

MANAGEMENT

Discussion and Analysis



DATO'
AMIRUDDIN
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OFFICIAL OPENING CEREMONIES

3

- KPJ Sabah Specialist Hospital
- KPJ Bandar Maharani Specialist Hospital
- KPJ Pahang Specialist Hospital

GROUNDBREAKING EVENTS

3

- KPJ Miri Specialist Hospital
- KPJ Batu Pahat Specialist Hospital
- KPJ Kluang Specialist Hospital

A year ago, I had shared about the foreseeable challenges in 2016 and the strategy to overcome them. I had stressed on the need to strengthen KPJ innovative capabilities in our journey to become the leading healthcare provider in Malaysia. The plan was to actively expand our capacity by either building new hospitals or increasing the number of beds. Besides that, we also foresee the importance of enhancing our capabilities by identifying new niches of services.

Against this backdrop, we are pleased to report that we had official opening ceremonies for 3 of our hospitals and also groundbreaking events for 3 other hospitals. The 3 hospitals which we had officially launched were the KPJ Sabah, KPJ Bandar Maharani and KPJ Pahang Specialist Hospitals whilst the groundbreaking was for the future KPJ Miri, KPJ Batu Pahat and KPJ Kluang Specialist Hospitals. This is part of our effort to increase our capabilities which will result in improvement of our performance and revenue.

Having identified the socioeconomic and geopolitical issues which will give adverse impact to KPJ, we proceeded to identify our strengths. This is necessary so as to soften the negative effects and allow us to remain as the leader in the provision of quality healthcare in the country. Among the major initiatives undertaken in 2016 were new and upgraded infrastructure for our IT system and also innovation initiatives which are hoped to strengthen our position.

Performance 2016

The year 2016 continued to be another sterling year for KPJ. Our efforts yielded a revenue of RM3.02 billion, which is a 6.1% growth year on year over 2015. This is also a new benchmark for KPJ having breached the RM3.0 billion revenue mark for the first time since its inception 35 years ago.

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KPJ's earning before interest, taxes depreciation and amortisation

RM **425.3** Million
a healthy 8.2% year-on-year growth

The Group has been consistently dedicated to reward its shareholders with quarterly dividend payout between **45% to 50%** of net profit.



Our earnings before interest, taxes, depreciation and amortisation grew a healthy 8.2% year-on-year, to over RM425.3 million. This was achieved despite of our ongoing expansion plans in 2016 and into the next three to four years. We foresee that our results will be improving further with more new hospitals completing their gestation periods.

This achievement was only made possible by lowering our operating costs by improving stock control measures at the hospitals. We had also embarked on lean management exercises at the hospitals hence reducing further the operational costs.

As previously shared, the gestation of new hospitals is between 3 to 5 years after commencement of operation. We are therefore proud to announce that KPJ Klang Specialist Hospital has successfully turned around during the year under review after only 3 years in operation, with an increase of 15% in its patient numbers year-on-year.

The net profit of the company recorded a 7.4% increase from 2015 at RM155.9 million. The increase was mainly due to lower tax charged during the year. The merger of matured hospitals with newly opened hospital under one entity has made the Group more tax efficient bringing it closer to the Malaysian statutory tax rate. KPJ had also contributed more than RM3.0 million towards zakat in 2016, which is higher than the contribution of RM2.3 million in 2015.

Our Indonesian operations saw heightened activity in 2016, reporting a revenue of RM59.6 million, an increase of 15% compared to RM52.0 million which was recorded in 2015. This is mainly due to our Rumah Sakit Medika Bumi Serpong Damai (RSMBSD) which delivered a strong performance with a 17.1% increase in revenue, from RM22.9 million in 2015 to RM26.8 million in 2016. This was mainly due to the appointment of RSMBSD as one of the panel hospitals under the Jaminan Kesehatan Nasional (JKN) scheme. The national healthcare scheme is under the management of the Social Security (Badan Penyelenggaraan Jaminan Sosial Kesehatan, BPJS). RSMBSD had also recorded a significant increase in profit from RM8,161 in 2015 to RM346,428 in 2016.

The Group has been consistently dedicated to reward its shareholders with quarterly dividend payout between 45% to 50% of the annual net profit attributable to shareholders. For the year

under review on the back of net profit attributable to shareholders of RM149.2 million, the Group had declared and paid a total dividend of RM68.4 million. During the year, the Group was also able to significantly reduce its effective tax rate compared to the preceeding year. Fifteen (15) companies within the Group has utilised the benefits from tax losses and other tax incentives, resulting in deferred tax assets recognised during the year, as they are anticipating to have sufficient taxable profits in the foreseeable future years.

Driving Cost Efficiencies

KPJ has undertaken a series of measures to generate more value from our existing assets. One of such measures are by reviewing our operations so as to reduce costs and improve efficiency. We had also reviewed our pricing strategy so as to soften the impact brought about by the increasing material costs.

We also take pride in controlling our gearing to be at the lowest level possible. Realising the parallel growth of gearing with our expansion plans, we have now embarked on 'design, build and lease' arrangements for future hospitals. Other than helping to keep our gearing under check, such arrangements will also keep us focused in our business. The first project under this model is KPJ Damansara 2 followed by KPJ Batu Pahat and KPJ Kluang Specialist Hospital. These projects will be completed in stages by the next 3 years.

We realised that as the Group grows bigger, more efficiency can be achieved through consolidation of our hospitals. Hence, in the year under review, we had undertaken the consolidation of the hospital operations of KPJ Damansara and KPJ Rawang under Rawang Specialist Hospital Sdn Bhd. Among the benefits derived from this exercise was cross-sharing of talent, expertise and resources between the hospitals, more effective capital expenditure and financial efficiency. The patients also benefit from such exercise by having easy cross-referrals between the two hospitals. Subsequent to the completion of the consolidation of KPJ Damansara and KPJ Rawang in April 2016, we had proceeded to undertake the consolidation of KPJ Puteri with KPJ Pasir Gudang, KPJ Seremban with KPJ Bandar Maharani and KPJ Penang with Taiping Medical Centre which exercise was completed in December 2016.

We also took major strides in our sustainability framework which looks into the management of



risks and explores all opportunities in the Group. For more information on sustainability initiatives please refer to Sustainability Statement on pages 82 to 104.

Realising the importance of continuous improvement of our services, we have put in place regulations, surveillance audit and preventive measures so as to mitigate risks associated with the stakeholders. Risk mitigation and best practices on disaster response is available on Business Continuity Management pages 178 to 179.

Our Global IT Strategic Transformation Project had contributed to the reduction in operational costs by trimming outsourced expenses. The Project aims to shift progressively the Group system into a private cloud support enterprise-wide network. This will allow KPJ to consolidate its resources and optimise costs resulting in more affordable healthcare cost to patients.

CREATING VALUE IN A CHALLENGING ENVIRONMENT

Improving Capacity and Capabilities

KPJ has seven (7) greenfield projects in the pipeline which have been scheduled to be fully developed between years 2017 to 2020. Acknowledging the importance of selecting the correct consultants and contractors for our projects, we have now a system to ensure the smoothness of such selection. Project consultants and contractors are now required to be registered with KPJ and tenders are awarded based

on the past projects, cost and desired results. The contractors' capabilities and competencies are to be evaluated by independent QS consultants.

In 2016, an additional 158 licensed beds have been added across the Group of which 102 beds were at KPJ Pahang which commenced its operations in May 2016. The said Hospital is the first private facility in Pahang to have its own cardiac catheterisation lab services. Even within barely a year since commencing operations at its new location in Tanjung Lumpur, the Hospital has successfully recorded a revenue of RM44.6 million.

We are also pleased to share that KPJ Selangor has successfully completed their new outpatient block in October 2016. The 8-floor building is targeted to be operational by the 1st quarter of 2017. There will be 54 new clinics at the new building which will provide better comfort to the patients.

KPJ Perlis, which was originally scheduled to open its doors to the public in 2015, will be completed and opened in 2017 with 60 beds in Phase 1.

In the year under review, our Rumah Sakit Medika Bumi Serpong Damai (RSMBSD) had also launched their new Kidney-Hypertension and Diabetic Clinic with an additional 8 dialysis machines. Together with the other 10 existing machines, RSMBSD saw a spike of its cases to an average of 688 per month. The Hospital was named the winner of the Trauma Centre Award 2016 – BPJS Ketenagakerjaan for the Province of Banten for their service excellence in 2016.

Meanwhile, our Sheikh Fazilatunnesa Mujib Memorial KPJ Specialized Hospital in Bangladesh had commendably recorded a revenue increase to RM7.5 million in 2016 compared to RM2.1 million the year before. The hospital increased the number of consultants from 11 to 17 in 2016 that saw a healthy growth in total patient arrivals from 15,910 to 54,232 in 2016.

All these positive achievements in 2016 were the results of KPJ strategies for sustainable long term growth. Backed by the Group's solid fundamentals, KPJ performance remains strong despite of the global challenges.

Ancillary Services Complementing the Hospitals

KPJ Group has, over the years, cultivated its own diverse range of healthcare-related business entities. These business support and complement our specialist hospitals.

In 2016, Pharmaserv Alliances Sdn Bhd (PASB) and Lablink (M) Sdn Bhd (Lablink) recorded RM386.9 million and RM73.5 million in revenue, respectively. PASB is the supplier of pharmaceutical, medical disposables and hospital related products while Lablink specialises in laboratory and pathology services. The improved results was mainly due to the increase in the sales of pharmaceuticals, medical and surgical products, and as laboratory services. These were significant improvement for each company compared to their achievements in 2015, where PASB had recorded RM365.9 million and Lablink with RM66.3 million.

KPJ Healthcare University College (KPJUC), our education arm, also registered an increase of 7.3% in revenue against its performance in 2015. The revenue of KPJUC for the financial year 2016 was RM43.2 million as compared to RM40.3 million in 2015. The improved performance was due to the increase in the number of students and programmes offered during the year in review.

Health Tourism Realising International Opportunities

The overall performance of KPJ's Health Tourism business in 2016 recorded an 8% increase in revenue, with 155,052 visits by foreign patients in the year under review. Revenue from this segment

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also grew a healthy 8% to RM124.2 million despite the challenging operating environment.

We are well-placed to gain from the Government initiatives to market the country internationally as an attractive hub for healthcare excellence. In this instance the temporary weakening of the Ringgit works in our favour to drive tourism dollars into the country. The KPJ Health Tourism team has been proactively expanding its portfolio of countries and services, especially to the Middle Eastern, Asian and East African regions.

Governance

The Board strives to provide effective leadership, strategic direction and a productive environment to sustain value creation for its stakeholders. KPJ's corporate governance structure assists the Board in achieving those objectives by ensuring compliance with regulations such as Bursa Malaysia Securities Berhad Listing Requirements and the Companies Act, 1965. Our full governance report is on pages 150 to 164.

As a healthcare services provider, KPJ has a comprehensive Clinical Governance framework, Medical Professionals By-Laws, based on integrated approach to clinical risk management and continuous quality improvement. The framework measures four major areas of organisational performance including Clinical Risk Management, Clinical Effectiveness, Effective Workforce and Customer Participation.

Performance across this area by all KPJ Hospitals is closely monitored by our Clinical and Quality Services, which reports to the Medical Advisory Committee (MAC) and the Board. More information on the stated MAC report is on pages to 172 to 177.

Accreditation continues to be our aim in meeting the demand by our patients for quality healthcare. Realising this, KPJ as a responsible healthcare group, puts a lot of emphasis on quality throughout the hospital processes. As at March 2017, KPJ has 18 MSQH-accredited hospitals and 4 JCI-accredited hospitals.

Managing Talent for Our Future

Employees continue to be our valued assets. Today, our growing business has more than 12,000 staff. Staff cost for the year 2016 amounted to RM666.2 million. The Group spent RM10.3 million for training purposes, an increase of up to 25% from the RM8.3 million spent in 2015.

Employees are recruited and regularly appraised against a formal job specification. Comprehensive policies covering all material aspects of employment have been established and we are committed to effective communication with employees by formal and informal approach.

KPJ's Employee Share Options Scheme (ESOS) was offered to staff to express our appreciation for their contributions, by making them our shareholders. Implemented since 2015 for a period of five (5) years, the scheme has benefitted more than 5,000 staff. ESOS expenses registered in 2016 was RM27.8 million compared to RM26.5 million in 2015.

Driving Innovation

KPJ, in 2016 and in during the 1st quarter of 2017, has already undertaken proactive measures to implement innovation that boost the Group's capabilities in delivering on our brand promise.

The Group's initiatives are driven by the Group's New Products and Services (NPS) unit, which is responsible for planned service enhancement process via technology-based systems. Among its current ventures include KPJ's retail pharmacy which provides online services to consumers.

A Digital Marketing Committee has been established to oversee KPJ's digital marketing strategy and campaign plans across all product portfolios.

KPJ is exploring collaborations with several renowned technology companies to introduce clinically advanced systems. We are in talks with IBM to acquire its Watson technology, which is a cognitive technology that can process information, analyse and interpret data much like the human thought process. This investment will be applied for oncology purposes. We hope to have this system operating by the end of 2017.

Strategic Partnerships

In August 2016, KPJ had entered into a tri-partite collaboration (MOU) with Sojitz Corporation and Capital Medica Co. Ltd. of Japan, for a proposed USD12 million oncology centre at Rumah Sakit Medika Bumi Serpong Damai (RSMBSD).

The signing took place at the 12th World Islamic Economic Forum (WIEF) in Jakarta, Indonesia, witnessed by YAB Dato' Sri Mohd. Najib Tun Razak, the Prime Minister of Malaysia, and YABhg Tun Musa Hitam, Chairman of the World Islamic Economic Forum Foundation.

On 23 September 2016, KPJ also signed and agreement to collaborate with Sebarun Hospital from Korea to set up a Minimal Invasive Surgery (MIS) Spine



Centre at KPJ Tawakkal Health Centre (THC). KPJ also signed a memorandum of understanding (MOU) with DK Medical Centre (DKMC) for a Cosmetics & Reconstructive Surgery at the THC, and the Daejeon Wellness Hospital (DWH) for a Specialised Wellness Centre in Johor Bahru. Both DKMC and DWH are also Korean companies. The ceremony was witnessed by Johor Menteri Besar Datuk Mohamed Khalid Nordin.

Customer Satisfaction

The Annual Customer Satisfaction Survey, carried out by KPJ's Service Quality Management indicated a favourable score of 86.1%, in terms of patient satisfaction. This was achieved from the improved service quality and new customer-centred initiatives rolled out in 2016.

Among the new customer-centred initiatives was the Patient Communication Management System (PCMS) in all hospitals to effectively compile and address in real-time patients' requests, feedback, and suggestions. We had also introduced Service Quality Coaches in all KPJ hospitals who had conducted service quality training for more than 6,000 staff. The Group also conducted special customer service workshops which were attended by more than 900 hospital staff, including case studies that are essential in equipping frontline personnel to deliver high-level service. Recently, we had introduced the KPJ Care Loyalty Programme Card to reward and provide value added benefits to patients.

Investing for Communities

KPJ's main Community Service thrust is the Klinik Waqaf An-Nur (KWAN) initiative which caters to the underprivileged. There are today 18 KWAN clinics and 1 Hospital Waqaf An-Nur (HWAN). During the year, the total number of patients seen at both KWAN and HWAN was 100,292 patients compared to 72,581 in 2015 which is an increase of 38%.

To date, KPJ has contributed more than RM5 million per year in operating expenses of KWAN and HWAN, which mainly comprised of the cost of medical suppliers and staff costs. We also had donated cash to KWAN amounting to RM3.5 million in 2016, compared to RM3.1 million in 2015.



Besides KWAN and HWAN, KPJ had participated in various other community services. We have also contributed more than RM1 million in terms of cash donations to other parties, including to the 'asnaf' category and public community programmes for underprivileged children.

Looking Ahead

I foresee a very challenging fiscal year in 2017. The global uncertainty, both from the political and economy aspect, should not be lightly brushed aside.

Be that as it may, we should instead identify our strengths than to dwell too much into the uncertainty of things. Innovation and technology still remain the key to improvement and betterment of KPJ performance. Improving the customer service and also strengthening the KPJ branding will also be the focus in 2017. All these will sum up to efficient quality care to the patients.

Being more than 30 years in the industry and as a leader, we shall use our expertise and constantly review our current standing against our competitors

and the market. Strategies will be regularly enhanced and updated to ensure their relevance in maintaining our competitive position. Plans are already afoot to add to the Group capacity and capabilities for the next five years.

While there is more work to be done, I believe we are on the right path. Let me assure you that KPJ is still an attractive investment that will yield meaningful long term returns for all.

May 2017 be another sterling year for KPJ!

DATU' AMIRUDDIN ABDUL SATAR
President & Managing Director
KPJ Healthcare Berhad