Healthway Medical Corporation

Victor Portfolio Management

Wai Yeong Choun, Victor

23 July 2012

Ticker	5NG
Exchange	Singapore Stock Exchange
Industry & Sector	Healthcare Services
Market Capitalization	S$ 182,813,603
52-wk Price Range	S$0.06 – S$0.10
Recent Price	S$0.083 (20/07/2012)
Net Asset Value	S$0.0718 (31/03/2012)
Current P/E	112x
Projected 2015 P/E	30.5x
Dividend Yield	nil
Benchmark	FTSE ST Healthcare Index

Recommendation

HOLD

Pros

- Ease of accessibility to Healthway Medical clinics island-wide
- China expansion on-going

Cons

- Business model focuses on volume and less on quality
- Manpower cost at 64% above industry norm
- Negative $35 m Retained Earnings with Management's focus on acquisition trail.
- Resignation of 2 Independent Auditors and change of Corporate Auditor to PwC

Intrinsic Value

S$ 0.078

Based on Free Cash Flow to Equity (FCFE)

1. Business Summary

Healthway Medical Corporation Limited is Singapore's largest network of private medical centres and clinics offering quality healthcare services across the medical value chain in primary healthcare, dental and specialist services. Operating from a centralised platform, the Group is able to leverage on shared patients and resources among each of their medical specialty groups. This enables them to serve an increasing number of patients and develop more specialist services and facilities to meet the rising healthcare needs of their patients. The partnership in 2011 with Bank of China enables Healthway Medical to tap on 20 million of the bank's customers.

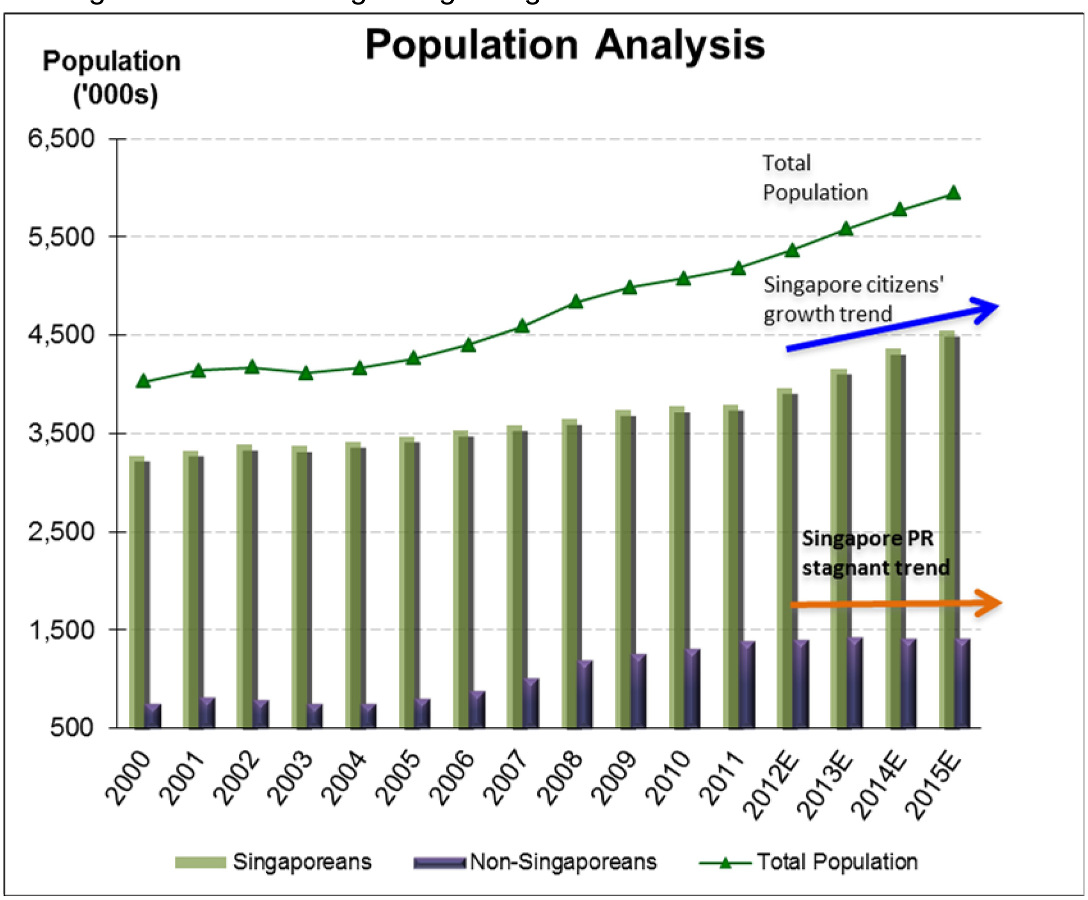
Healthway Medical mission is to provide high quality medical services and facilities that are both accessible and affordable to patients in the markets that they serve. It operates in 2 markets: Singapore and China. As of AR 2011, Healthway Medical owns, operates and manages over 100 medical centres and clinics in Singapore and Shanghai. There are 2 revenue reporting units: Primary healthcare and Specialist and Wellness healthcare. Primary healthcare comprises Family Medicine and Dentistry while Specialist and Wellness healthcare comprises Paediatrics, Orthopaedics and Wellness & Aesthetics.

2. Industry Overview

Changing demographics of Singapore and China to graying population have boosted the demand for the healthcare sector. As public healthcare provider experiences over-capacity, the rising affluent middle-class, which is more indifferent to cost, may be more willing to seek treatment with private medical practice. As such, private healthcare sector is in the growth cycle, poising for above-average growth in the next few years.

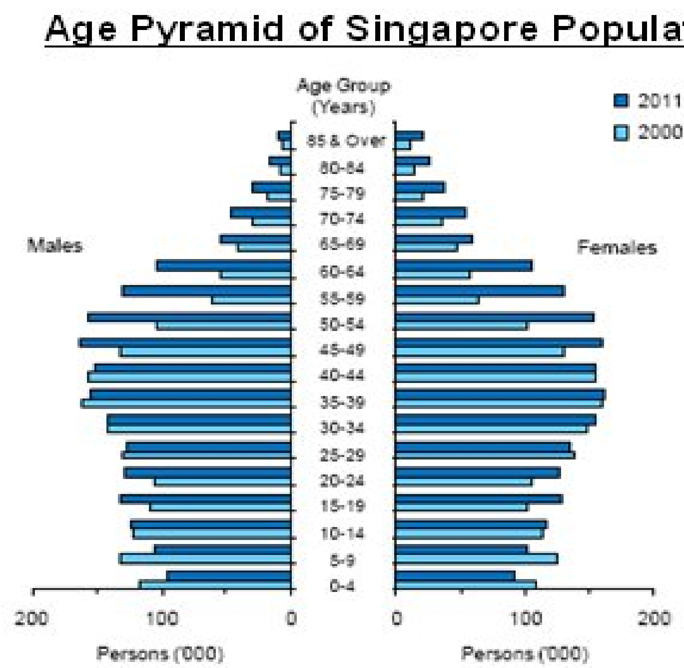
Medical tourism and proactive government policies have been the engines of growth for tertiary healthcare services. In addition, insurance policies covering insurers' inpatient treatment at private hospitals enhance the patient numbers for private healthcare providers.

Population growth in 2011 was 2.1%, an increase from 1.8% in 2010. This affirms government's effective policy. With increasing lifespan and positive government policies in encouraging births (eg. Baby bonus scheme, dragon year 2012), Singapore population is likely to increase at between 3.5% and 4%. Further, I have factored in the tightening immigration policy in restricting the influx of foreigners gaining PR status.



Source: Department of Statistics, VPM estimates

Singapore has more than 30 hospitals, 18 polyclinics and 417 private GP clinics. The number of doctors per 10,000 residents increased from 16 in 2009 to 18 in 2011, reported Ministry of Health. Despite the increase, Singapore still falls short of doctors compared to other developed countries like US, which has doctor 24.5 doctors per 10,000 residents. As such, the demand for medical services is likely to remain buoyant in Singapore. The chart below shows the changing demographics of Singapore, with longer life expectancy and median age of about 35 years old.



Source: Department of Statistics, 2011

Estimation of medical tourism receipts with available data from Singapore Tourism Board between 2008 and 2011 revealed compounded annualized growth rate (CAGR) of 24%. On average, 5% of a given year's gross tourism receipts would go to the medical industry. Extrapolating the results, and applying a conservative estimate of CAGR 15%, I derived estimates for Singapore medical industry to 2015. Strong growth for Singapore medical industry is likely to continue as Singapore claim more healthcare accolades and accreditation.[1]

Table 1: Tourism Receipts

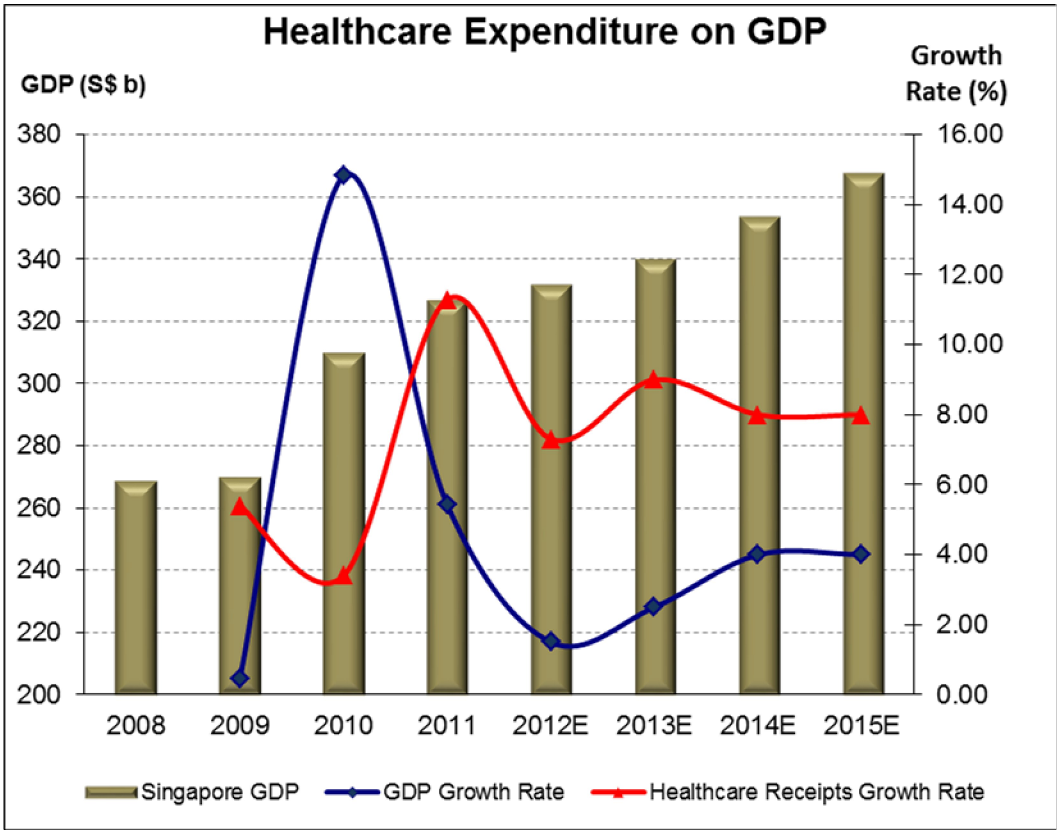
Year	2009	2010	2011	2012E	2013E	2014E	2015E
Medical Tourism Receipts ($ m)	732	940	1,130	1,300	1,494	1,719	1,976

Source: STB, Frost & Sullivan 2010[2], VPM estimates

Healthcare expenditure is more persistent than GDP growth fluctuations. As can be seen in the graph below, healthcare expenditure y-o-y changes are higher than GDP y-o-y changes.

[1] For a list of medical achievements see Ministry of Health, http://www.moh.gov.sg/content/moh_web/home/our_healthcare_system/OverviewofOurHealthcareSystem.html

[2] The Business Times, Nov 13, 2010, reported by Chen Huifen, Doctor is in but foreign patients dither, citing Frost & Sullivan's Dr Pawel Suwinski



Source: Department of Statistics and VPM estimates

Community Health Assist Scheme (CHAS) provides subsidized treatment for lower-income families at private clinics. Baby bonus scheme (ie. 4 months of maternity leave), subsidized home helper and other children educational top-ups serve to encourage citizens to have more children. Further, easier access to Medisave funds has stimulated private healthcare demand. On a personal note, I seem to be giving up seats on trains more frequently to pregnant ladies these days.

3. Porter's Five Forces

Rivalry among Existing Competitors: Moderate- High

In the private primary healthcare landscape, there are 2 groups of consumers: individual and corporate patients. Individual self-paying patient group is more elastic, with waiting time to seeing a doctor a crucial factor. Loyalty is not prevalent amongst the group. In contrast, corporate patients are less elastic as they enjoy subsidized corporate rate for medical treatment with Healthway Medical Corp.

Healthway Medical strategy of locating its clinics at neighborhood areas and at prominent junctions may be advantageous in defending its market share. With over 50 GP clinics and dental clinics island wide, easy accessibility to Healthway doctors is a barrier to deter. However, this barrier may be broken down should another stronger group of practice such as Raffles Medical Group open in close proximity to a Healthway Medical clinic.

Threat of New Entrants: Low- Moderate

Most private medical groups establish contractual agreements with corporate clients for their respective staff medical needs. Healthway boosts a strong clientele base which new entrants may find it difficult to match in the near term, unless they have a consolidated business model among individual clinics. Even so, brand recognition is an important consideration for corporate customers. It would be difficult for a company to make known the different clinics which entitle their staffs to waivers.

Healthway Medical has specialists across a comprehensive range of disciplines like paediatrics, orthopaedics and cardiology services. To acquire corporate clientele base, medical groups usually assist HR department in managing medical claims. Accordingly, high capital investment in systems and acquiring a large corporate clientele base are strong barriers for new entrants.

While I do not see the imminent threat of Connexion Medical Centre (target medical tourists) for Healthway Medical primary healthcare segment, the opening of the new complex in Year 2013 is likely to impact adversely on its Specialist and Wellness Segment.

Availability of Substitutes: Moderate

The brand recognition of Healthway Medical is closely tied to primary healthcare and vaccinations. For chronic diagnosis and disease management, patients of the middle income families are more likely to opt for Polyclinics. With polyclinic doctors' referrals, patients may consult Specialists at subsidized rates.

Buyers' Power: Low-Moderate

The demand of Healthway Medical services comes from the 2 groups as mentioned above. Individual patients with acute conditions, who do not need medical certification, may choose to self-medicate by purchasing their medicines over-the-counters at Guardian and Watson pharmacies. For corporate patients and, to a limited extent, individual patients, switching cost to other clinics is high as Healthway Medical retains medical records for reference and further consultation. In addition, extended opening hours provide convenience to patients.

Suppliers' Power: High

The main supplier of the industry is from the medical personnel. Staff cost is likely to remain high as doctors supply is low and their mobility is high. To acquire greater market share, Healthway Medical has many clinics extend their operating hours to midnight. Given the number of GPs they have, most doctors are working over-time.

Remarks

The healthcare industry is growing rapidly and the above justifications do not seem to suggest expenditure on private medical care is highly correlated with macro developments. However, the cost of medical personnel continues to exert significantly on the industry's margin. As the industry progresses, the competition at the primary segment is likely to intensify and compete on cost basis.

At the Specialist healthcare segment, Healthway Medical does not seem to have a clear guidance on whether to focus on volume or revenue per patient. Most of the patient revenue derived at this segment comes from referrals, thence high intra-revenue elimination. It remains to be seen if Healthway could target more wealthy foreign patients.

4. Opportunities

Healthway Medical China venture has not shown consistency in the net income for FY2011, from a profit of S$1.01 million to a loss of S$1.87 million. The Group could market itself strongly as a premium primary healthcare provider in China to acquire corporate clienteles, leveraging on the billing system developed in Singapore. Simultaneously, partnering with more insurance companies would enable the company to gain market share.

Brand packaging is of paramount importance along quality healthcare. According to a research report published by MOH in 2010, chronic disease patients are less likely to seek private healthcare.[3] Not many patients are aware of the specialist and wellness wings of Healthway Medical Group. By restructuring the Group similar to polyclinics, nurses could arrange secondary care for patients' follow-up, thereby limiting the outflow to public healthcare.

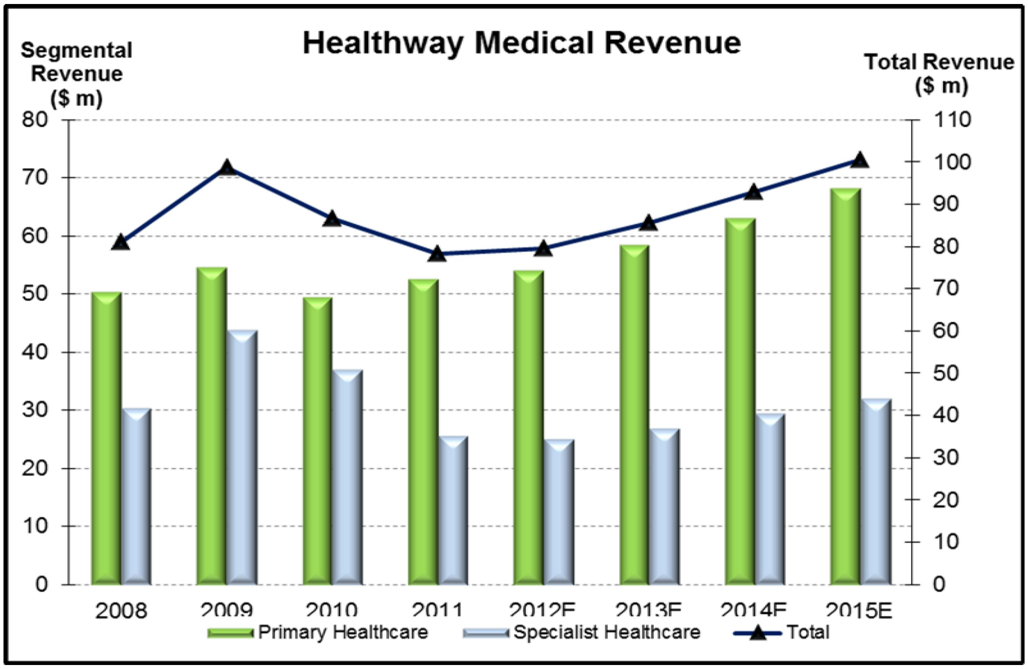
5. Major Shareholders

Fan Kow Hin, Executive Chairman	24.37%
Chee Yin Meh	24.19%
Aathar Ah Kong Andrew	9.77%
One Organisation Limited	11.29%
DMG & Partners Securities Pte Ltd	18.56%

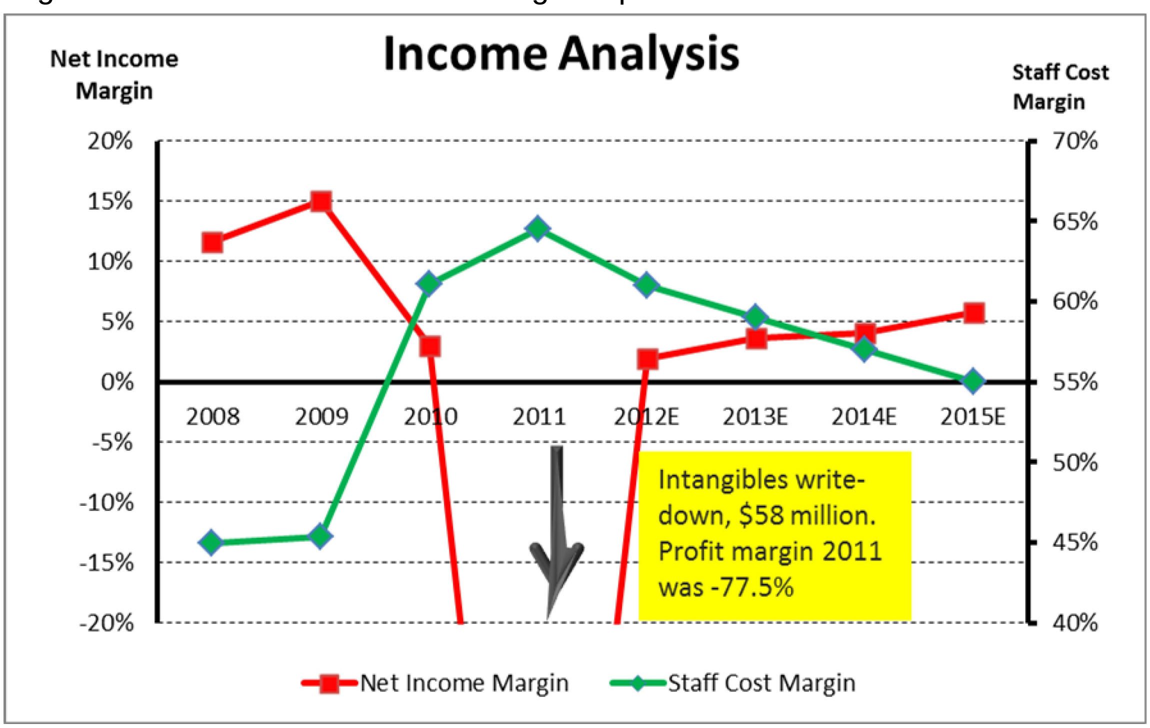
[3] Sng Qing Si, Primary Care Survey 2010: Profile of Primary Care Patients, http://www.moh.gov.sg/content/dam/moh_web/Publications/Information%20Papers/2011/Primary%20Care%20Survey%202010%20-%20Profile%20of%20Primary%20Care%20Patients.pdf

Citibank Nominees Singapore Pte Ltd 6.48%

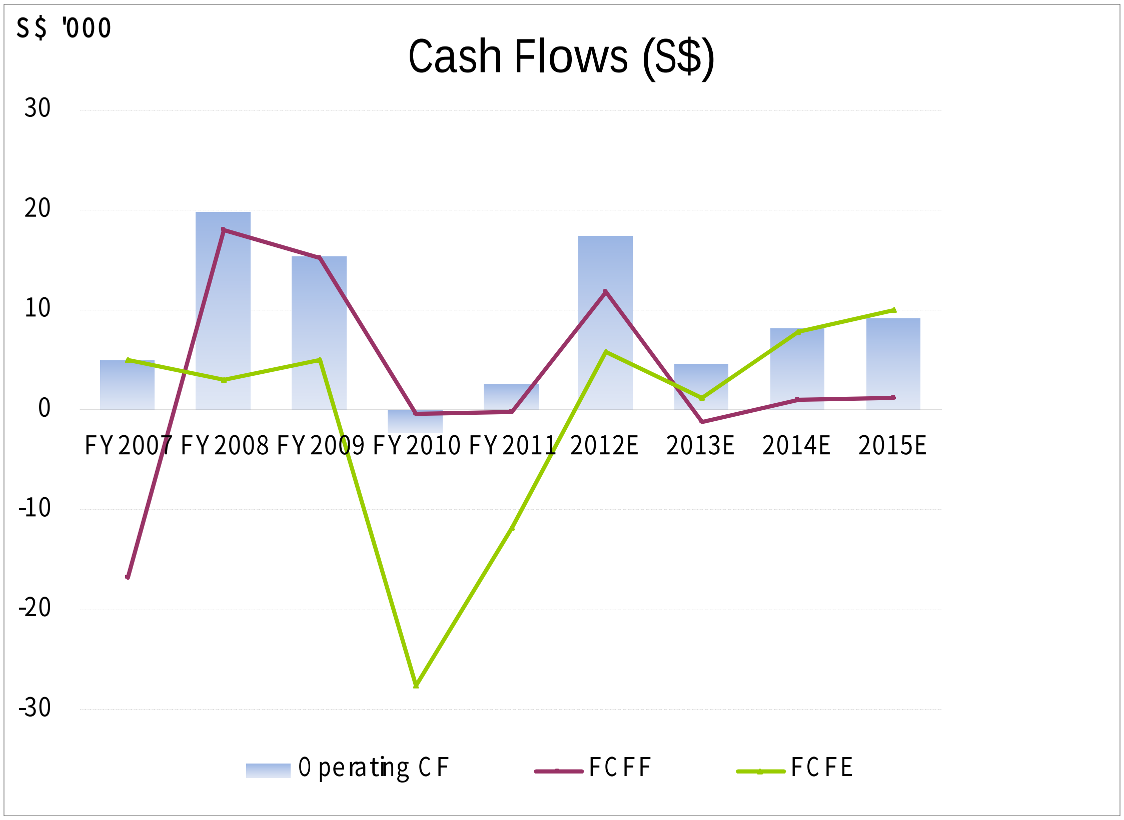
6. Financial Analysis



I grew Primary Healthcare revenue at 8% CAGR and Specialist & Wellness Healthcare at 8.5%. However, Specialist and Wellness revenue stream is expected to be tamed in the next couple of years before strong growth, as there are other private healthcare providers with stronger brand name abroad and offering comprehensive medical care as well.



A one-time write-off of the Group's intangible assets resulted in the negative margin of -77.5%. In annual report 2011, the management recognized the fact that they need to manage its cost and operational efficiency. If the Group can keep staff cost down to 55% of gross revenue, the Group may report stronger than the forecasted net margin above.



With 2010 as an exception, the Group's operating cash flow is positive. The sharp drop in FCFE in 2010 was a combination of weak operating profit and shares issuance. Moving forward, we should be able to see improvement in the company's debt control and more efficient use of the working capital and cash.

7. Ratios Analysis

Profitability

	2008	2009	2010	2011	2012E	2013E	2014E	2015E
Net Margin	11.62	15.05	3.00	-77.50	1.96	3.65	4.06	5.74
ROE	7.06	10.21	1.47	-42.75	1.04	1.83	2.31	3.35
ROA	5.84	6.74	1.20	-29.00	1.68	3.04	1.91	2.87

From the table above, we can observe decreasing margin to the latest reported FY2011. For the forecasted periods, profitability ratios are likely to be modest at best. Staff cost margin at 64% needs to be better managed as it is above its competitor Raffles Medical of 48.8%.[4]

[4] Raffles Medical Annual Report 2011, Pg 47. Staff cost as a percentage of Revenue $133046/272783.

Clinics in extended opening hours may need to evaluate the marginal overhead costs vs marginal revenue.

Price multiples

	2008	2009	2010	2011	2012, Jul 20
Year End Price ($)	0.080	0.135	0.165	0.079	0.083
P/E	6.05	12.09	100.87	-2.60	112.43
P/S	0.70	1.82	3.03	2.01	2.20
P/CF	2.90	11.90	-129.76	63.22	10.51
P/B	0.427	1.235	1.478	1.110	1.166

Earnings are not substantial to justify its current price. Hence, the price is 112x of earnings! Since the write-down of asset value for FY2011, the current price reflects a slight premium over its NAV. Other than P/CF ratio, all other multiples suggest that the Group is trending to greater overvaluation each year.

Debt Utilization

	2008	2009	2010	2011	2012E	2013E	2014E	2015E
LT Debt/Equity	21.34	29.02	7.97	8.06	4.39	5.79	10.79	8.29
Debt/ Equity	53.22	42.56	18.70	17.33	11.18	11.06	16.49	12.54
Financial Leverage	1.64	1.54	1.25	1.31	1.23	1.21	1.29	1.26

Healthway Medical manages to keep debt under control. However, this comes at the expense of common shareholders. In the past 3 years, the Group has undertaken Rights issue once and Placement shares once. The management's focus on acquisitions would translate to more dilution to shareholders. In addition, it remains to be seen when its Chinese subsidiaries would contribute meaningfully to the Group's bottom line.

Asset Utilization

	2008	2009	2010	2011	2012E	2013E	2014E	2015E
Asset Turnover	0.49	0.44	0.37	0.40	0.82	0.79	0.45	0.48

With the write-down of its intangible assets, I see a lagging improvement in asset turnover ratio. However, revenue would have to grow at least 15% y-o-y to keep asset efficiency high. This may be a task insurmountable as competition is stiffer with similar plans being revealed at Raffles Medical Group.

AR 2011 showed retained earnings at negative $35.5 million, but management's focus still on acquisition trail. This may not be sustainable as more cash in the form of debt or equity (equity highly likely) will add on liquidity risk and dilution to existing shareholders.

8. Valuations

My required rate of return for Healthway Medical Corp is 8.5%. Using a 2-stage FCFE model, with terminal growth rate at 4%, I have an estimated value of

	2012E	2013E	2014E	2015E	Terminal Value
FCFE	5,737	1,254	7,898	10,050	232,267
PV	5,288	1,065	6,183	7,252	167,598

Intrinsic Value = Sum of PV / No. of Shares
= 187386/2400000
= $ 0.078

I assumed the total number of issued shares (excl Treasury) is 2,400,000,000 shares.

9. Material Information

On April 16, 2012, Healthway Medical Corp issued a report stating material discrepancies from its unaudited accounts and audited accounts. Prior, there were 2 resignations of its Independent Committee members, cited increased workload and difference in management styles. This is worrisome from an investor's perspective on 2 fronts. Firstly, we do not know if its overseas reported figures can be trusted. Secondly, it appears that the management has significant influence on the Board to maneuver a convenient path.

What I have relied on is the optimism of KPMG issued a "true and fair view" of the company's financials. PwC would take over KPMG in the capacity of independent auditor with effect from July 2012. My confidence in forecasting comes from the recent significant write-down of the Group's intangible assets, which makes the reported statements more representative of the business, supposedly.

10. Technical Analysis

Currently, the stock at $0.082 is range-bound between $0.08 and $0.09. This range is chosen on the high volume bar set on 27 Jan 2012. It is unlikely to move out of this range in the short-term as the 200-day MA is still above the 50-day MA. Moreover, RSI indicator does not signal oversold.

Daily trading volume and turnover are light to negligible. Unless we see strong fundamental news in the form of government policy or earnings, we are not going to see break-outs of the range.

11. Disclosures

I do not hold Healthway Medical Corp and has no intention to initiate a position (buy/sell short) in the next 72 hours.