Al Hammadi Co.

Healthcare-Industrial
ALHAMMAD AB: Saudi Arabia
5 March 2023

US$2.114bn	66.15%	US$3.62mn
Market Cap	Free Float	Avg. Daily Volume

Target price	55.00	11% above current
Current price	49.50	as at 05/03/2023

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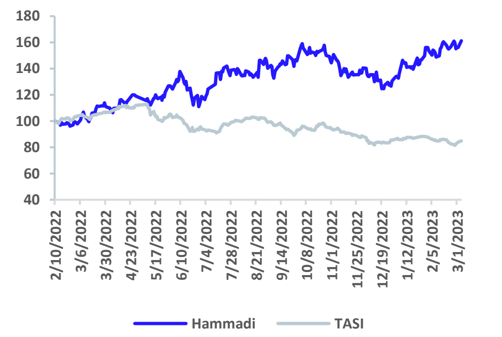
Existing rating

Underweight	Neutral	**Overweight**

Performance



Earnings

(SARmn)	2022A	2023E	2024E
Revenue	1,122	1,223	1,298
Revenue growth	17.9%	9.0%	6.1%
Gross profit	416	451	483
Gross margin	37.1%	36.9%	37.2%
Operating profit	292	320	346
Op. margins	26.0%	26.1%	26.6%
Net profit	257	290	306
Net margin	22.9%	23.7%	23.6%
EPS	1.61	1.81	1.91
DPS	1.45	1.27	1.43
Payout ratio	90.2%	70.0%	75.0%
P/E	30.7x	27.2x	25.8x
RoE	15.4%	16.8%	16.9%

Source: Company data, Al Rajhi Capital.

Al Hammadi Hospitals

Target price raised to SAR55/share

Hammadi is one of the most efficiently run hospitals with an estimated average length of stay below 3.0 days (ex- MoH patients). After a phase of weak profitability (2016-2021), the company has restructured itself through taking necessary provisions in 2021 to clean up its pending receivables, and deciding to renovate the Olaya hospital, that was struggling with operational issues. With net profit margins of over 22% and ROE's expected to improve over 16%, we believe the company offers one of the best profitability metrics in the industry. The demand for healthcare services is very strong in the country led by rising employment (mandatory insurance) and influx of expats as evident by the sharp rise in insured lives (more than 1.0 m insured lives added in 2022). We believe bulk of the rise in insured lives is in the class B segment, which is the target market for Hammadi. Although, the top line growth of the company would be limited to mid to high single digit for the next three years due to limited capacity increase, from a medium-term perspective, the company is well placed to benefit from the growing demand for healthcare. Once the Olaya hospital is ready in 2026e (ramp up should be quicker than other hospitals), we would be witnessing a phase of average 16% topline growth between 2026-2028e. Another medium term catalyst would be the plan to open new hospital in Narjes, for which the company has already bought a land. We are not pricing in the benefits yet as we await details on the timeline. On a trailing P/E, the stock trades at 31x and on our 2023e estimates, the multiple is 27x, below its historical blended forward P/E multiple of around 30x. In our view, given the strong results in 2022e, improving ROE levels, and strong medium-term prospects, we believe the stock should trade at a premium to its historical level. We raise our estimates as well as our target price to SAR 55/share from SAR 46/share and maintain our Overweight recommendation.

Q4 2022 results: Solid topline: Revenues of SAR 343 m (+22% y-o-y) were ahead of our estimates of SAR 300 m, mainly led by sharp growth in the pharma business. Even the hospital revenues were slightly ahead of our estimates. However, gross profits, GP, of SAR 127 m (+17% y-o-y) were just 9% above our estimates compared to 14% beat in topline as margins were on the weaker side mainly due to the mix impact (higher pharma revenues). Operating profits and net profits of SAR 82 m and SAR 73 m, were only modestly ahead of our estimates due to weaker gross margins. Hammadi announced dividends of SAR 0.35/share for Q1 2023. For full year 2022, the company paid SAR 1.45/share, implying dividend yield of 3.0%. The company has committed to pay at least 60% of its net profits per quarter for the next three years.

Figure 1 **Q4 2022 Results**

(SAR mn)	Q4 2022	Q3 2022	Q4 2021	*ARC Est.*	*Cons Est.*	*y-o-y*	*q-o-q*	*vs ARC*	*vs Cons*
Revenue	343	247	282	300	300	*21.59%*	*38.8%*	*14.27%*	*14.21%*
Gross Profit	127	83	109	117		*17.34%*	*52.5%*	*9.19%*	
G. margin	*37.17%*	*33.82%*	*38.51%*	*38.90%*					
Op. profit	82	66	17	80		*380.91%*	*23.3%*	*1.75%*	
Op. margin	*23.82%*	*26.81%*	*6.02%*	*26.75%*					
Net profit	73	57	11	71	65	*585.75%*	*28.1%*	*3.45%*	*11.74%*
Net margin	*21.35%*	*23.13%*	*3.79%*	*23.59%*	*21.83%*				

Source: Company data, Al Rajhi Capital

2023e estimates:

The company's topline growth in FY 2022 (+18% y-o-y) benefitted from price hikes in the hospital segment as well as pick up in pharma business (+18%). In the hospital segment, in addition to price increases, higher patient inflows at Suweidi and Nuzha aided the company. Going forward, better utilization levels at Suweidi, that still has the potential to grow inpatient volumes, should support hospital revenues. Moreover, focus on improving efficiency at the Nuzha, that operates at pretty high utilization levels (over 80% for the year), should support further increase in utilization as well as margins. We estimate a revenue growth of 9% in 2023e, however, in terms of margins, we estimate largely similar gross margin levels for 2023e as rising contribution from Pharma business (relatively low margin business) would offset margin gains from efficiency.

Valuations:

We apply a blended approach to value Hammadi with higher weight to relative valuation (60%) and 40% to DCF given that the current WACC (assumed 9.0% from 8.3% before) is at the peak level and might not represent the interest rates in the future years (years beyond 2024e). Our relative value based on a forward P/E of 32x (premium to its historical average of 30x) applied to one year blended forward EPS of SAR 1.8/share (average of 2023e/2024e, yields a fair value of SAR 59/share. Our DCF derived fair value is around SAR 49/share (WACC of 9.0%, terminal growth of 4.0%, FCF of 19% CAGR during 2023-2023e). The reason for higher terminal growth is the improving prospects for the healthcare sector led by insurance and growing awareness about the services offered by the private hospitals. In our view, efficiently run hospitals like Hammadi are at the forefront of benefitting from the growing demand. Moreover, we have not priced in the benefits of its planned hospital in the Narjes area as we await details around the timeline, thus higher terminal growth rate is warranted.

Our fair value derived through the blended methodology is SAR 55/share, that offers an upside of 11% from the current levels. We maintain our Overweight recommendation on the stock.

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