Malaysia
MARKET DATELINE ● PP 7767/09/2010(025354)

Corporate Highlights

RHB Research Institute Sdn Bhd
A member of the RHB Banking Group
Company No: 233327 -M

Visit Note

9 December 2009

KPJ Healthcare

Expansion On The Way

Share Price	:	RM5.70
Fair Value	:	RM6.14
Recom	:	**Outperform** (Upgraded)

Table 1: Investment Statistics (KPJ; 5878) **Bloomberg Ticker: KPJ MK**

FYE Dec	Revenue (RMm)	Net Profit (RMm)	EPS (sen)	Growth (%)	PER (x)	C.EPS* (sen)	P/NTA (x)	Net gearing (x)	ROE (x)	Gr. Div. Yld. (%)
2008a	1267.3	85.6	40.9	13.5	13.9	-	2.5	0.4	14.6	6.7
2009f	1404.0	97.8	46.4	13.6	12.3	45.0	2.0	0.2	14.0	5.3
2010f	1583.4	117.6	55.9	20.3	10.2	51.0	1.7	0.4	14.4	6.1
2011f	1757.1	126.5	60.1	7.5	9.5	56.0	1.4	0.5	13.4	7.0

Main Board Listing /Trustee Stock/Syariah Approved Stock By The SC ** Consensus based on IBES Estimates*

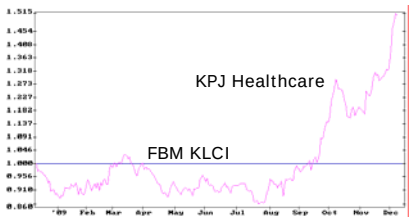
- **Five key highlights** from our meeting with KPJ:
- **Two hospitals p.a. from FY10 onwards.** For 2010 and beyond, management has revised its KPI upwards and is now looking to operate at least two new hospitals p.a., which we believe is set to meet management's internal target of achieving RM2bn revenue by 2012 (implying a 3-year revenue CAGR of 14%). For FY10, we believe that KPJ will be acquiring two established hospitals and for FY11, we had already projected for KPJ's new greenfield hospitals in Kuantan and Klang.
- **Indonesian hospital in operations this month.** KPJ's 75%-owned RS Bumi Serpong Damai, will be starting its operations this month, after changing its JV partner (due to conflict with its initial partner).
- **Fourth injection of hospitals into REIT.** KPJ intends to dispose off its remaining 5 hospitals to Al-Aqar KPJ REIT soon i.e. Taiping Specialist, Hospital Penawar, Kluang Specialist, Kuching Specialist and RS Bukit Serpong Damai. As with previous asset injections, we believe this disposal would be settled part cash and part Al-Aqar KPJ REIT units, which would likely push KPJ's stake to about 50% in Al-Aqar once again. Investors could potentially expect dividend-in-specie of Al-Aqar shares in FY10.
- **Expansion of its existing hospital.** KPJ will be expanding the capacity of its top performing hospitals i.e. Ampang Puteri and Damansara Specialist by 100 beds and 60 beds respectively. Meanwhile, its Tawakal Specialist replacement hospital will be starting operations this month.
- **Final dividend on the way.** We believe that KPJ will be paying at least another 10 sen final dividend (or 4 sen assuming completion of share split and bonus issue to be announced in the 4Q09 results), bringing total gross dividend to 30 sen (or 4-5% net dividend yield p.a.).
- **Forecasts.** The net impact to our forecasts is an increase of 2-4% p.a. for FY10-11, is after adjusting for: 1) increase in no. of new hospitals for FY10 to two (from one); and 2) higher capex for FY10.
- **Risk.** KPJ's earnings are vulnerable to any serious disease outbreak in Malaysia such as SARS, as the infected patients will have to be separated and admitted to government-appointed specialised hospitals.
- **Investment case.** After accounting for changes in earnings, we derive a fair value of RM6.14 (from RM4.90) based higher target PE of 11x FY12/10 EPS (from 9x FY10 EPS), which is at a 24% discount to our 14.5x target PE for the consumer sector. We raise our target PE to account for higher investor risk appetite for midcap stocks and improved market outlook. As such, we upgraded our recommendation to **Outperform** (from Market Perform).

Issued Capital (m shares)	211.1
Market Cap(RMm)	1203.0
Daily Trading Vol (m shs)	0.3
52wk Price Range (RM)	2.32-5.92
Major Shareholders:	**(%)**
Johor Corporation	50.3
Arisaig Asean Fund	9.1
Kumpulan Waqaf An-Nur	8.9

FYE Dec	FY09	FY10	FY11
EPS chg (%)	0.0	2.0	3.7
Var to Cons (%)	3.2	9.5	7.3

PE Band Chart

Relative Performance To FBM KLCI



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Please read important disclosures at the end of this report.

Visit Note

- **Five key highlights from our recent visit:**

  1. Two new hospitals p.a. from 2010 onwards
  2. Indonesian hospital starting operations in Dec 09
  3. Fourth injection of hospitals into REIT
  4. Expansion of existing hospitals
  5. Final dividend on the way

- **Two new hospitals p.a. from 2010 onwards.** We understand that KPJ will be acquiring a standalone private hospital soon to meet its 2009 KPI target of adding at least one new hospital during the year. However, no details as to location and pricing were provided. However, for 2010 and beyond, management has revised its KPI upwards and is now looking to operate at least two new hospitals p.a. (greenfield or acquisition of established hospitals). We believe this target is set to meet management's internal target of achieving RM2bn revenue by 2012 which implies 3-year (i.e. FY09-12) revenue CAGR of 14%. With this new KPI in place, KPJ would likely have to acquire two established hospitals in FY10, given that it takes at least 2 years to set up a greenfield hospital. As the KPI target of two new hospitals in FY10 is higher than our projection of just one new hospital, we have raised our FY10 new hospital target to two and increased our capex assumption to RM300m (from RM170m). However, our FY11 assumption of 2 new hospitals is intact, as we had already projected KPJ's two new greenfield hospitals in Tanjung Lumpur, Kuantan, Pahang and Klang, Selangor, to be completed during the year. As such, we raised our FY10 new hospital assumption to two (from one) and increased our capex assumption to RM300m (from RM170m).

- **Indonesian hospital in operations this month.** KPJ's 75%-owned Rumah Sakit Bumi Serpong Damai (BSD) in Indonesia, a 200-bed hospital which was completed in late 2007, has not been able to start operations due to a conflict with its JV partner. However, these issues have recently been resolved and KPJ will commence operations of BSD this month with a new JV partner. While KPJ still maintains its long-term plan to expand overseas to fuel earnings growth further, it intends to pursue this target in a cautious manner by initially managing the overseas hospitals first and only acquiring / building a new hospital in the country if successful.

- **Fourth injection of hospitals into REIT**. KPJ intends to dispose off its remaining 5 hospitals to Al-Aqar KPJ REIT soon, which will be its fourth asset injection into the REIT. KPJ's 5 remaining hospitals are Taiping Specialist; Hospital Penawar, Pasir Gudang; Kluang Specialist; Kuching Specialist and Rumah Sakit Bumi Serpong, Jakarta. As with all its previous asset injections, we believe this disposal would be settled with part cash and part Al-Aqar KPJ REIT units, which would likely push KPJ's stake in Al-Aqar to above the 50% mark once again. As such, in line with the previous injections, this would mean that investors could potentially expect another dividend-in-specie of Al-Aqar shares in FY10. We have yet to input the fourth injection into our forecast pending official announcement from management.

- **Expansion of its existing hospitals.** KPJ has recently started operations of its replacement Penang Specialist hospital, which has capacity of slightly more than 200 beds while the old hospital building (which previously had 80 beds) would be used as a nursing school, to be ready by mid-2010. Meanwhile, KPJ's replacement Tawakal Specialist hospital, to be to be completed in Dec 09, has capacity of about 200 beds while the old hospital building (which previously had 140 beds) would be used as a day care centre, covering a number of services including dialysis, eye/dental care, day surgeries etc. KPJ is also expanding the capacity of its top performing hospitals i.e. Ampang Puteri and Damansara Specialist by 100 beds (to be completed by 2012) and 60 beds (to be completed by 2010/11) respectively. We understand that the extensions would host more premium wards, which would also be a way to kick start its push for more medical tourism business but any significant contribution would only come in in three to five years time. Currently, medical tourism only accounts for 3% of total group revenue. Nevertheless, KPJ emphasised that its near-term plan is still to cater for the community, as it believes that there is still much room for expansion in Malaysia. We have already inputed these capacity expansions into our forecasts.

- **Final dividend on the way.** YTD-9M09, KPJ has declared a total gross dividend (less 25% tax) of 20sen (1st interim: 10 sen and 2nd interim: 10 sen). We believe that KPJ will be paying at least another 10 sen final dividend (or 4 sen assuming completion of share split and bonus issue to be announced in the 4QFY09 results). This will bring total gross dividend to 30 sen for FY09, or 48% net payout, in line with historical payout of 40-50%. While KPJ does not have any dividend policy in place, management indicated that KPJ still plans to keep its net payout ratio similar to the historical payout of 40-50%, which translates to 4-5% net dividend yield p.a..

Risks

- **Risk.** The risks to KPJ's earnings include lower number of patients due to slowdown in economy and serious disease outbreak (such as SARS or swine flu) in Malaysia as well as slower-than-expected turnaround in loss making hospitals.

Forecasts And Assumptions

- **Forecasts.** The net impact to our forecasts is an increase of 2-4% p.a. for FY10-11, is after adjusting for: 1) increase in no. of new hospitals for FY10 to two (from one); and 2) higher capex for FY10.

Valuations And Recommendation

- **Upgrade to Outperform.** After accounting for changes in earnings, we derive a fair value of RM6.14 (from RM4.90) based higher target PE of 11x FY12/10 EPS (from 9x FY10 EPS), which is at a 24% discount to our 14.5x target PE for the consumer sector. We raise our target PE to account for higher investor risk appetite for midcap stocks and improved market outlook. Our target PE is now based on the higher end of its historical 5-year PE band of between 5-15x. As such, we upgraded our recommendation to Outperform (from market perform).

Table 3. Earnings Forecasts

FYE Dec (RMm)	FY08a	FY09F	FY10F	FY11F
Turnover	**1267.3**	**1404.0**	**1583.4**	**1757.1**
Turnover growth (%)	14.4	10.8	12.8	11.0
Cost of Sales	(899.0)	(996.8)	(1124.2)	(1247.6)
Gross Profit	368.4	407.2	459.2	509.6
EBITDA	**155.4**	**172.5**	**183.5**	**236.0**
EBITDA margin (%)	*12.3*	*12.3*	*11.6*	*13.4*
Depreciation	(41.5)	(32.8)	(27.7)	(64.5)
Net Interest	(18.5)	(18.4)	(13.4)	(13.4)
Associates	18.7	20.0	26.9	26.9
Pretax Profit	**114.1**	**141.3**	**169.3**	**185.0**
Tax	(24.7)	(35.3)	(42.3)	(48.1)
Minorities	(3.7)	(8.2)	(9.4)	(10.5)
Net Profit	**85.6**	**97.8**	**117.6**	**126.5**

Source: Company data, RHBRI estimates

Table 4. Forecast Assumptions

FYE Dec	FY09F	FY10F	FY11F
No. of hospitals	20	22	24
No of in-patients	211,994	233,194	254,181
No. of out-patients	2,054,118	2,238,989	2,373,328

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The recommendation framework for stocks and sectors are as follows : -

Stock Ratings

Outperform = The stock return is expected to exceed the FBM KLCI benchmark by greater than five percentage points over the next 6-12 months.

Trading Buy = Short-term positive development on the stock that could lead to a re-rating in the share price and translate into an absolute return of 15% or more over a period of three months, but fundamentals are not strong enough to warrant an Outperform call. It is generally for investors who are willing to take on higher risks.

Market Perform = The stock return is expected to be in line with the FBM KLCI benchmark (+/- five percentage points) over the next 6-12 months.

Underperform = The stock return is expected to underperform the FBM KLCI benchmark by more than five percentage points over the next 6-12 months.

Industry/Sector Ratings

Overweight = Industry expected to outperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Neutral = Industry expected to perform in line with the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Underweight = Industry expected to underperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

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