

Overweight

Price Target (SAR): 267.0

Current: 225.2
Upside/Downside: 18.6% above current

| Valuation Multiples | 23E | 24E | 25E |
|---------------------|------|------|------|
| P/E (x) | 37.7 | 37.0 | 30.0 |
| P/B (x) | 12.3 | 11.3 | 10.3 |
| EV/EBITDA (x) | 30.7 | 27.3 | 22.7 |

Major Shareholders % Ownership

| | |
|-------------------------------------|-------|
| Al Habib Sulaiman Abdulaziz | 40.03 |
| Mohammed Abdulaziz Al Habib & Sons. | 33.75 |

| Price Performance | 1M | 3M | YTD |
|-------------------|-------|--------|------|
| Absolute | -3.3% | -24.7% | 2.1% |
| Relative to TASI | 1.4% | -12.1% | 2.7% |

Dr. Sulaiman Al Habib Medical Services Group

Very solid results, upgrade to Overweight

Despite seasonality, another quarter of strong results is encouraging. These results give us confidence that the company can ramp up the new hospitals in a much quicker time than anticipated and the growth in topline should offset the cost pressure (related to the opening of the hospitals). The company will open four large hospitals in 2024 (assuming North Riyadh opening gets delayed to Q1 2024) and in total there will be an addition of 1500 beds. On optimum utilization of these beds, there is a potential of revenues doubling in the next 3-4 years. For the first time, Habib or any other hospital operator will be adding this level of supply in the market in a single year, thus we are bit cautious on the margin fronts in the next 2-3 years. However, given the strong brand value and the rising penetration of insurance among the local population, we do not see major risks in terms of ramping up the facilities. Post two strong consecutive quarters of earnings, we raise our 2023 estimates as well as factor in the possibility of strong topline in the near future to curtail the pressure on the costs. We estimate the EPS to grow at almost 16% CAGR for the next 5 years and in our relative valuation methodology we assign a forward P/E multiple of 45x. Post the ramp up of all the facilities, which is expected to happen by 2028 and result in EPS doubling by then, the implied P/E on our target price is 23x. Our target price of SAR 267/share is derived through a blended approach that consists of DCF and P/E. The upside potential based on our target price is 18.6%, thus we upgrade the stock to Overweight from neutral.

Earnings

| (SARmn) | FY2022E | FY2023E | FY2024E |
|------------------|---------|---------|---------|
| Revenue | 8,311 | 9,706 | 12,736 |
| Revenue growth | 14.6% | 16.8% | 31.2% |
| Gross profit | 2,748 | 3,319 | 4,124 |
| Gross margin | 33.1% | 34.2% | 32.4% |
| Operating profit | 1,700 | 2,164 | 2,366 |
| Op. margin | 20.5% | 22.3% | 18.6% |
| Net profit | 1,651 | 2,093 | 2,132 |
| Net margin | 19.9% | 21.6% | 16.7% |
| EPS | 4.7 | 6.0 | 6.1 |
| DPS | 3.5 | 4.4 | 4.5 |
| Payout ratio | 73.8% | 73.8% | 73.8% |
| P/E | 47.7x | 37.7x | 37.0x |
| EV/EBITDA | 39.5x | 30.7x | 27.3x |
| RoE | 29.4% | 34.0% | 31.8% |

Source: Company data, Al Rajhi Capital

Figure 1 Earnings Summary Q3 2023

| 3Q23 Results | Q3 2023 | Q3 2022 | y-o-y | Q2 2023 | q-o-q | ARC | vs ARC |
|--------------|---------|---------|-------|---------|-------|-------|--------|
| Revenue | 2,443 | 2,052 | 19% | 2,272 | 8% | 2,298 | 6% |
| Gross Profit | 843 | 682 | 24% | 775 | 9% | 758 | 11% |
| G. margin | 35% | 33% | | 34% | | 33% | |
| Op. profit | 552 | 436 | 27% | 499 | 11% | 483 | 14% |
| Op. margin | 23% | 21% | | 22% | | 21% | |
| Net profit | 545 | 421 | 30% | 487 | 12% | 470 | 16% |
| Net margin | 22% | 20% | | 21% | | 20% | |

Source: Company data, Al Rajhi Capital

3Q23 Results: Habib's 3Q23 revenues (+19% y-o-y and +8% q-o-q) were 6% ahead of ours as well as consensus expectations. Despite the slowdown in the sector, the growth in the last two quarters can be attributed to the continued market share gains in both Riyadh as well as Khobar. This growth was fuelled by a rise in the patient count and increased inpatient occupancy. Notably, this surge in patient numbers exhibited a favourable correlation with the uptick in pharmacy segment sales when compared to the same quarter in the previous year. Gross profits grew at 24% y-o-y and 9% q-o-q, gross margins saw a modest improvement sequentially. Compared to our estimates, gross profit came in 11% above expectations. Operating margins also saw improvement, coming to 22.6% vs 22.0% in 2Q23 and higher than our expectations of 21.0%. Higher top line coupled with improved margins passed through to the bottom-line (+30% y-o-y, +12% q-o-q), which came 16% higher than our estimates and 11% higher than consensus.

Valuations: We value the company based on a blended approach with equal weight to the two stage DCF methodology and relative valuation approach. Our fair value based on DCF is SAR 261/share. We believe FCF to grow at a CAGR of 27% between 2022-2030e during our explicit forecast period. In the transition phase, we believe FCF growth of 10% CAGR (2030e - 2035e) can be maintained supported by efficient utilization of the capacity and modest price hikes. Our assumption for WACC is 8.4%, cost of equity is 10.2%, terminal growth is 3.5%. Our fair value through relative valuation methodology is SAR 274/share, valued at a 45x P/E on our 2024e EPS of SAR 6.1/share. Our blended average fair value is SAR 267/share, which implies 18.6% upside from the current level, implying an overweight rating on the stock.

Figure 2 **Relative Valuation & DCF estimates**

| Relative Valuation | Multiples/Values | DCF Estimates | Multiples/Values |
|---------------------------|------------------|--|------------------|
| Target 1 year forward P/E | 45.0x | WACC | 8.4% |
| 2024E EPS | 6.1 | Cost of Equity | 10.2% |
| PV of share | 274 | Terminal Growth rate | 3.5% |
| CMP | 225 | FCF CAGR: High growth phase (2022-2030E) | 26.7% |
| Price return | 21.7% | FCF CAGR: Transition (2030E-2035E) | 10.0% |
| Div. yield (2023E) | 1.9% | | |
| Total returns | 23.7% | | |

Source: Al Rajhi Capital estimates

Figure 3 **Valuation table**

| Valuation methodology | Fair Value | Weight | Value/Sh. |
|------------------------|------------|--------|--------------|
| DCF | 261 | 50% | 130 |
| Relative valuation | 274 | 50% | 137 |
| Value per share | | | 267 |
| CMP | | | 225 |
| Price return | | | 18.6% |
| Div. yield (2023E) | | | 1.9% |
| Total returns | | | 20.5% |

Source: Company data, Al Rajhi Capital

Financials

Figure 4 Income Statement

| Income Statement (SAR mn) | 2023E | 2024E | 2025E |
|--|--------------|--------------|--------------|
| Sales | 9,706 | 12,736 | 15,788 |
| <i>y-o-y growth</i> | 16.8% | 31.2% | 24.0% |
| Cost of Sales | (6,387) | (8,612) | (10,639) |
| <i>y-o-y growth</i> | 14.8% | 34.8% | 23.5% |
| Gross Income | 3,319 | 4,124 | 5,149 |
| <i>y-o-y growth</i> | 20.8% | 24.3% | 24.9% |
| <i>margins</i> | 34.2% | 32.4% | 32.6% |
| Employee costs | (505) | (739) | (900) |
| Selling and distribution expenses | (272) | (446) | (568) |
| Administrative expenses | (379) | (573) | (710) |
| Operating Income | 2,164 | 2,366 | 2,970 |
| <i>y-o-y growth</i> | 27.2% | 9.4% | 25.5% |
| <i>margins</i> | 22.3% | 18.6% | 18.8% |
| Investments and other | 139 | 145 | 153 |
| Financing Expense | (115) | (283) | (202) |
| Income from Affiliate | 20 | 20 | 21 |
| Net income before tax | 2,207 | 2,249 | 2,942 |
| Zakat & Tax | (155) | (180) | (235) |
| <i>tax rate</i> | 7.0% | 8.0% | 8.0% |
| Net Profit Before Minority Interest | 2,053 | 2,069 | 2,706 |
| Minority Interest (loss)/profit | (40) | (64) | 76 |
| Net Income | 2,093 | 2,132 | 2,630 |
| <i>y-o-y growth</i> | 26.8% | 1.9% | 23.4% |
| <i>margins</i> | 21.6% | 16.7% | 16.7% |
| EPS | 6.0 | 6.1 | 7.5 |
| DPS | 4.4 | 4.5 | 5.5 |

Source: Al Rajhi Capital estimates

Figure 6 Cash Flow Statement

| Cash flow statement (SAR mn) | 2023E | 2024E | 2025E |
|---|--------------|------------|------------|
| Net cash flows from Operating Activities | 2,388 | 2,704 | 3,316 |
| Cash Flows from Investing Activities | (2,991) | (480) | (295) |
| Cash Flows from Financing Activities | (311) | (1,841) | (2,742) |
| Net change cash & cash equivalents | (914) | 383 | 279 |

Source: Al Rajhi Capital estimates

Figure 5 Balance sheet

| Balance Sheet (SAR mn) | 2023E | 2024E | 2025E |
|--------------------------------------|---------------|---------------|---------------|
| Cash & Cash Equivalents | 1,833 | 2,216 | 2,495 |
| Receivables, Net | 958 | 1,257 | 1,559 |
| Prepaid expenses and other assets | 176 | 176 | 176 |
| Inventory | 449 | 515 | 695 |
| Total Current Assets | 3,421 | 4,169 | 4,929 |
| Property and equipment | 10,455 | 10,348 | 10,107 |
| Investment from associates | 187 | 187 | 187 |
| Total Non-current Assets | 10,942 | 10,835 | 10,594 |
| Total Assets | 14,362 | 15,004 | 15,524 |
| Liabilities and Equity | | | |
| Short-term Debt & Leases | 486 | 679 | 771 |
| Trade payable | 883 | 1,014 | 1,367 |
| Advance from customers | 36 | 36 | 36 |
| Accrued expenses and other liab. | 1,206 | 1,206 | 1,206 |
| Zakat payable | 170 | 170 | 170 |
| Total Current Liabilities | 2,781 | 3,104 | 3,550 |
| Long-Term Debt & Leases | 4,389 | 4,212 | 3,520 |
| Govt. grant | 60 | 60 | 60 |
| Employees' end of service benefits | 518 | 518 | 518 |
| Total Non-current Liabilities | 4,967 | 4,790 | 4,099 |
| Total Liabilities | 7,748 | 7,895 | 7,649 |
| Total Equity | 6,427 | 6,986 | 7,676 |
| Minority Interest | 187 | 123 | 199 |
| Total Owners Equity | 6,614 | 7,109 | 7,875 |
| Total liabilities and equity | 14,362 | 15,004 | 15,524 |

Source: Al Rajhi Capital estimates

Figure 7 Key Ratios

| | 2023E | 2024E | 2025E |
|----------------|-------|-------|-------|
| ROCE | 20% | 18% | 22% |
| ROA | 16% | 16% | 19% |
| ROE | 34% | 32% | 36% |
| Asset turnover | 25% | 28% | 34% |
| P/E | 37.7x | 37.0x | 30.0x |
| EV/EBITDA | 30.7x | 27.2x | 22.7x |
| P/BV | 12.3x | 11.3x | 10.3x |
| Dividend yield | 2.0% | 2.0% | 2.5% |

Source: Al Rajhi Capital estimates

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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.

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