National Medical Care Company

Healthcare – Industrial

CARE AB: Saudi Arabia

22 August 2022

الراجحي المالية
Al Rajhi Capital

US$0.765bn	9%	US$3.051mn
Market cap	Free float	Avg. daily volume

Target price	65.00	1.4% over current
Current price	64.10	as at 21/8/2022

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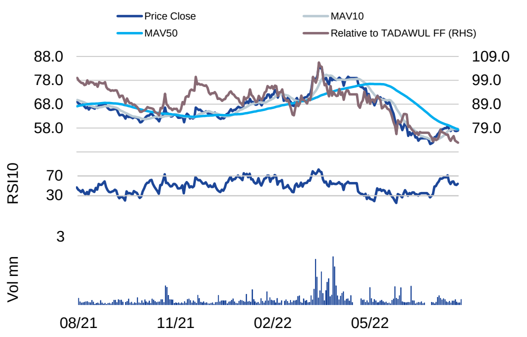
Existing rating

Underweight	Neutral	Overweight

Performance



Source: Bloomberg

Earnings

(SARmn)	2021A	2022E	2023E
Revenue	845	868	910
Revenue growth	5%	3%	5%
Gross profit	246	254	264
Gross margin	29%	29%	29%
Operating Profit	155	156	160
Op. margin	18%	18%	18%
Net profit	136	140	145
Net margin	16%	16%	16%
EPS	3.04	3.13	3.24
DPS	1.00	1.00	1.25
Payout ratio	33%	32%	39%
EV/EBITDA	11.7x	12.1x	10.5x
P/E	19.8x	20.5x	19.8x
RoE	12.1%	11.5%	11.1%

Source: Company data, Al Rajhi Capital

National Medical Care
Is it a value trap?

Q2 2022 results provided some relief to investors, who were worried, post the Q1 results, when among the companies under our coverage, Care was the only one to report a decline in topline y-o-y. The Q2 2022 revenues not only increased y-o-y (+6.9%) but also sequentially (+2.4% q-o-q). The sequential improvement is impressive, given that Q1 is seasonally a strong quarter. However, we believe Q2 to be the peak in terms of performance as there is little scope for further improvement in the utilization level, it was 81% in Q2 2022 (80% is usually considered to be the peak). Despite the strong quarterly numbers, the topline growth in H1 2022 was up just 2.7% y-o-y and operating income rose 1.7% y-o-y. And even if we assume a slightly better utilization level in H2 (77% estimated versus 76% in H1), the growth for FY 2022 is expected to be around just 3% y-o-y (assumed minimal contribution from the expansion at CNH). Also, from a medium-term perspective, the growth in the topline is modest. Thus, we believe the stock lacks any meaningful catalyst in the near term. We are reducing our target price to SAR 65/share (earlier: SAR78/share) which offers an upside of just 1.4%, implying a neutral rating on the stock.

Lack of growth catalyst: Our biggest worry is the lack of a clear roadmap for future growth. Both the hospitals of Care, the CNH and RCH operate at a very high utilization level (75%-80%). In the near term, the CNH hospital is expected to see additions of 125 beds, but the ramp-up is expected to be gradual. It has a spare capacity of 100-150 beds at its other hospital, RCH. But there is no clarity on the timeline for commissioning the same. Other than this, the company has not laid out any plan that provides a clear roadmap for future growth, while its peers are expanding aggressively. Its recent land purchase in the North of Riyadh does offer some respite. However, there are no details available regarding the timeline of the construction or the Capex budget. And even in the best-case scenario, this hospital would take 3-4 years for becoming operational, post the start of the construction, implying very less chance of a new hospital coming up in the next five years.

Is it a value trap? Care trades at a P/E of around 20x on our 2023e EPS, a discount of almost 46% to the industry average (companies under our coverage) of about 37x. Such a stark difference in multiple would seem attractive and push Care to feature among the value buying opportunities. The scenario of a stock's PE multiple lying at the extreme end of the industry range (whether low/top end) is often a function of its growth plans in the near future and its ability to create shareholder value, relative to its peers over a longer period of time. In our view, Care disappoints on both fronts. Our base case scenario for Care is a topline growth of an average of 4.0% during 2022-2025e versus the industry average of about 10% in the same period. Further, in the last five years, CARE has generated an ROE of about 9.0% barely meeting its current WACC of 8.8%. At the same time, in terms of capital efficiency and proactiveness, Care is a laggard. The company has not taken any major greenfield expansion (barring the recent land purchase) so far, unlike its peers, who are expanding aggressively, given the strong demand potential for healthcare led by insurance.

Figure 1 CARE: Summary of 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	216	211	202	197	201	*6.9%*	*2.4%*	*9.6%*	*7.5%*
Gross Profit	67	61	58	56		*15.6%*	*8.7%*	*18.6%*	
G. margin	*30.9%*	*29.1%*	*28.5%*	*28.5%*					
Op. profit	46	35	38	32		*22.2%*	*30.7%*	*44.9%*	
Op. margin	*21.2%*	*16.6%*	*18.6%*	*16.1%*					
Net profit	42	30	31	28	29	*36.7%*	*40.0%*	*49.8%*	*43.7%*
Net margin	*19.4%*	*14.2%*	*15.2%*	*14.2%*	*14.5%*				

Source: Company data, Al Rajhi Capital

Valuation: We apply a blended approach to value Care with equal weight to both DCF and relative valuation, which yields a target price of SAR 65/share. Our DCF-derived value for the stock is SAR 67 per share. The key inputs for the DCF are about 7% growth in FCF during 2022-2025e followed by a transition phase of 4% growth between 2026-2030e (expecting contribution from spare capacity at RCH at minimal Capex), terminal growth of 2.0%, and a WACC of 8.8%. At the same time, we are also assuming positive working capital flows of almost SAR 200 m in 2023e on the back of the recovery of receivables from GOSI. We are not considering any contribution from the new hospital in North Riyadh as we await further details. Our relative valuation yields SAR 64/share as the value for the stock. Our RV is based on a one-year blended forward P/E of 20x, a 20% discount from its historical average of 25x given the weak growth prospects.

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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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