

## KPJ Healthcare (KPJ MK)

# Entering into sale and leaseback for 3 assets

### Maintain BUY

We are relatively neutral on KPJ's sale and leaseback agreement for its 3 hospitals. Excluding a marginal disposal gain of MYR3.8m, the impact to earnings is neutral, but monetising its assets could free up more capital to improve its balance sheet and undertake its expansion and business transformation initiatives going forward. Maintain BUY with an unchanged SOTP-based TP of MYR1.01.

### Executing sale and leaseback for 3 assets

KPJ has entered into a sale and leaseback agreement with its 36.6% owned associate Al-Aqar Healthcare REIT for KPJ Pasir Gudang Hospital and two new buildings erected on KPJ Penang and KPJ Seremban Specialist Hospital's premises, for a total consideration of MYR192m. The transaction will be satisfied via cash of MYR167m and 20.5m new units of Al-Aqar shares at an issue price of MYR1.22 each, for MYR25m.

### Neutral impact to P&L; reduce net gearing

Excluding the MYR3.8m disposal gain (one-off), the impact to KPJ's earnings is relatively neutral, in our view, as the accretion from higher distribution income from Al-Aqar, and lower depreciation, interest expenses and other expenses transferred to Al-Aqar will be offset by new lease expense at the 3 hospitals' level, netting a marginal negative impact of MYR1.4m to KPJ's group pretax level, or 0.7% of FY22E pretax profit. MYR135m of the total proceeds will be used to repay sukuk and other banking facilities, MYR25m for hospital expansions, MYR5m for general working capital and the balance for the related transaction expenses. The borrowing repayments could lower KPJ's net gearing from 68% to 62%.

### Fueling its expansionary plans

The decision further frees up more capital to improve KPJ's balance sheet, and provide some capital to fund its expansionary initiatives. As its BOR is slowly approaching pre-pandemic levels, KPJ is planning ahead to expand its bed capacity, rolling out more ACCs (25 by 2027, from one currently), as well as establishing 6 quaternary care centers within its portfolio of hospitals over the next 2-3 years as part of its long-term operational transformation programme.

FYE Dec (MYR m)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	2,397	2,627	2,826	3,090	3,244
EBITDA	546	500	588	667	730
Core net profit	135	48	130	187	230
Core EPS (sen)	3.1	1.1	2.9	4.2	5.2
Core EPS growth (%)	(35.9)	(66.0)	172.0	43.9	23.2
Net DPS (sen)	1.2	0.8	1.6	1.8	1.8
Core P/E (x)	31.8	103.7	30.1	20.9	17.0
P/BV (x)	2.1	2.3	1.8	1.7	1.6
Net dividend yield (%)	1.2	0.7	1.8	2.1	2.1
ROAE (%)	5.6	2.4	6.0	8.3	9.7
ROAA (%)	2.2	0.8	2.1	3.0	3.6
EV/EBITDA (x)	10.8	13.1	9.4	8.2	7.4
Net gearing (%) (incl perps)	67.8	67.1	65.1	59.6	54.0
Consensus net profit	-	-	116	150	169
MKE vs. Consensus (%)	-	-	12.1	24.4	36.3

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# BUY

Share Price	MYR 0.88
12m Price Target	MYR 1.01 (+17%)
Previous Price Target	MYR 1.01

### Company Description

KPJ Healthcare is the largest private hospital operator in Malaysia by number of hospitals.

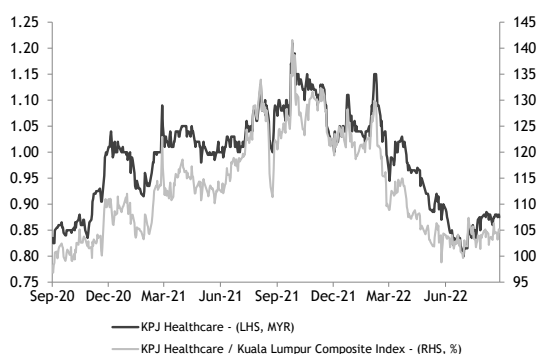
### Statistics

52w high/low (MYR)	1.21/0.80
3m avg turnover (USDm)	0.3
Free float (%)	31.6
Issued shares (m)	4,506
Market capitalisation	MYR3.9B USD879M

### Major shareholders:

Johor Corp.	43.6%
Employees Provident Fund	12.0%
Kumpulan Waqaf An Nur Bhd.	6.8%

### Price Performance



	-1M	-3M	-12M
Absolute (%)	3	(2)	(19)
Relative to index (%)	3	2	(14)

Source: FactSet

### Abbreviation:

BOR = Bed occupancy rate

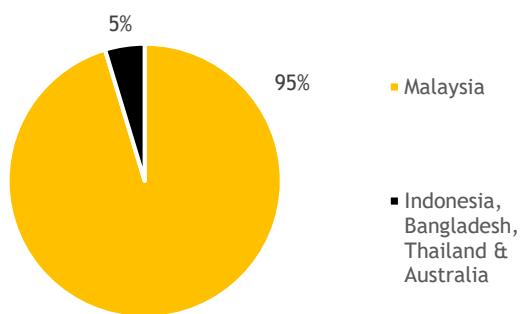
ACC = Ambulatory Care Center

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 Tear Sheet Insert

## Value Proposition

- KPJ is the largest private hospital operator in Malaysia with 28 hospitals and over 3300 beds. Through its broad reach in mature areas, KPJ has managed to capture the highest market share in combined outpatient and inpatient volume.
- Has long-term structural support i.e. aging population, growing insurance penetration, and rising group of affluent population demanding premium healthcare services.
- KPJ Lablinks is its initiative to pursue telemedicine and digital healthcare services.
- A pure play for Malaysian private healthcare sector as >90% revenues are derived from its local ops. Will likely stand to benefit from lifting of travel restrictions in Malaysia.

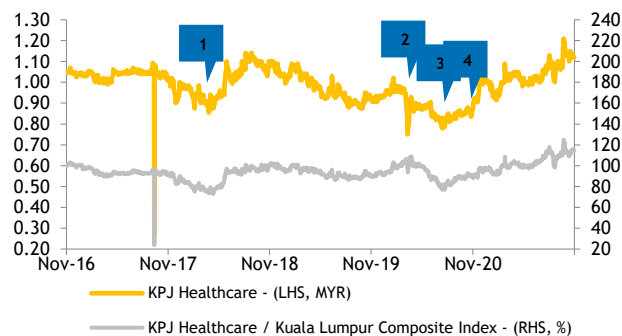
### Revenue by geography - FY21



Source: Company

## Price Drivers

### Historical share price trend



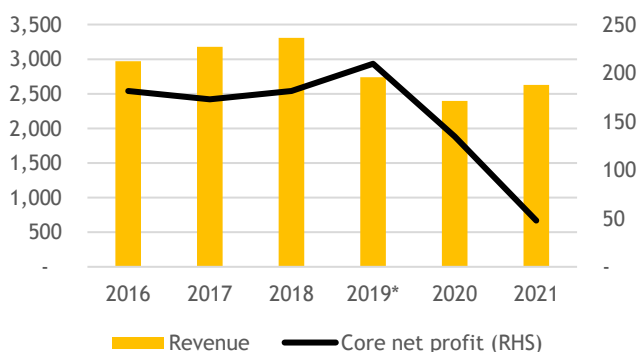
Source: Company, Maybank Kim Eng

1. Sale of 49% stake of Lablink (M) Sdn Bhd for RM120mil.
2. Nationwide lockdown imposed due to Covid-19 pandemic, impacting mobility of the population.
3. Disposed 80% stake in an Indonesian company that owns a hospital in Jakarta for RM28mil.
4. Better operational metrics seen as KPJ benefited from the partial lifting of lockdown measures in 3Q20.

## Financial Metrics

- Barring the impact from the pandemic, the company has recorded steady revenue and net profit growth over the last few years.
- Operating margins lagged regional healthcare players such as IHH Healthcare as KPJ also focuses on the broader market through its outpatient segment. The outpatient market is a high-volume, low-ticket size segment, and has lower margins vs the inpatient segment.

### Revenue and core profit trend (MYRm)



Source: Company

\*Revenue is stated net of consultant fees since 2019

## Swing Factors

### Upside

- Stronger-than-expected BOR recovery as travel restrictions ease.
- Sustained higher revenue intensity heading towards post-pandemic, even as mix of non-critical treatments increases.
- Material and sustainable cost cutting initiatives under the direction of new MD.

### Downside

- Prolonged lockdown and travel restriction measures, weakening the recovery in patient volumes.
- Gestation period of new hospitals takes longer than expected to achieve EBITDA-breakeven, dragging margins.
- Rising competition from other private hospital operators.

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Risk Rating & Score <sup>1</sup>	Medium & 23.0
Score Momentum <sup>2</sup>	+2.1
Last Updated	31 Mar 2022
Controversy Score <sup>3</sup> (Updated: 1 Jan 2000)	0

## Business Model & Industry Issues

- Being one of the largest private hospital operators in Malaysia, KPJ Healthcare adheres to strict regulations and guidelines to ensure deliverance of high-quality healthcare services while not compromising on sustainability practices.
- The Group’s sustainability initiatives and impacts are aligned with 15 UN Sustainable Development Goals (UNSDGs) since 2018.
- The group practices strong governance controls and internal measures. It also set targets to achieve a certain amount of water and electricity consumption while reducing waste. It has also launched initiatives to provide basic healthcare services to the underserved communities.
- Disclosures on its ESG practices are relatively better compared to its peers - it has been publishing its Sustainability Report in accordance with the GRI Standards Core option and is closely guided by Bursa Malaysia’s Sustainability Reporting Guide.
- KPJ is a constituent of the Bursa Malaysia FTSE4GOOD index.

### Material E issues

- Achieved some of the targets in emission and consumption reductions set for FY21.
- The group recorded 4% lower greenhouse gas (GHG) emissions in FY21 due to reduced operating hours during the pandemic.
- Achieved water management target of 99m3 usage per employee in 2021 (+3% yoy) compared to target of not more than 111m3, and electricity consumption of 23.6kWh per sq ft (+6% yoy) compared to target of not more than 27.69kWh.
- Average clinical waste generated per patient dropped by 13% to 0.48kg and met the target of not more than 0.5kg per patient.
- Has implemented policies to achieve long term targets on waste, water and energy management.

### Material S issues

- 78% of total employees are female in 2021. However, 60% of senior and top management staff are male. Further, 77% of total staff are bumiputera.
- Scored 86 in Net Promoter Score for patient loyalty in 2022 vs 75 in 2020. Customer Satisfaction Index (CSI) improved to 92.3% in 2021 vs 90.1% in 2020. Both were highest to-date.
- Managed admissions and treatments of patients referred by MOH to ease public healthcare burden during pandemic.
- Spent RM9.2mil on community outreach programmes and initiatives in FY21.
- Committed to serve the underserved segment e.g. served more than 44,000 patients, mainly for underprivileged and B40 groups, through 17 KWAN (Klinik Wakaf An-Nur) clinics and mobile clinics during the pandemic.

### Key G metrics and issues

- Board member comprised of 12 members - of this, 50% of the board members are Independent Non-Executive Directors (INEDs), while 92% are male.
- 92% of the board members have served with tenure of 3 years and below.
- The risk and governance committees are made up of 5 board members each. The audit committee is made up of 4, while the remuneration committee is made up of 6.
- The group plans to add one more Independent Director to broaden the professional level of its BOD, while also working to increase composition of female directors for a more gender-diverse representation.
- The remuneration of the MD, Ahmad Shahizam Mohd Shariff in FY21 was RM1.72m, representing 3.6% of the group core net profit in FY21.
- Ernst & Young was appointed as the auditor for FY20-21, following the appointment of PricewaterhouseCooper as the group’s auditor from FY15 to FY19.
- The group expects all its vendors, contractors, suppliers and other related third parties of the group to sign and comply with KPJ’s Corporate Integrity Agreement (CIA) declaration. As at end-2020, over 9,500 parties have signed the CIA.
- A recent related party transaction (RPT) is the downward rental revision on Jeta Gardens Retirement Village (JGRV) for a period of 1+4 years in 2021-26. This was due to an asset revaluation exercise undertaken to be in-line with market dynamics and comparable entities. JGRV is 57% owned by KPJ and 22% owned by JCorp.

<sup>1</sup>**Risk Rating & Score** - derived by Sustainalytics and assesses the company’s exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company’s enterprise value, respectively, from ESG-driven financial impacts. <sup>2</sup>**Score Momentum** - indicates changes to the company’s score since the last update - a **negative** integer indicates a company’s improving risk score; a **positive** integer indicates a deterioration. <sup>3</sup>**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

**Fig 1: KPJ Healthcare's portfolio of hospitals**

No	Hospital	Location	Under Al-Aqar REIT's portfolio
1	KPJ Ampang Puteri Specialist Hospital	Ampang, Selangor	Yes
2	KPJ Damansara Specialist Hospital	Damansara, Selangor	Yes
3	KPJ Puteri Specialist Hospital	Johor Bahru, Johor	Yes
4	KPJ Selangor Specialist Hospital	Shah Alam, Selangor	Yes
5	KPJ Ipoh Specialist Hospital	Ipoh, Perak	Yes
6	KPJ Perdana Specialist Hospital	Kota Bahru, Kelantan	Yes
7	KPJ Sentosa KL Specialist Hospital	Kuala Lumpur	Yes
8	KPJ Kajang Specialist Hospital	Kajang, Selangor	Yes
9	KPJ Penang Specialist Hospital	Seberang Perai, Pulau Pinang	Yes
10	KPJ Tawakkal KL Specialist Hospital	Kuala Lumpur	Yes
11	KPJ Seremban Specialist Hospital	Seremban, Negeri Sembilan	Yes
12	KPJ Klang Specialist Hospital	Klang, Selangor	Yes
13	KPJ Batu Pahat Specialist Hospital	Batu Pahat, Johor	Yes
14	Kedah Medical Centre, Alor Setar	Alor Setar, Kedah	Yes
15	KPJ Kluang Specialist Hospital	Kluang, Johor	Yes
16	Taiping Medical Centre	Taiping, Perak	Yes
17	KPJ Pasir Gudang Specialist Hospital	Pasir Gudang, Johor	Yes
18	KPJ Bandar Dato' Onn Specialist Hospital	Johor Bahru, Johor	No
19	KPJ Bandar Maharani Specialist Hospital	Muar, Johor	No
20	KPJ Johor Specialist Hospital	Johor Bahru, Johor	No
21	KPJ Kuching Specialist Hospital	Kuching, Sarawak	No
22	KPJ Miri Specialist Hospital	Miri, Sarawak	No
23	KPJ Pahang Specialist Hospital	Kuantan, Pahang	No
24	KPJ Perlis Specialist Hospital	Kangar, Perlis	No
25	KPJ Rawang Specialist Hospital	Rawang, Selangor	No
26	KPJ Sabah Specialist Hospital	Kota Kinabalu, Sabah	No
27	KPJ Sibu Specialist Medical Centre	Sibu, Sarawak	No
28	KPJ Sri Manjung Specialist Centre	Sri Manjung, Perak	No
29	Jeta Gardens Aged Care and Retirement Village	Australia	Yes
30	Damai Care Wellness Centre	Kota Kinabalu, Sabah	Yes
31	Kuantan Care Wellness Centre	Kuantan, Pahang	Yes
32	Kinrara Ambulatory Care Center (ACC)	Kinrara, Selangor	No
33	KPJ Damansara Specialist Hospital II	Damansara, Selangor	No

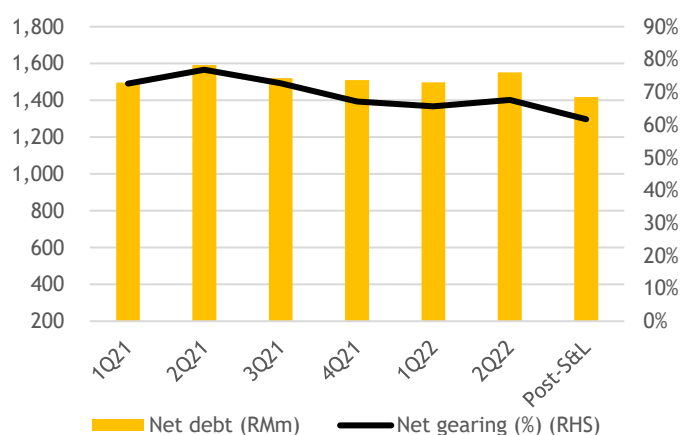
Source: Company

**Fig 2: Details on the assets to be disposed under the sale and leaseback agreement**

Hospital	KPJ Pasir Gudang Specialist	KPJ Penang Specialist	KPJ Seremban Specialist
Related properties to be disposed	Entire hospital and land	A new building erected on Al-Aqar's land	A new building erected on Al-Aqar's land
Tenure	99-year leasehold expiring on Dec-2108	Interest in perpetuity	99-year leasehold expiring on Jul-2088
Age of building	9.5 years	3.5 years	3.7 years
Gross floor area (sqft)	203,280	207,161	31,513
Occupancy rate	100%	100%	100%
Net book value @ Dec-21 (MYRm)	78.8	82.9	12.4
Market value @ Dec-21 (MYRm)	92.6	84.5	14.3
Original investment cost (MYRm)	80.3	84.6	12.4

Source: Company

**Fig 3: Bed occupancy rate (BOR) trend - Malaysia operations**



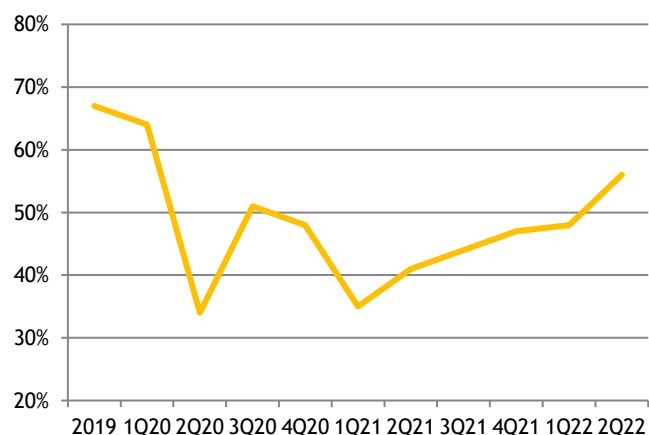
Source: Company, Maybank IBG Research

**Fig 4: Impact of sale and leaseback to the P&L**

Items	Value (MYRm)
Lower interest from repayment of borrowings	6.7
Higher distribution income from new Al-Aqar units	1.3
Lower depreciation expense from the disposed assets	3.2
Expenses to be borne by Al-Aqar upon lease commencement	1.3
Higher depreciation and interest charge from the lease	(14.0)
<b>Net impact to the pretax profit level</b>	<b>(1.4)</b>

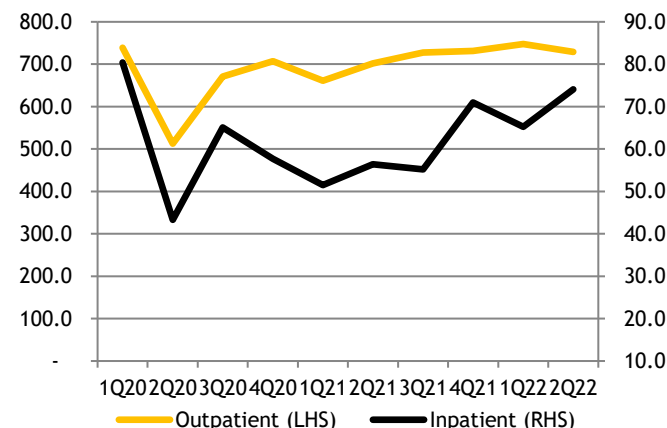
Source: Company

**Fig 5: Bed occupancy rate (BOR) trend - Malaysia operations**



Source: Company

**Fig 6: Patient volumes trend (in '000)**



Source: Company

**Fig 7: Sum of parts valuation**

Items	Value (RMm)	Method
Hospital operations	5,751	DCF (WACC: 7.98%, growth: 2.0%)
Al-Aqar Healthcare REIT	324	Market Value
Less: Net debt (MYRm)	1,507	End-FY22E
<b>Target equity value (MYRm)</b>	<b>4,569</b>	
Shares outstanding (mil)	4,506	
<b>Equity value per share (MYR)</b>	<b>1.01</b>	

Source: Maybank IBG Research

## Risk statement

There are several risks to our earnings estimates, target price and rating for KPJ. These include weaker-than-expected recovery in the patient volume, the inability to pass on cost escalation to customers, prolonged gestation period of the new hospitals, and rising competition from other private hospital operators

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Key Metrics</b>					
P/E (reported) (x)	34.6	91.1	30.1	20.9	17.0
Core P/E (x)	31.8	103.7	30.1	20.9	17.0
P/BV (x)	2.1	2.3	1.8	1.7	1.6
P/NTA (x)	2.4	2.6	2.0	1.9	1.7
Net dividend yield (%)	1.2	0.7	1.8	2.1	2.1
FCF yield (%)	2.9	3.9	6.3	7.9	7.7
EV/EBITDA (x)	10.8	13.1	9.4	8.2	7.4
EV/EBIT (x)	19.3	26.8	16.5	13.3	11.6

**INCOME STATEMENT (MYR m)**

Revenue	2,397.4	2,626.8	2,825.8	3,089.6	3,244.1
EBITDA	546.0	500.3	587.8	667.4	729.9
Depreciation	(223.3)	(243.8)	(240.0)	(244.6)	(248.9)
Amortisation	(15.4)	(11.5)	(11.5)	(11.5)	(11.5)
EBIT	307.3	245.0	336.3	411.3	469.5
Net interest income / (exp)	(149.3)	(158.6)	(170.2)	(169.5)	(168.3)
Associates & JV	16.9	25.9	26.6	27.4	28.3
Exceptionals	(24.1)	3.3	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	150.8	115.6	192.7	269.2	329.5
Income tax	(40.0)	(49.9)	(55.9)	(75.4)	(92.3)
Minorities	(0.4)	(14.6)	(7.0)	(7.0)	(7.0)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	110.4	51.0	129.8	186.8	230.2
Core net profit	134.5	47.7	129.8	186.8	230.2

**BALANCE SHEET (MYR m)**

Cash & Short Term Investments	462.2	318.0	321.9	381.1	431.7
Accounts receivable	446.9	481.4	517.8	566.2	594.5
Inventory	52.1	53.8	56.6	61.2	63.6
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	3,914.8	3,825.5	3,835.6	3,841.0	3,892.1
Intangible assets	235.8	220.0	213.5	207.0	200.5
Investment in Associates & JVs	450.8	437.1	463.7	491.1	519.4
Other assets	578.9	851.9	851.9	851.9	851.9
<b>Total assets</b>	<b>6,141.4</b>	<b>6,187.6</b>	<b>6,261.0</b>	<b>6,399.5</b>	<b>6,553.6</b>
ST interest bearing debt	505.8	860.5	860.5	860.5	860.5
Accounts payable	605.1	618.3	626.1	651.1	648.3
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	1,449.2	968.0	968.0	968.0	968.0
Other liabilities	1,379.0	1,490.0	1,490.0	1,490.0	1,490.0
<b>Total Liabilities</b>	<b>3,939.2</b>	<b>3,937.1</b>	<b>3,945.0</b>	<b>3,970.0</b>	<b>3,967.2</b>
Shareholders Equity	2,050.1	2,135.4	2,193.9	2,300.4	2,450.4
Minority Interest	152.1	115.1	122.1	129.1	136.1
<b>Total shareholder equity</b>	<b>2,202.2</b>	<b>2,250.5</b>	<b>2,316.0</b>	<b>2,429.5</b>	<b>2,586.4</b>
<b>Total liabilities and equity</b>	<b>6,141.4</b>	<b>6,187.6</b>	<b>6,261.0</b>	<b>6,399.5</b>	<b>6,553.6</b>

**CASH FLOW (MYR m)**

Pretax profit	150.8	115.6	192.7	269.2	329.5
Depreciation & amortisation	238.8	255.3	251.5	256.1	260.4
Adj net interest (income)/exp	149.3	158.6	170.2	169.5	168.3
Change in working capital	(149.5)	(46.8)	(31.4)	(28.0)	(33.5)
Cash taxes paid	(59.4)	(58.9)	(55.9)	(75.4)	(92.3)
Other operating cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	336.7	412.2	500.5	564.0	604.2
Capex	(240.5)	(216.6)	(250.0)	(250.0)	(300.0)
Free cash flow	96.3	195.6	250.5	314.0	304.2
Dividends paid	(72.7)	(23.7)	(71.4)	(80.3)	(80.3)
Equity raised / (purchased)	2.6	42.9	0.0	0.0	0.0
Change in Debt	154.0	(150.4)	0.0	0.0	0.0
Other invest/financing cash flow	(230.4)	(8.2)	(175.2)	(174.5)	(173.3)
Effect of exch rate changes	(3.1)	(1.2)	0.0	0.0	0.0
<b>Net cash flow</b>	<b>(53.3)</b>	<b>55.0</b>	<b>3.9</b>	<b>59.2</b>	<b>50.6</b>

FYE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	(12.4)	9.6	7.6	9.3	5.0
EBITDA growth	(8.2)	(8.4)	17.5	13.5	9.4
EBIT growth	(18.0)	(20.3)	37.2	22.3	14.2
Pretax growth	(45.2)	(23.3)	66.7	39.7	22.4
Reported net profit growth	(47.7)	(53.8)	154.4	43.9	23.2
Core net profit growth	(35.8)	(64.5)	172.0	43.9	23.2
<b>Profitability ratios (%)</b>					
EBITDA margin	22.8	19.0	20.8	21.6	22.5
EBIT margin	12.8	9.3	11.9	13.3	14.5
Pretax profit margin	6.3	4.4	6.8	8.7	10.2
Payout ratio	46.5	65.6	55.0	43.0	34.9
<b>DuPont analysis</b>					
Net profit margin (%)	4.6	1.9	4.6	6.0	7.1
Revenue/Assets (x)	0.4	0.4	0.5	0.5	0.5
Assets/Equity (x)	3.0	2.9	2.9	2.8	2.7
ROAE (%)	5.6	2.4	6.0	8.3	9.7
ROAA (%)	2.2	0.8	2.1	3.0	3.6
<b>Liquidity &amp; Efficiency</b>					
Cash conversion cycle	(48.7)	(31.0)	(27.6)	(23.0)	(19.7)
Days receivable outstanding	74.8	63.6	63.7	63.2	64.4
Days inventory outstanding	10.3	9.0	8.9	8.8	8.9
Days payables outstanding	133.7	103.5	100.1	94.9	93.0
Dividend cover (x)	2.2	1.5	1.8	2.3	2.9
Current ratio (x)	0.9	0.6	0.6	0.7	0.7
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	1.6	1.6	1.6	1.6	1.7
Net gearing (%) (incl perps)	67.8	67.1	65.1	59.6	54.0
Net gearing (%) (excl. perps)	67.8	67.1	65.1	59.6	54.0
Net interest cover (x)	2.1	1.5	2.0	2.4	2.8
Debt/EBITDA (x)	3.6	3.7	3.1	2.7	2.5
Capex/revenue (%)	10.0	8.2	8.8	8.1	9.2
Net debt/ (net cash)	1,492.8	1,510.5	1,506.5	1,447.4	1,396.7

Source: Company; Maybank IBG Research

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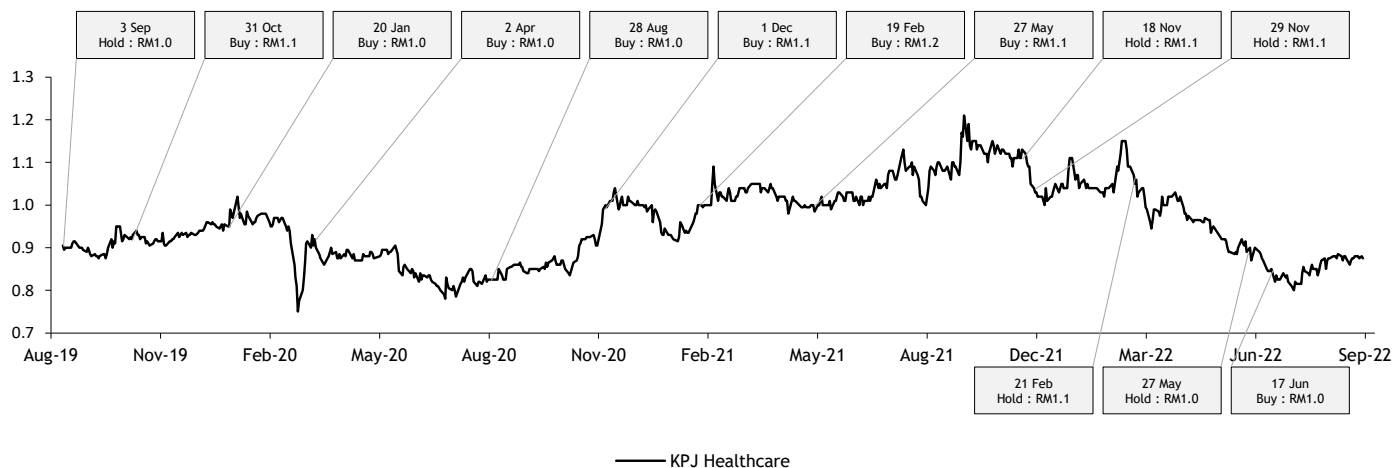
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