

22 March 2024

Consumer Non-cyclical | Healthcare

## KPJ Healthcare (KPJ MK)

**Buy** (Maintained)

### Setting Sights For a Stronger 1Q24; Still BUY

- **Still BUY, higher MYR2.12 TP (DCF) from MYR1.86, 12% upside.** We expect 1Q24 net profit to come within a MYR67-72m range (representing 26-36% YoY growth) predicated on strategic upscaling initiatives in driving the growth of revenue intensity, improvements in operating efficiency from hospitals under gestation, and pick-up in health tourism (HT). Our DCF-derived TP represents 15x 2024F EV/EBITDA, 2SD above the 12x 5-year historical EV/EBITDA average. Our TP incorporates a 0% ESG premium/discount given KPJ Healthcare's 3.0 ESG score.
- **Results preview.** We expect KPJ to continue posting positive YoY earnings growth – underpinned by robust patient traffic growth, improving operating efficiency of hospitals under gestation, and pick-up in foreign patient visits. Notwithstanding the above, we gather that the group is set to see a better patient-case mix in 1Q24 – this could potentially lift revenue intensity higher, in our view. Additionally, the Health Ministry's latest move to exempt the post basic qualification exemption for foreign nurses to work here (from Oct 2023 till Sep 2024) could potentially address the country's nursing shortage issue. We believe a private hospital player like KPJ could capitalise on such opportunities to meet its nursing requirements.
- **Based on our channel checks,** five hospitals under gestation are set to post narrower EBITDA losses in 1Q24, underpinned by gradual improvements in operating efficiency. Notably, Damansara Specialist Hospital 2's (DSH2) bed occupancy rate in Jan 2024 was guided to increase to 50% on top of healthy growth in average monthly revenue (c.20% MoM). Note: DSH2 recently boosted its operating beds to 100. It looks to add 30-50 beds by end 2024.
- **We think** visa-free entry to foreign tourists (particularly from China and India) is set to have a positive spillover effect on the HT sector here, as the two nations contributed 5% and 3% to Malaysia's HT revenue. KPJ's key emphasis: Prioritising the strengthening of its presence in Indonesia by setting up representative offices and recruiting agents that can help lead Indonesian patients along their HT route. Management has set an ambitious target of achieving 18-20% market share by 2024-2025 from the current 6%.
- **We keep our earnings estimates unchanged** but lower our required returns assumption to 9.2% from 9.6%. This is predicated on the various catalysts mentioned above. Maintain BUY with a higher MYR2.12 TP, which implies 15x EV/EBITDA, 2SD above KPJ's 5-year historical average. The 15x EV/EBITDA level is on par with IHH Healthcare's (IHH MK, BUY, TP: MYR7.50) traded EV/EBITDA for the past two years, as we think KPJ's domestic-centric focus (more defensive play) should offer it a valuation premium over IHH in the near term. Key downside risks: Lower-than-expected patient visits and higher-than-expected operating costs.

Target Price (Return): MYR2.12 (12.1%)  
Price (Market Cap): MYR1.89 (USD1,729m)  
ESG score: 3.0 (out of 4)  
Avg Daily Turnover (MYR/USD) 16.3m/2.75m

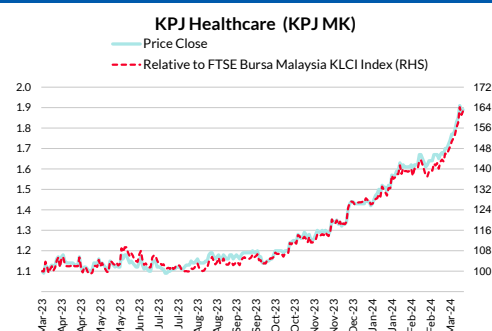
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	31.3	15.2	32.2	57.5	71.8
Relative	25.3	15.9	26.3	51.1	62.2
52-wk Price low/high (MYR)				1.09	1.91



Source: Bloomberg

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (MYRm)	2,868	3,419	3,597	3,763	3,905
Recurring net profit (MYRm)	161	289	302	335	369
Recurring net profit growth (%)	140.2	79.5	4.5	11.1	9.9
Recurring P/E (x)	51.01	28.54	27.30	24.57	22.35
P/B (x)	3.7	3.5	3.3	3.1	2.9
P/CF (x)	17.85	12.53	11.28	10.85	10.25
Dividend Yield (%)	1.1	1.6	1.9	2.1	2.3
EV/EBITDA (x)	17.77	14.65	12.74	11.77	11.03
Return on average equity (%)	4.8	8.3	12.3	12.9	13.3
Net debt to equity (%)	139.4	120.1	107.8	95.9	84.0

Source: Company data, RHB

#### Overall ESG Score: 3.0 (out of 4)

##### E: GOOD

KPJ has outlined its 2025 target to decrease greenhouse gas (GHG) emissions per patient and obtain 10% of energy from renewable sources. Clinical waste per patient was reduced by 16% in 2022 thanks to the group's initiative in adopting 3R (reuse, reduce, and recycling) in handling clinical waste.

##### S: EXCELLENT

To promote ethical business conduct, KPJ ensures pricing transparency in billings to accommodate patients' decision making. KPJ Healthcare University College also provides scholarships for outstanding students from underprivileged backgrounds to study. Recipients of such scholarships are also guaranteed jobs with its hospitals following their graduation.

##### G: GOOD

50% of its board members are independent and 20% are female. The female percentage is below the Malaysian Code on Corporate Governance's minimum 30%. On the positive side, KPJ provides full disclosures of its directors' remunerations. The group also holds regular investor briefings, embodying good transparency and disclosure practices.

## Financial Exhibits

<b>Asia</b>	<b>Financial summary (MYR)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
Malaysia	Recurring EPS	0.04	0.07	0.07	0.08	0.08
Consumer Non-cyclical	DPS	0.02	0.03	0.04	0.04	0.04
<b>KPJ Healthcare</b>	BVPS	0.51	0.55	0.58	0.62	0.66
KPJ MK	Return on average equity (%)	4.8	8.3	12.3	12.9	13.3
Buy						
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
We use Discounted Cash Flow (FCFF).	Recurring P/E (x)	51.01	28.54	27.30	24.57	22.35
	P/B (x)	3.7	3.5	3.3	3.1	2.9
	FCF Yield (%)	2.7	5.1	5.5	5.8	6.4
	Dividend Yield (%)	1.1	1.6	1.9	2.1	2.3
<b>Key drivers</b>	EV/EBITDA (x)	17.77	14.65	12.74	11.77	11.03
Our earnings forecasts are most sensitive to:	EV/EBIT (x)	31.03	23.72	18.73	16.82	15.45
i. Inpatient and outpatient numbers;						
ii. Revenue per patient;						
iii. Operating and financing costs.						
<b>Key risks</b>	<b>Income statement (MYRm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
Key downside risks:	Total turnover	2,868	3,419	3,597	3,763	3,905
i. Lower-than-expected patient visits/revenue intensity growth;	Gross profit	1,117	1,374	1,507	1,598	1,673
ii. Higher-than-expected operating costs.	EBITDA	606	720	819	876	922
	Depreciation and amortisation	(259)	(275)	(262)	(263)	(264)
	Operating profit	347	445	557	613	658
	Net interest	(182)	(185)	(176)	(172)	(167)
	Pre-tax profit	213	307	431	492	542
	Taxation	(73)	(75)	(95)	(119)	(132)
	Reported net profit	104	192	302	335	369
	Recurring net profit	161	289	302	335	369
<b>Company Profile</b>	<b>Cash flow (MYRm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
KPJ Healthcare is a healthcare provider that is mainly focused in Malaysia. It also has operations in Australia and Indonesia.	Change in working capital	(90)	(93)	(13)	(19)	(9)
	Cash flow from operations	460	658	731	760	804
	Capex	(234)	(241)	(280)	(280)	(280)
	Cash flow from investing activities	(26)	(95)	(259)	(259)	(259)
	Dividends paid	(84)	(146)	(157)	(174)	(192)
	Cash flow from financing activities	(287)	(438)	(404)	(419)	(433)
	Cash at beginning of period	318	468	785	853	936
	Net change in cash	147	125	68	82	112
	Ending balance cash	465	644	1,046	936	1,048
	<b>Balance sheet (MYRm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Total cash and equivalents	468	785	853	936	1,048
	Tangible fixed assets	4,337	4,360	4,379	4,396	4,412
	Total investments	848	874	902	932	962
	Total assets	6,994	7,246	7,455	7,570	7,760
	Short-term debt	884	587	587	587	587
	Total long-term debt	2,866	3,235	3,185	3,135	3,085
	Total liabilities	4,640	4,718	4,748	4,665	4,637
	Total equity	2,354	2,528	2,707	2,905	3,123
	Total liabilities & equity	6,994	7,246	7,455	7,570	7,760
	<b>Key metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Revenue growth (%)	10.8	19.2	5.2	4.6	3.8
	Recurrent EPS growth (%)	137.4	78.7	4.5	11.1	9.9
	Gross margin (%)	39.0	40.2	41.9	42.5	42.8
	Operating EBITDA margin (%)	21.1	21.1	22.8	23.3	23.6
	Net profit margin (%)	3.6	5.6	8.4	8.9	9.4
	Dividend payout ratio (%)	83.2	69.2	52.2	52.2	52.2
	Capex/sales (%)	8.2	7.0	7.8	7.4	7.2
	Interest cover (x)	1.79	2.17	2.83	3.16	3.43

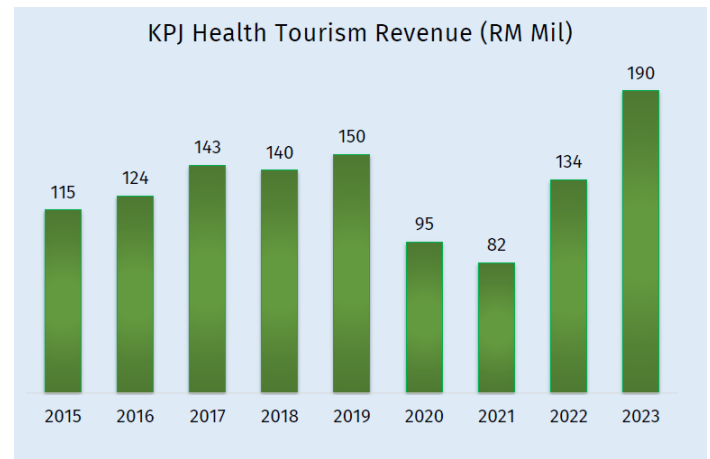
Source: Company data, RHB

Figure 1: Malaysia's HT Top 10 countries of O=origin

No.	Country of Origin	% of total HT Revenue
1.	Indonesia	65.8%
2.	China	5.1%
3.	India	3.1%
4.	United Kingdom	2.0%
5.	Japan	2.0%
6.	Australia	1.6%
7.	Singapore	1.6%
8.	Philippines	1.3%
9.	United States	1.2%
10.	Bangladesh	1.2%

Source: Malaysia Healthcare Travel Council

Figure 2: KPJ's HT revenue



Source: Company data

Figure 3: DCF valuation

FYE Dec (MYRm)	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F	FY32F	FY33F	Terminal
CFO	731	760	804	840	876	913	944	974	1,005	1,038	
+ Interest (1 - tax rate)	150	148	146	144	142	140	138	136	134	132	
- capital expenditure	(280)	(280)	(280)	(280)	(280)	(280)	(280)	(280)	(280)	(280)	
<b>Free cash flow to firm (FCFF)</b>	<b>600</b>	<b>627</b>	<b>670</b>	<b>704</b>	<b>738</b>	<b>773</b>	<b>802</b>	<b>830</b>	<b>859</b>	<b>889</b>	<b>16,692</b>
Discount factor	0.94	0.87	0.80	0.74	0.69	0.63	0.58	0.54	0.50	0.46	0.46
<b>PV of FCFF</b>	<b>566</b>	<b>546</b>	<b>538</b>	<b>522</b>	<b>506</b>	<b>489</b>	<b>469</b>	<b>448</b>	<b>428</b>	<b>410</b>	<b>7,687</b>
Risk-free	4%										
WACC	8%										
Terminal growth	2%										
Enterprise value (MYRm)	12,608										
Cash	468										
- Debt	(3,750)										
-Minority	(127)										
Equity value (MYRm)	9,199										
No of shares (m)	4,341										
<b>Intrinsic value (MYR)</b>	<b>2.12</b>										
ESG premium/(discount) %	0.00										
<b>FV (MYR)</b>	<b>2.12</b>										

Source: RHB

## Emissions And ESG

### Trend analysis

Emissions are on a rising trend due to spikes in patient registrations in 2022 post the pandemic.

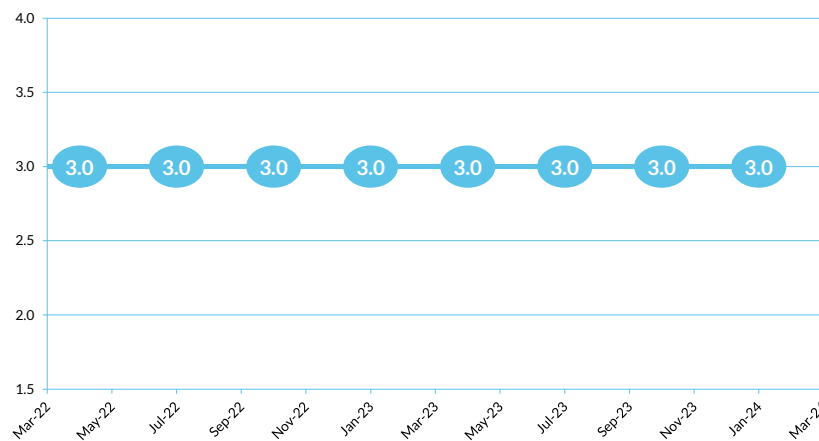
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	69	70	na
Scope 2	104,341	105,395	na
Scope 3	842	1,102	na
Total emissions	105,251	106,566	na

Source: Company data, RHB

## Latest ESG-Related Developments

- The group is in the midst of fulfilling its Green Building Index or GBI certification, which includes the installation of solar panels on rooftops and carparks at three selected hospitals.

## ESG Rating History



Source: RHB

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-02-19	Buy	1.86	1.61
2023-11-30	Buy	1.66	1.34
2023-09-01	Buy	1.46	1.18
2023-06-01	Buy	1.46	1.16
2023-02-21	Buy	1.50	1.09
2022-11-28	Buy	1.20	0.98
2022-08-30	Buy	1.03	0.88
2021-02-19	Buy	1.23	1.00
2020-12-01	Neutral	1.00	0.99
2020-08-28	Buy	1.00	0.83
2020-04-07	Neutral	0.93	0.88
2019-09-03	Neutral	0.97	0.91
2019-06-03	Neutral	0.97	0.93
2019-02-20	Neutral	1.13	1.07
2019-02-18	Neutral	1.13	1.09

Source: RHB, Bloomberg

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