Healthcare

Unhealthy Valuations but Defensive Earnings

UNDERWEIGHT

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We maintain our UNDERWEIGHT rating on the sector which is expected to be dull in terms of earnings growth and further capped by expensive valuations. However, we believe that the healthcare industry will continue to enjoy pedestrian but stable growth, supported by growing healthcare expenditure, rising medical insurance and an ageing population demographic. The latest 1QCY20 results season saw IHH and KPJ's earnings coming in line with expectations while Pharmaniaga's came in above due to higher-than-expected volume sales. However, IHH's 1QFY20 earnings were impacted by goodwill impairment on Global Hospitals. For stock pick, we like KPJ as (i) start-up costs from new openings will be absorbed by incremental ramp-ups from earlier openings and steady contributions from matured hospitals and (ii) the stock is currently trading at 20% and 40% discounts compared to historical average of 25.5x and regional peers of 35x, respectively.

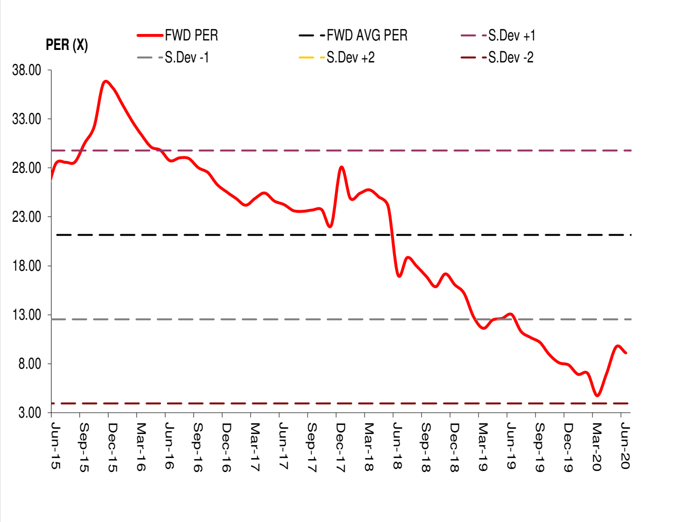
Growth in healthcare supported by ageing population. It is estimated that for the 2010-2040 period, Malaysian population aged 65 and over is projected to increase more than three-fold of the 2010 population. The increase will lead Malaysia into becoming an ageing population nation in 2021 when the population aged 65 years and over reaches 7.1%. Based on the United Nations (UN) definition, an aging society is when the population aged 65 and over reaches 7% of the total population. Population for the age group 0–14 years is projected to decline from 27.4% to 19.6% for the same period. However, the population for the age group 15–64 years and 65 years and over are expected to increase by 1.4 and 6.4 percentage points, respectively. Longer life spans have also resulted in a larger number of people aged 65 and above. This improvement has been attributed mainly to advances in medical technology, higher personal wealth and awareness of the importance of healthcare.

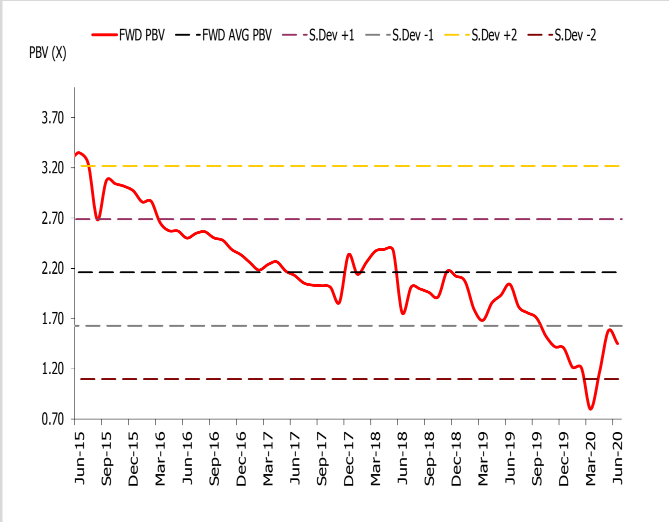
India and Turkey are concerns for IHH. IHH's 1QFY20 earnings were impacted by goodwill impairment on Global Hospitals and lower inpatient volume across the group's operating units including Singapore, Malaysia, India and Acibadem. With the re-opening of economies, the group expect subsequent quarters to show marked improvement. The group has undertaken cost initiatives measures to defer non-essential capex and opex to mitigate any short-term revenue shortfall. Due to the COVID-19 pandemic, the opening of Parkway Shanghai has been postponed to 2021. Thus far, the group has further deleveraged its non-lira debt in its Turkish operations from EUR267m as at Dec 2019 to EUR183m as at Mar 2020. Looking at performance of IHH's 62%-owned Continental Hospitals and 74%-owned Global Hospitals acquired back in 2015 where EBITDA is hardly positive, India is seen as a tough operating environment for IHH. We are also concerned over issues at Fortis, including an auditor's qualified audit report in FY19, potential risk of provisions, lapses in internal controls leading to regulatory probing, which could well mean execution risk.

Pharmaniaga's supply concession ceases, cloudy earnings visibility beyond Dec 2021. Pharmaniaga's 1QFY20 results came above expectations due to stronger demand from government and private hospitals in Malaysia and Indonesia. With the new contract arrangement as explained, the remaining unamortised rights to supply have been fully recognised. The Government has agreed to provide a 25-month interim period for procurement of drugs to Pharmaniaga Bhd after its concession ends on 30th Nov 2019. The interim period from 1st Dec 2019 to 31st Dec 2021 is to ensure no supply chain disruption in the supply and distribution of medicines nationwide while an open tender and appointment of a new concessionaire is developed. However, starting from 1st Dec 2019, the government has awarded Pharmaniaga a five-year contract extension for logistics and distribution of medicines based on its capabilities and performance. We highlight here that PBT margin for Logistics & Distribution segment is razor-thin, averaging at 0.2% over the past 20 quarters. We believe the contract extension for logistical support lies in Pharmaniaga's capability in the development of a procurement and logistical computerised system i.e. Pharmacy Information System (PHIS). PHIS play a vital and integral role in ensuring the distribution of drugs to patients and effective management of stock levels.

KPJ's valuation appears to be attractive again, Reiterate OP. 1QFY20 earning was impacted by additional expenses incurred mainly from the increase in the purchase of material costs and personal protection equipment for the pandemic front liners. The Group also contributed in terms of providing additional manpower, loaning of equipment and cash donations to the Ministry of Health (MOH) in managing the pandemic. The group is confident that start-up costs from new hospital openings will be absorbed by: (i) incremental ramp-ups from earlier openings, and (ii) steady contributions from matured hospitals. Earnings growth is expected to come from narrower losses and earnings from hospitals built 2-3 years ago. We like KPJ as (i) start-up costs from new openings will be absorbed by incremental ramp-ups from earlier openings and steady contributions from matured hospitals and (ii) the stock is currently trading at 20% and 40% discounts compared to historical average of 25.5x and regional peers of 35x, respectively.

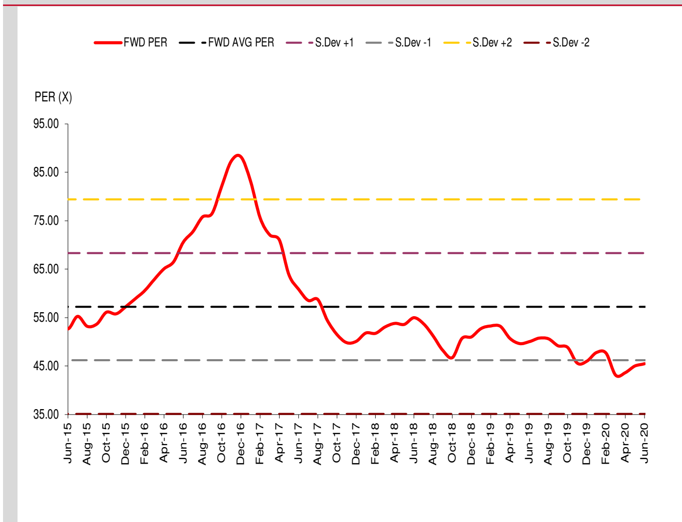
Pharmaniaga – Forward PER and PBV Band

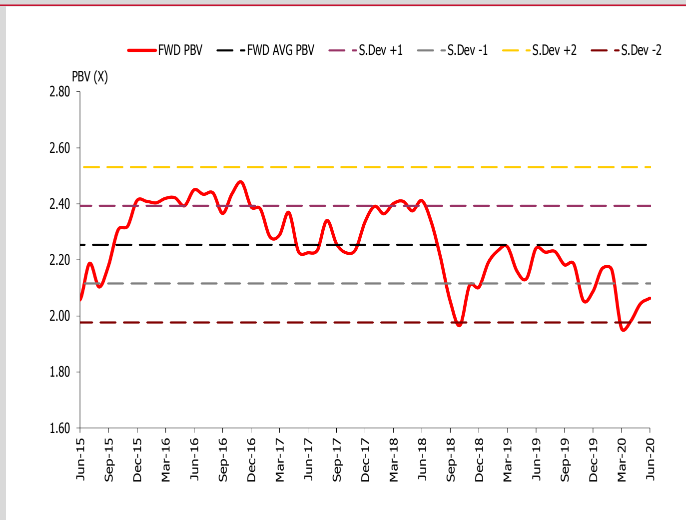




Source: Bloomberg, Kenanga Research

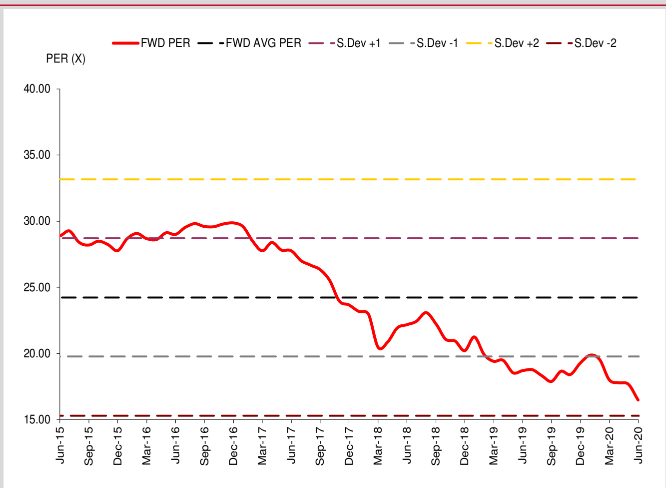
IHH Healthcare – Forward PER and PBV Band

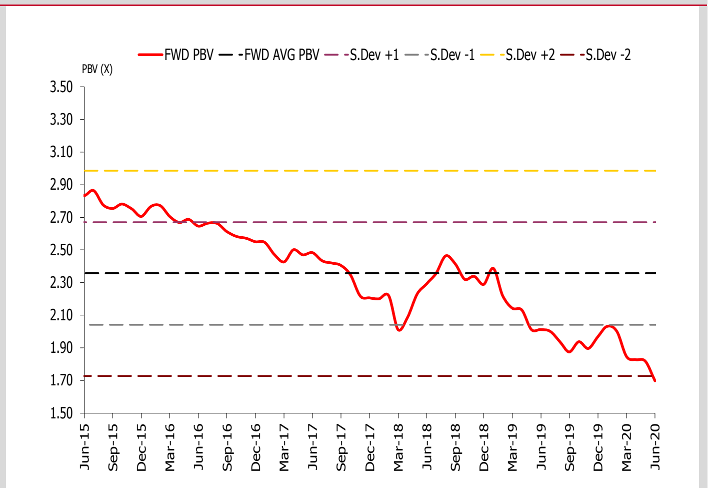




Source: Bloomberg, Kenanga Research

KPJ Healthcare - Forward PER and PBV Band





Source: Bloomberg, Kenanga Research

Peer Comparison

Name	Price @ 30/6/20 (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div Yld (%)	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.		
HEALTHCARE																	
IHH HEALTHCARE BHD	5.50	48,274	Y	12/2020	-4.0%	7.4%	13.5%	3.1%	49.2	46.1	44.7	2.0	2.1	4.6%	0.7%	4.70	UP
KPJ HEALTHCARE BERHAD	0.840	3,595	Y	12/2020	4.7%	3.3%	-3.6%	7.9%	17.5	18.1	16.8	2.0	1.8	10.4%	2.4%	1.20	OP
PHARMANIAGA BERHAD	2.22	581.0	Y	12/2020	4.2%	-7.1%	51.8%	-15%	12.8	8.5	9.9	1.7	1.5	18.9%	4.5%	1.35	UP

Source: Bloomberg, Kenanga Research

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Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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