese clinic and TCM have proven to be popular...

Excess capacity and more beds to be opened by the end of the year...

Incremental costs will not grow as fast as revenues as there is operating leverage...

The biggest risk is the potential loss of medical professionals...

Risk is currently muted for now...

anti-competitive. The immediate implication of this move is that healthcare providers are able to charge consultation fees at their own discretion without a cap on the fees, and will be able to pass on some of the rising operating costs to consumers.

This is yet another positive for RMG as it has the largest network GP clinics in Singapore, and under the GPM, all the clinics are under the group, and hence the potential increase in contributions will flow straight of the group.

Increasing take-up of health insurance coverage

The removal of the GOF will only lead to rising healthcare costs. With healthcare treatment getting more expensive, we believe that there will be an increase in the take up of health insurance to manage rising costs. RMG's insurance arm looks poised to capitalise on this trend.

Quality of healthcare

In terms of quality of healthcare, Singapore ranks as one of the world's best. According to the World Health Organisation's analysis of its 191 member states healthcare systems, Singapore ranked 6th overall, while the UK came in 18th and the US ranked only 37th. As the cost of medical treatment in Singapore is still much lower than UK/US, this makes Singapore a very attractive destination to patients from the Middle East as an alternative to US/UK hospitals.

On a regional basis, Singapore is able to attract rich patients from neighbouring countries who can afford to pay for medical services but is not available in their respective countries. We are also seeing an increasing number of patients from the Middle East, Vietnam, Mongolia, Russia, in addition to the traditional neighbouring countries like Indonesia and Malaysia.

Niche offerings

RMG have gone ahead with initiatives to target niche segments. The Raffles Japanese Clinic is proving to be very popular not only to Japanese patients residing in Singapore, but to Japanese residing in Malaysia and Indonesia as well. Another interesting initiative is the setup of a Traditional Chinese Medicine (TCM) clinic, to cater to patients seeking TCM healthcare.

Excess capacity at Raffles Hospital

As mentioned earlier, Raffles Hospital is licensed to operate 380 beds, but currently only 150 are in operation. Raffles Med intends to open up to 200 beds by the end of the year to cater to an expected increase in demand. The increase is likely to be staggered 150-175-200 by the end of the year.

Additional costs include staff and extra beds, and would not require much expenditure as the existing infrastructure is there. There is plenty of operating leverage to be tapped as the hospital has plenty of excess capacity without much capex required.

Risks

As with any of the healthcare providers, the loss of medical professionals (GPs, Specialists) is the greatest risk. For the case of RMG, this risk is even greater as the group subscribes to the GPM. Failure to attract or retain their medical professionals will have an adverse effect to the group.

For now, we think the risk is relatively muted. Management has maintained that they have a steady stream of doctors and specialists who are keen to

RMG pays a premium compared to restructured hospitals... the squeeze most likely felt at the latter...

Competition in the primary healthcare segment very intense...

No current plans for overseas expansions or acquisitions... Overseas expansion is a longer term objective...

Transparency can be improved by releasing segmental breakdowns and certain operating metrics, though we recognise the limitations given RMG's business model...

join the group under its GPM. Most recently, RMG has managed to attract a few top medical professionals from the restructured hospitals.

Remuneration wise, RMG pays the doctors a premium compared to what they will get at restructured hospitals. The doctors enjoy a higher base salary, and get a cut of professional fees. On top of that, they are entitled to a bonus dependent on the department's performance. Therefore, we think for the time being, RMG should not have problems attracting top medical professionals, and we believe that the squeeze will most likely be felt at the restructured hospitals.

Competition in the primary healthcare segment is very intense in Singapore. There are GP clinics located everywhere across the island. While the withdrawal of the 'Guidelines on Fees' by SMA is a positive for RMG, there is a limit as to how much they can increase prices due to competition.

Currently, RMG does not have any immediate plans to venture overseas via expansions or acquisitions. The immediate focus is still on the Singapore market, as the group believes that there is still plenty of potential for growth from volume and enhancement of capacity at its existing Raffles Hospital. This will be a longer term concern when current growth drivers begin to slow down. But for RMG, overseas expansion is a longer term objective.

On a separate note, we think that the transparency of the group can be improved. Currently, RMG does not provide segmental breakdowns or operating metrics and margins. We understand that there are limitations to the usage of such figures, as RMG offers a wide range of services from GP consultation to complex cases with different operating metrics and margins, and the group operates on a different business model. However, providing more details will allow us to obtain a further insight to the group's efficiency and operations.

Valuations

A fair comparison for valuations would be the regional peers listed in the table below. Most of the regional peers are from ASEAN, with the exception of India's Apollo Hospitals.

Figure 6

Regional listed comparison table

	Ticker	Mkt Cap (US\$)	Daily Vol (US\$)	Dec 06 PE(x)	Dec 07 PE(x)	Dec 08 PE(x)	Operating Margin	Price/Book (x)
Parkway Hldgs	PWAY SP	2,093	4.8	56.6	37.3	29.8	14.0	7.5
Bangkok Dusit MD	BGH TB	1,412	11.1	41.6	25.9	22.1	13.7	4.7
Bumrungrad Hosp	BH TB	1,110	0.5	33.0	29.9	23.8	20.2	11.0
Apollo Hospitals	APHS IN	633	0.7	52.4	36.2	30.6	10.8	4.1
KPJ Healthcare	KPJ MK	196	0.3	16.1	13.6	12.3	11.6	1.5
Thomson Medical	THOM SP	130	0.1	26.4	21.8	17.9	19.7	2.5
Average				37.7	27.4	22.7	15.0	5.2
Raffles Medical	RFMD SP	403	0.3	37.7	28.6	22.0	13.0	5.3

Source: CLSA Asia-Pacific Markets, Bloomberg

We value RMG at 23x FY08 PE, TP of S\$1.41, recommend O-PF...

Using PE as a valuation metric, we note that RMG trades around the peer group average on a trailing basis, and at a very slight discount on a forward basis. We value RMG at 23x FY08 PE, a slight discount to the 25x multiple we value Parkway at, and a slight premium to the 20x multiple for Thomson Med. This translates to a target price of S\$1.41. With a 7% upside to the current price of S\$1.32, we initiate coverage with an OUTPERFORM.

Figure 7

Ex-cash valuations

	FY06A	FY07CL	FY08CL	FY09CL
Cash and cash equivalents (S\$m)	41.9	37.8	40.5	44.7
Number of shares (m)	457.2	457.2	459.4	461.7
Cash per share (S\$)	0.09	0.08	0.09	0.10
Current share price (S\$)	1.32	1.32	1.32	1.32
Current share price-ex cash (S\$)	1.23	1.24	1.23	1.22
EPS	3.9	4.7	6.1	8.0
PEX (ex-cash)	31.5	26.2	20.1	15.3

Source: CLSA Asia-Pacific Markets

Ex-cash basis, lower PE multiple...

RMG is currently in a net cash position. From Fig 7 above, we can see that on an ex-cash basis, RMG is in fact trading at a lower FY08PE multiple.

Figure 8

Payout ratio / Dividend yield

	FY06A	FY07CL	FY08CL	FY09CL
Net profit (S\$m)	15.7	20.4	28.1	36.8
Total dividends per share (Scents)	4.0	4.3	5.5	6.5
Total dividends distributed (S\$m)	16.4	19.7	25.6	30.4
Dividend payout ratio (%)	104.5	96.1	90.9	82.4
Current share price (S\$)	1.32	1.32	1.32	1.32
Dividend yield (%)	3.0	3.2	4.2	4.9

Source: CLSA Asia-Pacific Markets

Dividend policy is to pay out everything if RMG cannot identify alternative uses for cash...

The dividend policy for RMG is to pay out everything if they cannot identify other alternative uses for the cash. The dividend payout ratio has been in excess of 80% for the last three financial years, and in FY06, RMG paid out dividends in excess of their net profit.

We expect dividend yield to be around 4% for FY08...

We think this is likely to be a one-off situation, though we expect dividends to continue to grow for the next three years. Based on current share price, we expect dividend yield to be around 4% for FY08.

Recommendation history - Raffles Medical RFMD SP

Date	Rec level	Closing price	Target
08 May 2007	O-PF	1.32	1.41

Source: CLSA Asia-Pacific Markets

Key to CLSA investment rankings: BUY = Expected to outperform the local market by >10%; O-PF = Expected to outperform the local market by 0-10%; U-PF = Expected to underperform the local market by 0-10%; SELL = Expected to underperform the local market by >10%. Performance is defined as 12-month total return (including dividends).

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Note: In the interests of timeliness, this document has not been edited.

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