

Initiating Coverage

Friday, 23rd May 2008

SJ Securities Sdn. Bhd.



PP7084/11/2006

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KPJ Healthcare Berhad

OVERWEIGHT

Growing Healthily...

Fair Value
RM5.17 (+45.22%)

Stock Data

Price (RM)	RM3.56
Stock code	5878
Bloomberg Ticker	KPJ
	MK
Listing	Main Board
Share Cap (RM mn)	207.75
Market Cap (RM mn)	740.76
Par value (RM)	1.00
52-wk high (RM)	3.90
52-wk low (RM)	2.55
Major shareholders:-	
Johor Corporation	50.33
Arisaig Partners Asia Pte Ltd	9.19
DWS Investments	5.06
DWS Investment S A	4.43

Financial Data

Trailing PER (x)	9.0
BV per share (RM)	2.60
P/BV (x)	1.37
ROE (%)	13.75
Beta (x)	0.89
Altman Z Score	2.24
Dividend yield (%)	5.51

Relative Performance (%)

1-month	11.03
3-month	19.51
6-month	17.04
12-month	13.05
YTD	16.63

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Investment Highlights

We are initiating coverage on KPJ Healthcare Bhd with an overweight recommendation based on a fair value of RM5.17. We base the fair value on a forward PER of 13x of 2008E's EPS.

KPJ is one of the largest healthcare providers in Malaysia and has an estimated market share of 20%. With its substantial share in the market, KPJ is set to ride on the growth of the industry. Demographic statistics indicate a favorable growth trends.

Hospital expansion. KPJ has been aggressively acquiring and building hospitals. Currently KPJ owns 18 hospitals in Malaysia from 11 previously in the year 2002. KPJ acquired the Taiping Medical Centre earlier this year while building two new hospitals to replace two older ones.

Growth in minor segments. KPJ is frequently in talks to manage foreign medical companies. KPJ successfully arranged a tie-up to manage two Middle East hospitals last year and currently manages 6 foreign hospitals. KPJ is engaged in medical based education and plans to grow this segment. KPJ has been increasing its programs and has purchased 17 acres of land for future expansions. Current enrolment is more than 1,200 students and KPJ plans to increase intake several fold together with its expansions.

Involvement in medical tourism. This is a highly lucrative segment and KPJ is one of Malaysia's frontrunners. KPJ has undergone various initiatives to promote their medical tourism. Contribution from this segment is still small in terms of percentage but has been growing at very high rates.

Good track record. KPJ has consistently recorded impressive revenue growth since its restructuring in 2002. EPS and DPS have been increasing constantly as well. Moreover it has improved its net gearing ratios and increased its interest coverage ratios.



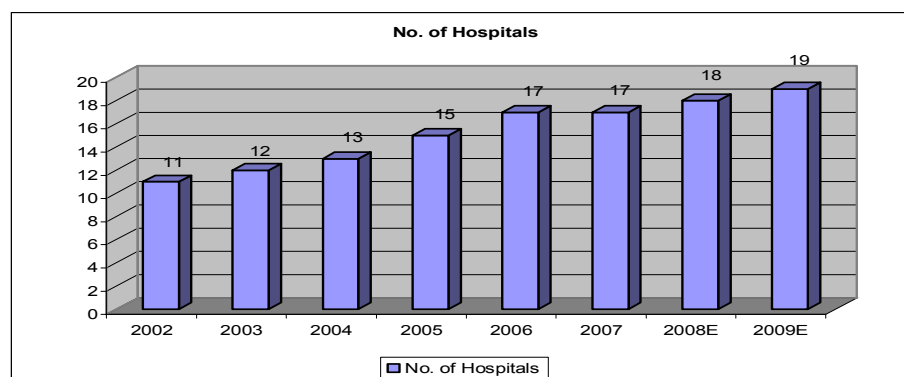
Corporate Profile

KPJ began operations in 1981 and is the healthcare division of JCorp. KPJ was listed on the Main Board on the 29th of November 1994. KPJ is very well established and is one of the largest healthcare providers in Malaysia. It has 42 subsidiary and associate companies which are principally involved in medical and specialist healthcare services. These include hospital management, healthcare technical services, hospital development and commissioning, nursing, health sciences and healthcare education, pathology services and central procurement. KPJ owns 18 private specialist hospitals in Malaysia and manages 6 foreign ones. The 6 foreign hospitals include 3 in Indonesia, 1 in Bangladesh and 2 in Saudi Arabia. Moreover it has strategic alliances with manufacturers, pharmaceutical companies and insurance companies.

Malaysian Based Hospitals

Hospital	Established	Location	Beds	Consultants
Johor Specialist Hospital	1981	Johor Bahru, Johor	205	37
Ipoh Specialist Hospital	1981	Ipoh, Perak	209	74
Ampang Puteri Specialist Hospital	1995	Ampang, Selangor	230	58
Tawakal Hospital	1984	Jln Pahang, Kuala Lumpur	147	55
Damansara Specialist Hospital	1997	Petaling Jaya, Selangor	250	64
Puteri Specialist Hospital	1993	Johor Bahru, Johor	146	35
Kuantan Specialist Hospital	1981	Kuantan, Pahang	80	22
Bukit Mertajam Specialist Hospital	1985	Seberang Perai, Pulau Pinang	90	15
Perdana Specialist Hospital	2001	Kota Bharu, Kelantan	55	21
Kedah Medical Centre	1979	Alor Setar, Kedah	103	23
Hospital Penawar	1997	Pasir Gudang, Johor	50	11
Kuching Specialist Hospital	2003	Kuching, Sarawak	30	19
Seremban Specialist Hospital	2004	Seremban, Negeri Sembilan	150	26
Damai Specialist Centre	1991	Kota Kinabalu, Sabah	22	9
Selangor Medical Centre	1998	Shah Alam, Selangor	180	53
KPJ Kajang Specialist Hospital	2006	Kajang, Selangor	68	n/a
Sentosa Medical Centre	2006	Jalan Cemor, Kuala Lumpur	212	n/a
Taiping Medical Centre	1983	Taiping, Perak	n/a	n/a

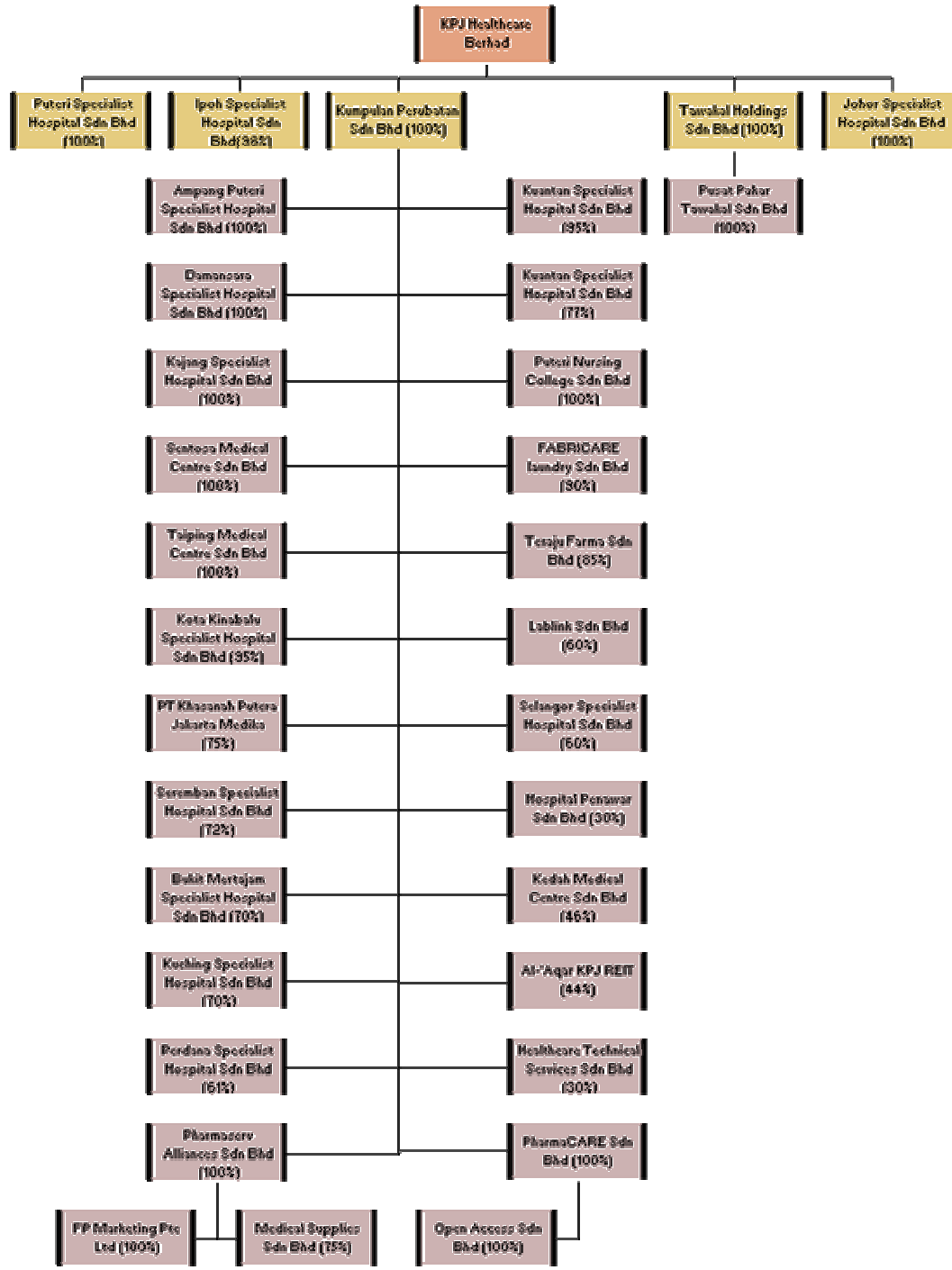
Source: Company



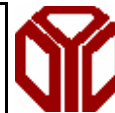
Source: Annual Report



KPJ Corporate Structure



Source: Annual Report



Analysis of the Business

KPJ is a large healthcare provider with a substantial market share of approximately 20% in Malaysia. With its substantial share in the market, KPJ is set to ride on the growth of the industry. Statistics indicate that demographic changes are trending favorably for the industry. The general population in Malaysia is aging while affluence is increasing as well. Moreover the population in Malaysia is increasing but at a decreasing rate. Another favorable trend is the growth in the insurance industry. Its growth increases the demand for private healthcare while favoring better healthcare alternatives.

Hospital expansion. A major part of KPJ's growth plans is through the acquisition and building of hospitals. KPJ has been acquiring hospitals aggressively. Currently KPJ owns 18 hospitals in Malaysia from 11 in the year 2002. KPJ has acquired a hospital, namely Taiping Hospital earlier this year. KPJ is also building two other hospitals. The Prai Specialist Hospital's construction is expected to be completed in the fourth quarter. The state-of-the-art Tawakal Hospital is expected to open for business by the end of January 2009. These two hospitals will replace two older ones. The two older hospitals are expected to be converted into other facilities.

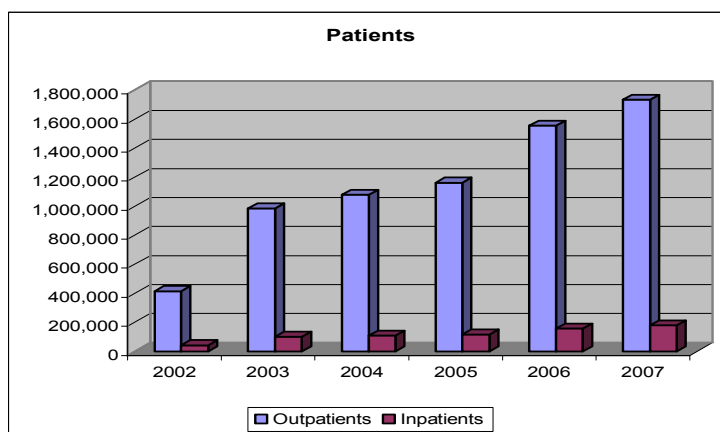
Medical based education. KPJ is engaged in education through PNC International College of Nursing and Health Sciences. Current contribution from this segment is small but KPJ plans to grow this segment. Currently KPJ offers 13 programs covering Degree and Diploma in nursing and health sciences. Two new programs commenced last year including Diploma in Pharmacy and Diploma in Physiotherapy. Currently the College's total enrolment is more than 1,200 students and KPJ plans to increase this intake several fold. For this, KPJ has purchased 17 acres of land near a current campus for future expansions. KPJ has long established international alliances with prestigious universities including Liverpool John Moores University and University of South Australia.

Management of foreign hospitals. KPJ is frequently in talks to manage foreign medical companies. KPJ's current network include foreign private hospitals including 3 in Indonesia, 1 in Bangladesh and 2 in Saudi Arabia. KPJ successfully arranged a tie-up to manage two Middle East hospitals last year. The fees are based on a fixed management fee but include a profit sharing arrangement after exceeding a threshold. The agreement lasts for 5 years with an option for renewal. KPJ owns a stake in an Indonesian hospital while managing two others. KPJ also owns a small stake at the Bangladesh hospital but also manages it.



Medical Tourism. Medical tourism is a very high margin sector while KPJ is one of the key players of Malaysia’s medical tourism. A few of KPJ’s hospitals have established themselves quite well with foreigners. Contribution from this segment is still small in terms of percentage. However KPJ targets to increase medical tourism’s contribution substantially. KPJ has undergone various initiatives overseas such as by participating in healthcare exhibitions and seminars to promote its presence. KPJ has a wide range of rooms including suites to accommodate overseas patients. Health tourism revenue increased by 41% to RM18.3million in 2007. KPJ now receives patients from countries such as Australia, UK, Saudi Arabia, UAE, Kuwait, Indonesia, Korea and other Asian countries.

Good track record. KPJ’s revenue has been consistently growing year after year. Revenue has grown over 413% from RM215.8mn in 2002 to RM1,108.0mn in 2007. This has been attributed by its strong growth in the number of patients. Number of outpatients has increased from 416,373 in 2002 to 1,733,500 in 2007. Number of inpatients has increased from 43,839 to 179,227 in 2007. Earnings per share have increased as well but at a slower rate from 20.66 in 2006 to 36.02 in 2007. KPJ has been paying out constant dividends while constantly increasing it year to year. KPJ’s has also addressed its previously high gearing of 80% in the year 2005 to 56% in the year 2007.



Source: Annual Report

Services and facilities enhancement. KPJ believes in staying at the forefront and has been constantly upgrading and expanding its facilities. The Johor Specialist Hospital is renovating its existing building as well as constructing a new hospital block to accommodate additional beds. This is to better cater for its medical tourism. Puteri Specialist hospital has purchased close to an acre of land for further expansion. The Ipoh Specialist Hospital has completed its expansion of a new hospital block to accommodate new consultants and wards. The Prai Specialist Hospital is expected to be completed with 120 beds in the third quarter of 2008. The Tawakal Hospital is expected to open for business by the end of August 2008. Some of the other hospitals have been fitted with new state of the art equipment.



Sale of buildings to its REIT. KPJ completed its 2nd injection of 5 additional hospital buildings including the Perdana Specialist Hospital building, Kuantan Specialist Hospital building, Sentosa Medical Centre Building, KPJ Kajang Specialist Hospital Building and Kedah Medical Centre building to Al-'Aqar KPJ REIT in March, 2008. The sale amounting to RM170mn was satisfied by RM85.7mn in cash and the issuance of 88.7mn new units in Al-'Aqar KPJ REIT at an issue price of RM0.95 per unit. KPJ has placed the extra units to raise further capital while reducing the REIT to an associate level. The REIT would continue to enable KPJ's constant expansion while maintaining a healthy balance sheet.

Reputable. KPJ is a highly reputed brand name as it has been in the industry for over 2 decades while its hospitals hold various awards and certifications. In the year 2007 alone, KPJ received 11 prestigious awards including Asia Hospital Management Award, National Award for Management Accounting Best Practice, Service Excellence Award and so on. KPJ's hospitals are MS ISO certified and hold together, hold numerous awards.

Multi-discipline. KPJ offers a very broad range of specialized medical services besides the more general services. This includes cardiac, renal dialysis, reconstructive surgery, radiotherapy, gallstones, cancer treatment, ICU, gynecology, a wide range of surgery, lithotripsy and so on.

Strategic locations. KPJ's Hospitals are strategically located. It has hospitals in Johor Bahru and Pasir Gudang which capitalizes on foreign tourism with Singapore and Indonesia. Moreover it has Hospitals in other affluent areas , towns or cities including Kuala Lumpur, Petaling Jaya, Shah Alam, Ipoh, Kuantan and Seremban.



Industry Outlook

Health statistics. Healthcare expenditure is expected to increase from the current 3.8% to 6% of GDP in 2020. Malaysia currently lags both the global of 8.7% and South East Asian average of 4.5%. Per capita expenditure on health is on par with South East Asian (SEA) average but substantially trails the global average. Malaysia recorded 18 beds per 10 000 population, ahead of the SEA average of 15 but trails the global average of 26. The number of health workers is comparable with the SEA average but substantially lags the global average.

Health Statistics

	Total Expenditure on health as % of GDP	Per capita expenditure on health (USD)	Hospital beds per 10,000 population
Brunei	3.2	473	27
China	4.7	70	22
India	5.0	31	7
Indonesia	2.8	33	6
Philippines	3.4	36	12
Singapore	3.7	943	28
Sri Lanka	4.3	43	30
Thailand	3.5	88	22
United States of America	15.4	6096	33
Vietnam	5.5	30	14
Malaysia	3.8	180	18
SEA Average	4.5	170	15
Global Average	8.7	645	26

Source: World Health Organization

Health Workers

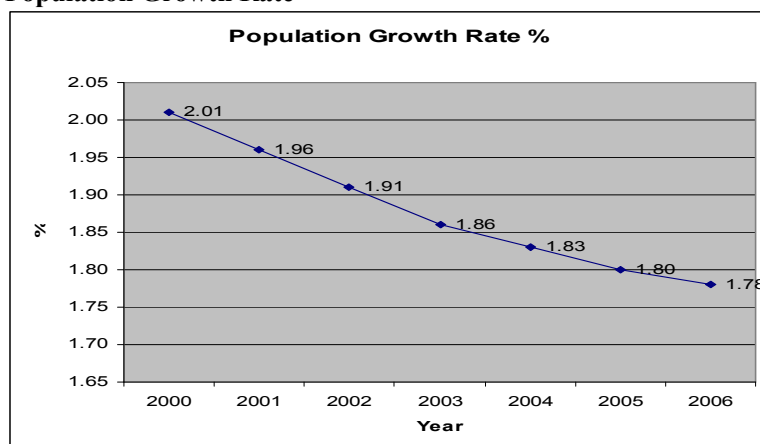
	Physicians per 1000 population	Nurses per 1000 population	Pharmacists per 1000 population
Brunei	1.01	2.67	0.27
China	1.06	1.05	0.28
India	0.60	0.80	0.56
Indonesia	0.13	0.57	0.03
Philippines	0.58	1.69	0.03
Singapore	1.40	4.24	0.28
Sri Lanka	0.55	1.20	0.06
Thailand	0.37	2.82	0.25
United States of America	2.56	9.37	0.88
Vietnam	0.53	0.56	0.08
Malaysia	0.70	1.35	0.10
SEA Average	0.53	1.50	0.11
Global Average	1.23	2.56	N/A

Source: World Health Organization



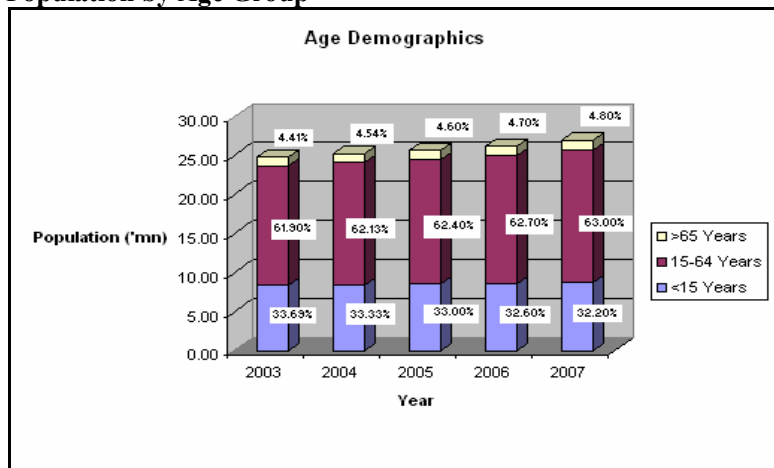
Demographics. The growing population of Malaysia naturally increases the demand for healthcare. Although Malaysia's population continues to increase, the rate has been declining gradually from an estimate of 2.01 in the year 2000 to an estimate of 1.75 in the year 2007. However, Malaysia's population is aging. The above 65 age group has increased from 4.4% in 2003 to 4.8% in 2007. Moreover the age group of 15-64 has increased from 61.9% in 2003 to 63.0% in 2007. An increasingly aging population, requires increasing healthcare services.

Population Growth Rate



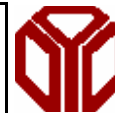
Source: Bloomberg

Population by Age Group



Source: Bloomberg

Growing affluence. Demand for private medical services would naturally grow with increasing affluence. People would demand for better facilities and would pay for costlier but more effective treatments. In recent years, real GDP growth has averaged about 6% per year. This has exceeded our annual population growth rate of between 1.5-2.5%. This indicates the gradually growing affluence in Malaysia. This has helped the insurance industry to thrive as well. Insurance expenditure per capita has been steadily increasing in recent years. The increase would also contribute to healthcare demand particularly in the private sector.



Medical Tourism. Malaysia's medical tourism industry is still in its infancy but its growth potential is promising due to several key advantages. Malaysia's medical services is relatively affordable while our expertise is at par with western countries. Most of Malaysia's healthcare facilities have internationally recognized quality standards. Malaysia's private hospitals offer state of the art healthcare facilities and highly qualified medical professionals that are multilingual. Malaysia's wide cultural mix offers a broader appeal due to the availability of various religious facilities, food and accommodation. Nevertheless, it would still take years for Malaysia medical tourism to develop as time is required to foster consumer trust, build networks and alliances is foreign medical groups.

Risks

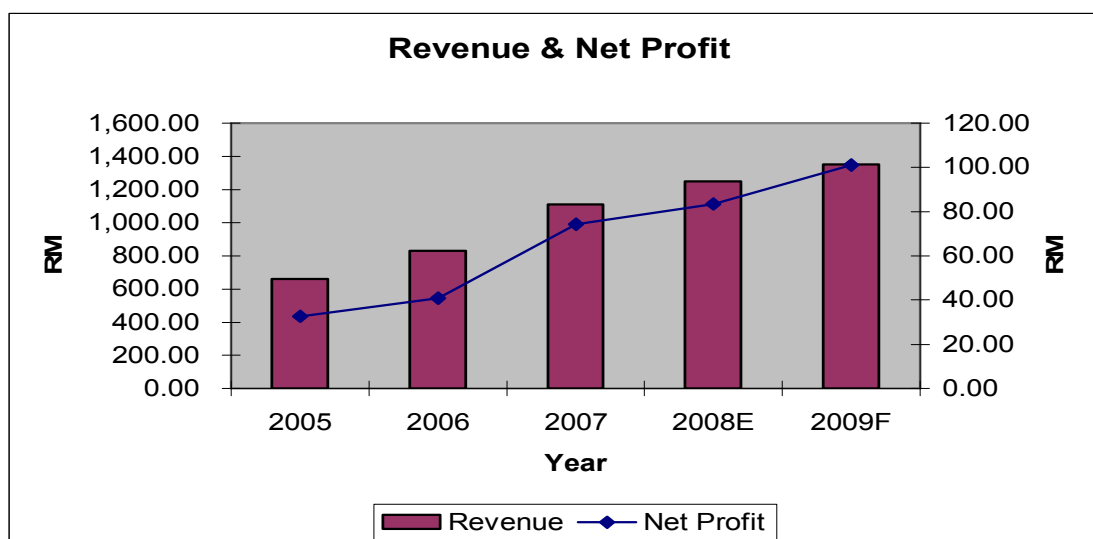
Economic slowdown. A potential slowdown in Malaysia may affect the affluence of its people. Declining affluence would encourage people to seek public healthcare services due to the high cost of private healthcare. GDP growth for the year is expected to be lower than the previous year while inflation is expected to accelerate. The US and European economies are showing signs of slowing and may weigh on global economies that are reliant on exports.

High gearing. KPJ's net gearing is relatively high. However this ratio has gradually decreased from 0.80x in 2005 to 0.56x in 2007. We also note that the increase coverage ratio has increased substantially from 2.0x in 2005 to 3.5x in 2007. Moreover the additional sale of hospital buildings is expected to substantially improve its cash positions.

Gestation periods. Gestation periods for newly opened hospitals may take a long time. Demand for private healthcare may be low for newly developing areas. Affluence of the area may take years to build. Moreover medical centers may encounter staffing difficulties due to high demand for medical personnel. Complete utilization of the medical facility make take several years.



Financial Highlight						
FYE Dec 31st	Units	2005	2006	2007	2008E	2009F
		RM mn	RM mn	RM mn	RM mn	RM mn
Revenue	RM mn	659.64	831.46	1,108.31	1,245.00	1,350.00
Gross profit	RM mn	187.97	242.91	329.07	361.05	391.50
Operating profit	RM mn	58.83	74.98	92.95	106.05	117.50
Profit before Tax	RM mn	42.30	60.06	85.23	98.05	109.50
Taxation	RM mn	(13.56)	(18.94)	(9.29)	(14.00)	(16.00)
Minority interest	RM mn	(3.92)	0.16	1.72	2.10	2.40
PATMI	RM mn	32.66	40.96	74.21	81.95	91.10
EPS (sen)	sen	16.2	20.3	36.0	39.8	44.2
DPS (sen)	sen	11.0	14.0	19.6	19.9	22.1
Growth %						
		2005	2006	2007	2008E	2009F
Revenue	%	13.1	26.0	33.3	12.3	8.4
PBT	%	4.1	42.0	41.9	15.0	11.7
Net Profit/Loss	%	3.7	25.4	81.2	10.4	11.2
Margins %						
		2005	2006	2007	2008E	2009F
Gross Margin	%	28.5	29.2	29.7	29.0	29.0
Operating Margin	%	8.9	9.0	8.4	8.5	8.7
Net Margin	%	5.0	4.9	6.7	6.6	6.7
Ratios						
PER	x	9.1	9.7	9.0	9.0	8.1
P/BV	x	0.7	0.8	1.2	1.3	1.2





Balance Sheet			
Balance Sheet (RM mn) FYE Dec 31st	2005	2006	2007
Non-current assets			
Property, plant & equipment	646.7	512.1	458.4
Prepaid leases	90.7	13.5	7.6
Investment properties	0.0	18.1	17.4
Interest in subsidiaries	0.0	0.0	0.0
Interest in associates	17.1	179.6	166.9
Other investments	3.6	4.0	4.0
Intangible assets	66.8	100.5	100.8
Deferred tax assets	17.1	18.4	12.1
Total	842.0	846.3	767.2
Current Assets			
Inventories	18.5	22.3	26.0
Receivables, deposits and prepayments	90.6	131.6	156.7
Tax refund receivable	8.2	7.0	21.2
Deposits, cash and bank balances	37.0	94.7	95.5
Total	154.2	255.6	299.4
Non-current assets held for sale	0.0	0.0	124.3
TOTAL ASSETS	996.3	1,101.9	1,191.0
EQUITIES AND LIABILITIES			
Share capital	201.1	204.0	207.7
Reserves	209.2	238.6	286.4
Total	410.3	442.6	494.1
Minority interest	24.6	44.7	45.7
Total equity / shareholders fund	434.9	487.3	539.8
Non-current liabilities			
Borrowings	323.6	322.9	332.4
Deposits	6.2	9.8	10.5
Deffered tax liabilities	52.7	31.2	29.1
Total	382.6	363.9	372.0
Current liabilities			
Payables	111.0	173.5	205.8
Borrowings	53.0	48.4	55.0
Current Tax liabilities	0.9	5.0	1.4
Dividends payable	11.6	20.6	15.2

Ratio	Units			
Current Ratio	x	0.9	1.0	1.1
Inventory turnover	x	35.7	37.3	42.7
BV/Share	RM	2.2	2.4	2.6
Net Gearing	x	0.80	0.59	0.56
ROE	%	7.51	8.41	13.75



Valuation and Recommendation

We are initiating coverage on KPJ Healthcare Bhd with an overweight recommendation and a fair value of RM5.17. We based the fair value on a PER of 13x and 2008E's EPS of 39.8 sen. The forward PER is based on a 38.1% discount to its regional peers of 21. The discount is due to a combination of greater expected CAGR of its peers, higher percentage contribution from medical tourism and the lower average PER valuations of the Bursa exchange.

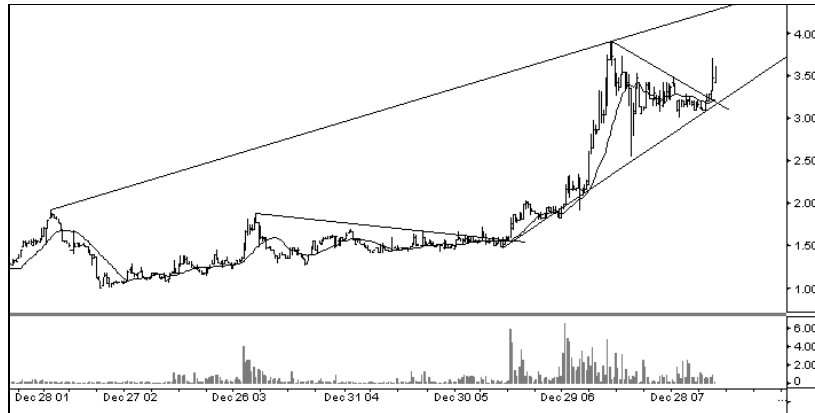
Peers Comparison					
Description	Stock exchange	Country	Market Cap (mn)	PER current	PER forward
KPJ HEALTHCARE	BURSA	Malaysia	MYR 749	9.0	9.0*
TMC LIFE	BURSA	Malaysia	MYR 343	36.2	31.5
BUMRUNGRAD	SET	Thailand	THB 24,943	16.0	21.5
BANGKOK DUSIT	SET	Thailand	THB 47,875	31.4	28.8
PARKWAY	SES	Singapore	SGD 3,292	8.3	27.1
RAFFLES	SES	Singapore	SGD 744	18.9	24.2
HEALTHSCOPE	ASX	Australia	\$1,167	15.4	14.4
RAMSAY HEALTHCARE	ASX	Australia	\$1,994	20.8	18.3
RYMAN HEALTHCARE	NZX	New Zealand	\$865	12.3	14.6
Average				18.7	21.0

(Source: Bloomberg, SJ Research)*

Constituent of Indices	
Kuala Lumpur Composite Index	no
FTSE Bursa Malaysia Large 30 Index	no
FTSE Bursa Malaysia Mid 70 Index	no
FTSE Bursa Malaysia EMAS Shariah Index	yes



Technical Analysis



KPJ (Stock code: 5878) – Consolidation Breakout

Resistance : 4.20 4.60
 Support : 3.30

Share price is at 3.56 on 23/5/08. Since October 2002's low of 1.00, the share has been on uptrend. Following the recent 10-month consolidation breakout at 3.28 in April 2008, the uptrend resumes. Upside is at the immediate overhead trendline at 4.20. Downside is limited to the support at 3.30. Resistance is at 4.60.

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