Hiccups from new hospitals continue

IHH's 2Q17 net profit increased to RM316.6m (29% yoy), but core net profit declined 50% yoy if we exclude gains from the partial divestment of non-core assets. While IHH's core hospital operations in Malaysia and Singapore are seeing earnings growth, higher new hospital start-up costs, pre-operating costs, amortization and finance cost continue to drag IHH's profit. As these headwinds may persist, we maintain a HOLD rating with an unchanged TP of RM6.56.

Solid revenue growth dampened by new hospital costs

IHH's 2Q17 revenue rose by 12% yoy to RM2.771bn, on the back of 10-30% revenue growth across major key markets. However, EBITDA declined 8% yoy due to higher pre-opening and start-up losses from new hospitals. Gleneagles Hong Kong (GHK) which opened in March 2017 saw EBITDA losses widened to RM67.8m in 2Q17 (1Q17: RM81.1m). On the other hand, Acibadem's EBITDA declined 9% yoy due to lower utilisation at Acibadem Kadikoy and Acibadem Kozyatagi, following the decanting of patients with complex conditions to Acibadem Altunizade. Higher operating costs and depreciation of Turkish Lira were also the culprits.

Disposal gain saved bottom line

The higher 2Q17 headline net profit of RM 316.6m (+29%yoy) was only due to a gain on disposal of the remaining 4.78% stake in Apollo Hospital, which amounted to RM241m. Excluding EIs, core net profit declined by 50% yoy to RM86.2m, mainly due to higher depreciation (+22%yoy), amortisation (+11%yoy) and finance costs (+60%yoy), following the opening of 2 new hospitals in Hong Kong and Istanbul in March 2017. At the EBITDA level, 1H17 accounted for 42% of our and consensus full year forecast, which we deem as largely in line as we expect higher EBITDA in 2H17 as 2 new hospitals which opened in March, to continue to ramp up operations. However, core net profit of RM288m fell short, accounting or 30% of our 2017 forecast, below our and consensus' estimates.

Maintain HOLD with unchanged DCF-derived TP of RM6.56

We lowered our core net profit by 6% to 10% for 2017-19E taking into account higher depreciation and finance cost. IHH's borrowings has increased by RM513m for working capital, capex, and potentially acquisition. While we like IHH for its aggressive expansion into regions where healthcare demand is underserved, we are concerned over prolonged losses arising from the new hospitals. Trading at a 2017 PE of 57x, we find the premium valuation unattractive at this level. Maintain Hold.

Earnings & Valuation Summary

FYE 31 Dec	2015	2016	2017E	2018E	2019E
Revenue (RMm)	8,455.5	10,021.9	11,685.3	13,541.6	15,166.9
EBITDA (RMm)	2,164.4	2,267.2	2,655.5	3,252.5	3,787.0
Pretax profit (RMm)	1,217.5	877.6	1,828.8	1,767.3	2,225.4
Net profit (RMm)	933.9	612.4	1,420.7	1,229.6	1,560.7
EPS (sen)	11.4	7.4	17.3	14.9	19.0
PER (x)	52.7	80.7	34.8	40.2	31.6
Core net profit (RMm)	899.2	866.0	867.8	1,229.6	1,560.7
Core EPS (sen)	11.0	10.5	10.5	14.9	19.0
Core EPS growth (%)	14.3	(4.0)	0.2	41.7	26.9
Core PER (x)	54.8	57.0	56.9	40.2	31.6
Net DPS (sen)	3.0	2.0	4.6	3.9	5.0
Dividend Yield (%)	0.5	0.3	0.8	0.7	0.8
EV/EBITDA (x)	25.9	24.9	20.9	16.9	14.1
Chg in EPS (%)			(9.7)	(6.5)	(5.5)
Affin/Consensus (x)			0.9	1.0	1.0

Source: Company, Affin Hwang estimates

Results Note

IHH Healthcare

IHH MK
Sector: Healthcare & Pharmaceuticals

RM6.00 @ 23 August 2017

HOLD (maintain)
Upside: 9 %

Price Target: RM6.56
Previous Target: RM6.56

Price Performance

	1M	3M	12M
Absolute	-0.2%	2.4%	-10.2%
Rel to KLCI	-0.9%	2.1%	-14.7%

Stock Data

Issued shares (m)	8,239.1
Mkt cap (RMm)/(US$m)	49,343/11,549
Avg daily vol - 6mth (m)	6.0
52-wk range (RM)	5.54-6.71
Est free float	18.6%
BV per share (RM)	2.73
P/BV (x)	2.20
Net cash/ (debt) (RMm)	(3,431)
ROE (2018E)	6%
Derivatives	Nil
Shariah Compliant	Yes

Key Shareholders

Khazanah National Bhd	41.1%
Mitsui & Co Ltd	18.0%
Employee Providend Fund	9.6%

Source: Affin Hwang, Bloomberg

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Segmental 2Q17 result commentary

i) **Singapore.** Revenue grew 10% yoy to RM958m, driven by 1.3% yoy growth in inpatient admissions and revenue intensity growth of 8.7% yoy. EBITDA margin improved by 2.1ppts to 26.9% due to the ramp up of Novena Hospital.

ii) **Malaysia**. Revenue increased by 15% yoy to RM455m, on 4.8% yoy growth in inpatient admission and revenue intensity growth of 10.3% yoy driven by more complex cases and pricing adjustments.

iii) **India and North Asia**. Revenue increased by 31% yoy and 29% yoy respectively. Gleneagles Hong Kong's RM68m start-up losses eroded Group's EBITDA.

iv) **Acibadem**. Revenue grew by 10% yoy to RM954m. The consolidation of Bulgaria hospitals contributed to 40% yoy inpatient admissions growth and revenue intensity increased by 4% yoy. EBITDA declined by 9% due to Acibadem Altunizade, which opened in March 2017. Higher operating costs from medical inflation and depreciation of Lira against the US$ were also the reasons of weaker EBIDTA margin.

Fig 1: Results Comparison

FYE Dec (RMm)	2Q17	QoQ % chg	YoY % chg	1H17	YoY % chg	Comment
Revenue	2,771.8	*3.2*	*12.1*	5,456.7	*10.3*	10% yoy increase in revenue was attributed to organic growth of its existing operations and the continuous ramp up of new hospitals.
Op costs	(2,247.3)	*(6.1)*	*18.1*	(4,365.1)	*15.7*	
EBITDA	524.6	*(7.5)*	*(8.1)*	1,091.6	*(7.1)*	Pre-operating and start-up costs from GHK and Altunizade eroded the margin.
EBITDA margin (%)	*18.9*	*-2.2ppt*	*-4.1ppt*	*20.0*	*-3.7ppt*	
Depr and Amort	(250.8)	*16.3*	*23.3*	(466.4)	*15.6*	
EBIT	273.8	*(22.1)*	*(25.5)*	625.2	*(18.9)*	
EBIT margin (%)	*9.9*	*-3.2ppt*	*-5ppt*	*11.5*	*-4.1ppt*	
Int expense	(109.9)	*22.0*	*59.8*	(200.0)	*50.3*	Higher borrowing used for working capital, capex and potential acquisitions.
Int and other inc	24.3	*(44.0)*	*8.3*	67.6	*68.0*	
Associates	(0.1)	*(106.5)*	*(102.8)*	2.0	*(76.4)*	
Exceptional items	219.5	*0.1*	*355.3*	438.9	*935.7*	RM555m gain on disposal of interest in Apollo Hospital in March and May 2017.
Pretax	**407.5**	***(22.5)***	***9.0***	**933.6**	***28.0***	
Core pretax	**188.0**	***(38.7)***	***(42.3)***	**494.7**	***(28.0)***	
Tax	(102.1)	*24.8*	*14.2*	(183.9)	*6.5*	
Tax rate (%)	*25.1*	*9.5ppt*	*1.1ppt*	*19.7*	*-4ppt*	
MI	11.1	*(56.7)*	*(129.1)*	36.9	*(149.3)*	
Net profit	**316.5**	*(32.7)*	*28.6*	**786.6**	*63.3*	
EPS (sen)	3.8	*(32.7)*	*28.4*	9.6	*63.3*	
Core net profit	**86.2**	*(57.3)*	*(50.3)*	**288.0**	*(30.1)*	Below our expectations due to higher depreciation cost from 2 new hospitals and finance cost.

Source: Affin Hwang, Company data

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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