Singapore Healthcare
Decoupling Opportunities

Resilient results, but not stocks
Singapore’s healthcare stocks’ earnings have been generally resilient. But in uncertain markets, their stock performances correlate more with the broader market, diverging temporarily from their fundamentals. Current short-term weakness caused by market weakness and stake reductions by institutional investors could present buying opportunities, in our view. Our top picks are Raffles Medical, ISEC and Q&M with catalysts expected from further expansions and M&As. We downgrade Cordlife to HOLD, as it has rallied significantly since our Six-for-16 strategy report dated 4 Jan 2016. Our SOTP-based TP already takes into account shareholding changes that could lead to a privatisation or other forms of corporate developments.

Short-term weakness...
We think that Street and our expectations for FY15 could be missed by 5-10%, as Raffles Medical and Cordlife could book higher-than-expected start-up costs from their major expansion. Also, both could have been affected by weaker demand last year, as Raffles Medical still heavily relies on Singapore and Cordlife’s products are discretionary.

Also, Raffles Medical and IHH could be sold down after their institutional-fund investors trimmed stakes in the companies. Fidelity reduced its position in Raffles Medical to ~5% on 8 Dec 2015. Aberdeen, which owns a 5.4% stake, has reduced this to 4.9%. (It has also cut stakes in other listed companies: Venture >20% to 8% and CityDev, 22% to 11%).

On the other hand, smaller-cap Q&M and ISEC are being supported by share buybacks from the companies themselves and major shareholders...

but multiples should be sustainable
We think that the sector’s >30x FY16 P/E valuations remain justifiable, as the companies have good expansion plans, earnings resilience, strong cash flow and healthy balance sheets to fund growth. For instance, ISEC completed an EPS-accretive acquisition in Malaysia in Dec 2015. Q&M completed two in Singapore in Sep 2015 and one in Dec 2015. In addition, we note that Raffles Medical’s and Q&M are now trading at 20% discount to Asia peers, at 30x FY16 P/E (Figure 8).

Catalysts
We believe that investors could start looking at beaten-down stocks that have corrected more than the STI’s -28% from its 52-week high:
1. ISEC, down 57% from its 52-week high, is in the early stages of its M&A spree and is the cheapest by P/E among peers.
2. Q&M, down 31% from its 52-week high, offers 60% EPS growth for FY16, supported by profit guarantees.
3. Raffles Medical, down 21% from its 52-week high, is aggressively expanding in China, with the help of its execution track record.

Risks are poor project execution or M&A delays, potentially caused by Chinese regulations.

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gyap@maybank-ke.com.sg

<table>
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<tr>
<th>Stock</th>
<th>Bloomberg code</th>
<th>Mkt cap (USD’m)</th>
<th>Rating</th>
<th>Price (LC)</th>
<th>TP (LC)</th>
<th>Upside (%)</th>
<th>P/E (x)</th>
<th>P/B (x)</th>
<th>Div yld (%)</th>
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</table>
Healthcare companies have resilient revenue...

Figure 1: Q&M Dental - Revenue

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Figure 2: Raffles Medical - Revenue

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... and earnings

Figure 3: Q&M Dental - core earnings

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Figure 4: Raffles Medical - core earnings

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But share prices & valuations could have de-coupled temporarily

Figure 5: Q&M Dental - rolling P/E band

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Figure 6: Raffles Medical - rolling P/E band

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### Figure 7: Earnings expectations summary

<table>
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<tr>
<th>Company</th>
<th>FYE</th>
<th>1Q15 Results</th>
<th>2Q15 Results</th>
<th>3Q15 Results</th>
<th>FY15E MKE’s earnings expectations (%YoY)</th>
<th>FY16E Consensus earnings expectations (%YoY)</th>
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<tbody>
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<td>Below</td>
<td>In-line</td>
<td>Below</td>
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Source: Bloomberg, Company

### Figure 8: Top 10 shareholders

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<tr>
<th>Shareholder</th>
<th>Shareholding (%)</th>
<th>No. of shares (m)</th>
<th>Position change (m)</th>
<th>Filing date</th>
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<td>28.4</td>
<td></td>
<td>03/12/2015</td>
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<td>(0.3)</td>
<td>29/05/2015</td>
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Source: Bloomberg, Company

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**January 20, 2016**
Figure 9: Valuations comparison of healthcare stocks in Asia

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<th>Curr.</th>
<th>Share price* (lccy)</th>
<th>Target price (lccy)</th>
<th>Market cap (USD m)</th>
<th>P/E FY15E</th>
<th>P/E FY16E</th>
<th>P/E FY17E</th>
<th>3Y EPS CAGR (%)</th>
<th>EV/EBITDA (x)</th>
<th>ROE (%)</th>
<th>Div yield (%)</th>
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<tr>
<td>Raffles Medical</td>
<td>BUY</td>
<td>SGD 3.95</td>
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*As of market close on 20 Jan 2016

Source: Bloomberg, Maybank KE

Asia ex-China peers

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<th>Target price (lccy)</th>
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<th>P/E FY16E</th>
<th>P/E FY17E</th>
<th>3Y EPS CAGR (%)</th>
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Average excluding Siloam

48 38 31 19 25 5.6 16 17 1.2

China peers

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<th>Target price (lccy)</th>
<th>Market cap (USD m)</th>
<th>P/E FY15E</th>
<th>P/E FY16E</th>
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<th>EV/EBITDA (x)</th>
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<th>Div yield (%)</th>
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<td>18</td>
<td>41</td>
<td>15</td>
<td>3.6</td>
<td>13</td>
</tr>
</tbody>
</table>

Average

48 36 28 31 26 7.5 17 17 0.7

Asia average

48 37 30 23 25 6.3 16 17 1.0

As of market close on 20 Jan 2016

Source: Bloomberg, Maybank KE

Figure 10: % gain of healthcare stocks since 2015 vs Straits Times Index (STI)

Source: Bloomberg, Maybank KE
ISEC (BUY) - Value Proposition

- Group medical practice that provides competitively-priced eye surgery, care and consultancy services. Group practice allows it to offer comprehensive facilities.
- Mix of junior/senior doctors caters to spectrum of customers. Sub-specialty variety also allows it to capture more patients than single-specialty solo practitioners.
- Readily scalable business, into regional markets from its Singapore/Malaysia base via M&As, using equity participation to spur doctors.

Recent acquisition adds significant economic value

<table>
<thead>
<tr>
<th></th>
<th>FY16E</th>
<th>FY17E</th>
</tr>
</thead>
<tbody>
<tr>
<td>SSEC acquisition price (MYR'000)</td>
<td>37,100</td>
<td></td>
</tr>
<tr>
<td>SSEC acquisition price (SGD'000) @ 3.10</td>
<td></td>
<td>11,968</td>
</tr>
<tr>
<td>Projected SSEC revenue (SGD'000)</td>
<td>4,471</td>
<td>4,764</td>
</tr>
<tr>
<td>Projected SSEC net after tax income (SGD'000)</td>
<td>1,118</td>
<td>1,191</td>
</tr>
<tr>
<td>ROI</td>
<td>9%</td>
<td>10%</td>
</tr>
<tr>
<td>ISEC WACC (Bloomberg)</td>
<td>6%</td>
<td></td>
</tr>
</tbody>
</table>

Source: Company

Financial Metrics

- Revenue should be boosted by consolidation of SSEC in Melaka, at 13-14% of FY16E profits. This MYR37m acquisition was completed on 9 Dec 2015.
- EBIT margins to strengthen following closure of ISEC Singapore clinic at Mount Elizabeth Novena in Dec 2015. ISEC should save opex of ~SGD1m in 2016E.
- Assuming MYR slips no further than 3.10/SGD in FY16, profits should rebound from FY15 weakness.

Recovery expected in FY16E even with MYR weakness

Price Drivers

Historical share price

Source: Company, Maybank Kim Eng

1. Optimism ran high on promise of earnings-accretive M&As soon after IPO.
2. But slide began when delays set in. Start-up losses of newly-opened clinic at Mount Elizabeth Novena also dragged down results.
3. Increasingly weak MYR. Malaysia accounts for 70-80% of sales and 50% of net profits.
4. Announcement of acquisition of SSEC in Melaka, but rally was curtailed by extreme global market weakness.

Swing Factors

Upside

- Closure of immediately-accretive M&A deals in regional markets such as Singapore, Malaysia, Taiwan, Indonesia, Vietnam or Cambodia in 1H16.
- Sustained recovery or stabilisation of MYR.
- Lower operating costs after closure of Mount Elizabeth Novena clinic.
- Higher than expected contribution from SSEC in Melaka.

Downside

- MYR weakness against SGD beyond our 2016 assumption of 3.10.
- Legal suits between patient and doctor could raise reputational risks.
Q&M Dental (BUY) - Value Proposition

- Fills the gap between cheap-but-slow public dental services and premium services.
- Group model enables dentists to concentrate on core duties, sparing them admin functions. They are also able to leverage the firm’s strong branding to attract patients.
- Acquisitions of smaller players at accretive valuations have been lifting growth since 2014. Able to attract more players in Singapore & China.

Acquisitions backed by long-term profit guarantees, FY14-15

Source: Company, Maybank Kim Eng

Price Drivers

Historical share price

Source: Company, Maybank Kim Eng

1. Apr 2011: secured USD15m strategic investment from International Finance Corporation (IFC) to fund expansion in China.
2. Feb 2014: 29% YoY growth in full-year earnings. Also, announced progress in two major acquisitions in China.
3. Mar 2015: 4Q14 earnings grew 112% YoY, above forecast. Issued SGD60m MTN for more acquisitions. Proposed largest acquisition, TP Dental, one month later.
4. Jun 2015: sold 8% vendor shares at >10% discount to last traded price.

Swing Factors

Upside

- More earnings-accretive acquisitions. Q&M has unutilised SGD23m from MTN issued to fund acquisitions.
- Penetration of China’s lucrative public dental hospitals, which command 90% of the market.
- JVs or strategic stakes in Q&M by influential Chinese parties, which could introduce more M&A or expansion opportunities.

Downside

- Adverse regulatory changes, especially in China, could slow down M&As and penetration of public dental hospitals.
- Newly-acquired entities may not be able to meet Q&M’s profit targets and adapt to new management.
- Succession planning. CEO and founder, Dr. Ng, was instrumental in originating and closing most of the deals on favourable terms.
Raffles Med (BUY) - Value Proposition

- Provides private medical services that fill the gap between cheap-but-slow public services and fast & affordable private healthcare.
- Proven operating and expansion track record of Singapore’s renowned hospital and clinics under the “Raffles Medical” brand.
- Unique group practice model which employs all the doctors and stringent auditing process ensure greater collaboration, consistent quality and fair pricing.

Affordable pricing of Raffles Medical vs peers (2014)

Source: Singapore Ministry of Health, Maybank KE

Price Drivers

Historical share price

Source: Company, Maybank Kim Eng

1. Feb 2013: letter of intent with China Merchants Shekou to develop a 200-bed hospital in Shenzhen. 4Q12 earnings up 14% YoY vs 7-10% in preceding three quarters.
2. Jan 2014: agreed to acquire land next to its Singapore hospital for extension. Also acquired office building in Holland Village to redevelop into a medical centre.
3. May 2015: formed JV with Shanghai LuJiaZui Group to develop a 400-bed hospital in Shanghai.
4. 3Q15 results below expectations, up only 1% YoY due to high start-up costs and softer revenue.

Financial Metrics

- 2015/2016 earnings growth expected to be slower due to costs for Raffles Hospital’s extension in mid-2017 and Shanghai hospital in mid-2018.
- Revenue growth of high single digits expected, on 1) opening of a new floor in Raffles Hospital, 2) opening of a new medical centre in Shaw Centre, and 3) acquisition of International SOS MC Holdings.
- Longer-term reversion to sustainable revenue and earnings growth of 10%.

Swing Factors

Upside

- Further progress in second hospital in China, which could be in Shenzhen or other top cities. Shenzhen hospital first announced in Feb 2013.
- Faster-than-expected breakeven for Singapore expansion. Normal breakeven is one year.
- Medical tourism in Singapore could recover from 2015 weakness as RFMD is constantly seeking new source markets.

Downside

- Execution risks for Shanghai hospital, its first outside Singapore.
- Higher-than-expected start-up costs in major expansion markets such as China.
- Structural decline of medical tourism in Singapore.
Cordlife (BUY) - Value Proposition

- Allows parents to freeze their children’s stem cells at a reasonable price, assured of their storage safety and longevity by a financially-strong company.
- Valued for its relationships with gynaecologists, obstetricians & parents. Demand is inelastic while service is a near monopoly in markets such as Singapore.
- Attractive for any buyer looking for instant leadership in Asia with Cordlife’s market access, recognised technology and fragmented shareholdings.

Leading market shares in important Asian countries

Source: Company

Price Drivers

Historical share price

Source: Company, Maybank Kim Eng

2. Aug 2014: extended SGD60m loan to chairman of CCBC to acquire CCBC convertible bonds.

Financial Metrics

- Client deliveries in India, Philippines and Indonesia to be main revenue drivers. Expect 15-20% growth in emerging markets vs 8-9% in mature Singapore/HK.
- Expect EBIT margins to improve in FY16 as A&P spending in India peters off after major expansion.
- A&P spending in Indonesia and Philippines to rise as more marketing resources will be channelled there after India but should be below India’s.

Cord blood banking client deliveries in key markets

Source: Company

Swing Factors

Upside

- Expect news flow on ventures into China to provide catalysts.
- Earnings-accrative M&As with net cash of SGD57m as of Sep 2015 or SGD0.32/share after payment of special dividend.
- Higher-than-expected growth rates in emerging markets, currently estimated at 15-20%.

Downside

- Failure to collaborate with new partners and/or regulatory risks in China.
- Losing share in highly-competitive markets such as India.
- Slower-than-expected acceptance of private cord blood storage services in emerging markets.
IHH (HOLD) - Value Proposition

- Healthcare leader in its early stages of life cycle, with a strong brand, superior pricing power and premium market positioning to capture growing demand.
- Operating and expansion track record in undeveloped and emerging markets without medical-pricing regulations.
- Huge initial capex on prime-land, state-of-the-art hospitals and long gestation dragged ROEs below 5%. Returns to improve over time.
- Best-in-class facilities appeal to price-insensitive customers and attract best medical talents.

Financial Metrics

- Operating cash flow, core EBITDA and recurring PATMI grew by 3-year CAGR of >20%. Low gearing of <20% provides headroom for growth.
- More than 3,000 new beds in the pipeline, to add to current 7,000. Will continue to ramp up hospitals opened in 2012-2015.
- Next leg of growth: Gleneagles HK in 2017-2020. Beyond that, China and India expansion.

Swing Factors

Upside

- Faster-than-expected ramp-up of new beds.
- Expansion beyond its existing pipeline.
- Continued weakening of MYR, especially against SGD.

Downside

- Regulatory risks, including caps on healthcare pricing and restrictions on foreign doctors.
- Strengthening of MYR against SGD and other currencies will lead to translation losses.
- Geopolitical risks in less-stable emerging markets such as Turkey, Iraq and UAE.
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