

## COMPANY UPDATE

# Raffles Medical Group (RAFG.SI)

Neutral

## Building purchase may favor REIT long term; stay Neutral, TP S\$1.50

### What's changed

Raffles has announced the purchase of the remaining 50% stake in CapitaLand-Raffles Properties (CRP) for S\$66.9 mn in cash funded by equity issuance of S\$63 mn, making CRP a wholly owned subsidiary of Raffles. CRP owns Raffles' sole hospital building.

### Implications

With Raffles now effectively owning 100% of the hospital building, we believe that there is a longer term possibility that it could inject the hospital building into a REIT to fund future strategic investments (e.g., an extension of its existing hospital premises, medical centers in China), as and when such opportunities arise. We cannot forecast the timing of the REIT exercise, but believe this may be a viable option in the future given: (1) the government could put up sites adjacent to Raffles existing hospital for sale in anticipation of future demand; and (2) we expect Raffles' capacity to gradually tighten each year. Post the CRP purchase, we have revised our EPS estimates by -11%, -5% and -3% in 2007E-2009E taking into consideration the enlarged share capital base.

### Valuation

We maintain our Neutral rating and raise our 12-month SOTP-based target price to S\$1.50 (previously S\$1.37, using an EV/EBITDA-based SOTP methodology) given improved cash flow (since Raffles effectively no longer pays rent on its hospital building). Our new target price is still based on the assumption of no REIT exercise, but we estimate an implied valuation of S\$1.65/share if a REIT scenario does materialize in 2008.

### Key risks

Failure to execute planned capacity expansion, overpaying for acquisitions (if any), failure to carry out a REIT exercise with reinvestment of funds.

### INVESTMENT LIST MEMBERSHIP

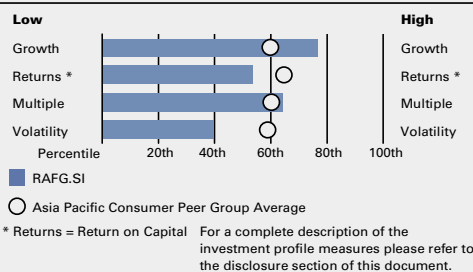
Neutral

### Coverage View: Neutral

Singapore:  
Healthcare Services

Christina Hee, CFA  
+65-6889-2462 | christina.hee@gs.com Goldman Sachs (Singapore) Pte

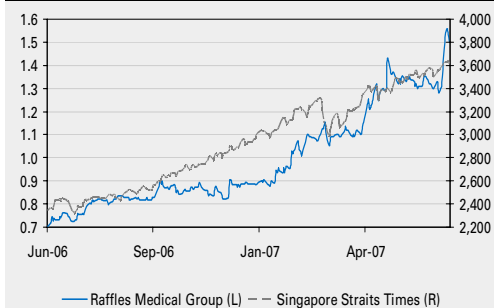
### Investment Profile: Raffles Medical Group



Key data	Current
Price (S\$)	1.50
12 month price target (S\$)	1.50
Market cap (S\$ mn / US\$ mn)	695.3 / 451.9
Foreign ownership (%)	--

	12/06	12/07E	12/08E	12/09E
EPS (S\$) New	0.04	0.04	0.06	0.08
EPS revision (%)	0.0	(10.7)	(5.1)	(2.6)
EPS growth (%)	28.5	24.6	42.7	25.7
EPS (dil) (S\$) New	0.03	0.07	0.06	0.08
P/E (X)	42.7	34.3	24.0	19.1
P/B (X)	6.0	3.9	3.8	3.6
EV/EBITDA (X)	14.0	25.4	15.9	12.9
Dividend yield (%)	2.3	2.0	3.4	4.2
ROE (%)	14.3	22.6	16.0	19.5

### Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	34.1	69.2	112.9
Rel. to Singapore Straits Times	19.5	37.7	38.9

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 6/22/2007 close.

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# Raffles Medical Group: Summary financials

Profit model (\$\$ mn)	12/06	12/07E	12/08E	12/09E	Balance sheet (\$\$ mn)	12/06	12/07E	12/08E	12/09E
<b>Total revenue</b>	<b>134.2</b>	<b>167.6</b>	<b>209.2</b>	<b>250.0</b>	Cash & equivalents	41.9	11.1	25.5	43.1
Cost of goods sold	(16.6)	(20.7)	(25.8)	(30.9)	Accounts receivable	16.8	18.4	23.0	27.5
SG&A	(72.7)	(89.3)	(113.4)	(134.6)	Inventory	3.4	4.3	5.3	6.4
R&D	--	--	--	--	Other current assets	14.3	17.3	17.3	17.3
Other operating profit/(expense)	(27.5)	(30.5)	(28.5)	(33.4)	<b>Total current assets</b>	<b>76.4</b>	<b>51.1</b>	<b>71.1</b>	<b>94.2</b>
<b>EBITDA</b>	<b>20.9</b>	<b>31.7</b>	<b>49.7</b>	<b>59.7</b>	Net PP&E	20.2	233.7	229.0	224.4
Depreciation & amortization	(3.4)	(4.7)	(8.3)	(8.7)	Net intangibles	0.2	0.2	0.2	0.2
<b>EBIT</b>	<b>17.5</b>	<b>27.1</b>	<b>41.4</b>	<b>51.1</b>	Total investments	54.0	0.0	0.0	0.0
Interest income	1.7	1.1	0.7	1.4	Other long-term assets	1.1	3.0	3.0	3.0
Interest expense	(0.1)	(0.6)	(2.0)	(2.0)	<b>Total assets</b>	<b>151.8</b>	<b>288.0</b>	<b>303.4</b>	<b>321.9</b>
Income/(loss) from uncons. subs.	0.9	0.6	0.0	0.0	Accounts payable	30.0	36.5	43.6	51.7
Others	0.1	0.0	0.0	0.0	Short-term debt	2.0	46.0	46.0	46.0
<b>Pretax profits</b>	<b>20.1</b>	<b>28.2</b>	<b>40.2</b>	<b>50.5</b>	Other current liabilities	5.9	7.3	9.7	11.8
Income tax	(4.3)	(5.6)	(8.0)	(10.1)	<b>Total current liabilities</b>	<b>37.9</b>	<b>89.8</b>	<b>99.3</b>	<b>109.5</b>
Minorities	(0.1)	(0.1)	(0.1)	(0.1)	Long-term debt	0.0	0.0	0.0	0.0
<b>Net income pre-preferred dividends</b>	<b>15.8</b>	<b>22.5</b>	<b>32.1</b>	<b>40.3</b>	Other long-term liabilities	0.7	0.7	0.7	0.7
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	0.7	0.7	0.7	0.7
<b>Net income (pre-exceptionals)</b>	<b>15.8</b>	<b>22.5</b>	<b>32.1</b>	<b>40.3</b>	<b>Total liabilities</b>	<b>38.7</b>	<b>90.6</b>	<b>100.1</b>	<b>110.2</b>
Post-tax exceptionals	0.0	12.5	0.0	0.0	Common stock & premium	101.1	166.1	166.1	166.1
<b>Net income</b>	<b>15.8</b>	<b>35.0</b>	<b>32.1</b>	<b>40.3</b>	Other common equity	11.8	31.0	36.9	45.1
EPS (basic, pre-except) (\$\$)	0.04	0.04	0.06	0.08	<b>Total common equity</b>	<b>112.9</b>	<b>197.1</b>	<b>202.9</b>	<b>211.2</b>
EPS (basic, post-except) (\$\$)	0.04	0.07	0.06	0.08	Minority interest	0.3	0.3	0.4	0.4
EPS (diluted, post-except) (\$\$)	0.03	0.07	0.06	0.08	<b>Total liabilities &amp; equity</b>	<b>151.8</b>	<b>288.0</b>	<b>303.4</b>	<b>321.9</b>
DPS (\$\$)	0.03	0.03	0.05	0.06	<b>BVPS (\$\$)</b>	<b>0.25</b>	<b>0.38</b>	<b>0.40</b>	<b>0.41</b>
Dividend payout ratio (%)	98.3	45.1	81.8	79.6					
Free cash flow yield (%)	4.8	3.2	4.9	6.1					
<b>Growth &amp; margins (%)</b>	<b>12/06</b>	<b>12/07E</b>	<b>12/08E</b>	<b>12/09E</b>	<b>Ratios</b>	<b>12/06</b>	<b>12/07E</b>	<b>12/08E</b>	<b>12/09E</b>
Sales growth	18.9	24.8	24.8	19.5	ROE (%)	14.3	22.6	16.0	19.5
EBITDA growth	32.4	52.2	56.5	20.3	ROA (%)	10.8	15.9	10.9	12.9
EBIT growth	37.7	54.8	53.0	23.3	ROACE (%)	19.7	14.5	14.5	18.6
Net income growth	31.9	121.9	(8.3)	25.7	Inventory days	70.1	67.9	67.9	69.2
EPS growth	28.5	93.8	(8.3)	25.7	Receivables days	39.5	38.3	36.2	36.9
Gross margin	87.7	87.7	87.7	87.7	Payable days	598.9	586.8	566.2	563.6
EBITDA margin	15.5	18.9	23.7	23.9	Net debt/equity (%)	(35.4)	17.7	10.1	1.4
EBIT margin	13.0	16.2	19.8	20.4	Interest cover - EBIT (X)	NM	NM	33.9	87.6
					<b>Valuation</b>	<b>12/06</b>	<b>12/07E</b>	<b>12/08E</b>	<b>12/09E</b>
<b>Cash flow statement (\$\$ mn)</b>	<b>12/06</b>	<b>12/07E</b>	<b>12/08E</b>	<b>12/09E</b>	P/E (analyst) (X)	42.7	34.3	24.0	19.1
Net income pre-preferred dividends	15.8	22.5	32.1	40.3	P/B (X)	6.0	3.9	3.8	3.6
D&A add-back	3.4	4.7	8.3	8.7	EV/EBITDA (X)	14.0	25.4	15.9	12.9
Minorities interests add-back	0.1	0.1	0.1	0.1	Dividend yield (%)	2.3	2.0	3.4	4.2
Net inc/(dec) working capital	0.6	4.0	1.5	2.6					
Other operating cash flow	(0.2)	0.2	3.6	2.6					
<b>Cash flow from operations</b>	<b>19.7</b>	<b>31.5</b>	<b>45.5</b>	<b>54.3</b>					
Capital expenditures	(2.3)	(3.2)	(3.6)	(4.1)					
Acquisitions	(0.7)	(0.7)	(0.7)	(0.7)					
Divestitures	0.0	0.0	0.0	0.0					
Others	1.1	(65.1)	1.4	2.1					
<b>Cash flow from investments</b>	<b>(1.9)</b>	<b>(69.0)</b>	<b>(2.9)</b>	<b>(2.7)</b>					
Dividends paid (common & pref)	(15.5)	(15.8)	(26.2)	(32.1)					
Inc/(dec) in debt	0.0	(40.0)	0.0	0.0					
Common stock issuance (repurchase)	4.8	65.0	0.0	0.0					
Other financing cash flows	(0.3)	(2.6)	(2.0)	(2.0)					
<b>Cash flow from financing</b>	<b>(11.0)</b>	<b>6.7</b>	<b>(28.2)</b>	<b>(34.1)</b>					
<b>Total cash flow</b>	<b>6.8</b>	<b>(30.8)</b>	<b>14.4</b>	<b>17.5</b>					

Note: Last actual year may include reported and estimated data.  
Source: Company data, Goldman Sachs Research estimates.

## Analyst Contributors

**Christina Hee, CFA**

christina.hee@gs.com

## Financial impact of the CRP acquisition

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We highlight the following:

- Raffles has raised net proceeds of S\$63 mn to finance the CRP purchase by issuing 25 mn new shares each (at S\$1.30 per share) to Temasek-subsiary, V-Sciences Investments, and Qatar Investment Authority, who will own 4.9% each of Raffles based on its enlarged share capital base of 513.5 mn shares. As a result, existing shareholders will find their stake in Raffles diluted by 10.8%.
- While Raffles could have easily funded the CRP purchase using internal cash or debt given its strong cash flow generation and low gearing, we believe that Raffles took the opportunity to issue shares to fulfill demand for its stock by strategic investors. We believe that a relationship with Temasek and the Qatar government could prove useful in the event of future overseas expansion.
- With CRP now a wholly-owned subsidiary (previously a 50%-owned associate), Raffles will also take on additional debt of c.S\$84 mn but will pay down c.S\$40 mn by year end. From a net cash position in 2006, we estimate Raffles' net-debt-to-equity ratio to be 18% in 2007E.
- We also incorporate an exceptional gain of S\$12.5 mn in our 2007E net income estimates, being the revaluation surplus on the hospital building. Based on a recent revaluation by independent valuers DTZ Debenham Tie Leung (DTZ), the Raffles hospital building is worth S\$215 mn.
- Note that with CRP now a wholly-owned subsidiary, Raffles effectively no longer pays rent on its hospital building. We have revised our earnings estimates to factor in lower rent, higher interest expense, higher depreciation and lower associate income. The net effect is that we have revised our EPS estimates by -11%, -5% and -3% in 2007E-2009E taking into consideration the enlarged share capital base of 513.5 mn shares.

## Assessing the likelihood of a REIT

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We believe that the move by Raffles to purchase the remaining 50% stake in CRP could be a precursor to a REIT exercise but the timing of such an exercise is uncertain and we see several potential obstacles.

### **Greater flexibility now that Raffles owns 100% of the building**

#### **CRP purchase allows greater freedom to redevelop or potentially inject into a REIT.**

Raffles has stated that part of the reason for the CRP purchase is to have greater flexibility to: (1) improve, alter and develop the hospital building without having to seek its partner's consent; and (2) leverage on the hospital building to fund future investments when the opportunity arises. We believe the purchase of the remaining 50% stake in the hospital building suggests that: (1) Raffles may have plans to extend its existing hospital premises and may prefer to have full control over this decision without having to consult its partners thereby delaying the process. (2) In the event of a REIT, Raffles may wish to have 100% rather than just 50% of the upside.

**Opportunity to extend existing premises or identification of attractive overseas acquisitions could trigger a REIT exercise** since management has previously indicated that Raffles is unlikely to embark on a REIT unless there is a good use of funds. The Singapore government has indicated that it may put up one or two sites for sale to private

hospital operators in anticipation of future demand. Recall that the Singapore government is targeting: (1) a population of 6.5 mn; and (2) 1 mn medical tourists annually in Singapore by 2012. We see scope for extension of Raffles existing premises given there is adjoining vacant land. Other possible investments include medical centers in China or hospital acquisitions in Malaysia.

### **Timing of a potential REIT is uncertain, near-term returns may be too low**

**Difficult to forecast timing of investments.** Unlike the acquisitive Parkway, Raffles has not been active in M&A and has little debt hence it does not have a significant funding requirement to warrant a REIT exercise. However, given that: (1) the Singapore government has demonstrated its willingness to release land sites this year in response to strong demand; and (2) we expect Raffles' capacity to gradually tighten each year, we cannot rule out the possibility of a REIT over the next 2 years, especially given the current bullish Singapore property market. Lastly, although Raffles may not have a portfolio of hospitals to inject into a REIT unlike Parkway, we still believe it could inject the hospital building into a REIT—just one not sponsored by Raffles.

### **ROE may be too low in the near term to support a REIT; look to US REIT yield spreads.**

We estimate that Raffles' 2007E ROE for the hospital business alone to be 8% in contrast to Parkway's (11.6% in 2007E). However with Raffles' ROE gradually improving every year as it opens more beds, we believe a REIT will become a more viable proposition in the future. We estimate that a healthcare REIT in Singapore may require an asset yield of 5.5%-6.5% if we were to apply a 1.5%-2% spread (being the rough spread between US office and healthcare REITs) to Singapore office REIT asset yields of 4%-4.5%. We estimate that Raffles' hospital building would currently have an asset yield of c.5%, making it less attractive to a REIT at present. However, we believe that the CRP purchase is part of a plan by management to develop the building and improve asset yields such as to make an injection into a REIT an attractive proposition in the future.

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#### **Exhibit 1: ROE comparison of Singapore hospitals**

	2006	2007E	2008E	2009E
Parkway hospitals	6.5%	11.6%	14.6%	16.9%
Raffles hospital	4.9%	8.0%	11.7%	14.7%

*Source: Company data, Goldman Sachs Research estimates.*

**Still room to open unutilized wards.** With occupancy rates of c.60% and capacity to spare (only c.200 out of its 380 licensed beds are operational), it could be argued that Raffles' hospital building may not be attractive to a REIT especially since the property manager would have less flexibility in determining the use of space. On the other hand, a REIT wishing to enjoy yield upside as Raffles gradually opens more beds, may choose to buy the asset now even though it has not matured.

## **We have a new target price of S\$1.50; implied valuation with REIT is S\$1.65**

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We continue to rate Raffles Neutral and raise our 12-month SOTP-based target price to S\$1.50 (previously S\$1.37 using an EV/EBITDA-based SOTP methodology) given improved

cash flow (since Raffles effectively no longer pays rent on its hospital building). Our new target price is still based on the assumption of no REIT exercise (see Exhibit 2) but in order to depict the scenario whereby a REIT exercise is carried out in 2008, we switch to using a DCF-based SOTP methodology. We estimate an implied valuation of S\$1.65/share if a REIT scenario does materialize.

Under the REIT scenario, we assume the hospital building to be worth S\$215 mn to the REIT, as valued by DTZ. We assume that Raffles invests S\$281 mn over 2008E-2009E (S\$211 mn from the proceeds of the REIT exercise and additional S\$70 mn in debt) into e.g., an extension of its existing hospital premises and/or medical centers in China which we assume could yield an IRR of 4.6%. For comparison purposes, we estimate that the IRR on Parkway's acquisition of Pantai was 11%, however, we assume a lower IRR for Raffles vis-à-vis Pantai as Pantai is an established Malaysian franchise.

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**Exhibit 2: Our price target calculation assumes no REIT exercise**  
SOTP valuation 1

	Value (S\$ mn)	Value per share (S\$)	Breakdown (%)	Methodology
Hospital business	776	1.51	79%	DCF (a)
Other investments	14	0.03	11%	Book value
<b>Enterprise value</b>	<b>790</b>	<b>1.54</b>		
Net cash / (debt)	(20)	(0.04)	10%	
<b>Equity value</b>	<b>769</b>	<b>1.50</b>		

(a) WACC of 6%, LT growth 1.5%, debt-to-capital ratio of 19%

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Source: Company data, Goldman Sachs Research estimates.

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**Exhibit 3: An asset securitization exercise with reinvestment of funds could imply a value of S\$1.65 per share**  
SOTP valuation 2

	Value (S\$ mn)	Value per share (S\$)	Breakdown (%)	Methodology
Hospital business	893	1.74	79%	DCF (a), (b)
Other investments	14	0.03	11%	Book value
<b>Enterprise value</b>	<b>907</b>	<b>1.77</b>		
Net cash / (debt)	(59)	(0.11)	10%	(c)
<b>Equity value</b>	<b>848</b>	<b>1.65</b>		

(a) WACC of 5%, LT growth 1.5%, debt-to-capital ratio of 60%

(b) Raffles invests S\$281 mn over 2008E-2009E (S\$211 mn from the proceeds of the REIT exercise and additional S\$70 mn in debt)

(c) Assumptions for the REIT

- We assume the hospital building to be worth S\$215 mn to the REIT, as valued by DTZ
- Cash available for distribution amounts to c.S\$7 mn pa
- Capitalization rate of 6%, LT growth 0.8% given leasehold tenure

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Source: Company data, Goldman Sachs Research estimates.

## Reg AC

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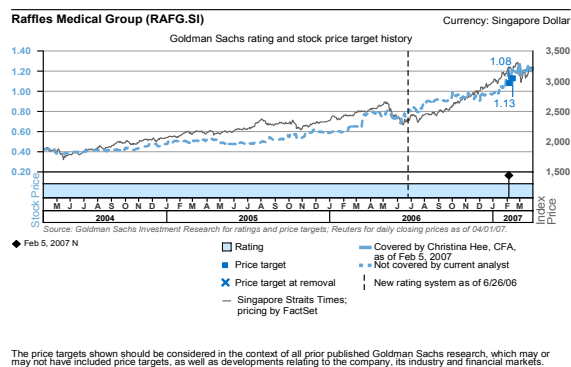
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Global	28%	59%	13%	41%	34%	31%

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## Price target and rating history chart(s)



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