Al Hammadi Company For Development and Investment

Healthcare – Industrial

ALHAMMAD AB: Saudi Arabia

23 August 2022

Al Rajhi Capital

الراجحي المالية

US$1.745bn	44%	US$4.379mn
Market cap	Free float	Avg. daily volume

Target price	46.00	+12.2% over current
Current price	41.00	as at 23/8/2022

Research Department

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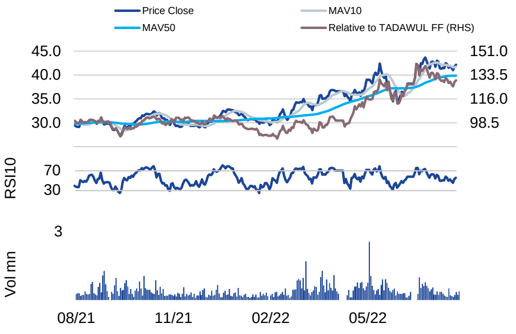
Existing rating

Underweight | Neutral | **Overweight**

Performance



Source: Bloomberg

Earnings

(SARmn)	2021A	2022E	2023E
Revenue	952	1,110	1,168
Revenue growth	25%	17%	5%
Gross profit	364	429	449
Gross margin	38%	39%	38%
Operating profit	125	299	319
Op. margins	13%	27%	27%
Net profit	90	250	256
Net margin	9%	22%	22%
EPS	0.56	1.56	1.60
DPS	0.45	0.94	0.96
Payout ratio	80%	60%	60%
EV/EBITDA	24.2x	15.8x	14.7x
P/E	63.3x	26.3x	25.7x
RoE	5.4%	14.6%	14.1%

Source: Company data, Al Rajhi Capital

Al Hammadi Hospitals

Upgrade to Overweight, target price SAR 46/share

The strong Q2 2022 results mark the second consecutive quarter of a positive surprise. In H1 2022, the revenues have increased 18%, while operating profit has gone up 132%, the latter driven by a sharp reduction in the provisions for credit losses. There are three fundamental catalysts that we believe would continue to drive the operating performance, one is the decision to take large provisions (almost SAR 155 mn) in 2021 to settle the issue of doubtful accounts, mainly related to the government receivables. We believe the cleaning up of receivables is largely done and it removes the uncertainty and volatility related to forecasting the provisions for credit losses. We estimate the provisions to normalize and average between 3.0-3.5% of the sales (in 2021 it was 16%) going forward. The second catalyst is the sharp improvement in the utilization level for its Suwaidi hospital, which was a laggard in recent years and was a drag on the operating margins. This along with the price hike taken by the hospital for its insurance clientele would address the near-term concern of growth until the revamp at the Olaya hospital is completed. We believe the topline to grow by an average of 8.0% (including 17% growth in 2022e) between 2021-2025e while operating profit to grow by about 31% on average (including the spike of 139% in 2022e). As we make significant changes to our 2022e as well as years beyond it, we notably raise our target price to SAR 46/share from SAR 33/share. Our new target price offers an upside of 12%, implying an overweight rating on the stock.

Recap of Q2 2022 results

- Al Hammadi's revenues of SAR 282 mn grew by 26% y-o-y, 12% q-o-q, and was 24% above our estimates. The growth in revenue was impressive, considering that the performance was better than even Q1 2022, which is traditionally a strong quarter. The growth in revenue was aided by a strong performance from the Nuzha and Suwaidi branch hospitals.
- Gross profits grew by 36% y-o-y, and 14% q-o-q, as gross margins improved to 38.7% in Q2 2022 (38.3% in Q1 2022 and 35.7% in Q2 2021). Overall net income grew by 61.5% y-o-y, and 5.1% q-o-q, and was aided by higher revenue, improvement in gross margins, and lower provision for credit losses (y-o-y). The net income was better than our estimates by 30% and was aided by higher-than-expected revenue, even as gross and operating margins were broadly in line with our expectations.
- On the back of its strong results, the company has proposed a dividend payout of at least 60% for the next three years.

Figure 1 Al Hammadi Q2 2022 results

(SAR mn)	Q2 2022	Q1 2022	Q2 2021	*ARC Est.*	*Cons Est.*	*y-o-y*	*q-o-q*	*vs ARC*	*vs Cons*
Revenue	282	251	224	227	238	*25.9%*	*12.4%*	*23.9%*	*18.6%*
Gross Profit	109	96	80	89		*36.4%*	*13.5%*	*23.0%*	
G. margin	*38.7%*	*38.3%*	*35.7%*	*39.0%*					
Op. profit	74	70	37	61		*99.2%*	*5.4%*	*22.0%*	
Op. margin	*26.2%*	*27.9%*	*16.6%*	*26.6%*					
Net profit	65	62	40	50	55	*61.5%*	*5.1%*	*29.9%*	*18.6%*
Net margin	*23.1%*	*24.7%*	*18.0%*	*22.0%*	*23.1%*				

Source: Company data, Al Rajhi Capital

Valuation: We apply a blended approach to value Hammadi with equal weight to both DCF and relative valuation, which yields a target price of SAR 46/share. Our DCF-derived value for the stock is SAR 43 per share. The key inputs for the DCF are a sharp jump in FCF in 2023e to SAR 204m from about SAR 38 m in 2022e and thereafter a CAGR growth of 15% between 2023e-2031e (including a contribution from the Olaya hospital from 2026). We assume a terminal growth of 2.5% and a WACC of 8.3%. Our relative valuation yields SAR 48/share as the value for the stock. Our RV is based on a forward P/E of 30x (over 10% premium to its historical average of 27x) applied to 2023e EPS of SAR 1.6/share.

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

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