Dallah Healthcare Co
Medical – Industrial
DALLAH AB: Saudi Arabia
09 November 2022

الراجحي المالية
Al Rajhi Capital

US$3.758bn	37%	US$6.433mn
Market cap	Free float	Avg. daily volume

Target price	119.00	-24% over current
Current price	157.00	as at 08/11/2022

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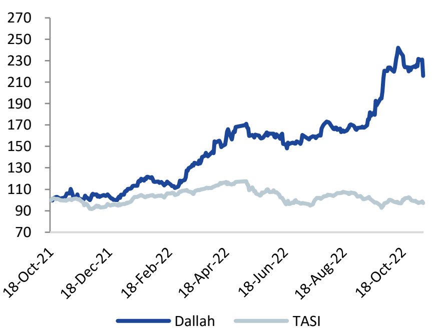
Existing rating

Underweight | **Neutral** | **Overweight**

Performance



Earnings

(SARmn)	2021A	2022E	2023E
Revenue	2,105	2,426	2,670
Revenue growth	60%	15%	10%
Gross profit	760	897	1,015
Gross margin	36%	37%	38%
Operating profit	328	388	459
Op. margins	16%	16%	17%
Net profit	259	280	332
Net margin	12%	12%	12%
Adj. net profit	248	280	332
EPS	2.87	2.99	3.40
Adj. EPS	2.76	2.99	3.40
DPS	1.50	1.49	1.70
Payout ratio	52%	50%	50%
EV/EBITDA	16.2x	30.4x	27.4x
P/E	23.1x	52.5x	46.2x
RoE	14.1%	12.2%	11.8%

Source: Company data, Al Rajhi Capital

Dallah Healthcare Co
Downgrade to Underweight

Dallah's net earnings in 2022 so far (9M) has grown by 31% y-o-y driven by pick up in utilization levels for its hospitals in Namar as well as Nakheel. The turnaround of the former, that was struggling to improve its utilization levels since its inception, has been the turning point for the company in terms of improving its profitability. Moreover, its Nakheel hospital, which is situated in the Northern part of Riyadh, has a strategic advantage in terms of location. Nakheel is the largest hospital with a bed capacity of over 500 and will continue to drive the earnings going forward. Regarding its Namar hospital, we believe return of expats, mainly the class B and C categories, is driving the demand for its hospital in the southern part of Riyadh. Also, we believe patients from MoH is driving the demand for its Namar hospital, implying better margins. We raise our estimate for utilization levels for both its hospitals. However, we remain cautious about its high leverage levels and its strategy of growing through inorganic route supported by equity issuance. Given that the marginal cost of funding could reach upto 6% next year, the interest cost for the company would go up notably from SAR 42 m in 2021 to SAR 62 m in 2022e and SAR 96 m in 2023e. Moreover, the stock is already pricing in the most optimistic scenario of peak utilization levels as well as improvement in pricing. On the back of better utilization levels for its hospitals, we raise our earnings estimates and also raise our target price to SAR 119/share from SAR 95/share before. However, at the current market price, our target price implies downside of 24%, implying Underweight rating. Thus, we downgrade the rating to Underweight from Neutral.

Catalysts priced in, profitability to be hurt by finance cost: We like Dallah for its ability to grow at a minimal capex, as its current utilization levels are below 55%. Also, we like the locations of its hospitals, especially the Nakheel. Moreover, the improvement in utilization at is Namar hospital is also a major relief as there were concerns that it will continue to weigh on the margins. We estimate revenues to grow by 10% CAGR between 2022-2026e, while operating income to grow by 15% driven by margin expansion as utilization levels are expected to improve going forward. However, we believe all the positives are more than priced in the stock price, that now trades at a 2023e P/E of 46x. Further, we are worried about its high leverage and the strategy to grow inorganically by issuing shares. Its debt is over SAR 1.8 bn and cash balance is modest at SAR 135 m. The interest cost is expected to more than double in 2023 from 2021 levels, which would weigh on the profitability in the near term.

Q3 2022 results provides a glance of what can be expected: Q3 2022 revenues of SAR 601 m (+10% y-o-y), was a tad below our expectations of SAR 608 m. However, the disappointment was the miss on both gross and operating margins, gross margins at 35.2% much lower than our expectations of 37.5%, an operating margin of 14.0% versus our expectations of 17.0%. Further, another major disappointment was the net income, that declined to SAR 44 m (-12% y-o-y and -37% q-o-q), versus our estimate of SAR 76 m, mainly pressured by higher financing costs.

Figure 1 Dallah Healthcare: Summary of Q3 2022 results

(SARmn)	Q3 2022	Q2 2022	Q3 2021	ARC Est.	Cons Est.	q-o-q	y-o-y	vs ARC	vs Cons
Revenue	600.9	583.8	544.1	607.6	601.5	2.9%	10.4%	-1.1%	-0.1%
Gross Profit	211.5	212.1	192.5	227.8		-0.3%	9.9%	-7.2%	
Gross Margin	*35.2%*	*36.3%*	*35.4%*	*37.5%*					
Operating Profit	84.2	96.7	69.9	103.3		-12.9%	20.4%	-18.5%	
Op. margins	*14.0%*	*16.6%*	*12.9%*	*17.0%*					
Net Profit	43.9	69.5	49.9	76.2	78.2	-36.9%	-12.0%	-42.4%	-43.9%
Net margin	*7.3%*	*11.9%*	*9.2%*	*12.5%*	*13.0%*				

Source: Company data, Al Rajhi Capital

Valuation: In terms of future expansion, the company has three projects lined up, The Dallah Medical Tower, Dallah North of Riyadh Hospital and Dallah Hospital Jeddah. At the moment, we are not fully accounting the impact on financials as the expansion plan is in the nascent stage and no details have been disclosed about the capex required. However, on a conservative basis, we are assuming 9% CAGR growth in FCF beyond 2026 till 2030, in addition to the 15% CAGR growth assumed during our explicit forecast period of 2022-2026e. Based on our two staged DCF valuation methodology, our DCF derived target price is SAR 119/share. Key inputs include COE: 10.9%, WACC: 8.7%, and terminal growth: 3.5%. We are valuing Faqih based on the current stake of 31.2% and not assuming the impact of its decision to buy the remaining stake in the company as the financial details for the additional purchase are not disclosed yet. For Mefic and Meras, and IMC (included amount to be paid for the additional stake), we have considered the latest book value of investments. Our new target price of SAR 119/share, implies a downside of 24%. Thus, we downgrade the stock to Underweight from Neutral rating before.

Figure 2 Valuations

Valuations (SARmn)	2021	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
FCF	**180**	**349**	**432**	**485**	**510**	**606**	**660**	**720**	**784**	**855**
Terminal Value	**8,519**									
EV	**12,203**									
Add Cash and investments	135									
Add Faqih (considered only 31.2% stake)	273									
Add: Mefic and Meras	92									
Add: International Medical Centre	1,008									
Less: Debt	(1,823)									
Less Minority interest	(247)									
Equity value	**11,642**									
number of shares	98									
value per share	***119***									

Source: Company data, Al Rajhi Capital

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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.

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