Raffles Medical Group (SGX: R01.SP)

Business Summary

Raffles Medical Group (RMG) is one of Singapore's largest private healthcare group practice in Singapore with over 5500 corporate clients and is operating a network of 79 multi-disciplinary clinics in Singapore, 4 medical centres in Hong Kong and Shanghai. Its 20 specialist centres in Singapore serve clients with different medical needs. Besides, RMG has healthcare financing services arm, which primarily writes health insurance policies for corporate and private clients. More than 1/3 of its patients are foreigners. On 26 Nov 2011, RMG received JCI accreditation, a testament of safe quality healthcare to its patients.

Recommendation and Price Info

Recommendation: BUY with Fair Value at $2.72

RMG is operating in a growth industry and has fundamentally sound financials with strong management focused on expansion in regional markets. A fair value estimate based on Residual Income Model represents an upside of 18.78% above its last dealt price.

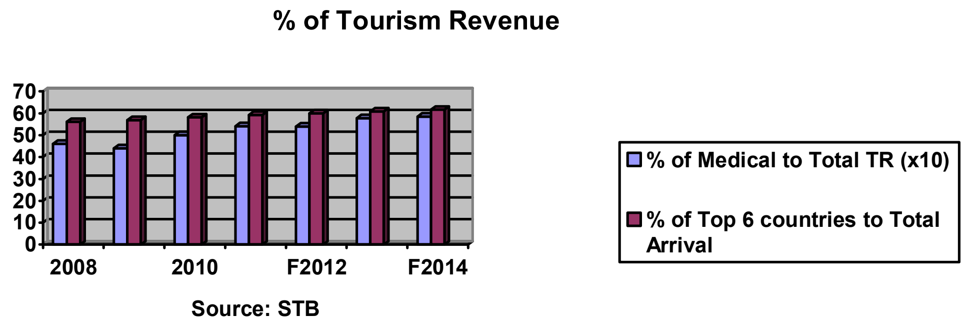
Positive government policies, aging population and rising affluence will drive demand in the premium medical sector. In addition, mobility via air travel would increase medical tourism receipts.

Last Done Price: $2.29
52-wk High (3/8/11): $2.53
52-wk Low (26/9/11): $2.02
Shares Outstanding: 530.3million
Market Cap (S$ m): 1,230
P/E (Trailing): 24.47
P/BV: 3.79
Div Yield: 1.75%

Source: Bloomberg

Industry Analysis

Rising affluence coupled with aging population drive demand for quality healthcare services in Singapore and abroad. The specialist services available make Singapore a premiere choice for regional patients.



The chart above shows the top 6 countries (Indonesia, PRC, Malaysia, India, Australia, Philippines/Japan) by arrival to Singapore. The forecast is estimated using a defensive CAGR of 1.36%. As a significant amount of medical receipt will be derived from the top 6 countries by arrivals, healthcare sector should place more emphasis on the countries by setting liaison offices. The preliminary estimate of tourism receipt in 2011 is $22 billion. Hence, based on 5.5% of total tourism receipts, about $1.21 billion could be attributed to the healthcare sector.

There are 6 major private tertiary healthcare providers in Singapore, with a combined capacity of 1,881 beds. With similar specialist services provided in most of these hospitals, the competition between them is stiff. Threat of entry is low as most of these companies rarely use up their credit facility and the fixed capital assets investment is high- average fixed capital turnover of 8 years. Parkway Novena (333-bed), Connexion (203-bed) and Raffles Medical Group expansion plan are certain to deter new entrants.

Suppliers to the industry are medical professionals and have strong bargaining power due to the healthcare companies focusing on specialist services. Doctors providing invasive surgeries with in-depth knowledge of single discipline average 12% of each medical school cohort. Hence, the supplier of labor has very strong bargaining power, which would limit the profitability of the industry.

	2008	**2009**	**2010**	**2011**	**2012E**	**2013E**	**2014E**
Population	4839400	4987600	5076700	5183700	5273500	5364900	5459300
Public Sector	4297	4610	4987	5240	5507	5787	6082
Private Sector	3051	3123	3292	3376	3463	3552	3643
Active Doctor per 1000 population	1.6	1.7	1.7	1.55	1.59	1.63	1.67
US average	**2.45**						

Source: Ministry of Health

As can be seen, from the table above, Singapore does not match up to the ratio of the US. Hence, we would reasonably expect longer waiting time for the public sector, fueling demand for private healthcare providers. Moreover, some private healthcare providers work with corporations to provide primary care for their respective employees. These healthcare providers would manage corporationsô employees sick leave as well as conduct loyalty program for their families. Hence, demand for private healthcare is relatively stable.

The Singapore government recognizes the need to keep public healthcare cost low. As such, National Healthcare Group and Singapore Health Services are expanding their current operating facilities to cater for the aging population and the middle-low income families. As the private healthcare providers do not compete on cost and that they have been actively growing their presence in the international markets, the impact of more hospital beds on-stream would not be expected to hurt the demand in the premium niche market.

Positive government policies, such as reducing the qualifying age to 40 for CHAS, provides subsidy for patients who would otherwise find it too costly to seek primary care in private clinics. In addition, most insurance underwriters have hospitalization plans which cover private hospital stay. These factors would raise demand for private healthcare providers.

Strengths

RMG is founded in 1976 and since then has grown in strength and depth. With 1/3 of their revenue from foreign patients, RMG has sufficiently diversified the risk of competition from public and private healthcare providers.

The acquisition of Thong Sia Building to develop into a specialist medical centre, expected to be operational in 1H-2013, will pit itself with competitors like Camden Medical Centre and Gleneagles Hospital at the heart of Singapore shopping district. The expansion of Raffles Hospital at its existing building will certainly increase its ability to serve a larger base of patients.

The low debt to equity ratio of 0.06 allows RMG to gain funding for expansion in regional markets. The purchase of Thong Sia building for $109 million was paid for with cash, and still has an ending cash of $50 million at the end of 2011, which is impressive. With International Medical Insurer (IMI), RMG has fostered a loyalty to their brand name by providing medical care to premium payers.

Weaknesses

The major weakness is the granting of share options which tends to dilute shareholdersô equity. The illiquidity of RMG traded shares makes the share price very volatile. Therefore, gapping up and gapping down can be observed frequently.

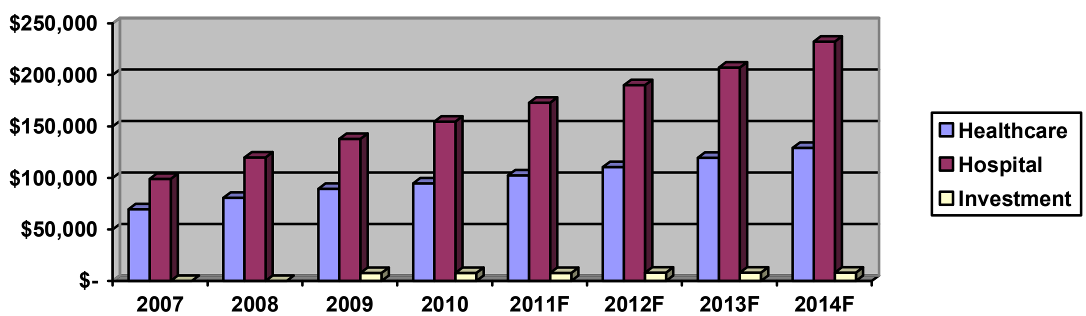
The expansion of 102408 sq feet at their current hospital premise for the next 2 years might inconvenient patients who seek a tranquil resting room. However, this expansion for about 18-24 months could enhance RMG operations and efficiency. Revenue will decrease in the near-term when the construction gets going. In addition, the management is not replacing medical equipment at a rate faster than their depreciation.

RMG does not have a strong dividend payout. Hence, investors looking for steady cash flow might be better off looking at other companies. Given its negative FCFE in FY2011 of negative $57.7 m, there is a high probability of more equity issues in the coming year.

Other operating expenses as a percentage of Revenue, which include marketing activities, are declining over the years. While such reduction enhances net profit margin, it does not indicate that the revenue growth rate in the future would be sustainable.

Opportunities

The continuous foray into overseas market, especially the North Asia region, would reap in higher returns when domestic growth becomes restrained. Currently, RMG has liaison offices in Cambodia, Myanmar and countries like Turkey. With a strong Raffles branding, RMG could explore setting up Raffles Hospital in both KL and Jakarta.



(in $ó000)	2007	2008	2009	2010	2011F	2012F	2013F	2014F
Healthcare Services	69658	80749	89382	94864	102481	109142	118419	128485
Y-o-Y growth		15.92%	10.69%	6.13%	8.09%	6.5%	8.5%	8.5%

Hospital Services	98,988	119,927	137899	154575	172800	186624	203420	221728
Y-o-Y growth		21.15%	14.98%	12.09%	11.18%	8%	9%	9%
Investment	13	93	7799	7940	8014	8100	8180	8262

The segmental revenue graph above illustrated the declining growth rate between FY08 and FY10 in Healthcare and Hospital services. In addition, the revenue per bed is not in the top-tier comparable to Parkway. Therefore, it is an indication that RMG is facing stronger intra-industry competition for revenue. The expansion project underway at RMG flagship Hospital can be seen as a positive for a sustainable long-term growth at approximately 9% for the 2 segments.

With new Integrated Healthcare Centre at Connexion and Parkway Novena operational in 2013, competition would squeeze RMGȇs revenue across all segments. Hence, regional expansion (resulting in higher operating expenses) is crucial to provide a constant revenue growth.

Threats

Regional medical brands, for example Bangkok Dusit Medical, have booths for international patients at the airport. Having liaison offices is insufficient to gain brand awareness. In addition, cities like KL and Bangkok are actively promoting medical tourism. RMG needs such exposure with the support of STB to boost medical tourism receipts.

Major Shareholders and Management

As of 2010, the major shareholders of RMG are Non-Independent Executive Director and Chairman Dr Loo Choon Yong (10.19%), Citibank (7.57%) and DBS (7.49%). Dr Loo is trained in clinical practices as well as in law. According to Forbes 40, he is ranked no. 23 in Singapore with an estimated net worth of $515m.

The management of RMG has vast experience in guiding its expansion projects. What stands out uncomfortably is that Dr Loo is serving multiple roles in the Board- Audit, Nomination & Compensation on top of being a Non-Independent Chairman of the Board.

Key Financial Ratios

	2007	2008	2009	2010	2011	2012F	2013F	2014F
Quick ratio	0.5x	1.06x	1.51x	2.05	1.07	1.54x	1.96x	2.54x

				x	x			
Leverage	1.4x	1.4x	1.35x	1.31 x	1.29 x	1.28x	1.25x	1.22x
Debt/Equity	0.13	0.12	0.10	0.08	0.07	0.07	0.06	0.05
Equipment age remaining	4.19	4.04	3.61	4.38	3.92	n.a	n.a	n.a
ROA (%)	12.8	10.2	11.3	12.5	12.2	12.0	12.0	12.3
ROE (%)	17.9	14.2	15.2	16.4	15.8	15.3	15.1	15.0
Operating Margin (%)	15.5	19.2	20.4	20.7	21.0	21.7	22.15	22.7
Staff Cost (%)	51	49	48	48.4	48.8	49	49	49
Profit Margin (%)	21.3	15.8	17.4	18.9	18.6	18.0	18.5	18.9
FCFF	-12.8	35.1	44.3	48.8	-51.1	57.0	60.3	59.7
FCFE	-22.3	23.9	30.2	35.9	-57.7	40.7	38.8	42.9
Residual Income at 8.5% ($m)	26.3	14.5	19.0	24.0	27.0	28.3	30.6	34.8

Valuation

RMG acquired freehold Thong Sia Building with cash, with $107 million of internally generated funds. Hence, FCFF is negative, which makes valuation using this metric meaningless. The same could be said for FCFE as positive FCFE. Therefore, valuation using 2-stage Residual Income (RI) is more appropriate for RMG.

FY12- FY14 valuation will be based on forecasted figures. First stage characterized by strong growth at 9% for the subsequent 3 years followed by constant growth rate of 5.5% into perpetuity. The equity required rate of return used is 8.5%.

Time	Value ($m)	PV ($m)
2012 : Yr 1	28.258	26.044
2013: Yr 2	30.597	25.991
2014: Yr 3	34.790	27.237
2015: Yr 4	37.921 at 9%	27.363
2016: Yr 5	41.334 at 9%	27.489
2017: Yr 6	45.054 at 9%	27.616
2018 thereafter	1584.401	971.150
Total Present Value		1132.89

The total quantity of common shares issued is approximately 540 million. Thus, present value of RMG based on Residual value is :

BVPS + PV(Residual)= 0.6251+ 1132.89/540
= $2.72

Based on current price of $2.29, discount rate of 8.5%, RI of 0.0509, and applying constant growth model, the implied growth rate is:

G=(rV-RI)/(RI+V)
= (0.085*2.29-0.0509)/(0.0509+2.29)
= 6.14%

Therefore, the target price would be adjusted if it falls below the growth rate estimated.

Technical Analysis

As can be seen, the volume is thin on all trading days except Jan 14, 2011. It serves as a range at which there is strong support & resistance. The parallel trend lines suggest that it is on an upward movement, while the lack of strong MACD does not give us a strong indication of entry. In addition, RSI of about 60 trends the recent movement to overbought region. In conclusion, we would initiate a technical buy when it falls to a strong support at the lower range bound at $2.27.

Prepared by: Victor Wai
Date: 9 April 2012
Disclosure: No holdings of RMG as of the date of report