SECTOR UPDATE

Healthcare – Malaysia

Compelling Catalysts Few And Far Between

Maintain MARKET WEIGHT as prospects do not appear especially compelling aside from palatable valuations. But we like KPJ as our top pick for the sector for its efforts to divest of its long-standing loss-making regional operations coupled with mainstay operations turning for the better. Aside from longing for government pharmaceutical contract terms to be revised, possible revisions to healthcare allocations under the new Budget are unlikely to shift investor sentiment significantly.

WHAT'S NEW

- **Healthcare allocation under new Budget to be largely intact?** In the Budget 2023 that was tabled in Oct 22, the then-government allocated RM36.1b to the Ministry of Health from RM32.4b in 2022. The public sector allocation for 2022 represents 2.6% of gross GDP. However, it is below the average of 4% for middle-income countries and 5-6% below the recommendation by the World Health Organization (WHO). Based on this, we largely expect the healthcare allocation for public sector to be largely intact under the upcoming Budget 2023 due on 24 February.

- **Funding to MHTC should benefit the likes of KPJ and IHH, China's reopening insignificant to medical tourism.** Apart from that, the previous budget allocated RM20m to the Malaysia Healthcare Travel Council to strengthen Malaysia's position as a destination of choice for health tourists. Malaysia offers a combination of high-quality yet relatively low-cost healthcare for health-conscious travellers. Empowering Malaysia Healthcare Travel Council (MHTC) will have a multiplier effect on private healthcare providers in Malaysia. At this juncture, foreign medical patients contribute close to 10% and 15% of KPJ Healthcare's (KPJ) and IHH Healthcare's (IHH) inpatient volume respectively. However, we note the reopening of China borders is not significant with China medical tourists accounting for less than 5% of foreign medical patients.

- **Hopefully a tender for pharmaceutical contracts with revised terms.** With an enlarged budget, pharmaceutical companies would be hoping for a retender on consumables supplied to the government. We gather that terms to existing approved products purchase list (APPL) contracts were last determined in 2017 when the ringgit ex-rate with the US$ was at 4.20 and has not been adjusted for inflationary cost as well.

ACTION

- **Maintain MARKET WEIGHT but near-term tactical OVERWEIGHT.** 2023's growth will be underpinned by further recovery in patient volume amid minimal COVID-19-related contributions (more so for IHH). Given KPJ's positive operating leverage, its earnings should grow 28.5% in 2023. This is the primary lift to sector earnings growth by 11.3% yoy. Meanwhile, hospital valuations are trading at -1.0SD to the five-year PE mean. These fundamentals underline a tactical OVERWEIGHT in 1H23, in line with UOBKH's broad market strategy to remain defensive. But as risk appetite improves beyond that, the sector recommendation reverts to a MARKET WEIGHT. Top picks for the sector include KPJ and Duopharma. We like KPJ for its intention to divest its loss-making regional operations, paving the way for improved earnings visibility and Duopharma: a) as there are no more further COVID-19 vaccine inventory writedowns, and b) for its potential approval of its associate's drug.

MARKET WEIGHT

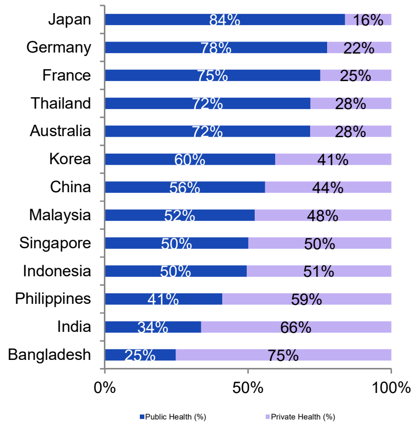
(Maintained)

SECTOR PICKS

Company	Rec	Share Price (RM)	Target Price (RM)
KPJ	BUY	0.99	1.23
Duopharma	BUY	1.65	2.05
IHH	BUY	5.97	7.10

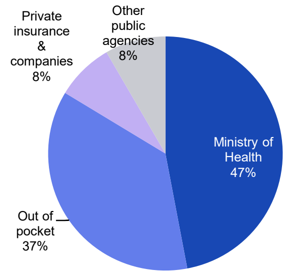
Source: UOB Kay Hian

PUBLIC VERSUS PRIVATE HEALTHCARE EXPENDITURE (2019)



Source: World Health Organisation (WHO)

SOURCES OF FUNDING FOR MALAYSIA HEALTHCARE EXPENDITURE (2019)



Source: Ministry of Health (MoH)

ANALYST(S)

Philip Wong
+603 2147 1996
philipwong@uobkayhian.com

PEER COMPARISON

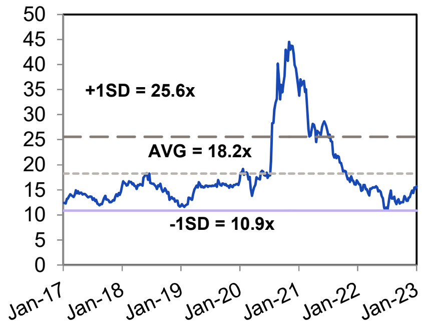
Name	Ticker	Rec	Currency	Price @ 16 Jan 23 (lcl)	Target Price (lcl)	Mkt Cap (US$m)	-------- PE (x) -------- 2023F	2024F	--- EV/EBITDA (x) --- 2023F	2024F	Div Yield (%) 2023F	P/B (x) 2023F
BKK. Dusit	BDMS TB	HOLD	THB	30.00	30.50	14585	39.1	37.6	21.7	21.0	1.8	5.2
IHH Healthcare	IHH MK	BUY	RM	5.97	7.10	12168	31.5	29.0	14.2	13.9	0.7	2.1
Bumrungrad Hosp	BH TB	HOLD	THB	213	205.00	5185	39.0	36.9	23.0	21.8	1.5	7.9
Raffles Medical	RFMD SP	BUY	SGD	1.37	1.58	1923	21.0	22.6	11.4	12.2	1.8	2.3
BKK. Chain Hosp.	BCH TB	BUY	THB	21.50	21.20	1627	28.5	27.8	14.9	14.6	1.8	4.1
KPJ Healthcare	KPJ MK	BUY	RM	0.99	1.23	1012	27.8	24.5	8.9	8.2	1.6	1.9
Regional hospitals avg						6083	31.1	29.7	15.7	15.3	1.5	3.9
APEX Healthcare	APEX MK	NR	RM	3.47	n.a.	20.2	19.1	16.3	15.9	1.7	2.7	2.3
Duopharma	DBB MK	BUY	RM	1.65	2.05	16.0	14.5	9.6	8.9	2.0	2.1	3.1
Pharmaniaga	PHRM MK	NR	RM	0.53	n.a.	10.6	9.1	10.6	10.0	6.6	1.4	2.6
Malaysia pharma avg						303	15.6	14.3	12.1	11.6	3.4	2.1

Source: Bloomberg, UOB Kay Hian

ESSENTIALS

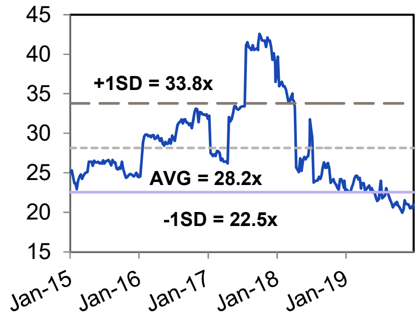
- **KPJ: Divesting of loss-making regional operations.** KPJ is looking to divest of its regional operations. This includes its hospital in Indonesia and an assisted living centre in Australia. On a 9M22 cumulative basis, these two regional operations' losses amounted to RM20.6m. Pre-pandemic, these regional operations were similarly loss-making, accounting for 8% of 2019's earnings. Management hopes to complete the divestment this year. It could be a catalyst for KPJ, allowing for better earnings visibility, should the divestment efforts prove successful.
- **KPJ: DSH 2 expected to break even sooner than expected.** The launch of Damansara Specialist Hospital 2 (DSH2) is expected to achieve EBITDA breakeven by the end of the year and turn earnings accretive in 2025. This is sooner than the usual 2-3 years for EBITDA to break even. Among the host of measures employed to accelerate the gestation are employment of sessional consultants, decanter patients from the public sector and targeting a high foreign medical patient mix. However, over the upcoming quarter, DSH 2 could weigh on earnings as it ramps up realises front-loaded start-up cost. The completion of DSH2 also signifies the end of greenfield hospital expansions for KPJ. This could be an inflection point to significantly improve margins vis-à-vis pre-pandemic levels going forward as KPJ realises its positive operating leverage.
- **Duopharma on the up.** Duopharma's insulin contract with the government faced supply issues in 2022. We expect improved fulfilment of this contract heading into 2023 with the resumption of global supply chain. The contract is worth RM125m p.a. or 15% of 2023's revenue. It is among the key primary growth drivers for Duopharma's 2023 earnings following the easing of Duopharma's consumer healthcare sales that were previously fuelled by the pandemic. Aside from that, Duopharma has fully written down on its COVID-19 vaccine inventory in 2022. While the losses are one-off in nature, this could be an additional lift to sentiment. Lastly, the ringgit has strengthened against the US dollar to 4.34 (from a low of USD4.74/MYR). It would alleviate concerns over a potential margin compression. Based on our estimates, for every +1% in the USD/MYR forex, Duopharma's 2023's earnings are impacted by -0.3%.
- **Duopharma's Alzheimer shot in the arm?** Duopharma has a 1.3% stake in AZTherapies (AZT), a private late-stage clinical biopharmaceutical company based in Boston that focuses on treatment of neurodegenerative diseases. It provides Duopharma access to marketing and manufacturing rights to AZT's novel product for Alzheimer's disease. Duopharma indicated that it hopes to gain these rights for the ASEAN region. In terms of drug developmental progress, AZT had completed its Phase 3 trial in Dec 20 and is undergoing a bridging study with the US Food and Drug Administration (FDA). The completion timeline is expected for 2023.
- **KPJ Healthcare (KPJ MK/BUY/Target: RM1.23).** Our target price is based on 10.5x EV/EBITDA, a 30% discount to regional peers', and implies 32.6x 2023F PE. We are encouraged over KPJ's reorganisation of its loss-making regional operations, paving the way for improved earnings visibility. In addition, KPJ completed its greenfield operations, allowing for a healthier balance sheet and realisation of its positive operating leverage. KPJ's valuations are also undemanding.
- **Duopharma Biotech (DBB MK/BUY/Target: RM2.05).** While sentiment over Duopharma's vaccine beneficiary role has swung back and forth, its primary operations have chugged along quietly but masterly. We expect Duopharma to gradually re-rate and appreciate for its consistent execution once vaccine-related expectations, noise and sentiment diminish. Our target price is pegged to 19.7x 2023F PE, or its five-year average PE mean.
- **IHH Healthcare (IHH MK/BUY/Target: RM7.10).** Valuations appear decent with: a) resilient yet defensive three-year earnings (2021-24) CAGR of 4.2%, and b) IHH's sound track record. IHH's attractive valuations and decent earnings growth outweigh the hyper-inflationary risks associated with Acibadem. Our SOTP-based target price implies 37.4x 2023F PE, or close to its -1SD of its five-year mean PE.

DUOPHARMA: FIVE-YEAR PE BAND



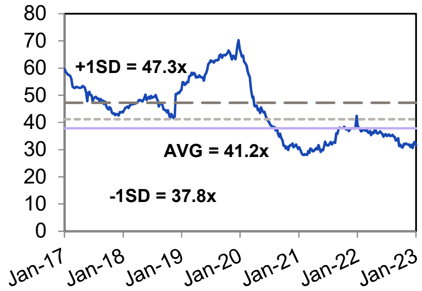
Source: Bloomberg, UOB Kay Hian

KPJ: HISTORICAL PE BAND (PRE-PANDEMIC)



Source: Bloomberg, UOB Kay Hian

IHH: FIVE-YEAR PE BAND



Source: Bloomberg, UOB Kay Hian

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