Dallah Healthcare

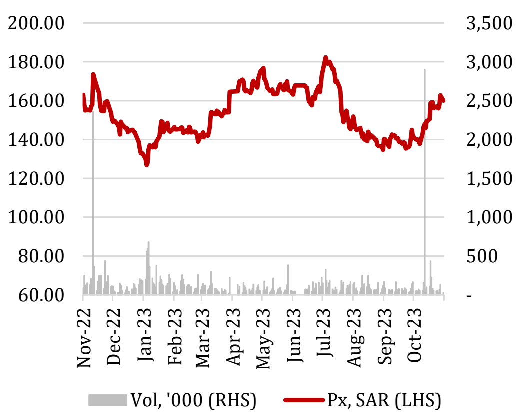
Target Price: SAR 160.50
Upside/ (Downside): 0.3%

Recommendation	**Hold**
Bloomberg Ticker	DALLAH AB
Current Market Price (SAR)	160.00
52wk High / Low (SAR)	189.80/125.40
12m Average Vol. (000)	137.9
Mkt. Cap. (USD/SAR mn)	4,157/15,629
Shares Outstanding (mn)	97.68
Free Float (%)	42%
3m Avg Daily Turnover (SAR'000)	20,020.6
6m Avg Daily Turnover (SAR'000)	18,292.1
P/E'23e (x)	46.5
EV/EBITDA'23e (x)	28.0
Dividend Yield '23e (%)	1.3%

Price Performance:	
1 month (%)	12.7
3 month (%)	10.0
12 month (%)	(4.1)

Source: Bloomberg, valued as of 19 Nov 2023

Price-Volume Performance



Source: Bloomberg

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- **DHC's hospital beds are estimated to rise by close to 400 over our forecast period till FY 2027, aided by the addition of a new hospital of 250 beds capacity by FY 2025e. However, DHC's healthcare facilities remain concentrated in the competitive Riyadh region.**
- **Dallah also intends to enhance its operational efficiency which, in our opinion, will lead to an increase in the beds and clinics utilization at its existing hospitals.**
- **Capacity expansions likely hit DHC's margins in the past by lifting its operational costs and leverage. However, with the company's cost optimization efforts, a decline in borrowings, and relatively limited capacity addition, margins are estimated to improve gradually.**

We reviewed our coverage of Dallah Healthcare Co. (DHC) and reduced our **target price to SAR 160.50** (previously, SAR 170.50), partly attributable to a higher WACC estimate. At the current market price, our target price indicates an upside of 4.7%. Hence, we **maintain Hold** rating on the stock. Currently, the stock trades at FY'23e P/E of 46.5x and EV/EBITDA of 28.0x, which is at a premium to 12 months (12m) blended forward average P/E of 30.3x and the 12m blended forward average EV/EBITDA of 25.0x of its peers and indicates Dallah's valuation already price-in near-term positives. Thus, we see limited catalysts on the upside to drive the stock price from the forecast levels.

Investment Thesis

Improvement is expected in financial metrics, though high valuation levels limit the stock upside potential

i) Dallah's hospital beds and outpatient clinics, according to our calculations, will expand further, led by the expansion at Namar and the addition of a new hospital in Riyadh.

ii) We revise our FY22-27e revenue growth CAGR to 17% (vs. 8%, estimated previously) as we model in Al Aarid hospital addition into our forecasts. This will be higher than the previous 5-year (FY17-22) CAGR of 15% which was spearheaded by significant capacity growth.

iii) Margins (EBITDA, net income) are estimated to weaken slightly in FY23e from FY22 levels partly due to higher impairment and finance costs, but expected to improve thereafter driven by cost optimization, & lower leverage.

iv) Capex is estimated to dip vs. the historical period given the relatively lower capacity addition. This clubbed with estimated improvement in margins should boost the company's liquidity. Accordingly, we estimate DHC to maintain its FY22 dividend payout in FY23e.

Year	FY20	FY21	FY22	FY23e	FY24e	FY25e
Revenues (SAR mn)	1,318.3	2,105.2	2,488.0	2,891.0	3,263.7	3,931.2
Net income (SAR mn)	132.0	258.6	274.5	333.5	403.1	530.3
Gross margin	34.1%	36.1%	36.0%	36.1%	36.3%	36.6%
Net profit margin	10.0%	12.3%	11.0%	11.5%	12.3%	13.5%
RoE	8.0%	14.1%	14.2%	12.9%	12.3%	15.2%
FCF (SAR/share)	(0.5)	2.6	2.2	2.7	3.8	4.1
DPS (SAR/share)	0.8	1.5	2.0	2.0	2.3	2.6
Dividend Yield	1.6%	2.0%	1.4%	1.3%	1.4%	1.6%
P/E (x)	32.9x	26.1x	48.5x	46.5x	38.5x	29.3x
P/BV (x)	2.4x	3.6x	6.7x	4.9x	4.6x	4.3x

Source: Company Reports, U Capital Research **P/E, P/B, and dividend yield from 2023 onwards are based on current price*

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Investment thesis

Additional capacities with a likely improvement in utilization to drive top-line growth

DHC's capacity in terms of hospital beds and outpatient clinics at the end of 3Q 2023 stood at over 1,000 and 500, respectively, according to our calculations, based on the most recent available information. At the end of FY 2017, this capacity stood at 348 hospital beds and 192 outpatient clinics, which indicates that the company more than doubled its hospital beds and clinics over the next five years through both organic and inorganic routes. As per our estimates, the hospital beds and outpatient clinics during FY 2017-FY 2022 swelled at a solid 25%, and 21% CAGR, respectively.

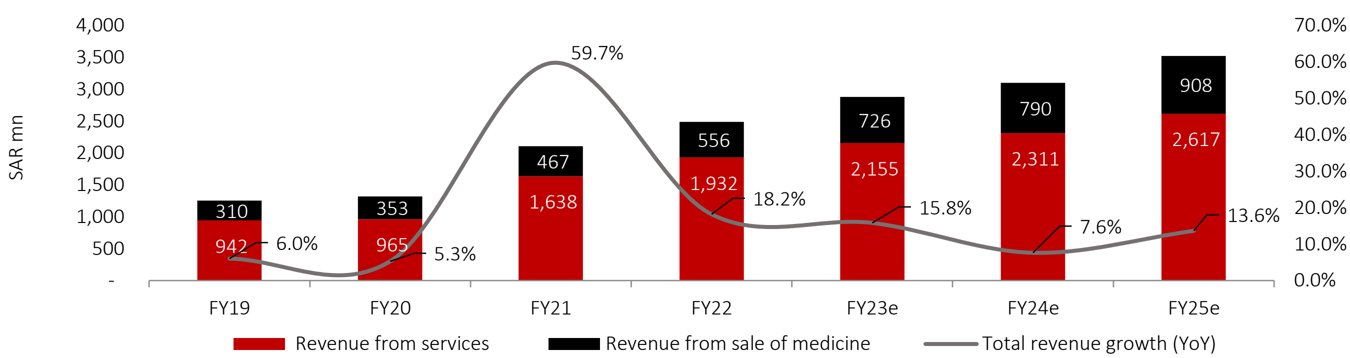
While the company expanded its healthcare infrastructure at a brisk pace, per hospital utilization rate reported by the company in FY 2021 indicated that the blended utilization rate of hospital beds and outpatient clinics stood at around 61% and 56%, respectively. While the company has not disclosed utilization rates of its facilities, we assume it to have risen further in FY 2022, partially driving the 18% YoY revenue growth as total capacities grew marginally. Having said that, we believe there remains decent scope for overall utilization to grow, with the company also seeking to increase the efficiency of its operational capacity.

Fig. 1: The current and expected capacities of DHC

Healthcare facilities	Estimated capacity, as of Jun 2023-end	Estimated capacity, as in FY 2027e	Remarks
Al Nakheel Hospital	508 beds; 242 clinics	534 beds; 242 clinics	Beds capacity estimated to rise slightly after a renovation
Namar Hospital	300 beds; 110 clinics	400 beds; 150 clinics	DHC intends to add 100 beds by next year-end
Kingdom Hospital	130 beds; 119 clinics	137 beds; 119 clinics	-
Makkah Medical Center	134 beds; 35 clinics	134 beds; 35 clinics	-
Al Aarid hospital	-	250 beds	Expected to commence operations by FY 2025
Total	**1,072 beds; 506 clinics**	**1,455 beds; 546 clinics**	

Source: Company Reports, U Capital Research

Fig. 2: Total revenue is expected to maintain consistent growth driven by new capacity additions and enhanced utilization



Source: Company Reports, U Capital Research

Thus, the availability of spare capacity and the ongoing expansion of some of its existing healthcare infrastructure partly explain the slowdown in the pace of the addition of greenfield capacities by DHC in the future, in our opinion. Over the next five years till FY 2027, we estimate Dallah's total hospital beds and outpatient clinics to increase at a relatively slower 6% and 2% CAGR, respectively, between FY 2022 and FY 2027e. This would primarily be driven by the commencement of the 250-bed Al Aarid hospital, likely from FY 2026e, and an increase in Namar Hospital's bed capacity to 400 from 300 currently by the end of FY 2024e. Overall, we estimate Dallah's top line to grow at a CAGR of 17% over the next five years

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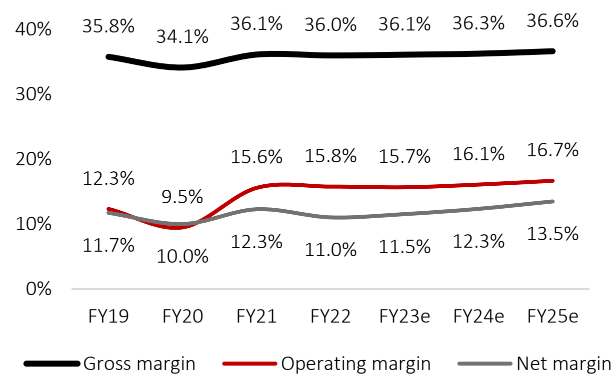
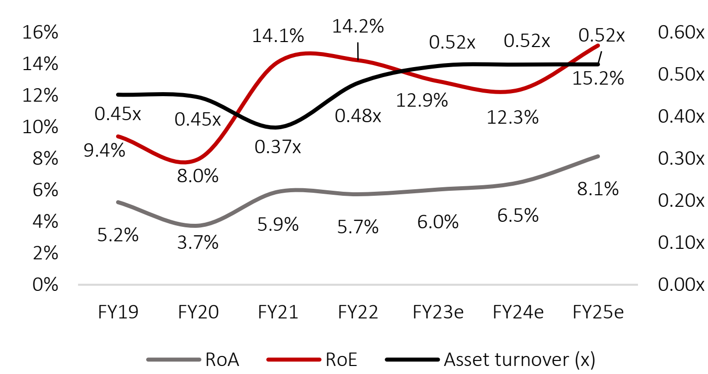
(FY 2022-2027e), higher than in the previous five years (FY 2017-2022: +15%), supported by a likely improvement in the average utilization.

Gross and operating margins are estimated to remain relatively stable but higher finance costs could pull net margin lower in FY 2023; however, gradual improvement is expected thereafter

DHC's margins have remained volatile in the past owing to varying reasons like some one-off losses, a rise in impairments partly attributable to the COVID-19 pandemic, and an increase in operational and finance costs resulting from capacity additions and acquisitions. During FY 2023, while we expect gross and operating margins to remain somewhat stable, net income margin is estimated to contract by slightly over 50 basis points (bps) from FY 2022, as the company's average finance charge rose by over 200 bps YoY during 9M 2023. Nevertheless, going forward we expect margins to improve gradually, given DHC's focus to optimize its costs by minimizing and consolidating resources. We also expect finance expenses to stabilize relatively on the back of a decrease in debt balance and the likelihood that the magnitude of the interest rate increase over the next year will be lower as compared to the past year, thereby lifting the bottom-line margin.

Fig. 3: Gross and operating margins have been relatively stable since FY21 though rising interest costs impacted the net margin





Source: Company Reports, U Capital Research

Source: Company Reports, U Capital Research

A relatively lower capital expenditure requirement, sustained top-line growth, and the likely improved profitability to boost balance sheet strength

We expect the capital expenditure (capex) requirement for DHC to come down over our forecast period mainly due to a lesser capacity expansion target during this period as compared to the past five years. Complemented with an expected improvement in profitability as per our discussion above, this is estimated to enhance free cash flow generation which the company can use to bring its leverage lower.

Fig. 4: D/E ratio estimated to ease in FY23 after remaining flat in the past two years

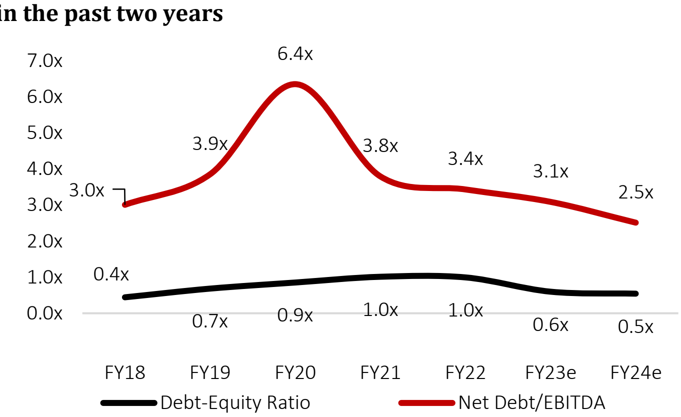
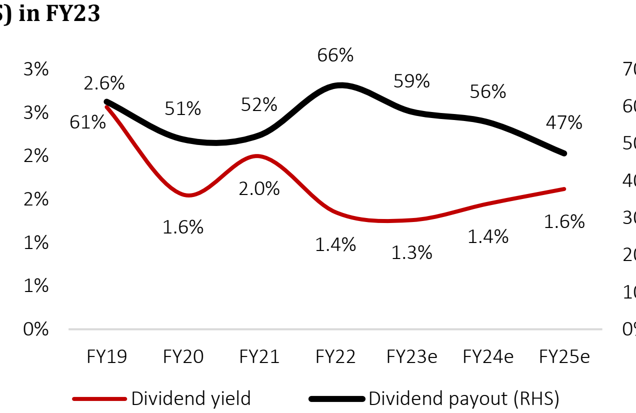


Fig. 5: DHC is expected to match the FY22 dividend per share (DPS) in FY23



Source: Company Reports, U Capital Research

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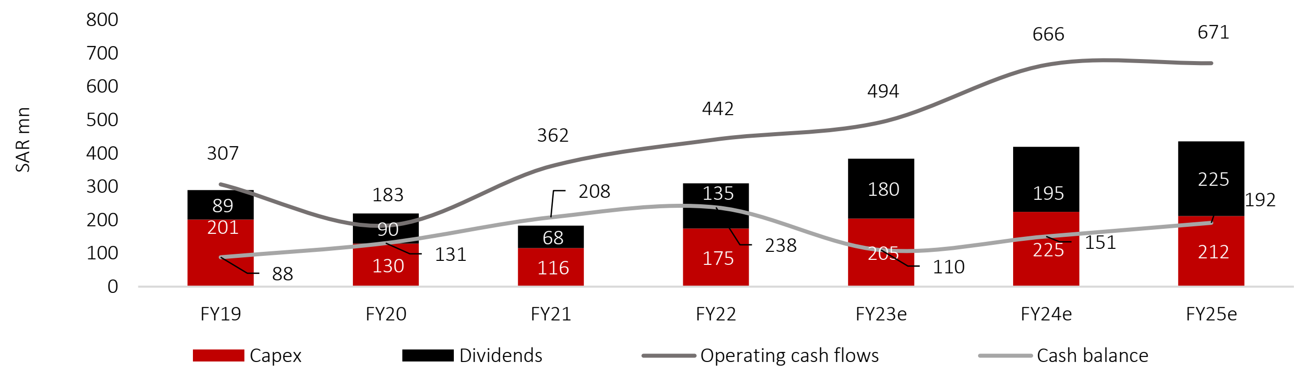
Fig. 6: Dallah's liquidity position is estimated to strengthen going forward, supported by improved margins and lower capex



Source: Company Reports, U Capital Research

The company seems to be already moving in this direction as after consistently rising till FY 2022, DHC's debt to equity (D/E) ratio eased to 0.6x at the end of 3Q 2023 as compared to 1.0x at the end of FY 2022. We opine this will benefit the company going forward as cash saved from reduced debt servicing can be utilized by it to fund future greenfield projects or M&A transactions with minimal debt support. On a separate note, we believe Dallah will maintain its dividend payout this year at FY 2022 levels, considering that it has already paid out SAR 1.5 dividend per share during 9M 2023 @ SAR 0.5 DPS during the first three quarters of 2023, and we see no issues for it in maintaining this rate in the last quarter of this year, thus matching SAR 2.0 DPS of FY 2022.

Valuation

Our target price is based on blended valuation methodologies – (i) DDM and (ii) Relative Valuation (using EV/EBITDA).

We revised our target price for the company to SAR 160.50 (previously, SAR 170.50), partially owing to a higher WACC estimate, with Saudi Arabia's risk-free rate (Rf) tightening by nearly 40 basis points (bps) from our last report under a rising interest rate environment. At the current market price, our target price almost matches the current market price and accordingly, we maintain our **Hold** rating on the stock, as we believe the current high valuation levels vs. the peer average already incorporate most of the near-term positives. Currently, the stock trades at FY'23e P/E of 46.5x and EV/EBITDA of 28.0x, which is at a premium to 12 months (12m) blended forward average P/E of 30.3x and the 12m blended forward average EV/EBITDA of 25.0x of its peers.

Risks

Key downside risks:

- i) Below expected revenue growth resulting from either a delay in the addition of the new hospital beds and clinic capacities than estimated or less-than-expected utilization and/or average revenue per bed/clinic.
- ii) An increase in competition can adversely affect utilization and average revenue rates, given that the company generates the bulk of its revenue from the central region of the Kingdom.
- iii) Profitability comes below our estimates either resulting from a higher than usual time taken to ramp up new facilities, an increase in impairment, or finance costs.

Key upside risks:

- i) The company is also working to increase the capacity of its existing capacity though exact details are not available, which exposes our capacity and revenue estimate to upside risk.
- ii) Better-than-projected margins and cash flows in case the company introduces any new process or technology in the future which expedites efficiency enhancement.

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Valuation

	Dallah Healthcare
(Currency)	SAR
DCF (80% weight)	
PV of Free Cash Flows (mn)	
Year 1 (Explicit forecast period)	258
Year 2 (Explicit forecast period)	344
Year 3 (Explicit forecast period)	345
Year 4 (Explicit forecast period)	396
Year 5 (Explicit forecast period)	489
Year 6 (Transition period)	491
Year 7 (Transition period)	493
Year 8 (Transition period)	495
Year 9 (Transition period)	497
Year 10 (Transition period)	499
Terminal Value	19,870
PV of Terminal Value	11,119
Less: Debt	1,894
Less: Minority interest	265
Less: Employee retirement benefits	265
Add: Cash & bank balances	143
Add: Investments	1,573
Equity value (mn)	14,719
Outstanding Shares (mn)	97.7
Assumptions	
Risk Free Rate (%)	5.2%
Adjusted Beta	0.66
Risk Premium (%)	2.8%
Cost of Equity (Ke) (%)	7.0%
WACC (%)	6.6%
Target Price	***163.54***
EV/EBITDA based Relative Valuation (20% weight)	
Target EV/EBITDA multiple (x)	*25.0*
EBITDA FY23e	579,664
Target Price	***153.42***
Weighted Average Target Price	**160.50**
Current Market Price	160.00
Upside/(Downside), %	*0.3%*
Recommendation	**Hold**

Source: Company Financials, Bloomberg, U Capital Research

Peer Group Valuation

Name	Mkt Cap (SAR mn)	Last Px (LC)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	EV/EBITDA'23e, (x)	P/E'23e, (x)	ROE'23e, (%)	Div Yield' 23e, (%)	FCF Yield TTM (%)
Healthcare										
Dr Sulaiman Al Habib Medical	91,070.0	260.20	13	0	18	40.2	42.1	32.3%	1.6%	0.1%
Mouwasat Medical Services Co	21,920.0	109.60	10	0	5	22.8	33.0	21.1%	1.8%	4.1%
Dallah Healthcare Co	15,629.0	160.00	13	10	8	28.0	46.5	12.9%	1.3%	1.4%
Middle East Healthcare Co	6,406.0	69.60	7	14	173	17.5	31.9	13.8%	0.9%	-0.7%
Al Hammadi Holding	9,072.0	56.700	11	9	41	19.5	26.9	18.7%	2.7%	4.9%
Nahdi Medical Co	17,706.0	136.200	-2	-12	-19	11.5	19.6	39.7%	3.9%	7.6%
National Medical Care Co	6,359.7	141.800	13	22	92	19.6	23.7	16.3%	0.9%	10.1%
Average						**22.7**	**32.0**	**22.1%**	**1.8%**	**3.9%**
Median						**19.6**	**31.9**	**18.7%**	**1.6%**	**4.1%**

Source: Bloomberg, U Capital Research, na – not available, nm – not meaningful; *valued as of 19 November 2023

Fig. 7: Healthcare - Price to Earnings & Dividend Yield

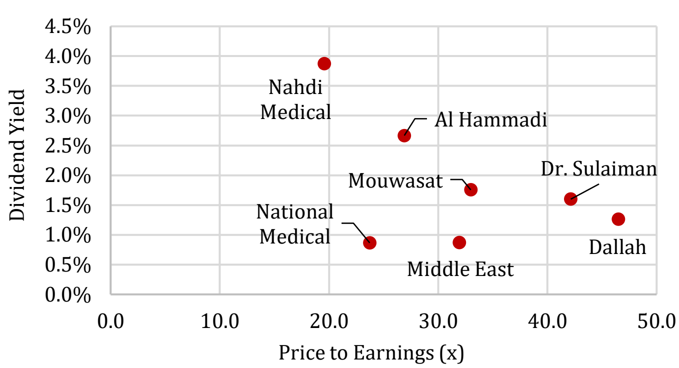
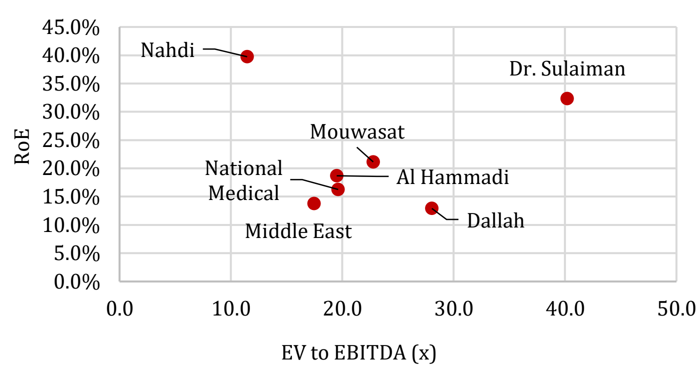


Fig. 8: Healthcare – RoE & EV to EBITDA



Source: Bloomberg, U Capital Research; As of 19 Nov 2023

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Key financials

In SAR mn, except stated otherwise	FY20	FY21	FY22	FY23e	FY24e	FY25e
Income Statement						
Revenue	1,318	2,105	2,488	2,891	3,264	3,931
Cost of revenue	(869)	(1,345)	(1,593)	(1,847)	(2,080)	(2,491)
Gross profit	**450**	**760**	**895**	**1,044**	**1,183**	**1,440**
General & administrative expenses	(281)	(375)	(430)	(510)	(573)	(688)
Selling & marketing expenses	(26)	(41)	(45)	(65)	(72)	(85)
Impairment losses on trade receivables/expected credit loss provision	(18)	(17)	(28)	(16)	(14)	(12)
Operating profit	**125**	**328**	**392**	**453**	**525**	**655**
The company's share in income of associates	(21)	(31)	(23)	(2)	(1)	2
Finance charges	(25)	(42)	(70)	(104)	(102)	(98)
Profit before zakat	**148**	**292**	**329**	**382**	**461**	**607**
Zakat expense	(13)	(17)	(34)	(21)	(25)	(33)
Profit attributable to shareholders of the company	**132**	**259**	**274**	**334**	**403**	**530**
Balance Sheet						
Cash and cash equivalents	131	208	238	110	151	192
Trade receivables	580	625	677	766	814	981
Prepaid expenses and other assets	82	106	114	147	166	201
Right of use assets	25	30	49	63	75	84
Property and equipment	2,743	2,768	2,847	2,934	3,004	3,046
Total assets	**4,130**	**4,645**	**4,920**	**6,122**	**6,334**	**6,687**
Accrued expenses and other liabilities	134	147	155	201	226	259
Short term lease liabilities	15	22	42	57	68	76
Trade payables	193	222	248	256	284	340
Total liabilities	**2,122**	**2,549**	**2,688**	**2,675**	**2,677**	**2,707**
Share capital	900	900	900	977	977	977
Retained earnings	794	840	921	1,041	1,179	1,406
Equity Attributable to Shareholders	**1,795**	**1,867**	**1,990**	**3,177**	**3,356**	**3,635**
Cash Flow Statement						
Net cash generated from operating activities	183	362	442	494	666	671
Net cash generated from investing activities	(428)	(425)	(226)	(215)	(221)	(206)
Net cash (used in) provided by financing activities	287	141	(186)	(407)	(404)	(424)
Cash and cash equivalents at the end of the period	**131**	**208**	**238**	**110**	**151**	**192**
Key Ratios						
Gross margin (%)	34.1%	36.1%	36.0%	36.1%	36.3%	36.6%
EBITDA margin (%)	16.7%	21.0%	20.4%	20.1%	20.4%	20.6%
Operating margin (%)	9.5%	15.6%	15.8%	15.7%	16.1%	16.7%
Net margin (%)	10.0%	12.3%	11.0%	11.5%	12.3%	13.5%
ROA	3.7%	5.9%	5.7%	6.0%	6.5%	8.1%
ROE	8.0%	14.1%	14.2%	12.9%	12.3%	15.2%
Current Ratio (x)	1.4x	1.3x	1.5x	1.3x	1.3x	1.5x
Capex/Sales	9.8%	5.5%	6.9%	7.0%	6.8%	5.3%
Debt-Equity Ratio	0.9x	1.0x	1.0x	0.6x	0.5x	0.5x
EPS	1.5	2.9	3.0	3.4	4.1	5.4
BVPS	19.9	20.7	22.1	32.5	34.4	37.2
DPS	0.8	1.5	2.0	2.0	2.3	2.6
Dividend Payout Ratio	51.1%	52.2%	65.6%	58.6%	55.7%	47.3%
Dividend Yield (%)	1.6%	2.0%	1.4%	1.3%	1.4%	1.6%
P/E (x)	32.9x	26.1x	48.5x	46.5x	38.5x	29.3x
P/BV (x)	2.4x	3.6x	6.7x	4.9x	4.6x	4.3x
EV/EBITDA (x)	27.1x	19.0x	29.7x	28.0x	24.3x	19.9x
Price as at period end*	48.3	75.1	148.0	158.8	158.8	158.8

*Source: Company Reports, U Capital Research; *Current market price is used for forecast periods*

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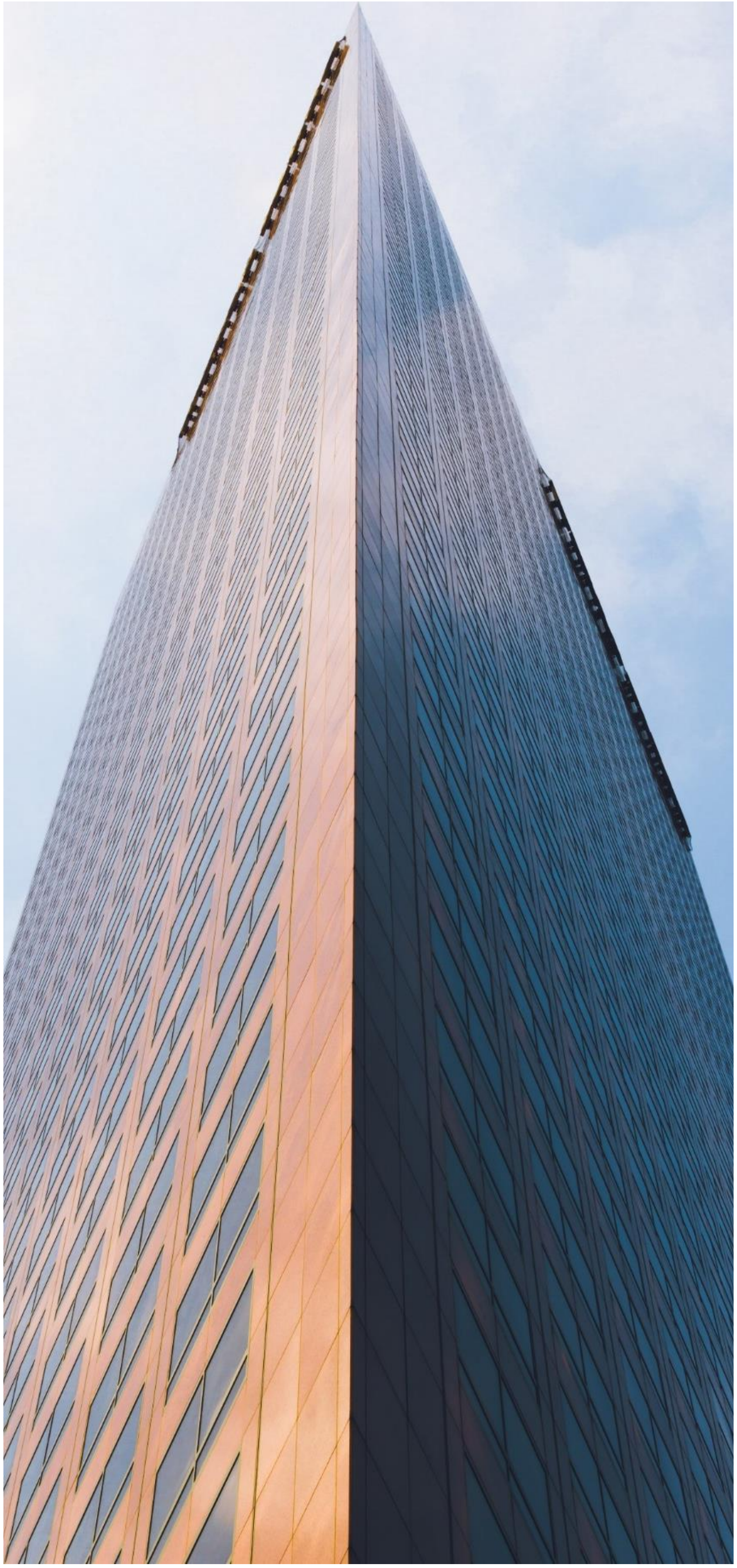

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Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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