Healthcare

Chronic Unexciting Prognosis

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. Overall, we still believe that the healthcare industry will continue to enjoy stable growth supported by the growing healthcare expenditure, rising medical insurance and an aging population demographic. The 1QCY19 results season saw a mixed bag of results. IHH's 1Q19 earnings came in within expectations. KPJ came in below expectations due to lower-than-expected revenue per inpatient. Pharmaniaga performed in line with expectations. On picks, we like KPJ because: (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% discount compared to the historical average of 27.5x and regional peers of 35x, respectively.

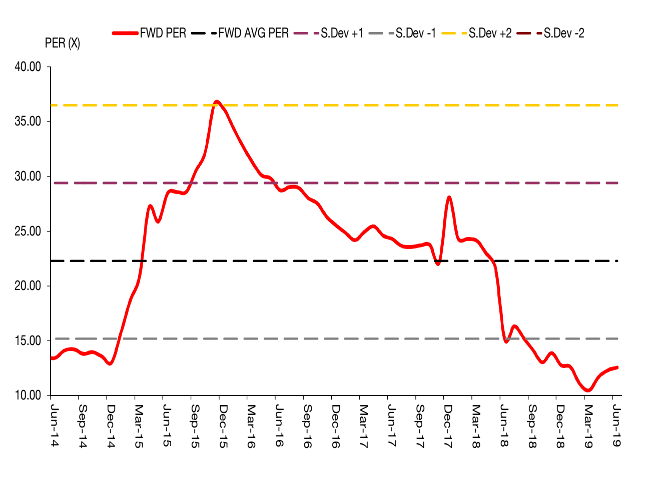
Growth in healthcare supported by ageing population. It is estimated that during the period of 2010-2040, Malaysia's population aged 65 and over is projected to increase more than three folds of the 2010 population. The increase will lead Malaysia to become an aging population nation in 2021 when the population aged 65 years and over reaches 7.1%. Based on the United Nations (UN) definition, an aging society is one where 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 period of 2010–2040. However, the population for the age group 15–64 years and 65 years and over is expected to increase by 1.4 and 6.4 percentage points, respectively, for the same period. 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 growing awareness of the importance of healthcare and disease prevention.

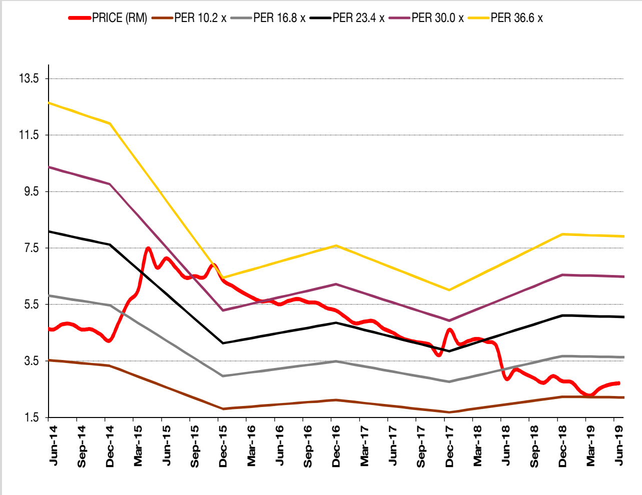
Fortis is a concern for IHH. IHH's 1Q19 earnings came in within expectations. However, we are concerned over issues at Fortis, including an auditor's qualified audit report in FY18, which has been carried forward into the quarterly review on 13 Feb 2019, risk of more provisions, and lapses in internal controls, which led to regulatory probing, which could well mean execution risk exposure. However, earnings continued to be dragged down by foreign exchange losses on Acibadem Holding's non-Turkish Lira denominated borrowings. The stock is expected to continue to be weighed down by marked-to-market volatility on translation of non-Turkish Lira borrowings. Looking ahead, over the medium term, IHH is expected to face tough operating conditions on the back of: (i) the uncertain Turkish Lira which has depreciated against USD, Euro and MYR with continued volatility, and (ii) execution risk at Fortis as well as uncertainty over its timeline in terms of a turnaround to profitability.

Pharmaniaga outlook clouded by uncertainty in the renewal of medical supplies concession. The de-rating is on concerns of the Government reviewing all medical supplies concession agreements, of which Pharmaniaga has a 10-year contract ending in November 2019. We are uncertain on the renewability of the contract but Pharmaniaga has the track record, platform and systems in place for the distributions of medical supplies. Its Indonesian operations remain a key area of growth, while further progress is being made in the European Union as the Group seeks to expand its global presence. In tandem with this, the Group is focused on implementing continuous cost optimisation measures across its operations. Over the longer term, we expect its manufacturing division to propel earnings growth. The group aims to add about 200 new products over the next 10 years to its existing portfolio of around 500 products, which should boost revenue and lift earnings. We downgrade **Pharmaniaga** from **Market Perform to Underperform** due to the concession renewal uncertainty.

KPJ's valuation appears to be attractive again, Reiterate OP. The group is confident that start-up costs from new openings will be absorbed by: (i) incremental ramp-ups from earlier openings, and (ii) steady contributions from matured hospitals. As indication, start-up losses are only seen in KPJ Perlis and Bandar Dato Onn. Earnings growth is expected to come from narrower losses and profitability for hospitals built 2-3 years ago including KPJ Rawang, Maharani, Pasir Gudang and Pahang. We like KPJ because: (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% discount compared to the historical average of 27.5x and regional peers of 35x, respectively.

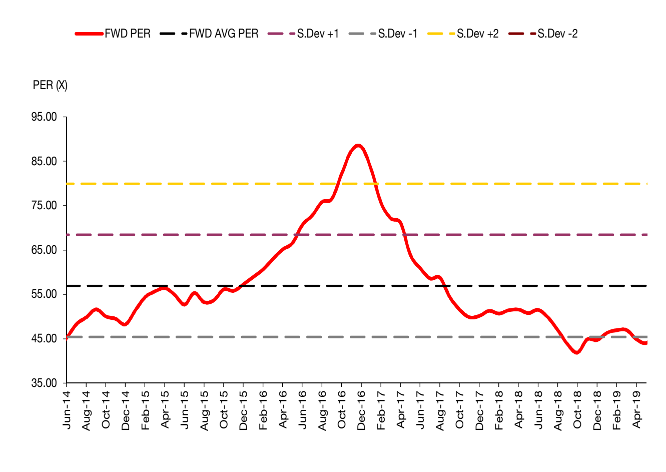
Pharmaniaga – Forward PER Band

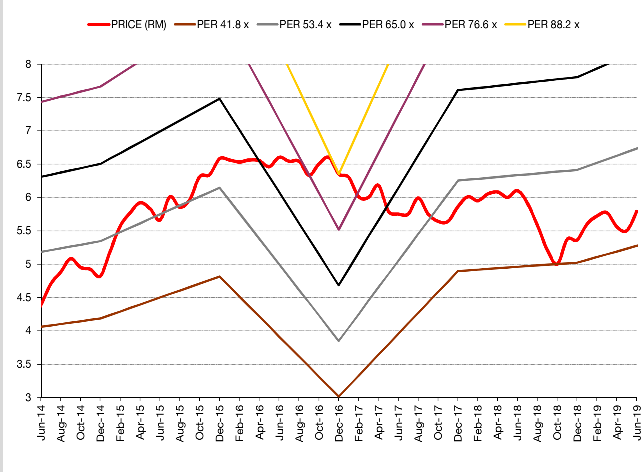




Source: Bloomberg, Kenanga Research

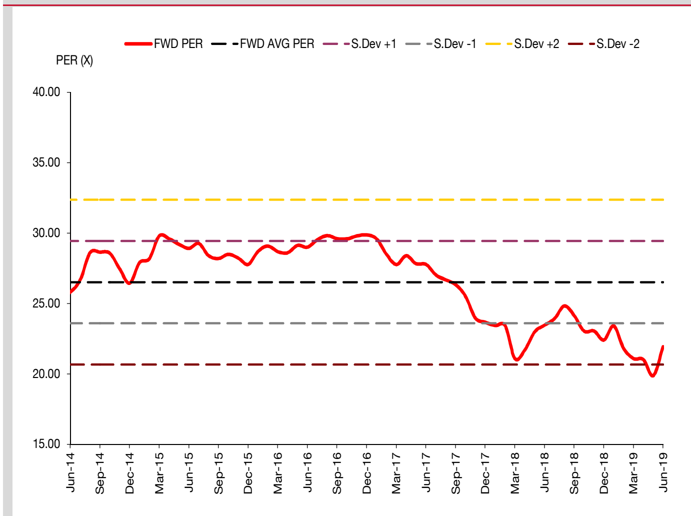
IHH Healthcare – Forward PER Band

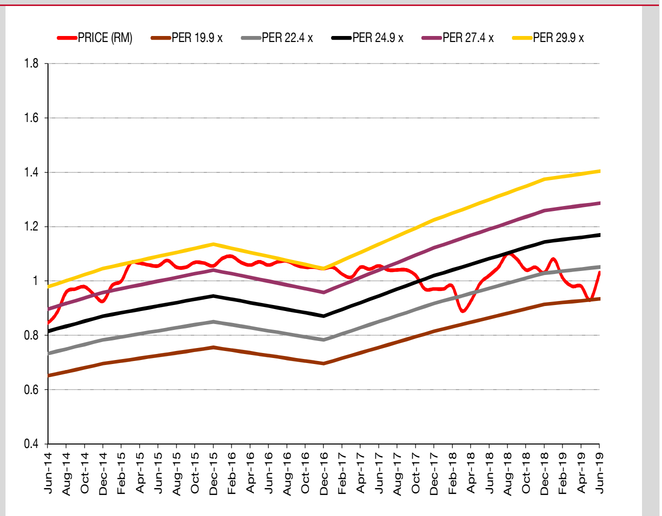




Source: Bloomberg, Kenanga Research

KPJ Healthcare - Forward PER Band





Source: Bloomberg, Kenanga Research

Peer Comparison

Name	Price @ 21/6/19 (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	5.79	50789.0	Y	12/2019	13.2	11.0	2.6	9.9	49.4	48.1	43.8	2.3	2.2	4.6	0.5	4.90	UP
KPJ HEALTHCARE BERHAD	1.03	4451.7	Y	12/2019	10.5	3.3	5.0	1.0	24.8	23.6	23.3	2.3	2.1	9.1	1.9	1.20	OP
PHARMANIAGA BERHAD	2.71	707.9	Y	12/2019	5.0	3.0	-1.6	-0.4	12.2	12.4	12.5	1.4	1.3	10.6	5.2	2.35	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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