

Key themes

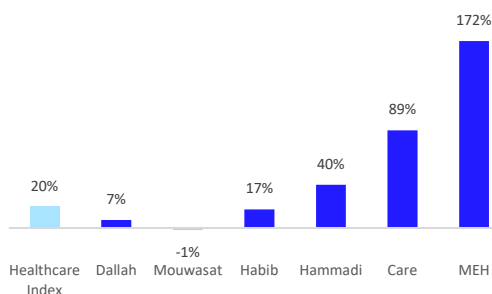
Q3 2023 earnings for hospital operators exceeded expectations, despite the seasonally weak period.

Notable growth in Q3 could be attributed to increased Ministry of Health (MoH) referrals, potentially driven by factors like a flu spike in September.

Medium-term prospects for private hospital operators look promising due to limited investments in public hospitals, supporting sustained MoH referrals. However, valuations appear to be full.

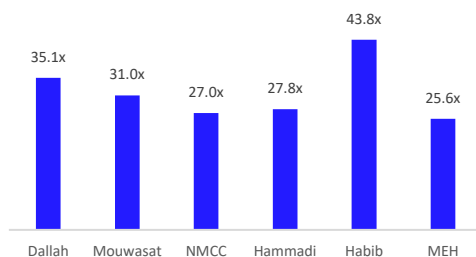
Notable changes: Saudi German TP raised, while on Care and Habib, turning neutral after the recent rally.

YTD Healthcare performance



Source: Bloomberg, Al Rajhi Capital. Closing price considered is as of 6th November 2023

Forward P/E (2024E) on our target price



Source: Bloomberg, Al Rajhi Capital. Forward P/E is calculated based on TP/FY24E EPS from ARC estimates. For Care, EPS is adjusted for credit loss provisions for GOSI.

Saudi Healthcare

Benefits of operating leverage

If Q2 2023 earnings were a negative surprise, then Q3 has been the exact opposite. Despite Q3 being seasonally weak with July in particular, the topline growth has been a surprise. And given the high fixed cost base, the benefits were reflected in the bottom-line growth. As hospital operators, such as Saudi German, Care and Dallah, that have notable exposure to MoH did much better than expectations, we believe notable part of the surprise came from spike in MoH referrals. The key question is on the sustainability of these earnings. One of the medium-term catalysts for the private hospital operators is the lack of incremental investments on public hospitals, thus the MoH referrals can remain elevated. However, in our view, part of the spike in Q3 could be due to the flu in September. Nevertheless, post the strong earnings we raise our 2023 estimates for all the hospital operators. We also make changes to our target prices but maintain our neutral recommendation on the sector.

Among the changes to our target price, the notable change is in Saudi German's TP to SAR 71/share from SAR 61/share. The Q3 earnings provided us with clarity that the company is moving well on its plan to control overhead costs and the ramp up at its new facility is also on track. Thus, we change our margin estimates for 2024E to over 15% from about 13% before. However, we continue to believe the stock should trade at a discount to its peers given the stretched balance sheet and growing competitive risks in Jeddah.

Figure 1 Summary of our rating and TP

Stock	Current Rating	Previous Rating	Current TP	Old TP	CMP	Upside/Downside
Dallah	Neutral	Neutral	143	139	158.8	-9.9%
Mouwasat	Neutral	Neutral	108	108	103.4	4.4%
Care	Neutral	Overweight	143	137	140.0	2.1%
Hammadi	Neutral	Neutral	57	54	56.0	1.8%
Habib	Neutral	Neutral	267	267	258.0	3.5%
MEH	Neutral	Neutral	71	61	69.1	2.7%

Source: Bloomberg, Al Rajhi capital, CMP is as of 6th November 2023

Figure 2 Summary of 3Q23 Earnings

Sector Earnings	3Q23	3Q22	y-o-y	2Q23	q-o-q
Revenue	5,078	4,200	21%	4,716	8%
Gross Profit	1,893	1,459	30%	1,704	11%
Gross margin	37.3%	34.7%		36.1%	
Operating Profit*	1,140	809	41%	991	15%
Operating margin	22.5%	19.3%		21.0%	
Net Income*	998	698	43%	860	16%
Net Income margin	19.7%	16.6%		18.2%	

Stock	Revenue		Net Income		Y-o-y growth		Beat vs. ARC	
	(SAR mn)	(SAR mn)	Revenue	Net Income	Revenue	Net Income	Revenue	Net Income
Dallah	750	99	25%	125%	11%	89%		
Mouwasat	641	156	17%	28%	1%	2%		
NMCC*	275	65	16%	52%	10%	20%		
Hammadi*	298	80	21%	40%	6%	25%		
Habib	2,443	545	19%	30%	6%	16%		
MEH	671	53	31%	380%	6%	49%		

Source: Company Data, Al Rajhi capital. *Note: Numbers are adjusted for one-off items.

Earnings summary for each company:

Dallah: Dallah's topline was a strong beat. Revenues of SAR 750 mn (+25% y-o-y, +12% q-o-q) were 10% ahead of our estimates. Given that the cost base is mostly fixed and the margins on MoH referrals are high, Dallah's gross margins came in at 37.5% versus our estimates of 35.4%. The benefits of operating leverage were more noticeable in the operating performance. Operating profits of SAR 131 mn were up 44% y-o-y and 29% ahead of our estimates. Net profits of SAR 99 mn, more than doubled y-o-y and were much ahead of our estimates of SAR 52 mn and consensus of SAR 60 mn. The bottom-line was additionally supported by SR 3 mn in profits from its share of the results of assets invested in equity (associates), compared to SR 6.3 mn in losses during the same time the previous year.

Mouwasat: 3Q23 Revenues of SAR 641mn (+17% y-o-y, +2% q-o-q) came in 1% above our estimates and 3% above consensus supported by rise in the number of OPD visits and higher inpatient occupancy. However, despite a miss on the topline, gross profit of SAR 298mn (+21% y-o-y, +2% q-o-q) was in line with our estimates. Implied gross margins came around 46.5% versus 47.0% with our estimates. On the other hand, due to lower-than-expected selling and distribution costs, operating profit of SAR 182mn (+31% y-o-y, +6% q-o-q) was 3% above our estimates. Implied operating margins came around 28.4% versus 27.9% with our estimates. Consequently, net income came in at SAR 156mn (+28% y-o-y, +4% q-o-q), 2% above our estimates and 7% above consensus estimates.

CARE: Revenue of SAR 275mn for 3Q23 (+16% y-o-y, +12% q-o-q) were 10% above our estimates and 8% above consensus. In Q323, the total number of patients increased by 9% mainly led by outpatient visits (+10%), while inpatients were flattish. The jump in outpatients was due to increased referrals from GOSI and improved business with MOH. MOH billing further increased due to Care facilities achieving HIMSS accreditation. Despite the topline beat, the gross margins of 33.3% were largely in line with our estimates due to cost absorption related to salaries and consumables. The operating profit grew by 49% y-o-y to SAR 75mn, ahead of our expectations of SAR 60mn. It was partly aided by reversals of expected credit loss provisions due to settlements with insurance companies and receipt of receivables from the National Guard of previous years. The net positive impact from the reversals was SAR 8mn versus our expectations of negative impact of SAR 3.9mn. The bottom-line adjusted for this reversal came in at SAR 65mn versus our adjusted net profit of SAR 54mn, a beat of 20%.

Hammadi: Q3 2023 revenues (21% y-o-y and 8% q-o-q) were 6% above our expectations and 9% above consensus numbers. The y-o-y and q-o-q expansion in topline dual driven by higher revenues reported by both Al Hammadi's medical services and pharmaceutical segments. Given the high fixed base, the growth in the top line reflects more notably in gross profits. Gross profits increased by 35% y-o-y and margins came to 37.9% for 3Q23 versus our expectations of 33.2%. Operating profits adjusted for reversals came in at SAR 92 mn versus our expectations of SAR 76 mn. Adjusted net income that excludes the ECL reversal came to SAR 80mn which was 25% above our estimates and 5% above consensus estimates.

Habib: 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 and Khobar. This growth was fueled by a rise in the patient count and increased inpatient occupancy. Notably, this surge in patient numbers exhibited a favorable 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.

MEH: Revenues increased 31% y-o-y and 7% sequentially and came 6% above our estimates and 5% above consensus estimates. The top-line growth was bolstered by the ongoing healthy ramp-up of newly added capacities in SGH Riyadh and SGH Makkah, with both entities combined driving 50% of the y-o-y growth delivered during the quarter. Total number of inpatients increased by 34% y-o-y to 24k patients, mainly led by MoH referrals, while total number of outpatients was up 24% y-o-y to 513k patients. In terms of footprint, Makkah contributed the lion's share to the overall increase in inpatients' census, followed by Riyadh and Dammam, driving combined close to two-thirds of the Group's IP volume growth. SGH Makkah, the Group's latest greenfield expansion, generated SAR 46mn in revenues, with a contribution of 7% to the Group's top line. Gross profit increased 75% y-o-y and 16% sequentially and came 15% above our estimates. Implied gross margin stood at 40% versus 37% in 2Q22. Higher topline flew through resulting in increased net income (+380% y-o-y, +32% q-o-q), coming 49% above our estimates and 14% above consensus estimates.

Key Financials

Figure 3 **Dallah**

(SARmn)	2023E	2024E	2025E
Revenue	2,906	3,095	3,404
Revenue growth	16.8%	6.5%	10.0%
Gross profit	1,061	1,123	1,225
Gross margin	36.5%	36.3%	36.0%
Operating profit	508	529	568
Op. margins	17.5%	17.1%	16.7%
Net profit	360	398	479
Net margin	12.4%	12.9%	14.1%
EPS	3.7	4.1	4.9
DPS	2.4	2.7	3.2
Payout ratio	66%	66%	66%
P/E	43.1x	39.0x	32.4x
RoE	18%	18%	21%

Source: Al Rajhi Capital

Figure 4 **Mouwasat**

(SARmn)	2023E	2024E	2025E
Revenue	2,599	2,818	3,175
Revenue growth	11.3%	8.4%	12.7%
Gross profit	1,243	1,324	1,464
Gross margin	47.9%	47.0%	46.1%
Operating profit	739	794	890
Op. margins	28.5%	28.2%	28.0%
Net profit	638	696	805
Net margin	24.6%	24.7%	25.4%
EPS	3.2	3.5	4.0
DPS	1.6	1.7	2.0
Payout ratio	50%	50%	50%
P/E	32.4x	29.7x	25.7x
RoE	21%	20%	21%

Source: Al Rajhi Capital

Figure 5 **Habib**

(SARmn)	2023E	2024E	2025E
Revenue	9,706	12,736	15,788
Revenue growth	16.8%	31.2%	24.0%
Gross profit	3,319	4,124	5,149
Gross margin	34.2%	32.4%	32.6%
Operating profit	2,164	2,366	2,970
Op. margins	22.3%	18.6%	18.8%
Net profit	2,093	2,132	2,630
Net margin	21.6%	16.7%	16.7%
EPS	6.0	6.1	7.5
DPS	4.4	4.5	5.5
Payout ratio	74%	74%	74%
P/E	43.1x	42.4x	34.3x
RoE	34%	32%	36%

Source: Al Rajhi Capital

Figure 6 **Hammadi**

(SARmn)	2023E	2024E	2025E
Revenue	1,204	1,279	1,320
Revenue growth	7.2%	6.2%	3.2%
Gross profit	462	489	505
Gross margin	38.4%	38.2%	38.3%
Operating profit	353	344	344
Op. margins	29.3%	26.9%	26.1%
Net profit	337	328	330
Net margin	28.0%	25.6%	25.0%
EPS	2.1	2.0	2.1
DPS	1.5	1.5	1.2
Payout ratio	70%	75%	60%
P/E	26.6x	27.3x	27.2x
RoE	19%	18%	17%

Source: Al Rajhi Capital

Figure 7 **Care (ex-Chronic Care)**

(SARmn)	2023E	2024E	2025E
Revenue	1,055	1,148	1,205
Revenue growth	14.9%	8.8%	4.9%
Gross profit	356	388	398
Gross margin	33.7%	33.8%	33.0%
Operating Profit	250	260	263
Op. margin	23.7%	22.7%	21.8%
Net profit	235	237	237
Net margin	19.3%	18.7%	17.7%
EPS	5.2	5.3	5.3
Adjusted EPS*	4.5	4.8	4.8
DPS	1.0	1.3	1.5
Payout ratio	19%	24%	28%
P/E	26.7x	26.4x	26.5x
Adjusted P/E	30.9x	29.3x	29.5x
RoE	14%	14%	12%

Source: Al Rajhi Capital, note: Adjusted EPS is net income adjusted for provisions for credit losses. Assumed 2.5% of sales as provisions

Figure 8 **MEH**

(SARmn)	2023E	2024E	2025E
Revenue	2,637	2,875	3,208
Revenue growth	22.5%	9.0%	11.6%
Gross profit	996	1,088	1,203
Gross margin	37.8%	37.9%	37.5%
Operating profit	384	439	486
Op. margins	14.6%	15.3%	15.2%
Net profit	214	255	333
Net margin	8.1%	8.9%	10.4%
EPS	2.3	2.8	3.6
P/E	29.7	24.9	19.1
RoE	15%	15%	17%

Source: 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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