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### Singapore Miscellaneous

Reuters RAFG.SI  
Bloomberg RFMD SP

Priced on 28 June 2007  
STI @ 3,538.2

12M hi/lo S\$1.61/0.71

12M price target S\$1.49  
±% potential +1%  
Target set on 29 Jun 07

Shares in issue 513.5m  
Free float (est.) 43.9%

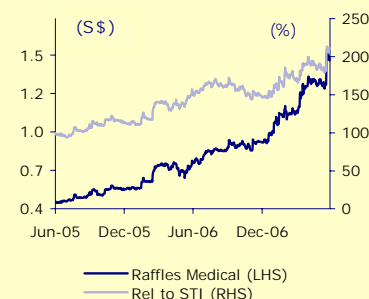
Market cap US\$444m

3M average daily volume  
S\$0.8m (US\$0.5m)

Major shareholders  
Raffles Medical Holdings 44.7%  
Loo Choon Yong 11.5%

### Stock performance (%)

	1M	3M	12M
Absolute	12.2	34.7	102.1
Relative	11.4	21.9	34.3
Abs (US\$)	11.5	33.2	110.1



Source: Bloomberg

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## Swinging the pendulum

The recent placement of 50m new shares to Temasek and the Qatar govt leaves shareholders with a 10.8% dilution, but the presence of these strategic investors could swing the pendulum further away in the longer term. We see immediate earnings accretion from the acquisition of CapitaLand's 50% stake in the flagship Raffles hospital from interest savings. Applying the same 23x FY08PE valuation, we maintain O-PF on our new TP of S\$1.49, supported by a 3.7% dividend yield.

### Strategic Move One

RMG is acquiring CapitaLand's 50% stake in the flagship Raffles Hospital for a consideration of S\$67m, a move it sees as highly strategic as it allows full flexibility of the building from full ownership. Given the two JV partners have differing interests (healthcare and property), the acquisition will allow Raffles Med to have a free hand in restructuring the building and reducing financing costs from the S\$80m debt carried by the JV.

### Strategic Move Two

RMG could have funded the acquisition via debt given its strong cash levels, but ultimately chose to place out 50m shares (@S\$1.30 each) to Temasek and the Qatar govt. The management believes that the presence of these two strategic investors could help pave the way for expansion plans and opportunities in both Singapore and the Middle East.

### Management Update

We met the management for an update, and took the opportunity to tour the hospital. The presence of many non-locals convinced us that the medical tourism story is very much a reality, and RMG is certainly poised to capture a portion of that from a larger slice. Anticipating an upward trend in demand for beds, capacity at Raffles Hospital should be maxed out in 2-3 years time. Meanwhile, RMG could enter a bid for a new hospital to ensure a smooth transition given the timeframe required to construct one. While a REIT cannot be ruled out over the longer term, it does not make economic sense for RMG as it does not require the cash for now.

### Upgrade to our earnings

The revaluation of the hospital will net the company a pre-tax gain of S\$12.5m, but the immediate earnings accretion comes from interest savings held at the JV level. An upside to our numbers exist should the company obtain a concessionary tax rate for FY08, but for now, we continue to value the stock at 23x FY08 PE, TP of S\$1.49. Maintain O-PF.

### Financials

Year to 31 Dec	05A	06A	07CL	08CL	09CL
Revenue (S\$m)	112.9	134.3	162.7	195.3	234.3
Rev forecast change (%)			0	0	0
Net profit (S\$m)	12.0	15.7	31.6	33.3	42.7
NP forecast change (%)			54.7	18.4	16.0
EPS (S¢)	3.0	3.9	6.9	6.5	8.3
CL/consensus(5)(EPS%)	-	-	149	106	107
EPS (% YoY)	24.5	28.2	76.1	(5.8)	27.6
PEX (@S\$1.47)	48.4	37.7	21.4	22.7	17.8
Dividend yield (%)	1.9	2.7	3.1	3.7	4.4
Price/book (x)	5.4	5.3	4.1	4.0	3.9
Net cash (S\$m)	35	42	40	45	53

Source: CLSA Asia-Pacific Markets

Figure 1

**Raffles Hospital (RMG has 50% stake pre-acquisition)**

<b>13 storey hospital</b>		<b>Sq metres</b>
Site area		6,810.7
Gross floor area (inclusive of carpark)		46,233.2
Carpark		17,628.3
Land tenure	99 years (from 1 March 1979)	
<b>Valuations</b>		<b>S\$m</b>
At book		190
By DTZ Debenham Tie Leung		215
Revaluation gain		25
Debt		82
Adjusted NAV (after debt)		133
Purchase consideration		67
<b>FY06 full-year rental expense</b>		<b>6.5</b>

Source: CLSA Asia-Pacific Markets

S\$12.5m revaluation gain for FY07...

The value of the building at book is ~S\$190m. The acquisition price was based on a 1x P/B value of S\$215m, appraised by DTZ Debenham Tie Leung. The immediate impact is that RMG will recognise S\$12.5m in revaluation gain for FY07, should the acquisition be completed.

Immediate earnings accretion...

The earnings accretion will come from the interest expense from the debt of S\$82m held at the JV level. Post acquisition, RMG will be able to reduce the debt almost immediately given its strong cash holdings, and we can expect cost savings of S\$3-4m a year on interest expenses. Depending on how the leasing agreement is restructured, we could see potential rental savings. FY06 rental expense was S\$6.5m.

Flexibility with space planning...

Most importantly, with complete control of the building, RMG can maximise asset yield internally, be it space allocation within hospitals for revenue generating activities (the conundrum between clinics and beds), or eventually if they decide to let the asset go to a REIT.

Slightly geared, but could eliminate borrowings soon due to strong cash flow...

Following the acquisition, RMG will be slightly geared in the region of about S\$15-20m. However, given the business model of RMG and its strong cash flow, it could eliminate its borrowings in 1-2 quarters.

Demand could max out beds by 2010...

**Expansion plans**

The hospital is currently licensed for 380 beds, and is opening 200 beds at the end of FY07. Demand is expected to grow and the hospital could operate 300-350 beds by 2010.

Govt is releasing 3 sites for hospital use... RMG could bid for one to ensure a smooth transition when beds are full...

The government is looking at releasing 3 sites for hospitals – Race Course Road, Biopolis and Novena. We are ruling out Race Course Road as the site is planned for a hospital cum hotel building. RMG could potentially bid for one of the other two sites and start construction of a new hospital, to prepare for a smooth transition from its existing one, given that a new hospital requires about 3 years to build.

Expanding beyond Singapore...

In terms of expansion beyond Singapore, RMG is exploring the option of setting up clinics and offering consultancy services in the Middle East (which is why the placement to the Qatar govt is a strategic move). Besides that, they are also considering building either a medical centre in Beijing or Shanghai.

Funding expansion should not be difficult...

Management has not ruled out REIT, but does not make economic sense for now.

Healthy cash levels, no immediate use of REIT proceeds...

Upgrade earnings and arrive at new TP of S\$1.49

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

### Funding/REIT

As RMG sits on healthy cash levels, funding for projects and expansion plans should not be too difficult as the company could easily gear up, or seek collaborations.

While the possibility of a REIT has been mooted, management has not ruled that out in the future, but in the near term, it is highly unlikely they will proceed with a REIT as it does not make economic sense. Firstly, rental expense of S\$6.5m is approximately 3% of the appraised value. If a REIT structure has been put in place, there will be massive earnings dilution from increased rental expenses which will hit RMG's bottom line.

Moreover, RMG is sitting on healthy cash levels, and there will not be optimal utilisation of the REIT proceeds as they do not need to restructure debt nor have any major expansion plans in the pipeline.

### Valuations

We have upgraded our earnings forecast for FY08-9 by about 16-18% to factor in interest savings, increased depreciation and potentially lower rental expenses. Using the same valuation metric of 23x FY08PE (discount to Parkway's 25x and premium to Thomson Med's 20x), we arrive at our target price of S\$1.49. We maintain O-PF as the small upside is supported by a dividend yield of 3.7%.

As previously mentioned in our initiation report, RMG could be in line to enjoy a concessionary tax status for subscribing to the Group Practice Model. Our understanding is that RMG could enjoy a tax rate of 10% once the administrative process is finalised. For the time being, we still maintain our conservative assumption of a 18% tax rate.

#### Recommendation history - Raffles Medical RFMD SP

Date	Rec level	Closing price	Target
29 June 2007	O-PF	1.47	1.49
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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