# Saudi Healthcare Sector, *in an expansion mode…*

**17 November 2022**

| Company | Rating |
|---|---|
| **Dr. Sulaiman Al Habib Medical Services Group (HMG) (BBG Ticker: SULAIMAN)** | **Hold** |
| **Mouwasat Medical Services (MMS) (BBG Ticker: MOUWASAT)** | **Hold** |
| **Dallah Healthcare Co. (DHC) (BBG Ticker: DALLAH)** | **Hold** |
| **Al Hammadi Holding Co. (HHC) (BBG Ticker: ALHAMMAD)** | **Accumulate** |
| **Middle East Healthcare (MEH) (BBG Ticker: MEH)** | **Hold** |


**Ayisha Zia**

Head of Research

a.zia@u-capital.net

Tel: +968 24 94 90 36


- **The government and related agencies are the dominant players in Saudi's healthcare sector.**
- **Healthcare is an important pillar of the Kingdom's Vision 2030. The government introduced a sector transformation program this year, aimed at increasing private sector participation.**
- **The country's healthcare infrastructure has steadily improved, reaching ~77k beds by 2021 However, market experts believe KSA will need about 20k additional beds by 2030.**
- **Changing demographics, a sedentary lifestyle, improving healthcare infrastructure, and increasing health coverage are some of the drivers of the sector.**
- **Prospects of the listed healthcare companies appear promising with the favorable market dynamics and solid expansion plans, but valuations look expensive.**

We initiate coverage on Saudi Healthcare Sector with five names in focus – **Dr. Sulaiman Al Habib, Mouwasat Medical Services, Dallah Healthcare, Al Hammadi Holding, and Middle East Healthcare (Saudi German Health or SGH).** Overall, we have a positive view of the sector, given the government's resolve to transform the Kingdom into an economic and tourist hotspot that will lead to an increased inflow of people over the coming years, thereby driving the healthcare demand higher. We have used two valuation methodologies (DCF, and relative valuation – P/E) to arrive at the target price.

- **The government aims to transform the KSA healthcare sector with private participation.** Healthcare is among the priority sectors in the Kingdom's Vision 2030 plan and hence it remains among the top 4-5 sectors in terms of government budgeted spending allocation. As a steppingstone to achieving Vision's objectives, the government introduced a program in 2022 with the broad aim to restructure the sector through increased participation of the private sector, improving the coverage, quality, and efficiency of healthcare services for its residents and citizens, leading to an increase in average life expectancy.
- **Demographic changes, unhealthy living, and rising instances of lifestyle diseases are some of the key catalysts for the sector.** Rapid economic development, resulting in more job opportunities and higher disposable income, coupled with technological advancements has led to increased affordability and dependency on gadgets in day-to-day life. While this has made our lives easier and more comfortable, it has also led to an increase in unhealthy eating habits, low physical activity, and higher work-related stress. These have led to rising instances of lifestyle-related diseases like diabetes, stroke, hypertension, obesity, etc., which will certainly create more demand for healthcare services in the coming times.
- **The government's focus to boost private participation in healthcare sector development is a positive for listed players.** Listed players in KSA are likely to benefit from the government's move to increase the private sector's share of the healthcare sector, which currently is dominated by the government and/or allied agencies. Almost all the listed players are adding new hospitals and clinics or expanding the capacity of existing facilities during our forecast period and beyond. We believe these new facilities would comfortably reach their optimum operating capacity in the due course of time, as the Kingdom's ongoing transformation and development are expected to keep the demand for medical services high going forward. Among our coverage firms, Dr. Sulaiman is the largest player having superior financial metrics, while MEH is struggling to run a profitable business.

| Name | Last Px (SAR) | Target Price (SAR) | Upside / (Downside) (%) | P/E'23e, (x) | P/B'23e, (x) | EV/EBITDA '23e, (x) | ROE'23e, (%) | TTm Cash Div Yield, % |
|---|---|---|---|---|---|---|---|---|
| Dr. Sulaiman Al Habib | 219.60 | **220.00** | 0.2% | 42.2 | 12.3 | 35.6 | 29.6% | 1.5% |
| Mouwasat Medical | 190.00 | **195.00** | 2.6% | 27.3 | 6.4 | 20.8 | 25.1% | 1.4% |
| Dallah Healthcare | 166.80 | **170.50** | 2.2% | 44.2 | 7.2 | 29.0 | 16.8% | 1.2% |
| Al Hammadi Holding | 41.00 | **47.50** | 15.9% | 24.4 | 3.7 | 15.6 | 15.4% | 2.7% |
| Middle East Health | 27.20 | **25.50** | -6.2% | 33.4 | 1.8 | 17.6 | 5.6% | 0.0% |
| **Average** | | | | **34.3** | **6.3** | **23.7** | **18.5%** | **1.4%** |

*Source: Bloomberg, U Capital Research; Last price as of 17 November 2022*




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# Saudi Healthcare Sector

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# Valuation

We have used DCF (80% weight) and relative valuation (20% weight) methodologies to derive the target price for each company. For DCF, we have used either a single, two, or three-stage model, depending on when the capacity additions of different companies are coming online. This is because new healthcare facilities generally take around 2-3 years and the real impact of the facilities coming towards the end of our forecast period will get reflected in the later years only. Further, some of the projects currently are under design or pre-construction phase for which a timeline is not given but we expect those to commence operations after the end of our forecast period in FY 2026. Afterward, we assumed a 2% terminal growth rate, based on our internal assessment. We have then calculated the present value of future cash flows (Enterprise Value or EV) using the weighted average cost of capital (WACC). After computing EV, we have made the required adjustments such as net debt, minorities, etc. to derive fair value.

For the relative valuation (P/E), we have considered the average of the FY22e P/E of relevant peers as the target multiple. For Al Hammadi, Dallah, Mouwasat, and Middle East Healthcare, we have used the average Bloomberg estimated FY22e P/E multiple of Saudi healthcare companies, which also includes the five companies under our initiation and some more companies. However, for Dr. Sulaiman Al Habib, we have taken a different peer set comprising some global healthcare companies, as per the Bloomberg classification. This is because Dr. Sulaiman is significantly larger than the other four companies under our coverage, and it is set to grow even bigger over the next few years. The adjusted multiples are then multiplied by the forecasted EPS.



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**Valuation**

| | Al Habib | Mouwasat | Dallah | Al Hammadi | Middle East |
|---|---|---|---|---|---|
| (Currency) | SAR | SAR | SAR | SAR | SAR |
| **DCF (80% weight)** | | | | | |
| **PV of Free Cash Flows (mn)** | | | | | |
| Year 1 (Explicit forecast period) | 274 | 139 | 273 | 178 | -219 |
| Year 2 (Explicit forecast period) | 399 | 404 | 334 | 289 | 131 |
| Year 3 (Explicit forecast period) | 757 | 560 | 366 | 250 | 81 |
| Year 4 (Explicit forecast period) | 1,229 | 610 | 402 | 229 | 105 |
| Year 5 (Explicit forecast period) | 1,513 | 629 | 437 | 303 | 130 |
| Year 6 (High Growth/Transition period) | 1,581 | 647 | 444 | - | - |
| Year 7 (High Growth/Transition period) | 1,653 | 666 | 452 | - | - |
| Year 8 (High Growth/Transition period) | 1,728 | 685 | 459 | - | - |
| Year 9 (High Growth/Transition period) | 1,806 | 705 | 466 | - | - |
| Year 10 (High Growth/Transition period) | 1,888 | 725 | 474 | - | - |
| Year 11 (Transition period) | 1,883 | - | - | - | - |
| Year 12 (Transition period) | 1,879 | - | - | - | - |
| Year 13 (Transition period) | 1,875 | - | - | - | - |
| Year 14 (Transition period) | 1,871 | - | - | - | - |
| Year 15 (Transition period) | 1,867 | - | - | - | - |
| Terminal Value | 120,992 | 27,637 | 23,637 | 8,386 | 5,697 |
| PV of Terminal Value | 58,869 | 14,999 | 14,799 | 6,384 | 4,691 |
| Less: Debt | 3,558 | 1,029 | 2,017 | 300 | 2,171 |
| Less: Minority interest | 216 | 89 | 242 | - | 40 |
| Less: Employee retirement benefits | 537 | 134 | 263 | 70 | 241 |
| Add: Cash & bank balances | 2,448 | 116 | 341 | 43 | 14 |
| Add: Investments | 300 | 21 | 208 | 124 | - |
| Fair value (mn) | 79,508 | 19,656 | 16,934 | 7,429 | 2,480 |
| Outstanding Shares (mn) | 350.0 | 100.0 | 90 | 160 | 92.0 |
| **Assumptions** | | | | | |
| Risk Free Rate (%) | 4.8% | 4.8% | 4.8% | 4.8% | 4.8% |
| Adjusted Beta | 0.81 | 0.83 | 0.48 | 0.76 | 0.89 |
| Risk Premium (%) | 2.7% | 2.7% | 2.7% | 2.7% | 2.7% |
| Cost of Equity (Ke) (%) | 7.0% | 7.0% | 6.1% | 6.9% | 7.2% |
| WACC (%) | 5.2% | 6.9% | 5.3% | 6.8% | 4.8% |
| ***Target Price*** | ***227.17*** | ***196.56*** | ***188.16*** | ***46.43*** | ***26.95*** |
| **P/E based Relative Valuation (20% weight)** | | | | | |
| Target P/E multiple (x) | *41.0* | *34.0* | *34.0* | *34.0* | *34.0* |
| EPS FY22e | *4.67* | *5.55* | *2.94* | *1.52* | *0.58* |
| ***Target Price*** | ***191.36*** | ***188.75*** | ***99.85*** | ***51.78*** | ***19.72*** |
| **Weighted Average Target Price** | **220.00** | **195.00** | **170.50** | **47.50** | **25.50** |
| Current Market Price | 219.60 | 190.00 | 166.80 | 41.00 | 27.20 |
| *Upside/(Downside), %* | *0.2%* | *2.6%* | *2.2%* | *15.9%* | *-6.2%* |
| **Recommendation** | **Hold** | **Hold** | **Hold** | **Accumulate** | **Hold** |

***Source: Company Filings, Bloomberg, U Capital Research; *The target PE multiple for Dr. Sulaiman is based on the peer set II table on the following page: **Current market price as of 17th November 2022***



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# Peer Group Valuation

**Fig. 1: Peer set I – KSA-based healthcare companies**

| Name | Mkt Cap (SAR mn) | Last Px (SAR) | Curr. Div. Yld. (%) | Curr. ROE, (%) | P/E'TTM, (x) | P/E'22e, (x) | P/E'23e, (x) |
|---|---|---|---|---|---|---|---|
| Dr Sulaiman Al Habib | 75,740 | 216 | 1.5 | 29.2 | 47.5 | 47.7 | 44.9 |
| Mouwasat Medical | 19,260 | 193 | 1.4 | 21.5 | 34.4 | 30.8 | 26.6 |
| Dallah Healthcare | 14,850 | 165 | 1.2 | 16.1 | 55.1 | 47.9 | 37.4 |
| Al Hammadi Holding | 6,688 | 42 | 2.9 | 13.8 | 34.1 | 28.1 | 26.5 |
| Middle East Health | 2,499 | 27 | na | 2.0 | 46.0 | 32.6 | 26.3 |
| Nahdi Medical Co. | 25,740 | 198 | 1.2 | 50.7 | 26.7 | 29.6 | 31.2 |
| National Medical Care | 3,319 | 74 | 1.4 | 13.2 | 21.9 | 22.1 | 20.9 |
| **Average** | | | **1.6** | **20.9** | **38.0** | **34.1** | **30.5** |
| **Median** | | | **1.4** | **16.1** | **34.4** | **30.8** | **26.6** |

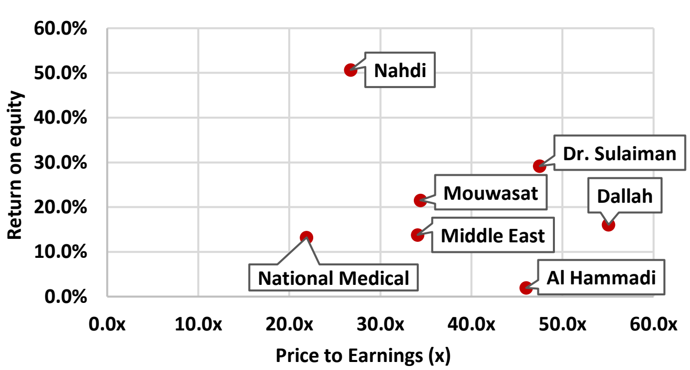
**Source: Bloomberg, U Capital Research, na – not available, nm – not meaningful**

**Fig. 2: Peer set II – Global healthcare companies**

| Name | Mkt Cap (SAR mn) | Last Px (SAR) | Curr. Div. Yld. (%) | Curr. ROE, (%) | P/E'TTM, (x) | P/E'22e, (x) | P/E'23e, (x) |
|---|---|---|---|---|---|---|---|
| Bangkok Dusit Med Service | 50,552 | 3 | 1.7 | 14.9 | 39.5 | 42.5 | 38.9 |
| Aier Eye Hospital Group | 104,952 | 15 | 0.3 | 24.1 | 71.9 | 66.4 | 50.8 |
| IHH Healthcare Bhd | 43,331 | 5 | 1.0 | 7.1 | 25.9 | 33.4 | 28.7 |
| Ramsay Health Care Ltd | 36,027 | 157 | 1.6 | 5.2 | 53.3 | 34.0 | 23.7 |
| Universal Health Services | 33,819 | 479 | 0.6 | 12.4 | 12.9 | 13.0 | 11.7 |
| Apollo Hospitals | 29,731 | 207 | 0.3 | 20.6 | 61.0 | 64.6 | 45.6 |
| Acadia Healthcare Co | 27,498 | 302 | na | 14.5 | 19.6 | 25.7 | 24.1 |
| Max Healthcare Institute | 19,023 | 20 | na | 10.2 | 68.0 | 40.1 | 35.2 |
| Bumrungrad Hospital | 19,142 | 24 | 1.4 | 23.4 | 45.4 | 46.3 | 40.2 |
| **Average** | | | **1.0** | **14.7** | **44.2** | **40.7** | **33.2** |
| **Median** | | | **1.0** | **14.5** | **45.4** | **40.1** | **35.2** |

**Source: Bloomberg, U Capital Research, na – not available, nm – not meaningful**

**Fig. 1: Saudi Healthcare - Price to Earnings & Return on Equity**




***Source: Bloomberg, U Capital Research; P/E and RoE are current and sourced from Bloomberg***



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# Risks to Valuation

Key downside risks to our valuations include:

- Delay in the addition of new projects that are estimated in the model
- Below estimated utilization of the healthcare facilities, and/or per bed or clinic revenue
- Margins come in below than expected, constraining earnings growth
- Contrary to the forecasted movement in the working capital
- More than the estimated increase in capex could adversely impact free cash flows

Key upside risks to our valuations include:

- More than expected utilization of the healthcare facilities, and/or revenue per hospital bed or clinic
- Better than expected profitability levels
- More than the estimated increase in capacities, probably through inorganic routes

# Sensitivity Analysis

Our TP for **Dr. Sulaiman** is moderately sensitive to +/- 0.25% changes to terminal growth or in WACC assumptions (changes about +/- 4-8%). Our TP is not sensitive to +/-0.50x changes in the target P/E multiple, as it changes by less than 0.5% with every change.

**Dr. Sulaiman Al Habib**

| WACC \ Terminal growth | 1.50% | 1.75% | 2.00% | 2.25% | 2.50% |
|---|---|---|---|---|---|
| 4.7% | 230.7 | 243.1 | 257.8 | 275.3 | 296.9 |
| 5.0% | 215.0 | 225.3 | 237.3 | 251.5 | 268.5 |
| 5.2% | 201.4 | 210.0 | **220.0** | 231.6 | 245.4 |
| 5.5% | 189.5 | 196.8 | 205.2 | 214.9 | 226.1 |
| 5.7% | 179.1 | 185.3 | 192.4 | 200.5 | 209.9 |

| P/E multiple \ FY22e EPS (SAR) | 3.67 | 4.17 | 4.67 | 5.17 | 5.67 |
|---|---|---|---|---|---|
| 40.0x | 211.1 | 215.1 | 219.1 | 223.1 | 227.1 |
| 40.5x | 211.4 | 215.5 | 219.5 | 223.6 | 227.6 |
| 41.0x | 211.8 | 215.9 | **220.0** | 224.1 | 228.2 |
| 41.5x | 212.2 | 216.3 | 220.5 | 224.6 | 228.8 |
| 42.0x | 212.5 | 216.7 | 220.9 | 225.1 | 229.3 |

Our TP for **Mouwasat** is slightly sensitive to +/- 0.25% changes to terminal growth or in WACC assumptions (changes about +/- 3-5%). Our TP is not sensitive to +/-0.50x changes in the target P/E multiple, as it changes by less than 0.5% with every change.

**Mouwasat Medical Services**

| WACC \ Terminal growth | 1.50% | 1.75% | 2.00% | 2.25% | 2.50% |
|---|---|---|---|---|---|
| 6.4% | 200.8 | 207.8 | 215.5 | 224.2 | 234.0 |
| 6.7% | 191.7 | 197.9 | 204.7 | 212.3 | 220.9 |
| 6.9% | 183.4 | 188.9 | **195.0** | 201.7 | 209.2 |
| 7.2% | 175.9 | 180.8 | 186.2 | 192.2 | 198.8 |
| 7.4% | 169.0 | 173.4 | 178.3 | 183.6 | 189.4 |

| P/E multiple \ FY22e EPS (SAR) | 4.55 | 5.05 | 5.55 | 6.05 | 6.55 |
|---|---|---|---|---|---|
| 33.0x | 187.3 | 190.6 | 193.9 | 197.2 | 200.5 |
| 33.5x | 187.7 | 191.1 | 194.4 | 197.8 | 201.1 |
| 34.0x | 188.2 | 191.6 | **195.0** | 198.4 | 201.8 |
| 34.5x | 188.6 | 192.1 | 195.5 | 199.0 | 202.4 |
| 35.0x | 189.1 | 192.6 | 196.1 | 199.6 | 203.1 |


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Our TP for **Dallah** is moderately sensitive to +/- 0.25% changes to terminal growth or in WACC assumptions (changes about +/- 5.5-8.5%). Our TP is not sensitive to +/-0.50x changes in the target P/E multiple, as it changes by less than 0.5% with every change.

**Dallah Healthcare**

| WACC \ Terminal growth | 1.50% | 1.75% | 2.00% | 2.25% | 2.50% |
|---|---|---|---|---|---|
| 4.8% | 176.6 | 188.2 | 202.0 | 218.6 | 238.8 |
| 5.0% | 163.7 | 173.5 | 185.0 | 198.5 | 214.7 |
| 5.3% | 152.5 | 160.9 | **170.5** | 181.7 | 195.0 |
| 5.5% | 142.7 | 149.9 | 158.1 | 167.6 | 178.6 |
| 5.8% | 134.1 | 140.3 | 147.4 | 155.4 | 164.7 |

| P/E multiple \ FY22e EPS (SAR) | 1.94 | 2.44 | 2.94 | 3.44 | 3.94 |
|---|---|---|---|---|---|
| 33.0x | 163.3 | 166.6 | 169.9 | 173.2 | 176.5 |
| 33.5x | 163.5 | 166.9 | 170.2 | 173.6 | 176.9 |
| 34.0x | 163.7 | 167.1 | **170.5** | 173.9 | 177.3 |
| 34.5x | 163.9 | 167.3 | 170.8 | 174.2 | 177.7 |
| 35.0x | 164.1 | 167.6 | 171.1 | 174.6 | 178.1 |

Our TP for **Al Hammadi** is slightly sensitive to +/- 0.25% changes to terminal growth or in WACC assumptions (changes about +/- 3-4%). Our TP is not sensitive to +/-0.50x changes in the target P/E multiple, as it changes by less than 0.5% with every change.

**Al Hammadi Holding**

| WACC \ Terminal growth | 1.50% | 1.75% | 2.00% | 2.25% | 2.50% |
|---|---|---|---|---|---|
| 6.3% | 48.0 | 49.9 | 51.9 | 54.2 | 56.8 |
| 6.6% | 46.1 | 47.8 | 49.6 | 51.6 | 53.9 |
| 6.8% | 44.4 | 45.9 | **47.5** | 49.3 | 51.3 |
| 7.1% | 42.8 | 44.1 | 45.6 | 47.2 | 49.0 |
| 7.3% | 41.3 | 42.6 | 43.9 | 45.4 | 47.0 |

| P/E multiple \ FY22e EPS (SAR) | 0.52 | 1.02 | 1.52 | 2.02 | 2.52 |
|---|---|---|---|---|---|
| 33.0x | 40.6 | 43.9 | 47.2 | 50.5 | 53.8 |
| 33.5x | 40.6 | 44.0 | 47.3 | 50.7 | 54.0 |
| 34.0x | 40.7 | 44.1 | **47.5** | 50.9 | 54.3 |
| 34.5x | 40.7 | 44.2 | 47.6 | 51.1 | 54.5 |
| 35.0x | 40.8 | 44.3 | 47.8 | 51.3 | 54.8 |

Our TP for **Middle East Healthcare** is highly sensitive to +/- 0.25% changes to terminal growth or in WACC assumptions (changes about +/- 13-17%). Our TP is not sensitive to +/-0.50x changes in the target P/E multiple, as it changes by less than 0.5% with every change.

**Middle East Healthcare**

| WACC \ Terminal growth | 1.50% | 1.75% | 2.00% | 2.25% | 2.50% |
|---|---|---|---|---|---|
| 4.3% | 26.2 | 30.3 | 35.3 | 41.5 | 49.4 |
| 4.6% | 22.4 | 25.8 | 29.9 | 34.9 | 41.1 |
| 4.8% | 19.2 | 22.1 | **25.5** | 29.6 | 34.5 |
| 5.1% | 16.5 | 18.9 | 21.8 | 25.2 | 29.2 |
| 5.3% | 14.1 | 16.2 | 18.7 | 21.5 | 24.9 |

| P/E multiple \ FY22e EPS (SAR) | -0.42 | 0.08 | 0.58 | 1.08 | 1.58 |
|---|---|---|---|---|---|
| 33.0x | 18.8 | 22.1 | 25.4 | 28.7 | 32.0 |
| 33.5x | 18.7 | 22.1 | 25.4 | 28.8 | 32.1 |
| 34.0x | 18.7 | 22.1 | **25.5** | 28.9 | 32.3 |
| 34.5x | 18.7 | 22.1 | 25.6 | 29.0 | 32.5 |
| 35.0x | 18.6 | 22.1 | 25.6 | 29.1 | 32.6 |



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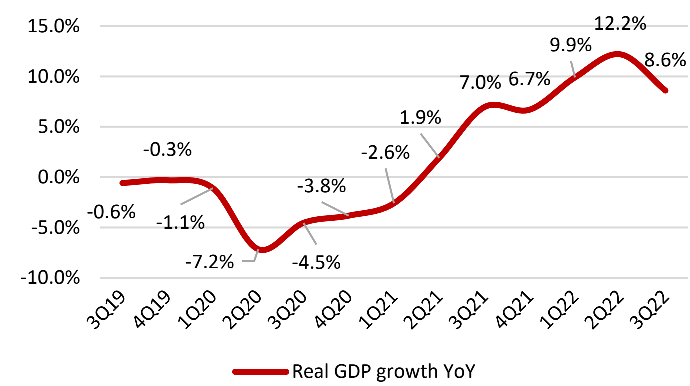
# Macro-economic & Sector Overview

## The economy remains in an expansionary mode for a sixth straight quarter

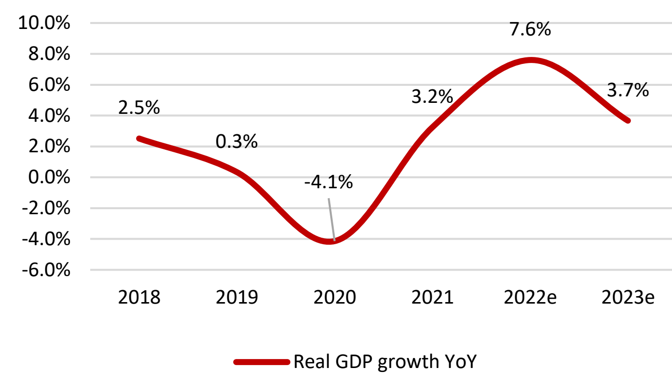
Saudi Arabian economy remained on a robust growth path as the real gross domestic product (GDP) expanded 8.6% YoY in 3Q 2022, after climbing by 12.2% YoY in 2Q 2022, which was the highest growth rate registered since 3Q 2011. 3Q 2022 GDP was mainly driven by a 14.5% YoY increase in the oil sector's activity (higher crude oil production, as well as average crude oil prices). The non-hydrocarbon sector also contributed with its GDP rising by 5.6% YoY.

**Fig. 2: GDP remains on a strong growth path**




***Source: GASTAT, U Capital Research***

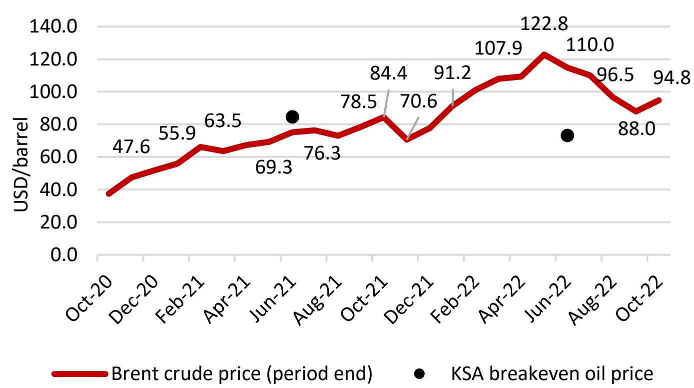
**Fig. 3: Real GDP growth forecasted to hit multi-year high in 2022**




***Source: GASTAT, IMF, U Capital Research***

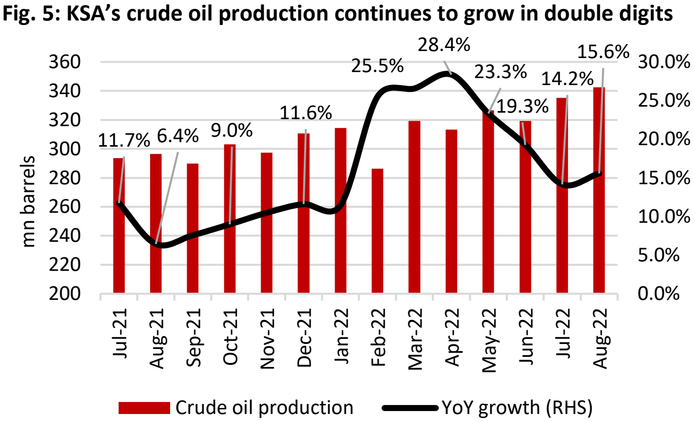
After clocking 3.2% real GDP growth in 2021, its fastest pace of expansion since 2015, the Kingdom's GDP is estimated by the IMF to advance at an accelerated pace of 7.6% in 2022, driven by increased oil production, comparatively high crude oil prices, and further supported by growing non-oil output.

**Fig. 4: Oil price strengthens on recent OPEC+ cut**




***Source: Bloomberg, IMF, U Capital Research***

**Fig. 5: KSA's crude oil production continues to grow in double digits**



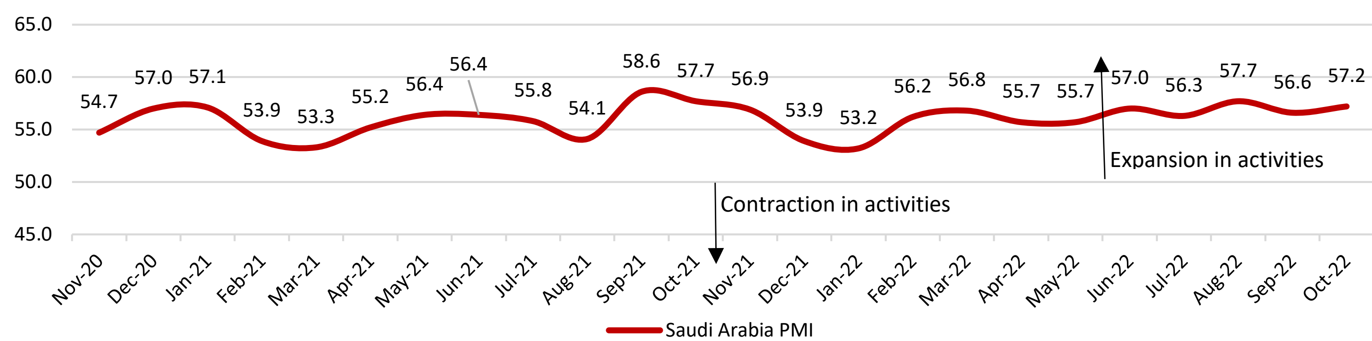

***Source: JODI, U Capital Research***

The IMF estimates Saudi Arabia's real GDP growth to slow down to 3.7% in 2023, albeit on a higher base, partially due to inflationary pressures. However, it still is marginally higher than its April 2022 estimate of 3.6%. This, in our opinion, is partly attributable to the likelihood of crude oil prices remaining at elevated levels despite an expected softening in crude oil demand, owing to the October 2022 OPEC+ agreement to reduce crude oil production by 2 million barrels per day (bpd) from November. The US EIA forecasts Brent crude price per barrel to average c. USD 102 in 2022 and around USD 95 in 2023. Similarly, the World Bank estimates Brent to average USD 100 in 2022 and USD 92 in 2023. While the OPEC+ agreement might curb crude oil production, the diversion of trade caused by the Ukraine war might offset some impact as a few European nations consider replacing Russian oil.

## Non-oil private sector activity remains vibrant

Apart from driving GDP growth, higher crude oil prices also bode well for the finances of the Kingdom's government. Accordingly, the government estimates to record a budget surplus for the first time in around 10 years in 2022 at ~2.5% of GDP. This will support the government in maintaining its spending to achieve economic diversification and realize Vision 2030 goals. Saudi Arabia is currently undertaking several mega projects like NEOM and introduced initiatives like the SAR 5tn 'Shareek' program to induce private investment in the country and enhance their contribution to economic growth. Shareek aims to bring SAR 5tn worth of private investment into the economy by 2030 and is part of a larger SAR 12tn investment program. The initiative revealed that by the end of this decade, private consumption spending would reach SAR 5tn, in addition to government spending of SAR 10tn. This as well as other similar initiatives being rolled out by the government will ensure sustained development of the Kingdom's non-oil sector. The PMI numbers indicate that the efforts of the government are bearing fruit as the non-oil sector activity has remained in expansion mode for over two years now. Rapid economic development will also require the availability of adequate, affordable, and quality healthcare services since only a healthy population will be able to drive the economy on a long-term growth path. This would provide ample growth opportunities for the players in the Kingdom's healthcare sector, in our view.

**Fig. 6: Saudi non-oil sector's activity expanded for the 26th month in a row**

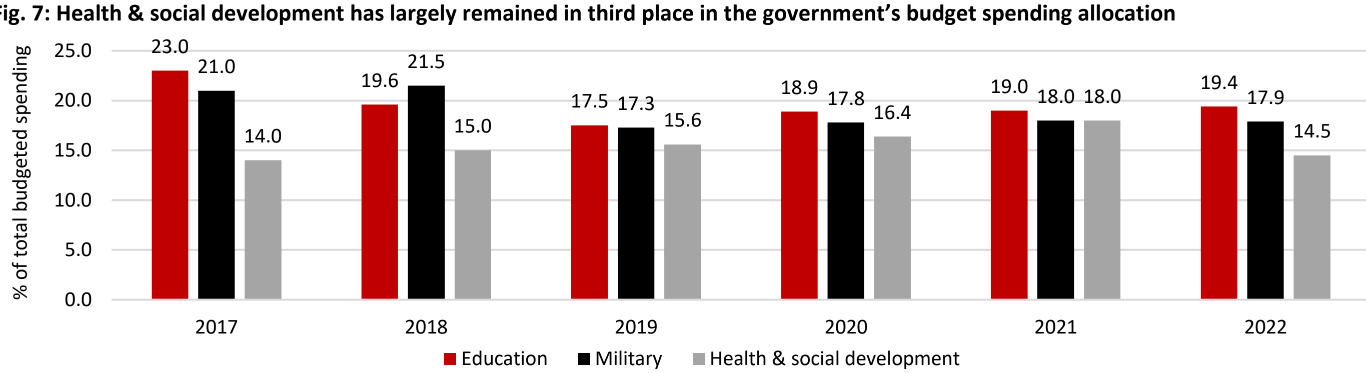



**Source: Trading Economics, FX Empire, markiteconomics.com, U Capital Research**

## Overview of the Saudi healthcare sector

Saudi Arabia is the MENA region's biggest economy and hence its healthcare sector is the largest in the region. Health & social sector has remained among the top five over the last few years in terms of the government's budgeted spending allocation.

**Fig. 7: Health & social development has largely remained in third place in the government's budget spending allocation**




**Source: Media reports on KSA budget, U Capital Research**

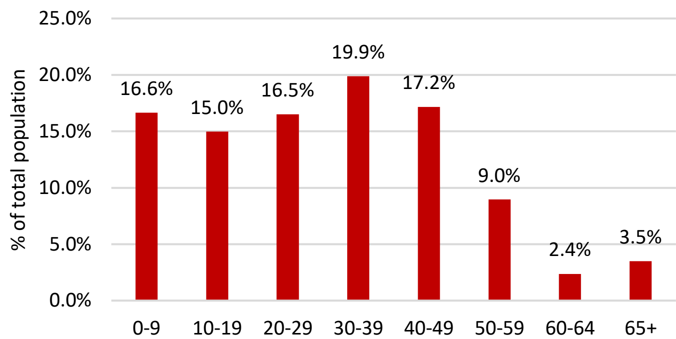
The Healthcare sector is one of the major pillars of Saudi Vision 2030 and the government intends to invest USD 65bn in the program for its development. In 2022, the government launched the Health Sector Transformation Program (HSTP) as part of Vision 2030 to restructure the sector and achieve Vision's objectives. The program aims to cover 88% of the Kingdom's population, including those living in rural areas, under inclusive health services by the end of 2025. While the government primarily manages the healthcare sector in the Kingdom, HSTP aims to make the private sector a strategic contributor to providing health services to beneficiaries and play an important role in the development of the sector. Accordingly, the private sector's contribution to the healthcare sector is targeted to be raised to 35% by 2030 from 25% currently through privatizations, public-private partnerships, and other such initiatives. Reportedly, the government aims to privatize 290 hospitals and 2,300 primary health centers by 2030. Thus, the government's resolve to improve access to health services for its citizens and residents through the equitable geographical distribution of healthcare facilities, together with the enhanced provision of e-services and digital solutions would provide private healthcare providers in the Kingdom with immense growth potential, in our view.

## Key demand drivers for the healthcare sector in the Kingdom

### Demographic changes

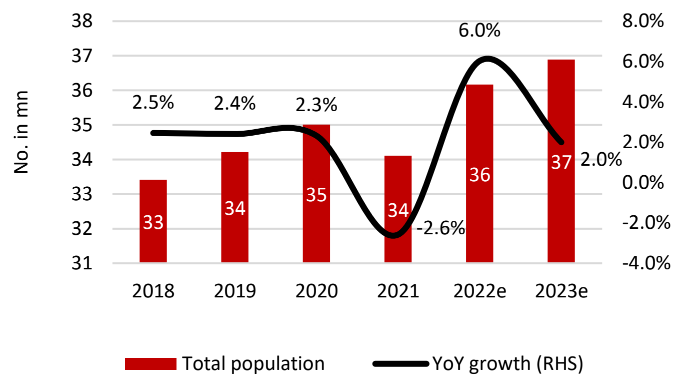
The GCC countries, including Saudi Arabia, boast of a young population. As per the mid-2021 population census, around 48% of the population was up to 29 years of age, while 68% of people were in the 0-39 years age group. Saudi Arabia is the most populous country in the GCC, and its population grew at a ~2% rate on average during 2017–2020 but fell in 2021 by 2.6% to 34.1mn as expatriate population, which accounts for a significant portion of the total population (36.5% in 2020), shrank post imposition of expat fees and the COVID-19 pandemic as the employment opportunities reduced and the government intensified its Saudization drive. Nevertheless, as COVID-19 ebbs and economic activity rebounds, expatriates are expected to return. Accordingly, the IMF forecasts the Saudi population to reach about 36mn by 2022-end, implying a 6% YoY growth, and continue expanding at ~2% average rate over the medium term. At this rate, we estimate the Kingdom's population to reach around 40mn by FY2027-28.

**Fig. 8: Close to 50% of the total KSA population is below 30 years**




*Source: GASTAT, U Capital Research; *as per the mid-2021 census*

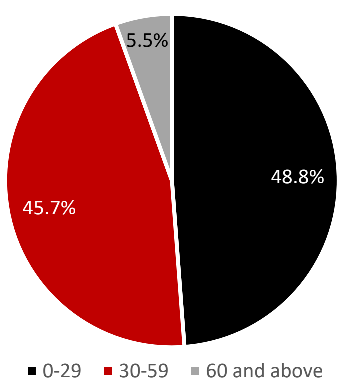
**Fig. 9: Saudi population likely to grow in 2022 after declining in 2021**




*Source: GASTAT, IMF, U Capital Research*

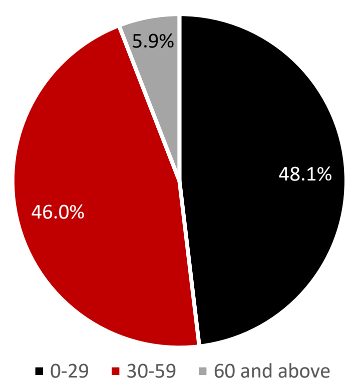
Apart from expanding, Saudi Arabia's population is also aging progressively. The proportion of the population below 29 years fell slightly from 48.8% in 2018 to roughly 48.1% in 2021. On the other hand, the proportion of the population aged 60 and above edged up from 5.5% in 2018 to 5.9% in 2021.

**Fig. 10: Saudi has a young population**




*Source: GASTAT, U Capital Research; *as per the mid-2018 census*

**Fig. 11: Saudi population to continue expanding at ~2% average rate**



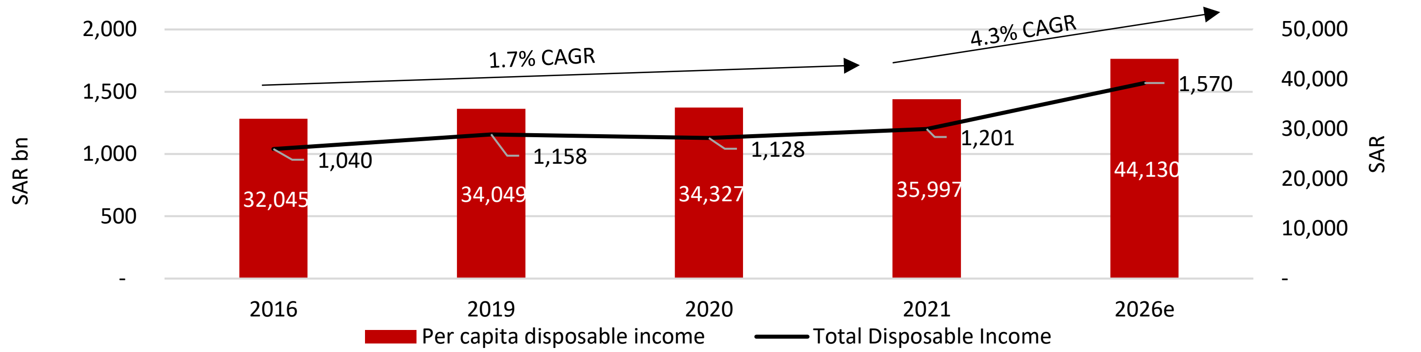

*Source: GASTAT, U Capital Research; *as per the mid-2021 census*

Moreover, on the back of improvements in the quality of healthcare infrastructure services, the average life expectancy in the Kingdom increased from 74.8 to 75.3 in four years. With the planned transformation of the healthcare sector, HSTP aims to increase it further to 80 years, matching the average life expectancy of G8 countries and meeting Vision 2030 goals. A growing population with an increasing share of adult people will surely lead to an increase in the demand for healthcare and pharmaceuticals.

### Rising income levels with unhealthy lifestyle

Saudi Arabia's per capita disposable has increased gradually over the years on the back of growing government spending and rising employment opportunities.

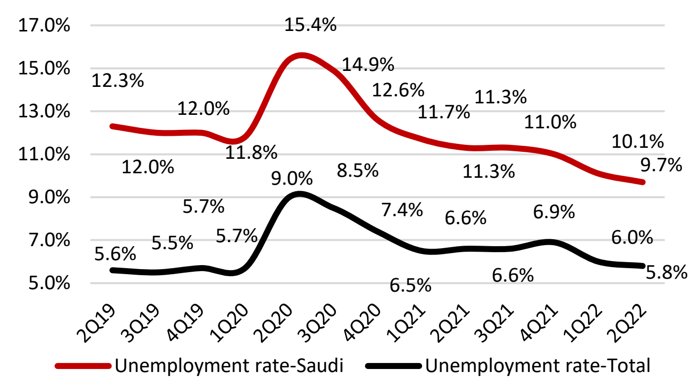
**Fig. 12: Per capita disposable income growth is expected to accelerate at ~4% CAGR backed by healthy economic expansion**




**Source: Nahdi Medical Company Prospectus, U Capital Research**

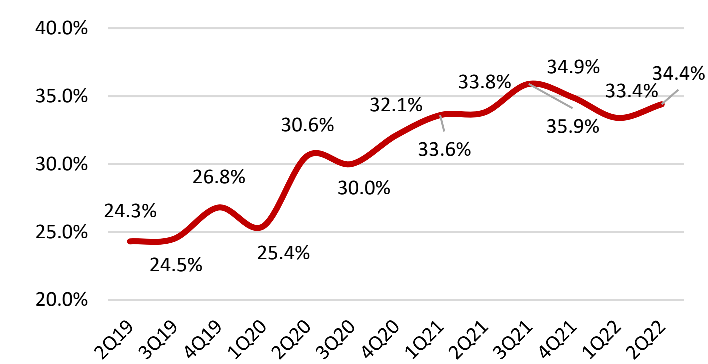
While the labor market conditions deteriorated with the onset of COVID, a rebound in economic growth following the reopening of the economy has relieved the pressure on the job market. The Saudi unemployment rate, after reaching a high of 15.4% in 2Q 2020 at the peak of the coronavirus crisis, eased and fell to 9.7% in 2Q 2022. Along with a decrease in the jobless rate, female participation in the country's labor force is consistently rising, supported by the reforms undertaken by the government previously like the removal of the ban on women driving. These developments are likely to continue driving households' disposable income higher over the coming years.

**Fig. 13: KSA's unemployment rate continues to ease**




***Source: GASTAT, U Capital Research***

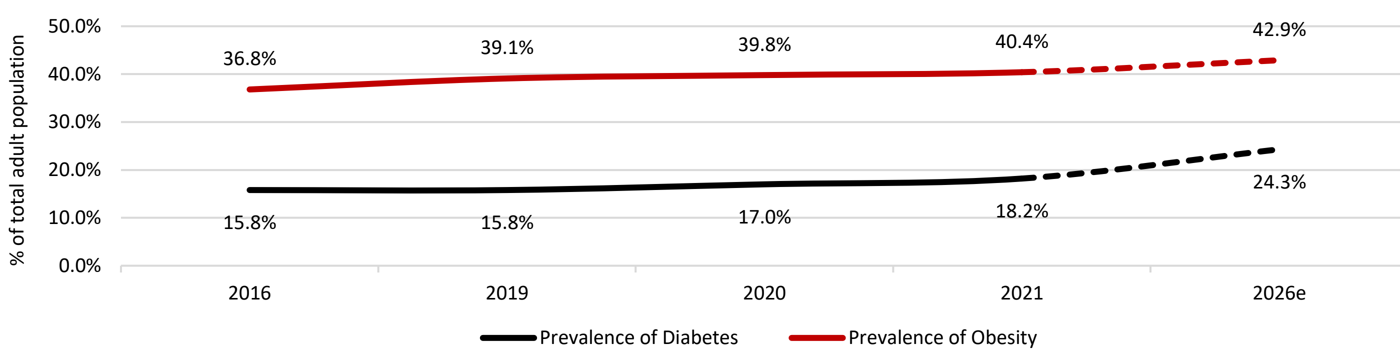
**Fig. 14: Female participation in KSA's labor force in an uptrend**




***Source: GASTAT, U Capital Research***

However, while economic and technological advancements have enhanced the earning and spending capacity of households, they also have cast an adverse impact on personal well-being. Preference for sophisticated and comfortable living with little physical activity, sedentary work practices, job-related stress, and unhealthy eating habits have led to a significant increase in lifestyle-related diseases like obesity, diabetes, heart stroke, etc., in recent times and the trend is likely to continue.

**Fig. 15: Lifestyle changes are likely to lead to increased cases of certain health disorders**

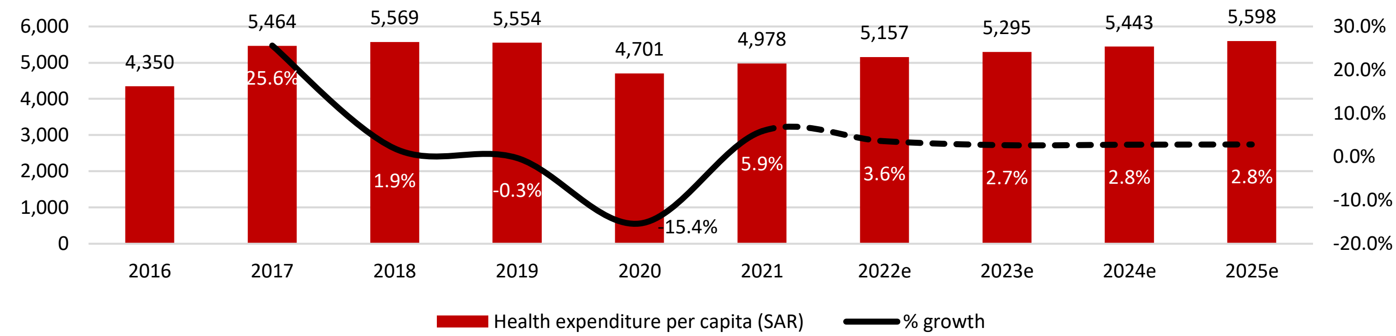



**Source: Nahdi Medical Company Prospectus, U Capital Research**

For instance, according to HSTP, the diabetic population in the Kingdom is likely to jump by over 80% to reach 8.4mn by 2030 as compared to 4.6mn in 2016. Some of these diseases like diabetes, hypertension, heart disease, etc. require the patient to administer regular medicines over his/her lifetime. Hence, it goes with saying that rising cases of such diseases will boost the demand for healthcare services and pharma products.

The societal changes highlighted above, i.e., rising income levels with unhealthy living are likely to increase a household's healthcare expenditure. Saudi Arabia's per capita healthcare expenditure grew at over 8% CAGR between 2016 and 2019 but fell about 5% YoY in 2020 as people deferred several non-urgent treatments or surgeries during COVID. This is also visible in available patient data of listed Saudi healthcare companies that witnessed an increase in inpatients and a dip in outpatients during COVID. However, as the situation has normalized to a large extent now, per capita health expenditure is expected to resume a growing trend.

**Fig. 16: Healthcare expenditure was reduced in 2020 as some non-critical treatments were delayed with the onset of COVID**

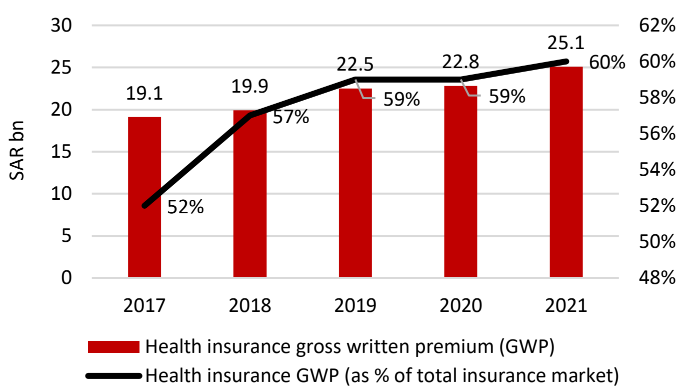



**Source: Scientific & Medical Equipment House Prospectus, U Capital Research**

## Growing health insurance spending

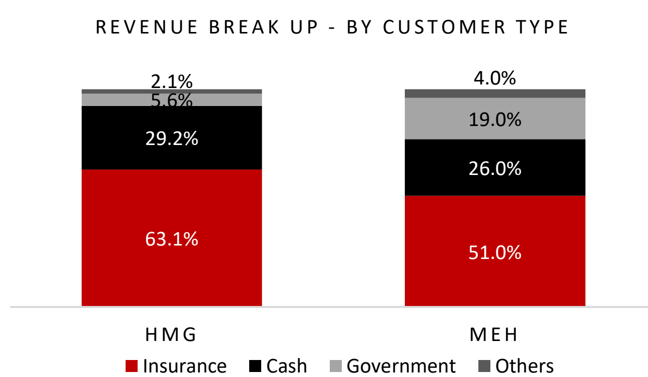
Saudi Arabia introduced health insurance in 1999 which currently is governed by the Council of Cooperative Health Insurance (CCHI). The healthcare insurance market has evolved with the government introducing/amending legislations and policies with the changing requirements. For instance, in the aftermath of COVID-19, the government made healthcare insurance mandatory for all working Saudi Nationals, expatriates and their respective families, Hajj pilgrims, and visitors to the Kingdom. The Kingdom's health insurance sector has registered healthy growth over the years, and we expect the trend to continue, driven by governmental regulations, increased awareness about health insurance benefits, particularly after the coronavirus pandemic, and rising healthcare costs. This increase in health insurance coverage is beneficial for the growth of the healthcare sector as the insured population accounts for a major portion of the overall business of healthcare providers.

**Fig. 17: Health insurance's share of the total market continues to rise**



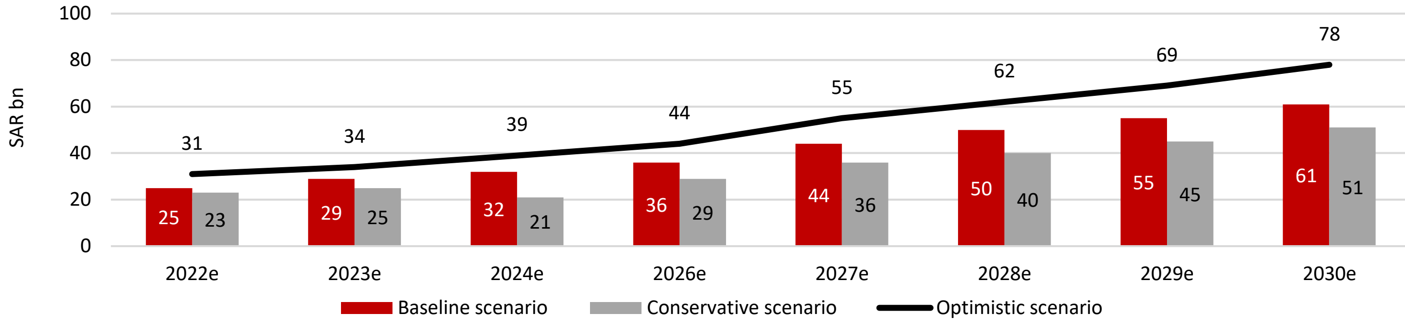

***Source: MEH 2Q'22 presentation, U Capital Research***

**Fig. 18: Insured customers generate the bulk of revenue**



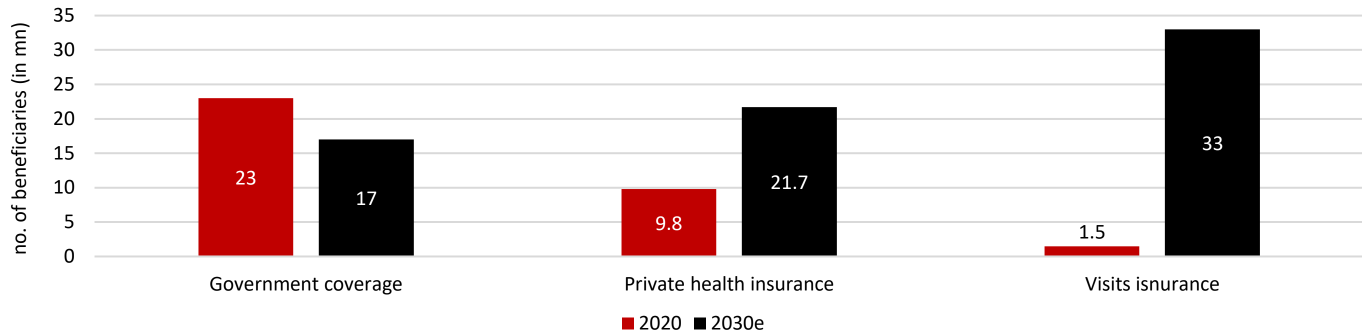

***Source: HMG and MEH presentation, U Capital Research***

**Fig. 19: Health insurance's GWP forecasted to reach around SAR 61bn by 2030**




**Source: DHC 2021 annual report, U Capital Research**

**Fig. 20: The market share of private players in the total health insurance market is estimated to more than double by 2030 vs. 2020**

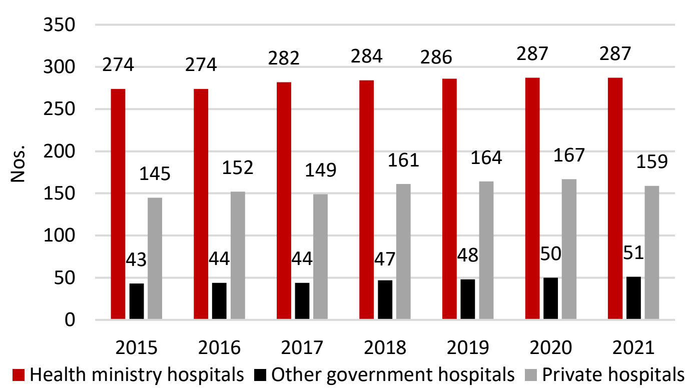



**Source: DHC 2021 annual report, U Capital Research**

## Improving healthcare infrastructure

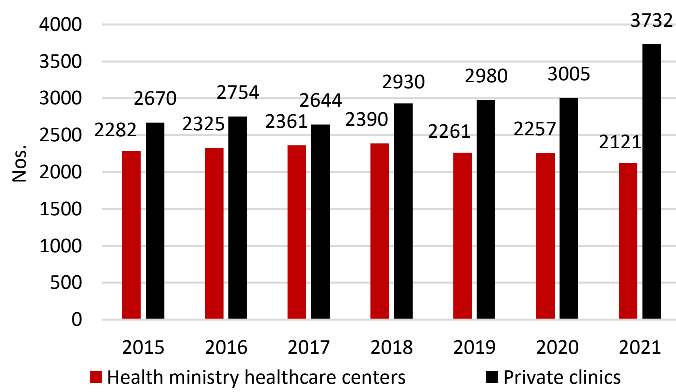
On the back of the government's focus to improve the quality and availability of healthcare facilities, Saudi Arabia has witnessed a gradual increase in the number of hospitals, healthcare centers, and clinics. Over the last decade ending 2021, total hospitals in the Kingdom increased at about 1.7% CAGR to reach close to 500 in 2021, accommodating over 77,000 beds, while the number of healthcare centers and clinics combined grew at 3.6% CAGR to reach over 5,000 by the end of 2021.

**Fig. 21: MoH accounts for over 50% of total hospitals in KSA**




*Source: Argaam, U Capital Research*

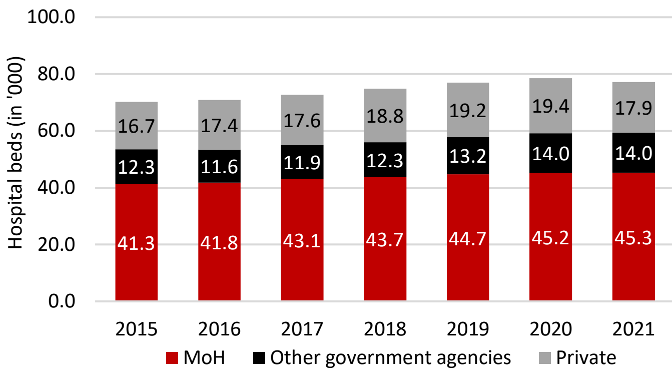
**Fig. 22: Private clinics are rising while ministry health centers decline**




*Source: Argaam, U Capital Research*

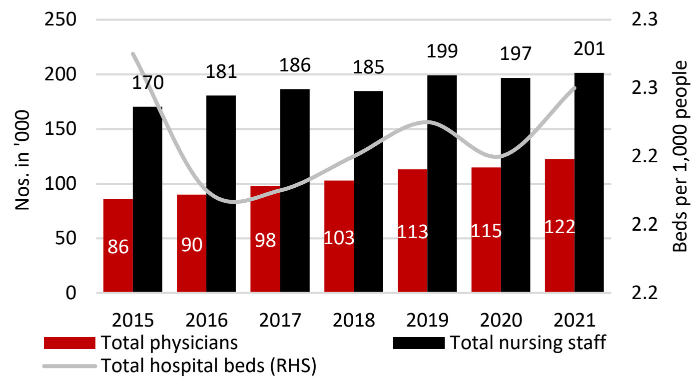
The latest documents of the listed healthcare providers show almost each of them is adding new healthcare facilities and/or expanding the existing ones. The MoH also intends to launch health clusters across the country and increase internationally accredited hospitals. Thus, we believe that the Kingdom's healthcare infrastructure would continue to swell going forward. According to an estimate from consultancy Colliers International, Saudi Arabia will need 20,000 additional beds, i.e., reach around 98,000 beds by 2030 to cater to the potential increase in permanent and temporary population increase.

**Fig. 23: Total hospital beds clocked 1.6% CAGR during FY15-21**




*Source: Argaam, U Capital Research*

**Fig. 24: Hospital beds per 1,000 people on a rising trend since 2016**




*Source: Argaam, U Capital Research*

While the new under-development hospitals are spread across the Kingdom, Riyadh, which accommodates ~25% of the total population (as of 2019) and hence has a dominant share of the existing healthcare infrastructure, is likely to further get several of the upcoming hospitals and clinics, considering the available data of the listed companies. This makes sense, in our view, since the government is focusing to transform Riyadh into a major global economic center. To achieve this, the development authorities intend to pump SAR 220bn and forecast the population of the capital region to double to 15-20mn and attract over 40mn visitors by 2030, which signals Riyadh will continue to provide a large addressable market for the healthcare players over the coming several years.

**Fig. 25: Riyadh continues to witness the establishment of several new hospitals despite having several of them already**

| Company | Existing hospitals | Under construction/proposed hospitals |
|---|---|---|
| **HMG** | Total: 7; Riyadh: 4 | Total: 5; Riyadh: 2; Jeddah: 2 |
| **MMC** | Total: 6; Riyadh: 1 | Total: 2; Riyadh: 1; Yanbu: 1 |
| **DHC** | Total: 4; Riyadh: 3 | Total: 3; Riyadh: 2; Jeddah: 1 |
| **HHC** | Total: 2; Riyadh: 2 | Total: 1; Riyadh: 1 |
| **MEH** | Total: 7; Riyadh: 1 | Total: 3; Riyadh: 1 |

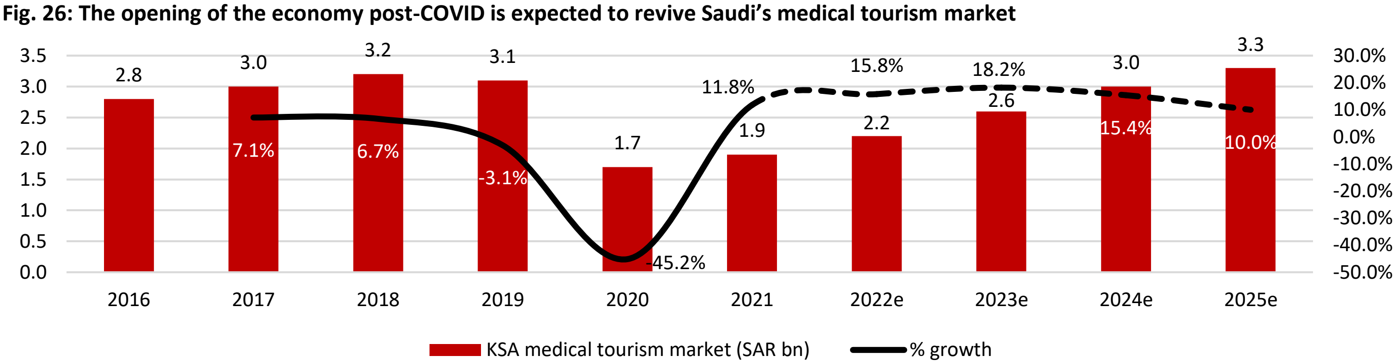
*Source: Company documents, U Capital Research*

Apart from expansion, the healthcare sector operators in Saudi Arabia have also opened new departments and inducted new technologies over the past few years, providing a wide range of treatment facilities for both critical and non-critical cases as well as support services like radiology, laboratory services, etc. This, in our view, will help attract more patients while retaining existing ones, who otherwise would have been going overseas for treatments

## Rebound in the medical tourism market

When visitors arrive in a country for medical treatment due to the availability of better and advanced treatment facilities there, and/or relatively lower costs of treatment, they are termed as medical tourists. Saudi Arabia's medical tourism market was growing steadily, but the advent of the pandemic impacted it significantly. However, with the situation now moving toward normalization, this market is expected to revive.

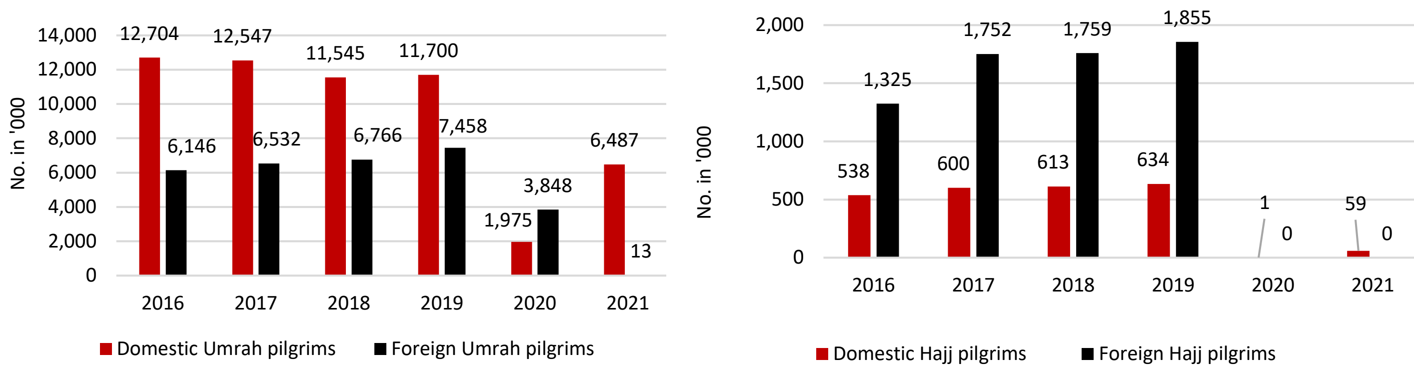
**Fig. 26: The opening of the economy post-COVID is expected to revive Saudi's medical tourism market**




*Source:* **Scientific & Medical Equipment House Prospectus, U Capital Research**

Apart from medical tourism, religious tourism is also likely to drive healthcare demand with the resumption of the Hajj and Umrah pilgrimage as they bring in a horde of foreigners in the country for a relatively longer duration than normal visitors, with many older people that have a higher probability of seeking medical attention. According to media reports, nearly 1mn pilgrim performed Hajj in 2022, significantly higher than 59k Hajj pilgrims in 2021.

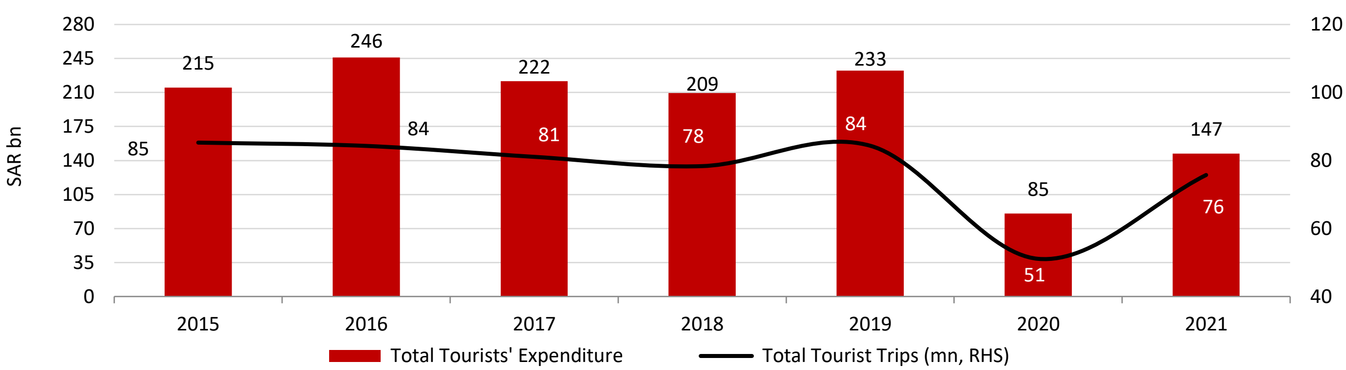
**Fig. 27: Hajj and Umrah pilgrims started to rise as the government eases COVID-related restrictions**




***Source: GASTAT, U Capital Research*** ***Source: GASTAT, News reports, U Capital Research***

In addition, Saudi Arabia's plan to raise the attractiveness of the Kingdom as a tourist destination also presents a sizeable opportunity for the country's healthcare sector, since it brings a significantly higher number of people to the country each year as compared to the resident population. For instance, in 2022, the government looks forward to attracting 70mn tourists vs. 62mn tourists in 2021. Further, by 2030, the Kingdom targets to bring in 100mn visitors, including 55mn international tourists every year.

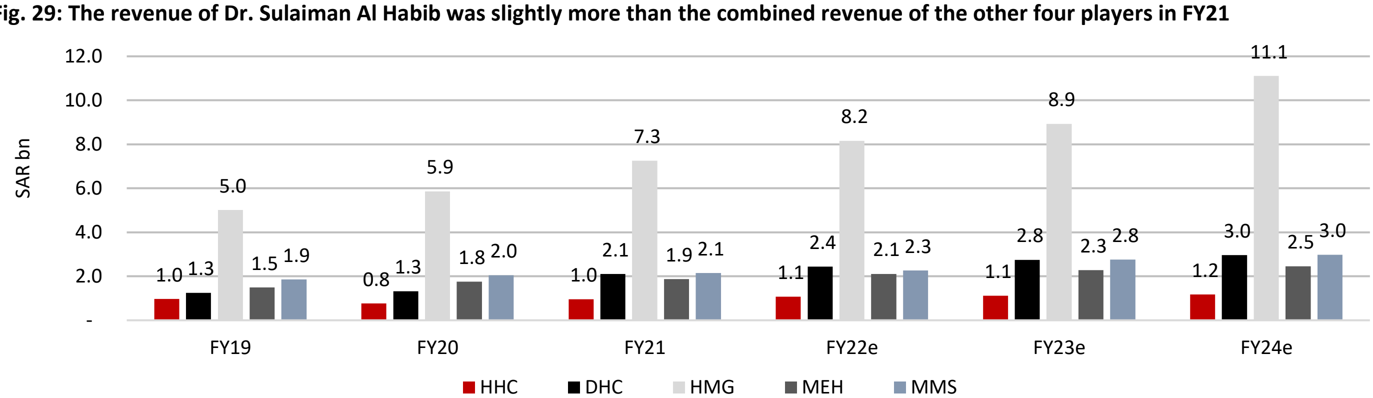
**Fig. 28: KSA's tourism sector post a rebound as travel-related curbs eased after COVID eases**




***Source: Saudi Ministry of Tourism, U Capital Research***

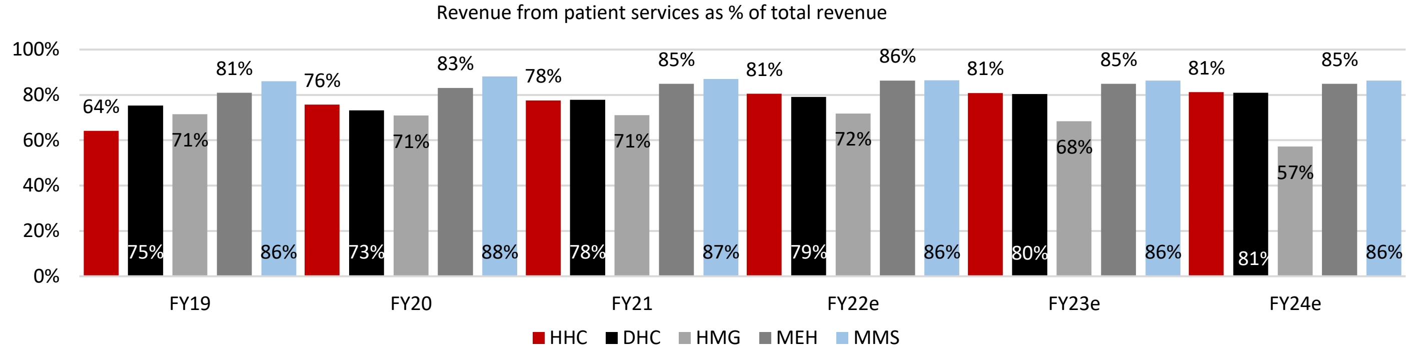
## Some KPIs of the five healthcare companies under our coverage

**Fig. 29: The revenue of Dr. Sulaiman Al Habib was slightly more than the combined revenue of the other four players in FY21**



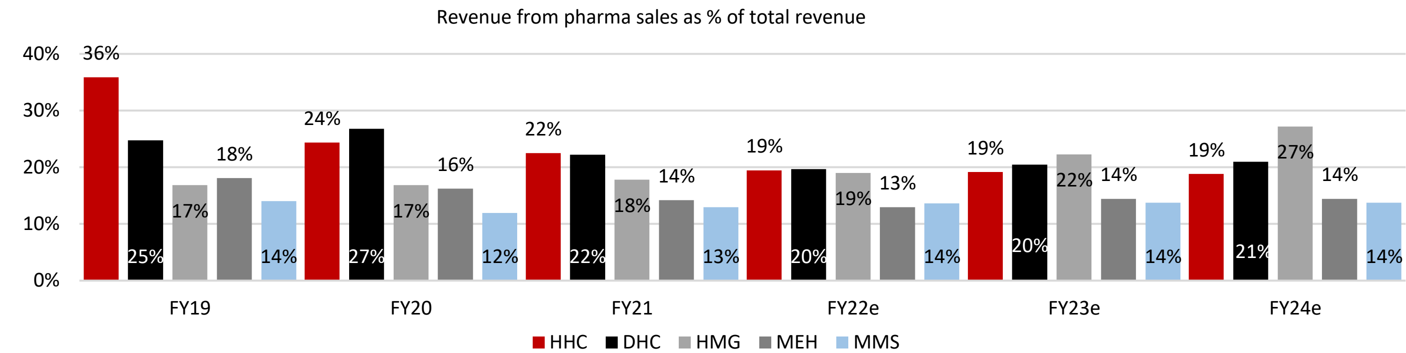

***Source: Company documents, U Capital Research***

**Fig. 30: Revenue from patient services accounts for a majority of the revenues of the healthcare companies**



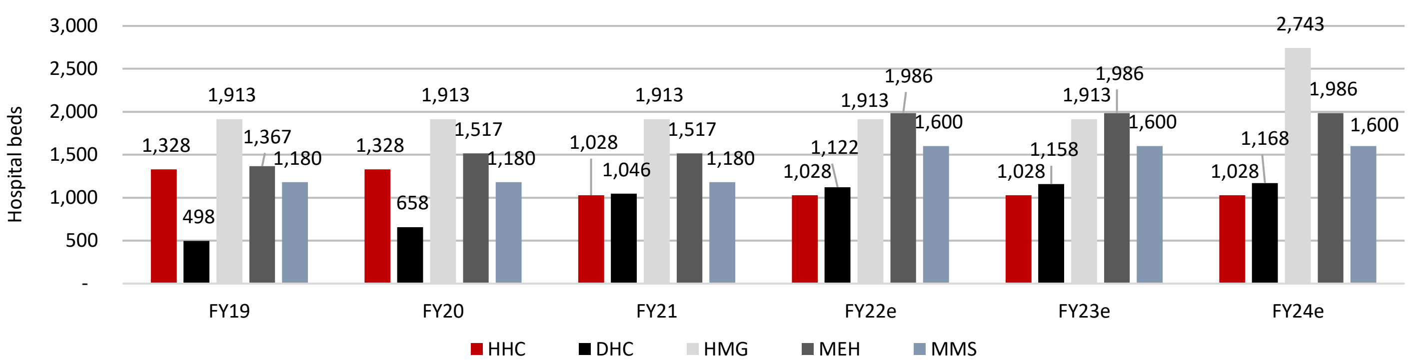

*Source: Company documents, U Capital Research*

**Fig. 31: Revenue from pharma sales as % of total revenue**



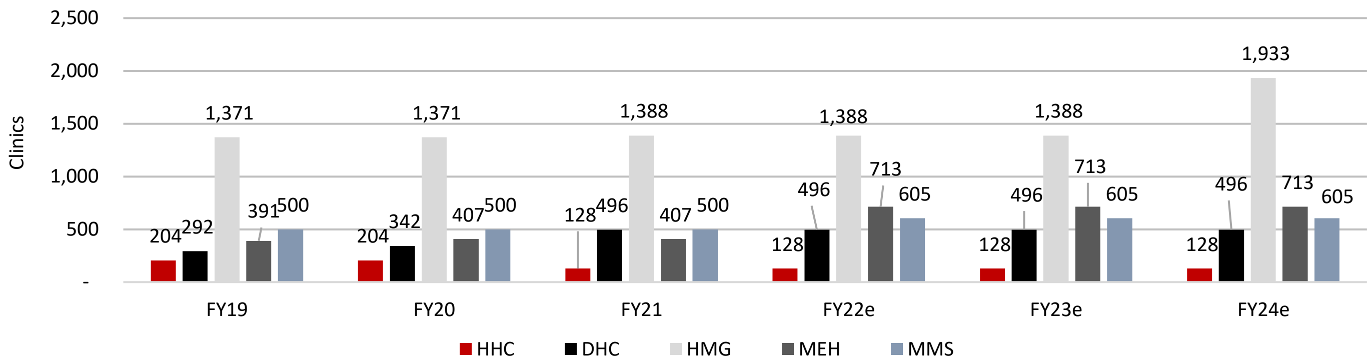

*Source: Company documents, U Capital Research*

**Fig. 32: MEH is estimated to have the highest number of hospital beds in FY22e, followed by HMG**



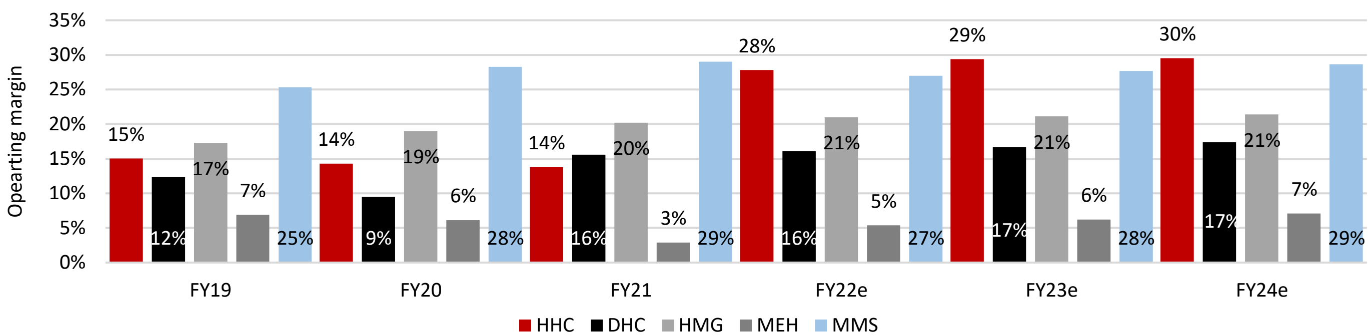

*Source: Company documents, U Capital Research*

**Fig. 33: By FY24e, HMG's clinics will be almost equivalent to the combined clinics of the other four players**



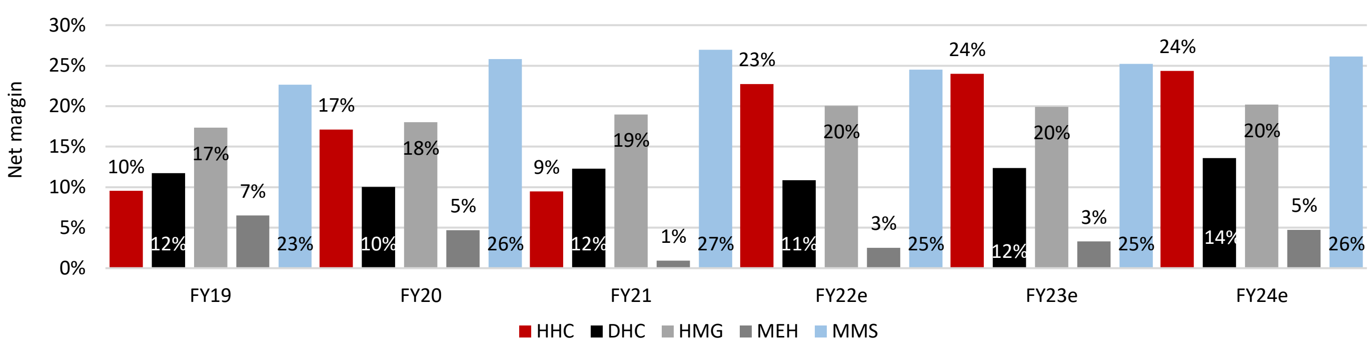

***Source: Company documents, U Capital Research***

**Fig. 34: Mouwasat has the best operational efficiency, though Al Hammadi is expected to catch up**



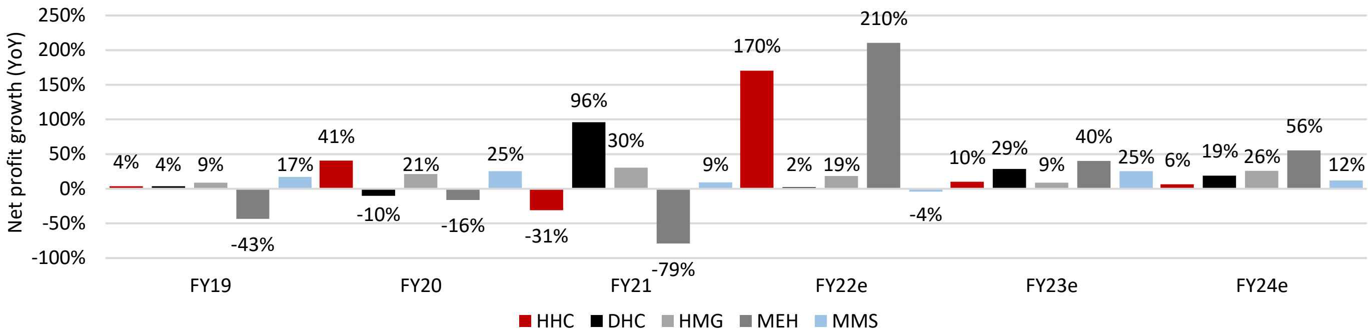

***Source: Company documents, U Capital Research***

**Fig. 35: Middle East Healthcare has the thinnest net margin among all the five players**



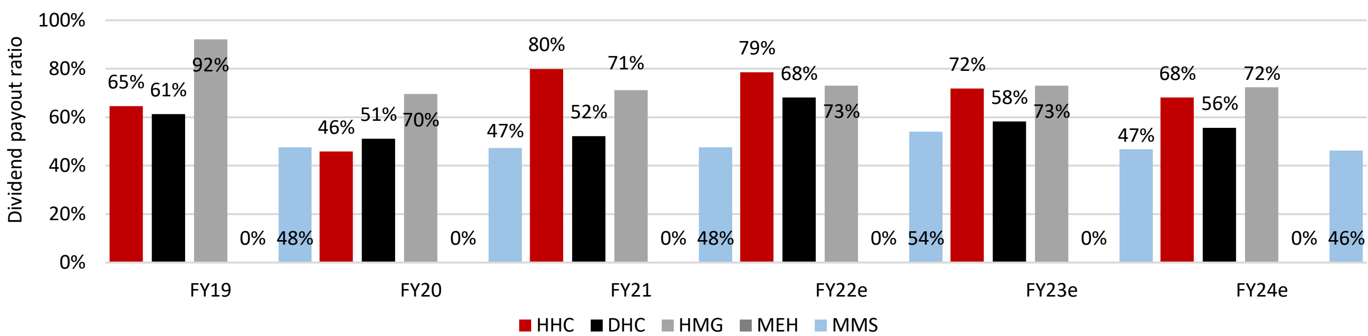

***Source: Company documents, U Capital Research***

**Fig. 36: During FY19-FY21, only HMG and MMS posted consistent earnings growth**



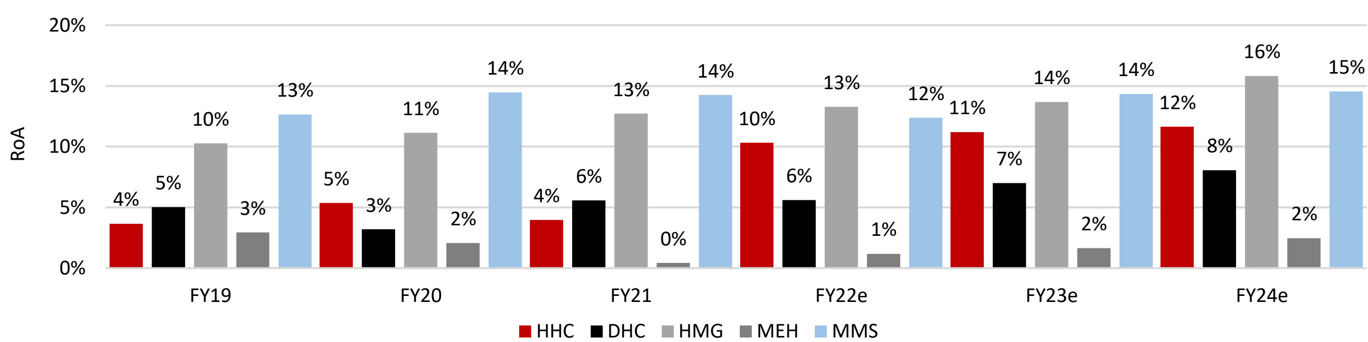

***Source: Company documents, U Capital Research***

**Fig. 37: Al Hammadi is expected to have the highest dividend payout this year and the next**



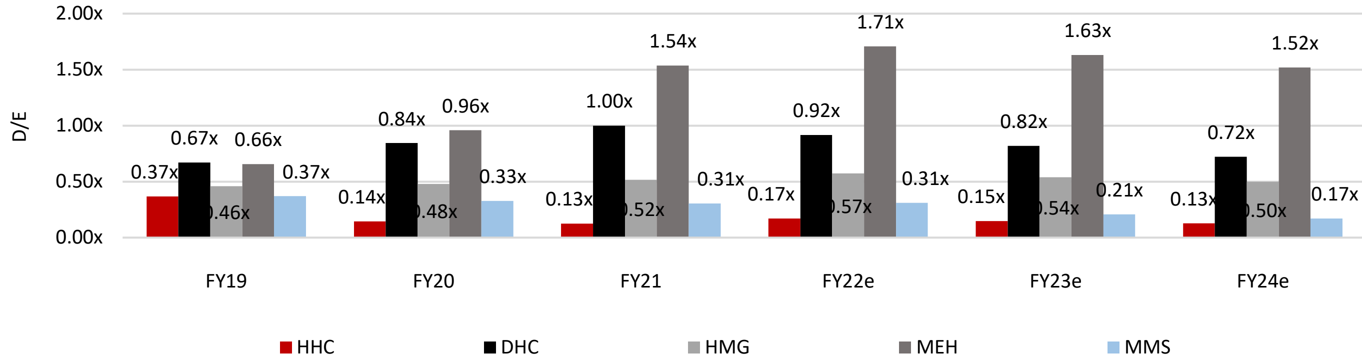

***Source: Company documents, U Capital Research***

**Fig. 38: Mouwasat has been generating one of the best returns on its assets**



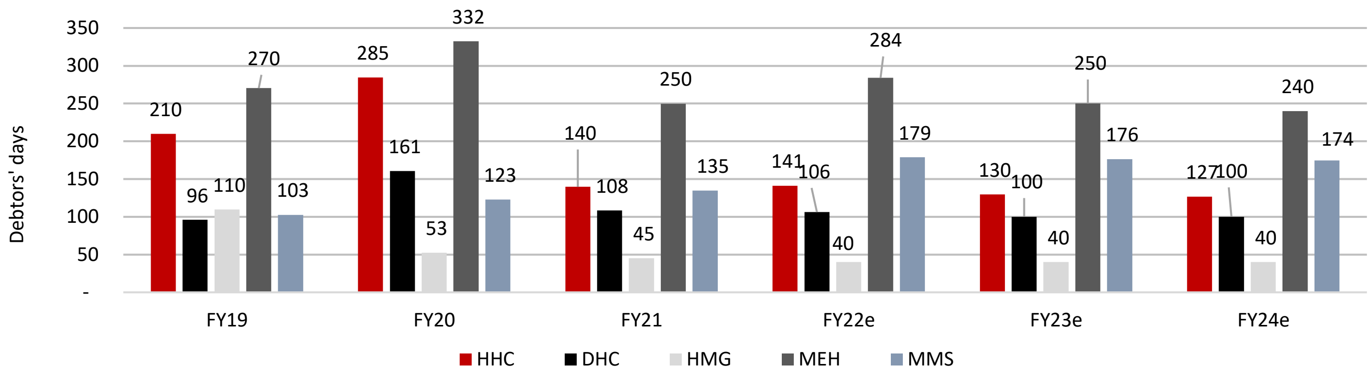

***Source: Company documents, U Capital Research***

**Fig. 39: Al Hammadi and Mouwasat have among the lowest debt/equity**



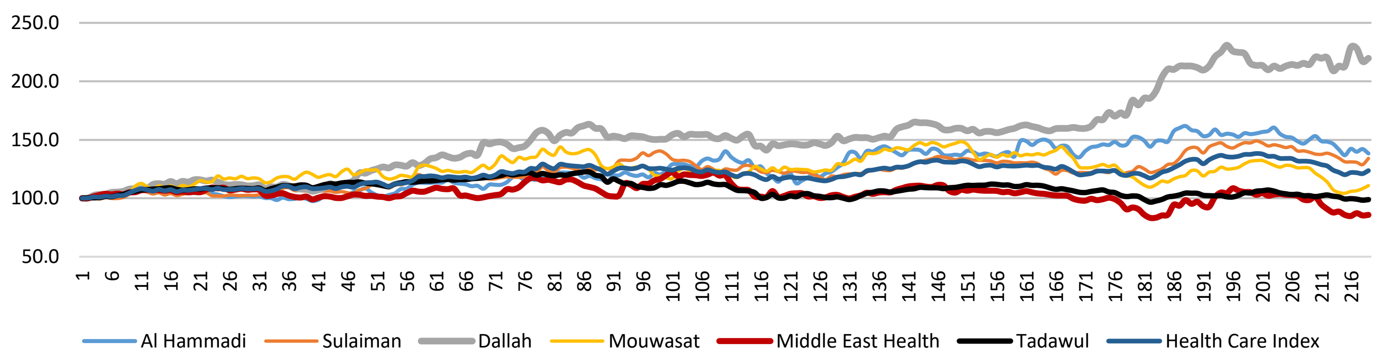

***Source: Company documents, U Capital Research***

**Fig. 40: Dr. Sulaiman has managed its debtors in the most efficient manner**




***Source: Company documents, U Capital Research***

**Fig. 41: Healthcare index has generated ~24% returns YTD till 17 November while Tadawul fell marginally by 1% during this period**




***Source: Company documents, U Capital Research***

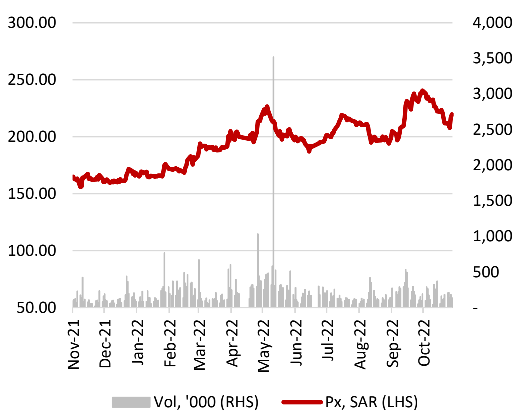
# Dr. Sulaiman Al Habib

**Target Price: SAR 220.00/share**
**Upside/(downside): 0.2%**

| **Recommendation** | **Hold** |
|---|---|
| Bloomberg Ticker | SULAIMAN AB |
| Current Market Price (SAR) | 219.60 |
| 52wk High / Low (SAR) | 240.60/148.00 |
| 12m Average Vol. (000) | 210.5 |
| Mkt. Cap. (USD/OMR mn) | 20,441/76,860 |
| Shares Outstanding (mn) | 350.0 |
| Free Float (%) | 24% |
| 3m Avg Daily Turnover (SAR'000) | 39,876.1 |
| 6m Avg Daily Turnover (SAR'000) | 48,718.4 |
| P/E'23e (x) | 43.2 |
| EV/EBITDA'23e (x) | 35.6 |
| Dividend Yield '23e (%) | 1.7% |
| | |
| **Price Performance:** | |
| 1 month (%) | (7.7) |
| 3 month (%) | 4.5 |
| 12 month (%) | 31.3 |

***Source: Bloomberg, valued as of 17 November 2022***

**Price-Volume Performance**




***Source: Bloomberg***

- **A leading private player in the Kingdom's healthcare sector, having 6 hospitals, 14 pharmacies, and one medical center in Saudi, plus a hospital and 3 pharmacies in Dubai**
- **HMG has among the highest number of hospital beds and clinics in KSA currently, and these are expected to further jump by over 70% during the next five years**
- **The company posted solid top-line growth with margin expansion over the last five years, and we expect it to showcase similar performance going forward**
- **HMG's stock has appreciated ~36% YTD and look expensive at FY22e P/E of about 47x**

We initiate coverage on Dr. Sulaiman Al Habib Medical Services Group (HMG) and assign a **Hold** rating with a target price of SAR 220.00 per share, indicating an upside of 0.7%. Currently, the stock trades at a P/E of 43.2x, based on our FY 2023 estimates. HMG is a major private healthcare player in Saudi, which accounted for over 50% of the combined top and bottom line of the five companies under our coverage in FY 2021. HMG has posted strong financial performance and is the only player among our coverage to post consistent revenue and earnings growth with profitability improvement. The company is constructing 5 new hospitals that are expected to commence operations during FY 2024-2026 (vs. one hospital opened during the past five years), which will further boost the company's market position.

## Investment Thesis

**Valuation and risks:** Our target price is based on blended valuation methodologies – (i) Discounted Cash Flow (DCF) and (ii) Relative Valuation (using P/E multiple). Key downside risks to our valuation include i) delay in the expected opening of new hospitals/clinics, ii) lower-than-estimated utilization of the medical facilities iii) below-expected growth rate of the revenue per utilized bed and/or effective clinic, iv) below-expected margins, and iv) higher than estimated leverage levels. Key upside risks to our valuation include i) higher-than-estimated addition and/or utilization of hospital beds and/or clinics ii) below-expected growth rate of the revenue per utilized bed and/or effective clinic iii) above-expected margins, and iv) lower-than-forecasted debt levels and/or effective interest costs.

**Exceptional performance:** HMG operates 6 hospitals in Saudi, with 4 hospitals in Riyadh, and one hospital in the UAE. i) Total hospital beds stood at 1,913 at FY21, estimated to reach over 3,300 by FY26. Clinics to increase to ~2,400 from 1,388 in FY21 ii) Revenue clocked 13% CAGR during FY17-21. Estimated to grow further at 14% CAGR till FY26, driven by over 70% expansion in its capacity iii) Operating margin expanded over 500bp, the net margin by 400bp during FY17-21, aiding net income to grow at 20% CAGR. We estimate net profit to grow at 16% CAGR during FY21-26 iv) Strong balance sheet with solid cash flows (SAR 2.4bn at 3Q22-end vs. SAR 1.1bn at FY17-end) v) Capex as % of revenue to remain high (~21% in FY22e; ~18% in FY23e), but gradually edge lower as projects reach completion vi) Consistent dividend payout.

| Year | FY19 | FY20 | FY21 | FY22e | FY23e | FY24e |
|---|---|---|---|---|---|---|
| Revenues (SAR mn) | 5,016.3 | 5,861.6 | 7,250.5 | 8,156.5 | 8,929.5 | 11,105.2 |
| Net income (SAR mn) | 870.2 | 1,055.5 | 1,376.6 | 1,633.5 | 1,779.4 | 2,241.1 |
| Gross margin | 30.4% | 31.8% | 32.1% | 33.3% | 33.4% | 33.6% |
| Net profit margin | 17.3% | 18.0% | 19.0% | 20.0% | 19.9% | 20.2% |
| RoE | 20.0% | 22.7% | 26.9% | 29.4% | 29.6% | 34.1% |
| FCF (SAR/share) | (0.2) | 3.6 | 1.2 | 0.8 | 1.2 | 2.4 |
| DPS (SAR/share) | 2.3 | 2.1 | 2.8 | 3.4 | 3.7 | 4.6 |
| Dividend Yield | NA | 1.9% | 1.7% | 1.6% | 1.7% | 2.1% |
| P/E (x) | 0.0x | 36.1x | 41.0x | 47.1x | 43.2x | 34.3x |
| P/BV (x) | 0.0x | 7.8x | 10.6x | 13.3x | 12.3x | 11.2x |

*Source: Company Reports, U Capital Research* **P/E, P/B, and dividend yield from 2022 onwards calculated on price of 17/11/2022*



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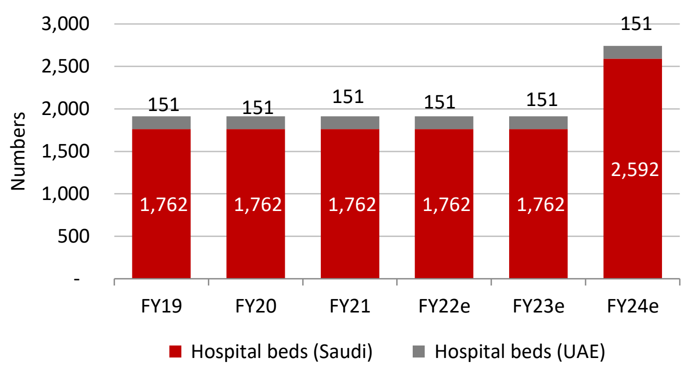
## Five new hospitals are expected to be added during FY 2024-2026, boosting capacity by over 70%

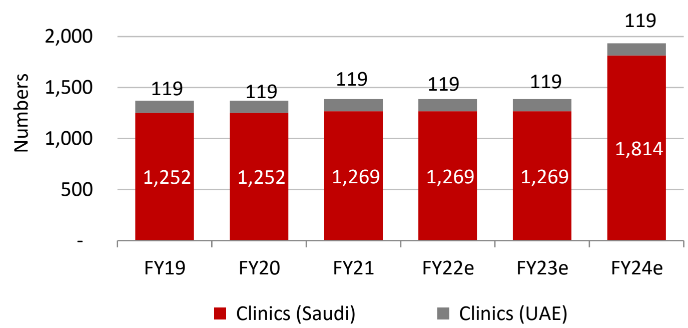
HMG is one of the major healthcare service providers in the GCC, owning and operating a network of hospitals, clinics, and pharmacies. During FY 2021, the group operated six hospitals (four in Riyadh, and one each in Khobar and Qassim), a Medical Center, and 14 pharmacies in the Kingdom. Moreover, it has one hospital and three pharmacies in the UAE, Dubai. Together, they accounted for 1,913 hospital beds and 1,388 outpatient clinics. HMG also established an Operated Contracts Company in 2017 through which it operates intensive care facilities for third parties at several locations across the Kingdom like Dammam, Qassim, Madinah, NEOM, and others.

**Fig. 42: Opening of new hospitals will start lifting capacity of beds…**




**Source: Company Reports, U Capital Research**

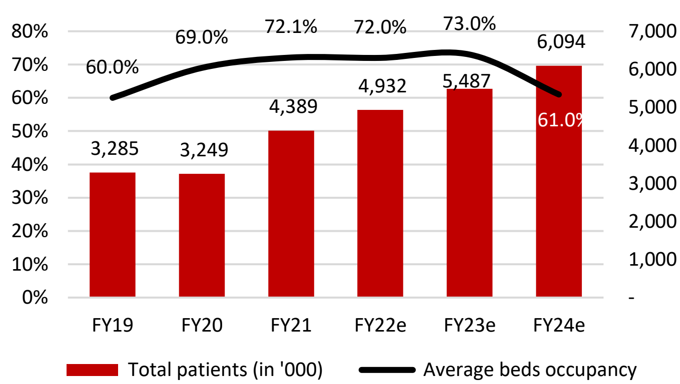
**Fig. 43: …as well as clinics from FY24e**




**Source: Company Reports, U Capital Research**

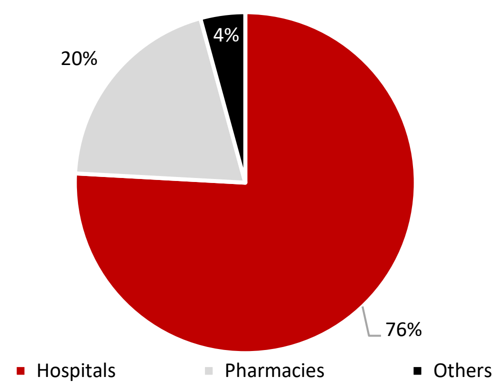
HMG has added new hospitals at regular intervals, leading to a consistent increase in hospital beds and clinics which we believe drove its patients' traffic at c.18% CAGR during FY 2007-2021. During the last five years, HMG has added one hospital (Khobar) in 2019 with 458 beds and 307 clinics and one Medical Center consisting of 17 outpatient clinics. However, the company is on track to add five more hospitals in the Kingdom by FY 2026 which would boost its hospital beds and outpatients' clinics capacity by more than 70% to 3,379 and 2,402, respectively. Apart from these, HMG also intends to open 6 medical centers over the next 2 years, four in Riyadh, one in Buraidah, and one in Dammam. These centers would generally include multi-specialty clinics, laboratories, pharmacies, etc.

**Fig. 44: Occupancy will dip in FY24e as new hospitals open**




**Source: Company Reports, U Capital Research; *FY19 occupancy is estimated**

**Fig. 45: Hospitals provide most of the revenue**




**Source: Company Reports, U Capital Research**

## Capacity expansion to drive patients' volume, culminating in revenue growth

Hospitals generate the bulk of the revenue for HMG, but they are gradually losing their share to pharmacies. The company received about 76% of its total revenue from hospitals during 3Q 2022, as compared to c. 82% in FY 2017. Overall revenue, though, grew at a solid 13% CAGR during FY 2017-2021, which we believe resulted from a similar increase in patient traffic during this period (FY 2017-2021 CAGR: 11%). The company also reported an increase in its average bed occupancy to 72.1% in FY 2021 as compared to 69% in FY 2020. Though the company has not given occupancy of clinics, we expect a similar figure for them as around 95% (based on FY 2017 and 2018 reported data) of the patients traffic of the group emanates from outpatients.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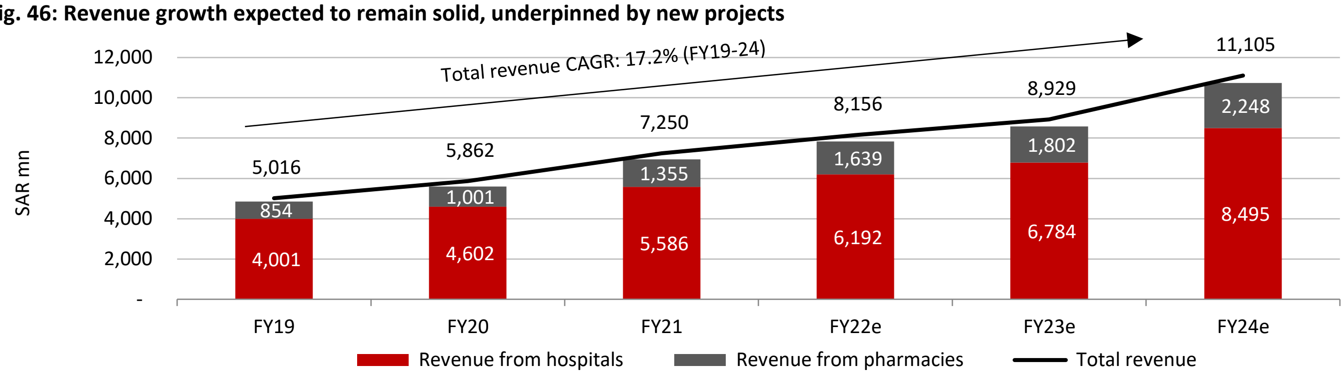
Given the HMG's good market positioning, wide and expanding geographical reach with the upcoming hospitals and medical centers, and the provision of end-to-end medical solutions, we opine the company remains well placed to carry on its strong growth momentum over the near-to-medium term. Accordingly, we estimate HMG's top line to replicate its historical performance and expand at about 14% CAGR till the end of our forecast period in FY 2026. We also expect HMG to remain on a healthy growth path post our forecast period, as the hospitals and clinics opened during FY 2024 and FY 2025 are likely to reach optimum capacity beyond FY 2026 only. In addition, the company is also working to set up a hospital each in Tabuk and Madinah, which currently are in the excavation and design phase, respectively, and we are optimistic that it will continue to undertake similar other projects in the future, backed by its strong balance sheet and healthy liquidity.

**Fig. 46: Revenue growth expected to remain solid, underpinned by new projects**

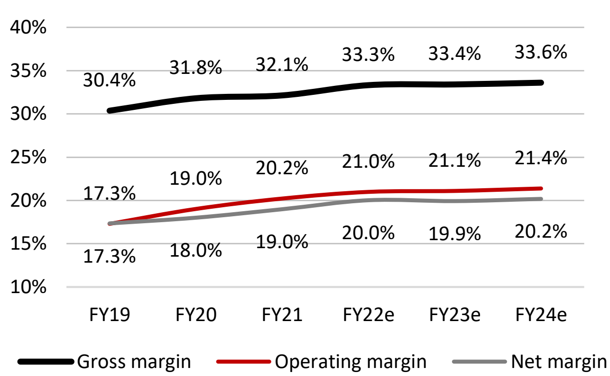



**Source: Company Reports, U Capital Research**

## Margins expand significantly in the past, but we expect somewhat muted improvement going forward

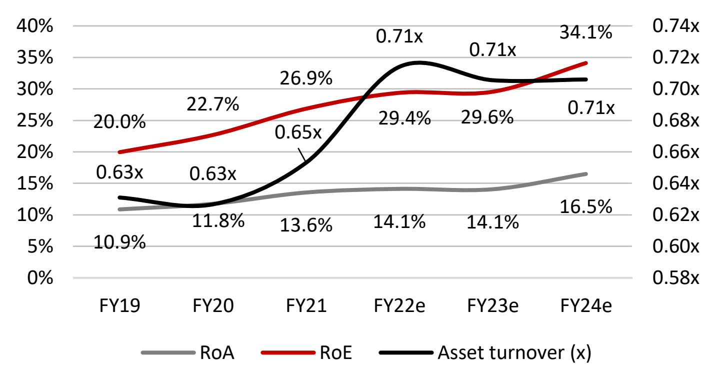
HMG has maintained good profitability with consistent improvement over the last five years. This is commendable, considering this included the pandemic period and a couple of new projects coming online, which generally take around two to three years to ramp up fully. HMG has kept on implementing the latest technologies with a focus on automation of services, and it also benefitted from economies of scale, which, together, aided it in ensuring growth with profitability, in our opinion. As increasing operational efficiency remains a key strategic priority for the company, we are hopeful it will be able to sustain the rising profitability trend. However, considering the time required in ramping up the new projects coming online over the next few years, we have estimated margins to expand at a relatively lower pace vs. in the past. Accordingly, operating, and net margins are forecasted to improve by slightly over 125 bp each by FY 2026e from FY 2021 (FY 2017-2021 – OPM: +526 bp; NPM: +400 bp).

**Fig. 47: Margin expansion accompanied by revenue growth…**




**Source: Company Reports, U Capital Research**

**Fig. 48: …lifting return to shareholders**




**Source: Company Reports, U Capital Research**

## Excellent working capital management enhances balance sheet strength

HMG has exhibited good fiscal management while consistently investing in expansions to achieve strong business growth. Although the debt-equity (D/E) ratio has increased gradually over the past few years, in our view, at 0.62x (March 2022-end), it remains at an acceptable level, in our view. Further, the company managed its working capital well as its days of sales outstanding reduced drastically from 139 days in FY 2017 to 39 days (on an annualized basis) during 3Q 2022. As a result, its net operating cycle days have come down to 12 by 3Q 2022-end from 118 at FY 2017-end.

**Fig. 49: The company lowered its cash collection period significantly**



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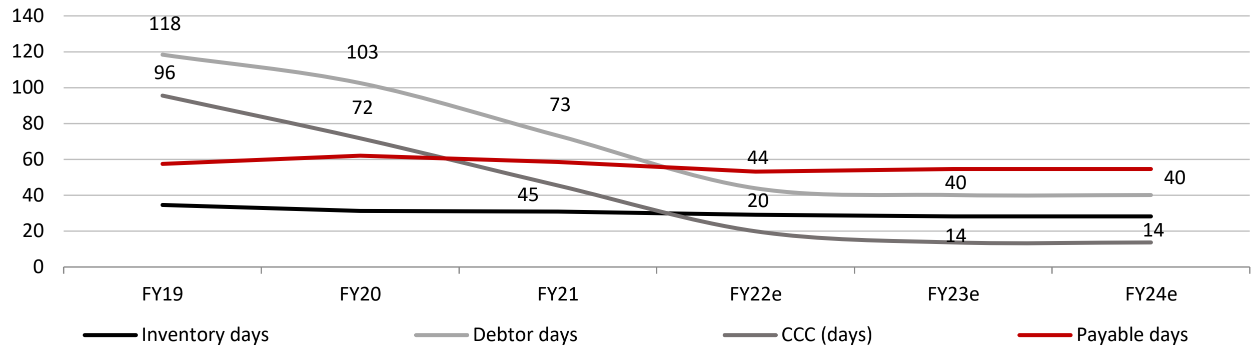
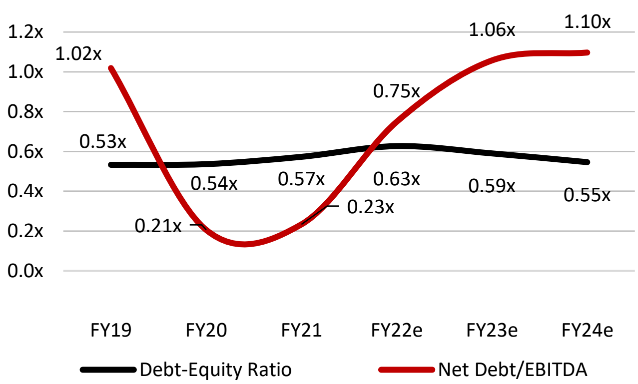



**Source: Company Reports, U Capital Research**

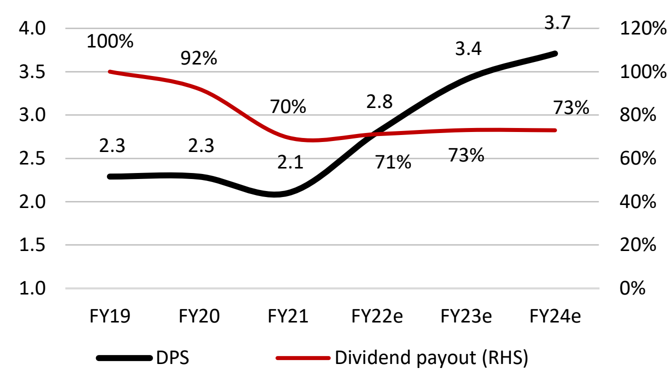
This has impacted HMG's liquidity positively with its cash balance swelling to ~SAR 2.4bn by the end of 3Q 2022 as compared to SAR 1.1bn at the end of FY 2017, even as its capital expenditure (capex) tripled to ~SAR 1.25bn in FY 2021 from SAR 421mn during FY 2017. However, going forward, we expect the company's capex requirements to gradually come down as construction of its ongoing projects finishes and they commence operations during FY 2024 and FY 2025. We also estimate HMG to continue enjoying healthy liquidity going forward with the projected increase in revenue and profitability, plus the prudent working capital management. Thus, on the back of healthy cash flows and the likely lower capex needs, the company might go for debt reduction and hence we estimate its D/E ratio to fall to ~0.5x by FY 2026e from ~0.6x currently.

**Fig. 50: D/E ratio forecasted to decrease going forward**




**Source: Company Reports, U Capital Research**

**Fig. 51: Dividend payout expected to remain above 70% in future**




**Source: Company Reports, U Capital Research**

Our estimate shows that excluding capex and debt repayment, HMG would be left with ample cash flows to keep rewarding its shareholders with consistent and good dividend payouts. The company's average dividend payout during FY 2017-2021 works out to nearly 85%, with the absolute DPS remaining stable or increasing every year, except in FY 2020. Since FY 2020, HMG has been following a quarterly dividend payment policy, and during the first three quarters of FY 2022, it has paid SAR 2.55 DPS on a cumulative basis (9M 2021: SAR 2.10). Assuming the company maintains a 4Q 2022 dividend at 2Q 2022 and 3Q 2022 level of SAR 0.86 per share, it would raise total DPS to SAR 3.41 (FY 2021: SAR 2.80), implying a dividend payout of about 73% based on our estimated FY 2022 net profit.

## Assign a Hold rating owing to the current high valuation multiple

HMG, with its superior financial metrics, solid expansion visibility, market-leading position, and good efficiency levels remains well-placed to sustain its strong top and bottom-line growth going forward. We also like the prudent financial management of the company, which is reflected in the significant decrease in its debtor days, contrary to some of its peers who have struggled on this front. However, with about 31% appreciation in the stock price since the start of this year, HMG is trading at a premium valuation (c. 43x at FY 2023e EPS). Accordingly, we assign a **HOLD** rating on the stock with a target price of SAR 220.00, implying an upside of 0.2%.

## About HMG

HMG is a diversified healthcare company based in Saudi Arabia. The company started operations in 1995 when it opened Olaya Medical Complex accommodating multi-specialty clinics and a pharmacy in Riyadh. Currently, HMG operates six hospitals in the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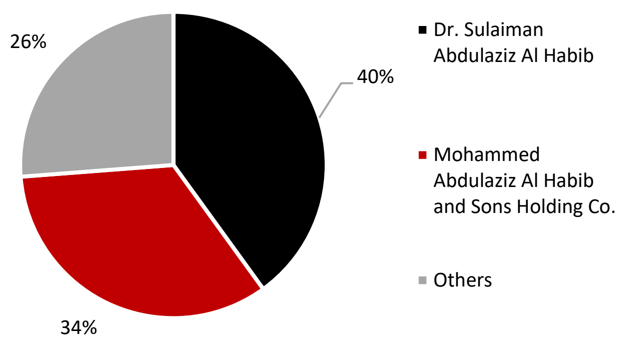
Kingdom and one hospital in Dubai, while another five hospitals are expected to start functioning over the next 5-6 years. The company generates bulk (over 75%) of its revenue through hospitals. There also are 17 pharmacies in the HMG's portfolio (14 in Saudi Arabia and three in Dubai). Patient traffic at the company's hospitals and clinics reached around 4.4mn in 2021 as compared to about 1.3mn in 2011. HMG employs over 13,500 personnel with 37% male and 63% female staff. It also has more than 3,000 physicians with a 90% retention rate. The company launched its IPO in March 2020 and subsequently got listed on Tadawul.

**Fig. 52: HMG: Shareholding Structure**




**Source: Company filings**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**Key financials**

| In SAR mn, except stated otherwise | FY19 | FY20 | FY21 | FY22e | FY23e | FY24e |
|---|---|---|---|---|---|---|
| **Income Statement** | | | | | | |
| Revenue | 5,016 | 5,862 | 7,250 | 8,156 | 8,929 | 11,105 |
| Cost of revenue | (3,493) | (3,997) | (4,920) | (5,439) | (5,947) | (7,373) |
| **Gross profit** | **1,524** | **1,864** | **2,330** | **2,718** | **2,983** | **3,732** |
| General & administrative expenses | (475) | (535) | (622) | (701) | (765) | (943) |
| Selling & marketing expenses | (181) | (215) | (242) | (305) | (334) | (415) |
| Other operating income | - | - | - | - | - | - |
| **Operating profit** | **868** | **1,115** | **1,466** | **1,712** | **1,884** | **2,375** |
| Interest expenses on lease liabilities | - | - | - | - | - | - |
| Finance charges | (28) | (48) | (38) | (45) | (59) | (60) |
| **Profit before zakat** | **903** | **1,128** | **1,501** | **1,791** | **1,947** | **2,452** |
| Zakat expense | (66) | (93) | (114) | (120) | (130) | (164) |
| **Profit attributable to shareholders of the company** | **870** | **1,055** | **1,377** | **1,634** | **1,779** | **2,241** |
| **Balance Sheet** | | | | | | |
| Cash and cash equivalents | 1,197 | 2,339 | 2,644 | 2,095 | 1,331 | 733 |
| Trade receivables | 1,507 | 844 | 899 | 893 | 981 | 1,220 |
| Advance payments for acquisition of property & equipment | - | - | - | - | - | - |
| Right of use assets | 330 | 282 | 295 | 310 | 323 | 328 |
| Property and equipment | 4,812 | 5,366 | 6,357 | 7,826 | 9,134 | 10,472 |
| **Total assets** | **8,467** | **9,481** | **10,827** | **12,295** | **13,002** | **14,172** |
| Accrued expenses and other liabilities | 415 | 555 | 716 | 1,030 | 1,126 | 1,397 |
| Short term lease liabilities | 318 | 271 | 292 | 310 | 324 | 329 |
| Trade payables | 656 | 628 | 805 | 823 | 890 | 1,104 |
| **Total liabilities** | **3,877** | **4,393** | **5,300** | **6,288** | **6,478** | **6,980** |
| Share capital | 3,500 | 3,500 | 3,500 | 3,500 | 3,500 | 3,500 |
| Retained earnings | 426 | 838 | 1,128 | 1,406 | 1,709 | 2,330 |
| **Equity Attributable to Shareholders** | **4,394** | **4,912** | **5,339** | **5,781** | **6,262** | **6,882** |
| **Cash Flow Statement** | | | | | | |
| Net cash generated from operating activities | 1,059 | 2,234 | 2,183 | 2,352 | 2,195 | 2,744 |
| Net cash generated from investing activities | (731) | (812) | (1,248) | (2,193) | (1,673) | (1,726) |
| Net cash (used in) provided by financing activities | (501) | (280) | (631) | (708) | (1,286) | (1,616) |
| **Cash and cash equivalents at the end of the period** | **1,197** | **2,339** | **2,644** | **2,095** | **1,331** | **733** |
| **Key Ratios** | | | | | | |
| Gross margin (%) | 30.4% | 31.8% | 32.1% | 33.3% | 33.4% | 33.6% |
| EBITDA margin (%) | 22.4% | 24.4% | 24.6% | 25.0% | 25.0% | 24.8% |
| Operating margin (%) | 17.3% | 19.0% | 20.2% | 21.0% | 21.1% | 21.4% |
| Net margin (%) | 17.3% | 18.0% | 19.0% | 20.0% | 19.9% | 20.2% |
| ROA | 10.9% | 11.8% | 13.6% | 14.1% | 14.1% | 16.5% |
| ROE | 20.0% | 22.7% | 26.9% | 29.4% | 29.6% | 34.1% |
| Current Ratio (x) | 2.2x | 2.2x | 2.0x | 1.6x | 1.2x | 1.0x |
| Capex/Sales | 14.6% | 13.9% | 17.3% | 21.5% | 18.7% | 15.5% |
| Debt-Equity Ratio | 0.5x | 0.5x | 0.6x | 0.6x | 0.6x | 0.5x |
| EPS | 2.5 | 3.0 | 3.9 | 4.7 | 5.1 | 6.4 |
| BVPS | 12.6 | 14.0 | 15.3 | 16.5 | 17.9 | 19.7 |
| DPS | 2.3 | 2.1 | 2.8 | 3.4 | 3.7 | 4.6 |
| Dividend Payout Ratio | 92.1% | 69.6% | 71.2% | 73.1% | 73.0% | 72.3% |
| Dividend Yield (%) | NA | 1.9% | 1.7% | 1.6% | 1.7% | 2.1% |
| P/E (x) | 0.0x | 36.1x | 41.0x | 47.1x | 43.2x | 34.3x |
| P/BV (x) | 0.0x | 7.8x | 10.6x | 13.3x | 12.3x | 11.2x |
| EV/EBITDA (x) | 1.4x | 27.2x | 32.3x | 38.5x | 35.6x | 29.1x |
| Price as at period end* | - | 109.0 | 161.4 | 219.6 | 219.6 | 219.6 |

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



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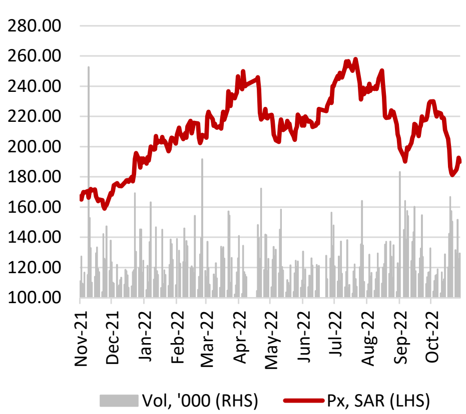
# Mouwasat Medical Services

**Target Price: SAR 195.00/share**
**Upside/(downside): 2.6%**

| **Recommendation** | **Hold** |
|---|---|
| Bloomberg Ticker | MOUWASAT AB |
| Current Market Price (SAR) | 190.00 |
| 52wk High / Low (SAR) | 259.40/158.80 |
| 12m Average Vol. (000) | 109.9 |
| Mkt. Cap. (USD/OMR mn) | 5,053/19,000 |
| Shares Outstanding (mn) | 100.00 |
| Free Float (%) | 47% |
| 3m Avg Daily Turnover (SAR'000) | 25,638.7 |
| 6m Avg Daily Turnover (SAR'000) | 23,672.8 |
| P/E'23e (x) | 27.3 |
| EV/EBITDA'23e (x) | 20.8 |
| Dividend Yield '23e (%) | 1.7% |
| | |
| **Price Performance:** | |
| 1 month (%) | (17.0) |
| 3 month (%) | (19.1) |
| 12 month (%) | 13.1 |

***Source: Bloomberg, valued as of 17 November 2022***

**Price-Volume Performance**




***Source: Bloomberg***

- **Fairly widespread network with the presence of hospitals and clinics in six cities in KSA**
- **MMS' hospital beds and clinics capacities have remained stable during FY 2019-2021 but increased this year with the completion of some projects. Capacity likely to largely remain stable over the next 4-5 years**
- **Healthy top-line growth averaging around 9% per annum, with the operating profit rising at a higher 14% rate driven by efficiency improvement**
- **We expect MMS to maintain its solid business and earnings growth aided by the addition of new capacities, wide geographical presence, and financial prudence**

We initiate coverage on Mouwasat Medical Services (MMS) and assign a **Hold** rating with a target price of SAR 195.00 per share, indicating an upside of 2.6%. The stock is currently trading at a P/E of 27.3x, based on our FY 2023 estimates. MMS has registered decent revenue growth with its capacities remaining largely stable. With new capacities coming online this year, and considering the past operational experience of the management, we are hopeful that the company will be able to replicate similar performance going forward. Margins might dip this year as the newly added facilities take time to ramp up but improve gradually as the utilization optimizes. With the recently concluded additions, capex requirements are expected to reduce relatively, boosting liquidity.

## Investment Thesis

**Valuation and risks:** Our target price is based on blended valuation methodologies – (i) Discounted Cash Flow (DCF) and (ii) Relative Valuation (using P/E multiple). Key downside risks to our valuation include i) lower-than-estimated utilization of the medical facilities ii) below-expected growth rate of the revenue per utilized bed and/or effective clinic, iii) below-expected margins, iv) higher-than-estimated leverage levels, and v) higher than forecasted capex. Key upside risks to our valuation include i) higher-than-estimated addition and/or utilization of hospital beds and/or clinics ii) below-expected growth rate of the revenue per utilized bed and/or effective clinic iii) above-expected margins, and iv) lower-than-forecasted debt levels and/or effective interest costs.

**Healthy operations:** MMS runs hospitals and outpatient clinics at six locations across KSA and is working to expand in a new city. The company has registered healthy business growth with i) its net profit expanding at a higher rate of 14% CAGR vs. 9% CAGR of revenue ii) Earnings growth is expected to remain strong, though at a relatively lower pace of 8% CAGR, as the newly opened healthcare facilities take time to ramp up iii) Margins are estimated to expand further, in line with the management's view, though expected to dip in the near term iv) Solid free cash flow generation with 29% CAGR during FY17-21, v) D/E on a downtrend, a positive under the current rising interest rate scenario.

| Year | FY19 | FY20 | FY21 | FY22e | FY23e | FY24e |
|---|---|---|---|---|---|---|
| Revenues (SAR mn) | 1,857.2 | 2,045.0 | 2,144.1 | 2,264.2 | 2,753.5 | 2,977.5 |
| Net income (SAR mn) | 421.0 | 528.2 | 578.2 | 555.1 | 695.0 | 778.6 |
| Gross margin | 44.7% | 47.0% | 46.4% | 46.0% | 46.0% | 46.2% |
| Net profit margin | 22.7% | 25.8% | 27.0% | 24.5% | 25.2% | 26.2% |
| RoE | 23.0% | 24.9% | 23.7% | 21.4% | 25.1% | 24.6% |
| FCF (SAR/share) | 3.4 | 2.8 | 3.3 | 1.5 | 4.4 | 6.5 |
| DPS (SAR/share) | 2.0 | 2.5 | 2.8 | 3.0 | 3.3 | 3.6 |
| Dividend Yield | 2.3% | 1.8% | 1.6% | 1.6% | 1.7% | 1.9% |
| P/E (x) | 20.9x | 26.1x | 30.1x | 34.2x | 27.3x | 24.4x |
| P/BV (x) | 4.5x | 6.1x | 6.7x | 7.4x | 6.4x | 5.6x |

*Source: Company Reports, U Capital Research* **P/E, P/B, and dividend yield from 2022 onwards calculated on price of 17/11/2022*



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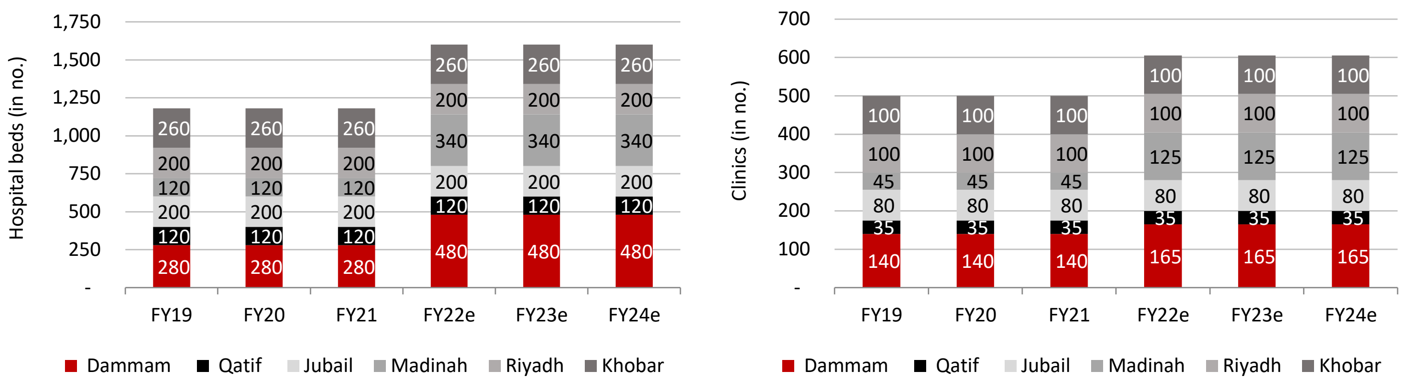
## Capacity increases after three years in FY 2022, likely to remain stable over the next 4-5 years

MMS' healthcare network in Saudi Arabia is spread over six cities, namely, Dammam, Riyadh, Khobar, Jubail, Madina, and Qatif. The company has a hospital each in the above six locations with different capacities of beds and dispensaries. Cumulatively, the total capacity of the company's hospitals stood at 1,180 beds and 500 clinics at the end of 2Q 2022, as per our calculations.

**Fig. 53: Capacity of hospital beds and clinics increased at Dammam and Madinah**




**Source: Company Reports, U Capital Research** **Source: Company Reports, U Capital Research**

However, this capacity has likely increased as the company announced in June 2022 that the pilot phase of the new Mouwasat Hospital in Al-Madinah was completed, and the actual operation likely started from that month's end. This new hospital has a capacity of 220 beds and 80 clinics. Similarly, the capacity of Dammam's hospital also increased post-completion of expansion work by 200 beds and 20 clinics. As a result, we estimate MMS' total hospital beds and clinic capacity to have grown to 1,600 and 605, respectively by the end of 3Q 2022.

Meanwhile, the company is also pursuing some inorganic and organic transactions that could lead to a further increase in the company's healthcare capacity. For instance, in August 2022, MMS signed a non-binding MoU to purchase the entire shares of the owners of Al-Marasem International Hospital Company in Egypt. In addition, it is working to build a new hospital in Yanbu with a capacity of 200 beds and 60 outpatient clinics costing about SAR 465mn and awarded a contract worth SAR 295mn in June 2022 to carry out its construction involving electrical, health, and mechanical works. The duration of this contract is about two and a half years while the entire project is expected to take around 36 months after the start of its construction. In June 2022, MMS also approved to set up of a new hospital in the Al Qadisiyya neighborhood in Riyadh with a sum of SAR 335mn, though the timeline and other details of the projects, like capacity, are not disclosed. Hence, in the absence of the availability of specific information on the above projects, we are not considering them in our forecasts and only taking the current increased capacity till FY 2026. However, we shall include them in our projections in the future as and when the required details become available.

## Healthy revenue generation is expected to continue with new capacities chipping in

Medical services, including inpatient and outpatient departments, generate a majority of the revenue for the company, with its share in the total revenue rising slightly to 87.0% in FY 2021 as compared to 85.6% in FY 2017. The rest of the revenue comes from the sale of medicines. MMS' medical services revenue has grown consistently every year during FY 2017-2021, despite a dip in inpatient admissions and outpatient visits during FY 2020, achieving a 10% CAGR with both the inpatient departments and clinics contributing almost equally. In our opinion, a resilient revenue stream shows the company holds a good market position and has also benefitted from its presence in several major cities of the Kingdom offering healthcare services across the spectrum, from critical illness to cosmetic treatments. With these traits, an increase in capacity, and the opening-up of the economy post-COVID, we project MMS to continue posting regular top-line growth. Overall, we estimate the top line to clock 8% CAGR over the next five years till FY 2026 to reach around SAR 3.2bn as compared to SAR 2.1bn in FY 2021.

**Fig. 54: Medical services, comprising inpatients and outpatients, will continue to drive revenue growth in the future**



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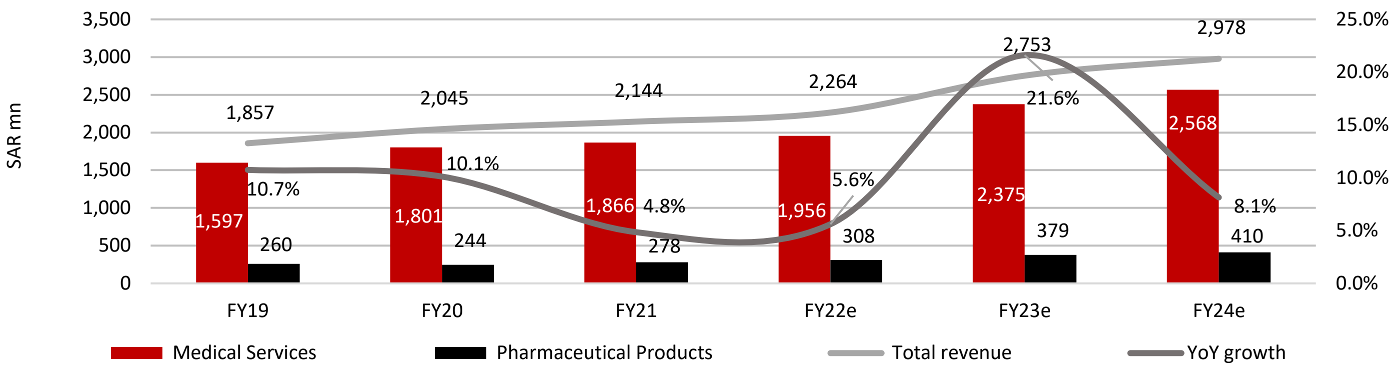
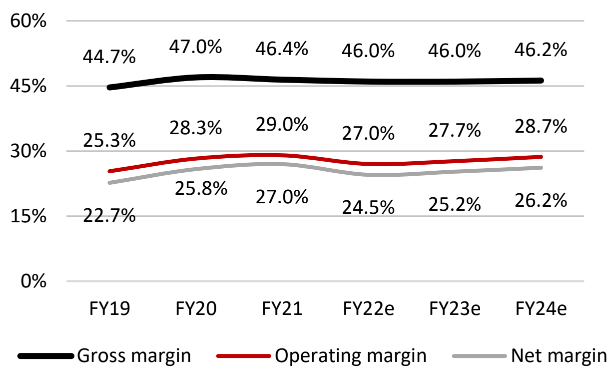



**Source: Company Reports, U Capital Research**

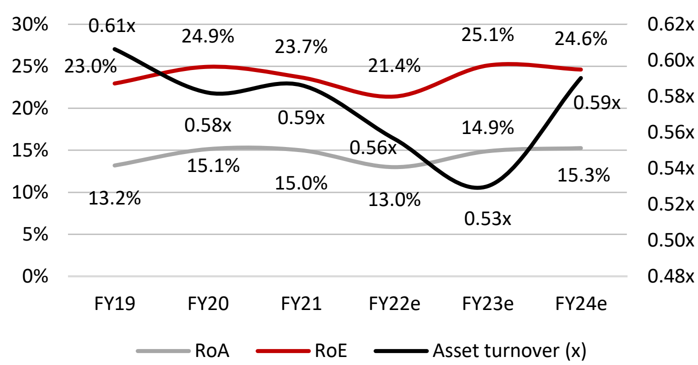
## Efficiency improvement aids in enhancing the benefits of revenue growth

MMS' healthy business growth hasn't come at the expense of profitability deterioration. The company's revenue growth has been accompanied by profitability improvement, with its operating and net margin expanding by over 4 percentage points (pp) to 29% and 27% in FY 2021, from 24.7% and 22.3%, respectively, in FY 2017. As a result, operating and net margins have grown at a relatively higher CAGR (vs. revenue) of 14% during FY2017-2021. Going forward, we expect margins to settle at slightly lower levels from last year as the new capacities added recently would operate at lower utilizations initially. However, as these facilities reach their optimum operations level, we project margins to revert to the expansion mode.

**Fig. 55: Profitability to dip slightly in FY22 due to the additions of new hospitals and clinics and recover gradually**




**Source: Company Reports, U Capital Research**




**Source: Company Reports, U Capital Research**

## Reducing debt levels amid healthy cash flow generation is favorable as interest rates rise

A strong top-line growth accompanied by profitability improvement and no major capacity expansion has led to sufficient liquidity generation for the company over the past few years to fulfill its day-to-day operations and investment needs. The company has also utilized its cash flows in bringing down its leverage slightly, which is a smart move, in our view, as it will help in saving on the interest expense in the current rising interest rate environment, given that 97% of the company's outstanding loans at June 2022 end were from commercial banks and carry a commission rate based on SIBOR plus an agreed margin.

**Fig. 56: Falling D/E ratio to boost interest coverage**

**Fig. 57: MMS expected to meet most of its spending needs internally**



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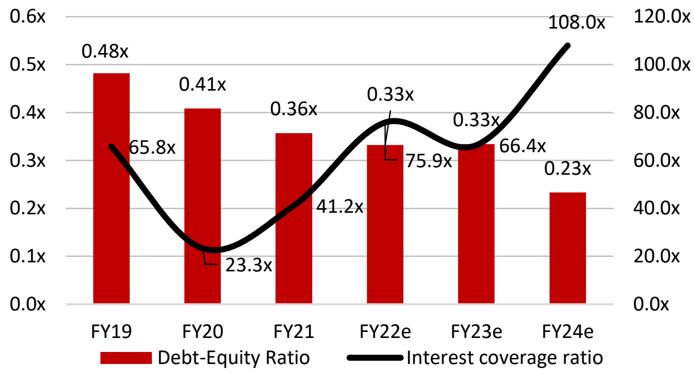
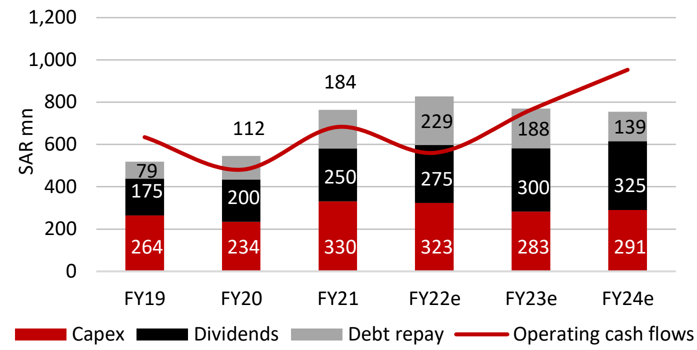



Source: Company Reports, U Capital Research



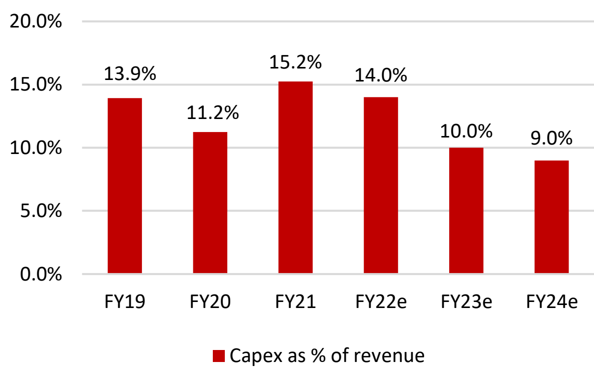

Source: Company Reports, U Capital Research

This will also enhance the interest coverage ratio which already is on an uptrend since FY 2019, reaching 99.4x at the end of 2Q 2022 (on an annualized basis) from 23.3x in FY 2019, and the trend is expected to continue going forward. A point worth highlighting here is that for its under-consideration hospital project in Riyadh, the company intends to raise debt equivalent to 75% of the project's cost. Given the SAR 335mn project cost, the debt portion comes to c. SAR 250mn. While we have not included this in our current forecasts, our calculations show that this new debt raising is unlikely to have any material impact on the company's leverage position, and we expect the overall debt/equity ratio to continue receding, supported by stable cash flows and scheduled debt repayments.

## Capex requirements to go down as capacities have increased recently

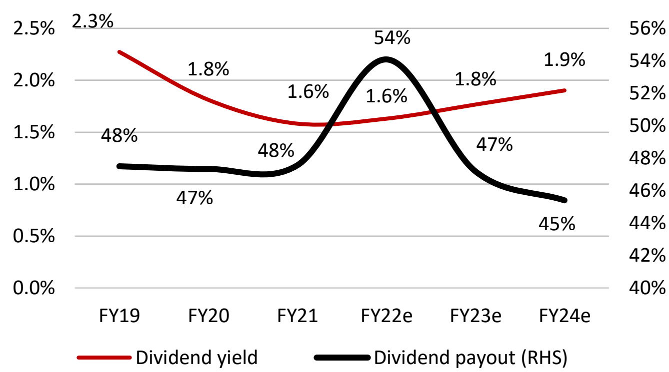
The company's capex (as % of revenue) decreased gradually during FY 2017-FY2020. However, it increased in FY 2021, which we attribute to the expansions MMS undertook in Dammam and Madinah. Going forward, we estimate capex/revenue to remain relatively stable even after accounting for spending on the Yanbu hospital project and maintenance capex. The other proposed hospital in Riyadh seems to be in the conceptualization phase only and hence we have not considered the same for our capex forecasts as of now. Hence, we estimate the company will be able to fund most of the upcoming spending requirements on expansions and/or daily business operations comfortably going forward, while also continue rewarding its equity shareholders with consistent dividend payouts, which the company has historically maintained in the range of 45% to 50%.

**Fig. 58: Capex needs to ebb following recent capacity additions**




Source: Company Reports, U Capital Research

**Fig. 59: Steady dividend payouts**




Source: Company Reports, U Capital Research

## Assign Hold rating

We like MMS' geographically diversified presence, consistent revenue and net profit growth with margin expansion, strong balance sheet with low leverage (D/E), and consistent dividend payout. We are optimistic about the company's future as the recent capacity expansions will aid it in capitalizing on upcoming demand. Capacity is set to grow further since the company is working on a couple of projects that could commence operations toward the end of our forecast period or later (not incorporated in our model currently due to the lack of a specific timeline). With the company providing healthcare services across different verticals — specialized and critical care, pharmacy, radiology, laboratory, etc., and supported by an increase in capacity, we believe the company will continue to post



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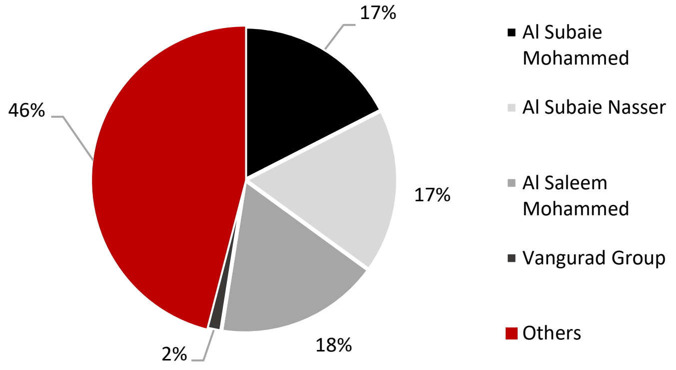
healthy and profitable business growth. However, at the current valuation level, we prefer to assign a **Hold** rating to the stock with SAR 195.00 target price.

## About MMS

MMS started its journey as a private dispensary in Dammam in the year 1975. The company opened its first hospital in Dammam in 1987 and was converted to a Limited Liability Company in 1997 with a share capital of SAR 3mn. Since then, the company has launched five more hospitals at five different locations in Saudi Arabia, apart from Dammam. The company got listed on Tadawul in 2009 and currently has a share capital of SAR 1,000mn divided into 100mn shares. The company intends to expand its presence in the Kingdom further and a new hospital development is under consideration in Yanbu.

**Fig. 60: MMS: Shareholding Structure**




**Source: Company filings**



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**Key financials**

| In SAR mn, except stated otherwise | FY19 | FY20 | FY21 | FY22e | FY23e | FY24e |
|---|---|---|---|---|---|---|
| **Income Statement** | | | | | | |
| Revenue | 1,857 | 2,045 | 2,144 | 2,264 | 2,753 | 2,978 |
| Cost of revenue | (1,028) | (1,085) | (1,148) | (1,222) | (1,487) | (1,601) |
| **Gross profit** | **829** | **960** | **996** | **1,042** | **1,266** | **1,377** |
| General & administrative expenses | (251) | (258) | (275) | (316) | (374) | (393) |
| Selling & marketing expenses | (108) | (124) | (99) | (114) | (130) | (131) |
| Other operating income | - | - | - | - | - | - |
| **Operating profit** | **470** | **578** | **622** | **611** | **762** | **853** |
| The company's share in income of associates | 4 | 4 | 10 | 8 | 8 | 9 |
| Finance charges | (20) | (14) | (8) | (9) | (7) | (7) |
| **Profit before zakat** | **462** | **577** | **632** | **618** | **771** | **864** |
| Zakat expense | (13) | (15) | (22) | (27) | (31) | (35) |
| **Profit attributable to shareholders of the company** | **421** | **528** | **578** | **555** | **695** | **779** |
| **Balance Sheet** | | | | | | |
| Cash and cash equivalents | 205 | 160 | 157 | 151 | 142 | 436 |
| Trade receivables | 523 | 690 | 791 | 1,109 | 1,330 | 1,423 |
| Advance payments for acquisition of property & equipment | 103 | 170 | 243 | 246 | 246 | 246 |
| Right of use assets | 38 | 35 | 31 | 28 | 24 | 21 |
| Property and equipment | 2,076 | 2,203 | 2,419 | 2,603 | 2,700 | 2,792 |
| **Total assets** | **3,328** | **3,649** | **4,059** | **4,484** | **4,847** | **5,357** |
| Accrued expenses and other liabilities | 134 | 115 | 125 | 166 | 202 | 217 |
| Short term lease liabilities | 38 | 38 | 33 | 29 | 26 | 22 |
| Trade payables | 212 | 198 | 219 | 287 | 349 | 376 |
| **Total liabilities** | **1,276** | **1,269** | **1,357** | **1,800** | **1,748** | **1,789** |
| Share capital | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |
| Retained earnings | 674 | 979 | 1,304 | 1,284 | 1,654 | 2,073 |
| **Equity Attributable to Shareholders** | **1,956** | **2,279** | **2,604** | **2,584** | **2,954** | **3,373** |
| **Cash Flow Statement** | | | | | | |
| Net cash generated from operating activities | 635 | 481 | 683 | 561 | 764 | 953 |
| Net cash generated from investing activities | (398) | (317) | (446) | (244) | (283) | (291) |
| Net cash (used in) provided by financing activities | (162) | (208) | (240) | (308) | (491) | (368) |
| **Cash and cash equivalents at the end of the period** | **205** | **160** | **157** | **165** | **142** | **436** |
| **Key Ratios** | | | | | | |
| Gross margin (%) | 44.7% | 47.0% | 46.4% | 46.0% | 46.0% | 46.2% |
| EBITDA margin (%) | 33.1% | 35.5% | 36.4% | 34.5% | 34.5% | 35.4% |
| Operating margin (%) | 25.3% | 28.3% | 29.0% | 27.0% | 27.7% | 28.7% |
| Net margin (%) | 22.7% | 25.8% | 27.0% | 24.5% | 25.2% | 26.2% |
| ROA | 13.2% | 15.1% | 15.0% | 13.0% | 14.9% | 15.3% |
| ROE | 23.0% | 24.9% | 23.7% | 21.4% | 25.1% | 24.6% |
| Current Ratio (x) | 2.0x | 2.2x | 2.1x | 1.4x | 1.6x | 1.8x |
| Capex/Sales | 13.9% | 11.2% | 15.2% | 14.0% | 10.0% | 9.5% |
| Debt-Equity Ratio | 0.4x | 0.4x | 0.3x | 0.3x | 0.2x | 0.2x |
| EPS | 4.2 | 5.3 | 5.8 | 5.6 | 7.0 | 7.8 |
| BVPS | 19.6 | 22.8 | 26.0 | 25.8 | 29.5 | 33.7 |
| DPS | 2.0 | 2.5 | 2.8 | 3.0 | 3.3 | 3.6 |
| Dividend Payout Ratio | 47.5% | 47.3% | 47.6% | 54.0% | 46.8% | 46.2% |
| Dividend Yield (%) | 2.3% | 1.8% | 1.6% | 1.6% | 1.7% | 1.9% |
| P/E (x) | 20.9x | 26.1x | 30.1x | 34.2x | 27.3x | 24.4x |
| P/BV (x) | 4.5x | 6.1x | 6.7x | 7.4x | 6.4x | 5.6x |
| EV/EBITDA (x) | 15.6x | 20.2x | 23.5x | 25.5x | 20.8x | 18.5x |
| Price as at period end* | 88.0 | 138.0 | 173.8 | 190.0 | 190.0 | 190.0 |

*Source: Company Reports, U Capital Research*

*Current market price is used for forecast periods



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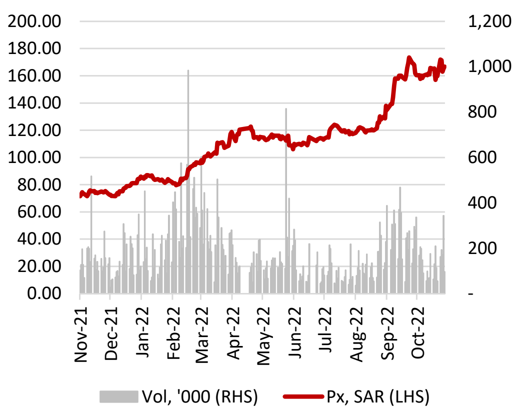
# Dallah Healthcare

**Target Price: SAR 170.50/share**
**Upside/(downside): 2.2%**

| **Recommendation** | **Hold** |
|---|---|
| Bloomberg Ticker | DALLAH AB |
| Current Market Price (SAR) | 166.80 |
| 52wk High / Low (SAR) | 176.00/70.50 |
| 12m Average Vol. (000) | 184.4 |
| Mkt. Cap. (USD/OMR mn) | 3,993/15,012 |
| Shares Outstanding (mn) | 90.00 |
| Free Float (%) | 37% |
| 3m Avg Daily Turnover (SAR'000) | 26,052.4 |
| 6m Avg Daily Turnover (SAR'000) | 20,945.0 |
| P/E'23e (x) | 44.2 |
| EV/EBITDA'23e (x) | 29.0 |
| Dividend Yield '23e (%) | 1.3% |
| **Price Performance:** | |
| 1 month (%) | 3.1 |
| 3 month (%) | 42.3 |
| 12 month (%) | 130.4 |

***Source: Bloomberg, valued as of 17 November 2022***

**Price-Volume Performance**




***Source: Bloomberg***

- **DHC's healthcare facilities are primarily concentrated in the competitive Riyadh region**
- **Current business plans suggest capacity would rise only slightly by FY26e after nearly tripling (hospital beds) during FY17-21**
- **Current utilization of ~61% for hospital beds and 56% for clinics shows room for growth exists through boosting utilization of existing facilities without significant investments**
- **Margins and cash flows have remained a bit uneven, possibly due to regular capacity expansions undertaken in the recent past, causing the D/E ratio to rise. However, with the capacities stabilizing relatively, we expect profitability to improve gradually**

We initiate coverage on Dallah Healthcare Co. (DHC) and assign a **Hold** rating with a target price of SAR 170.50 per share, indicating an upside of 2.2%. DHC's stock has risen the most among the five healthcare companies under our initiation by over 120% YTD till 17 November, and thus we believe most of the near-term catalysts are already priced in. Currently, the stock trades at FY23e P/E of 44.2x. DHC is estimated to post decent revenue and earnings growth backed by a forecasted improvement in existing utilization, coupled with slight capacity expansion. No major capacity addition is likely soon, except for through the acquisition of a majority stake in the associate Dr. Mohammad AlFagih Hospital (50 beds and 72 clinics) for which DHC has initiated the process (not modeled). Three more hospitals are under consideration, but no specific details are available. Thus, we expect DHC's capex requirement to come down relatively going forward, thereby benefitting margins and cash flows.

## Investment Thesis

**Valuation and risks:** Our target price is based on blended valuation methodologies – (i) Discounted Cash Flow (DCF) and (ii) Relative Valuation (using P/E multiple). Key downside risks to our valuation include i) lower-than-estimated utilization of the medical facilities ii) below-expected growth rate of the revenue per utilized bed and/or effective clinic, iv) below-expected margins, and iv) higher than forecasted levels of debt. Key upside risks to our valuation include i) higher-than-estimated addition and/or utilization of hospital beds and/or clinics ii) below-expected growth rate of the revenue per utilized bed and/or effective clinic iii) above-expected margins, and iv) lower-than-forecasted debt levels and/or effective interest costs.

**Margins likely to expand further:** Despite operating in a competitive landscape of Riyadh i) DHC achieved a solid 21% revenue and 22% bottom-line CAGR during FY18-21 ii) Profitability improved in FY21 as DHC finished working on capacity increase majorly by FY20. We expect it to expand further with improving operating conditions and no major capacity additions which generally drag margins during the initial phase of operations iii) D/E has risen due to investment in expansions but is likely to ease going forward iv) Debtors days increased from below 3 months in FY17 to slightly over 4 months in FY20. However, we expect it to ease slightly factoring in the recent trend.

| Year | FY19 | FY20 | FY21 | FY22e | FY23e | FY24e |
|---|---|---|---|---|---|---|
| Revenues (SAR mn) | 1,252.1 | 1,318.3 | 2,105.2 | 2,433.8 | 2,752.8 | 2,971.5 |
| Net income (SAR mn) | 146.9 | 132.0 | 258.6 | 264.3 | 339.9 | 404.4 |
| Gross margin | 35.8% | 34.1% | 36.1% | 36.5% | 37.1% | 37.4% |
| Net profit margin | 11.7% | 10.0% | 12.3% | 10.9% | 12.3% | 13.6% |
| RoE | 9.4% | 8.0% | 14.1% | 13.8% | 16.8% | 18.5% |
| FCF (SAR/share) | 0.6 | (0.5) | 2.6 | 3.1 | 3.9 | 4.5 |
| DPS (SAR/share) | 1.0 | 0.8 | 1.5 | 2.0 | 2.2 | 2.5 |
| Dividend Yield | 2.6% | 1.6% | 2.0% | 1.2% | 1.3% | 1.5% |
| P/E (x) | 23.9x | 32.9x | 26.1x | 56.8x | 44.2x | 37.1x |
| P/BV (x) | 2.3x | 2.4x | 3.6x | 7.7x | 7.2x | 6.6x |

*Source: Company Reports, U Capital Research* **P/E, P/B, and dividend yield from 2022 onwards calculated on price of 17/11/2022*



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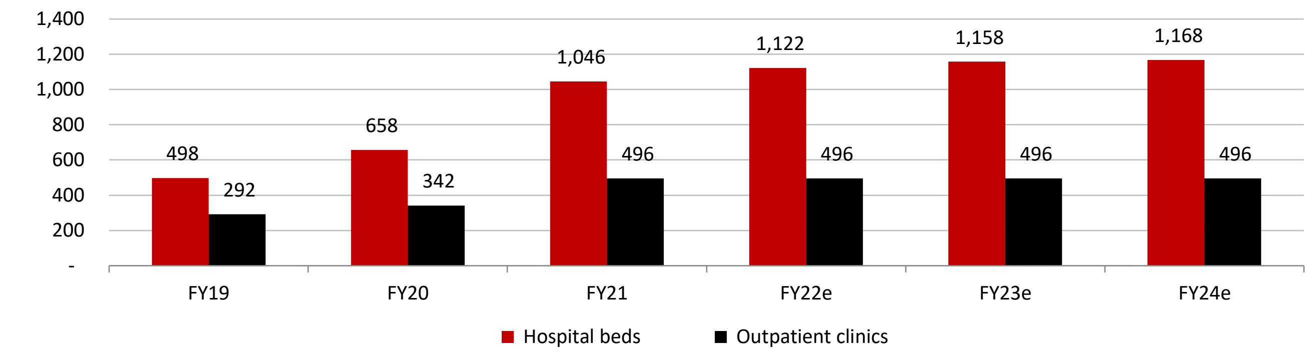
## New hospital beds and clinics added thrice over the last five years…

DHC provides comprehensive medical services through four hospitals in the Kingdom of Saudi Arabia, comprising inpatient departments and outpatient clinics, providing a gamut of medical treatment facilities as well as related support services like laboratory, radiology, etc. DHC's hospitals are mainly located in Riyadh, and hence Central Region accounts for a bulk of the company's revenue. The company's healthcare infrastructure has grown at a rapid pace over the last 5 years driven both by expansions and acquisitions. According to our estimates, DHC added about 700 hospital beds and 300 outpatient clinics between FY 2017 and FY 2021 to reach 1,046 beds and 496 clinics at the end of FY 2021.

**Fig. 61: Hospital beds more than doubled during the past two years but are expected to increase subtly going forward**




**Source: Company Reports, U Capital Research**

## …but the pace is expected to reduce going forward

The average bed utilization at the company's hospitals ranged from 51% to 66%, which provides it decent scope to grow its revenue by raising utilization. In addition, the company is undertaking a renovation at its biggest hospital Al Nakheel, which will increase its capacity from 508 currently to 534 by next year, as per our assumption. Beds capacity in its second major hospital in Riyadh, Namar, stood at 274 in FY 2021. DHC received approval from the Ministry of Health to increase the capacity by 150 beds in April 2022, which we expect to be implemented by this year-end, taking the total capacity to 300. The maximum operational capacity at Namar is 350 beds and we assume DHC to gradually increase it over the coming years, as intended by the management. The company also aims to increase the bed capacity of Kingdom Hospital by 50 this year.

## Future revenue growth to come from further capacity augmentation coupled with utilization improvement

Hence, incorporating the above developments, we estimate total beds to grow further, but at a much lower pace (FY 2021-2026 CAGR: 3%) than earlier, reaching over 1,150 by FY 2026 end. The number of outpatient clinics at the existing facilities, on the other hand, is expected to remain stable during our forecast period. Thus, we believe, the planned addition of beds and available spare capacity should suffice for DHC in catering to the prospective patients' demand in the near-to-medium term. DHC is also in the process of buying the remaining stake in its associate Dr. Mohammed Rashed Alfagih which it does not hold currently. Dr. Mohammad AlFagih Hospital has 50 beds and 72 clinics, which would come under DHC if the deal is closed successfully. While the company plans to add three more hospitals in Saudi, in the absence of any specific details available, we do not expect these to come online during our forecast period till FY 2026e.

**Fig. 62: Clinics' utilization rate improves sharply even during COVID**

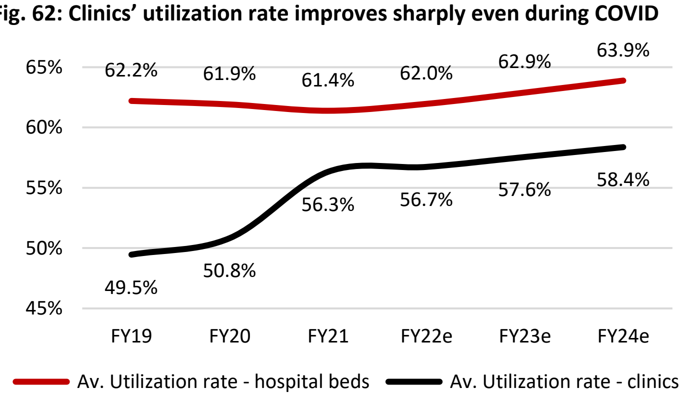
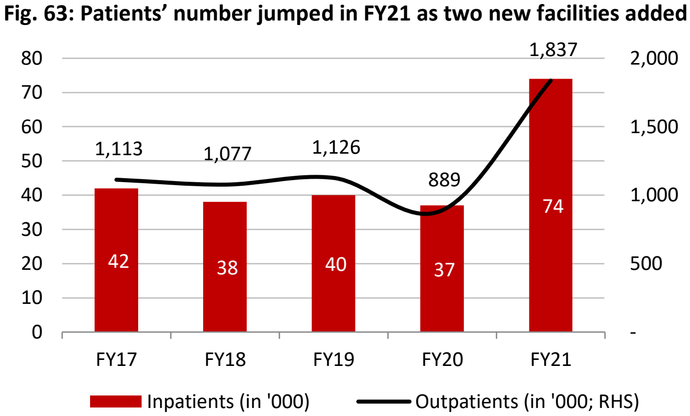



**Fig. 63: Patients' number jumped in FY21 as two new facilities added**



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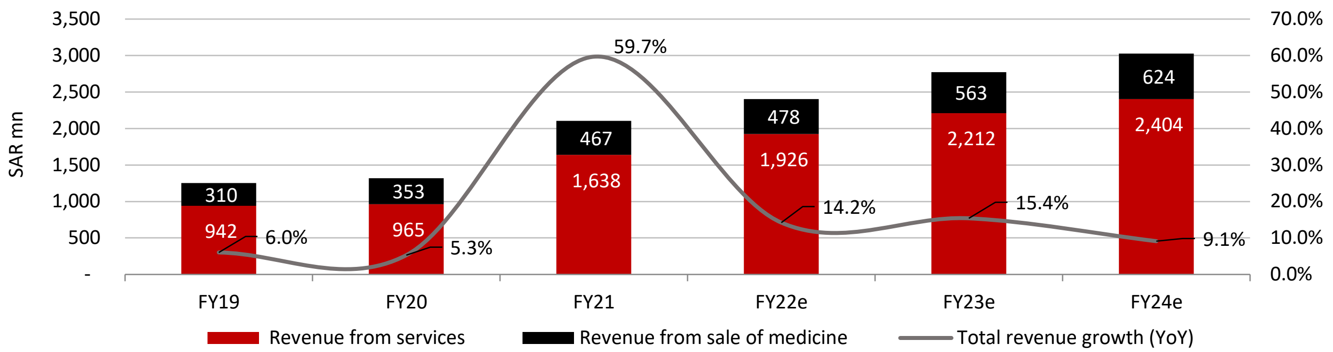
**Source: Company Reports, U Capital Research** **Source: Company Reports, U Capital Research**

**Fig. 64: An expected rise in utilization coupled with a gradual increase in capacity to support revenue growth**



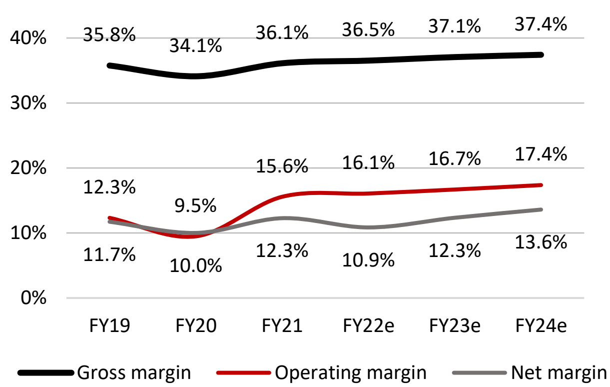

**Source: Company Reports, U Capital Research**

We expect DHC to continue its healthy top-line growth momentum, supported by further growth in capacity and an increase in utilization. The company aims to decrease the average length of stay for inpatients, which as per our calculation stood at slightly over three days in FY 2021, as compared to 2.8 days before the pandemic, assuming the same utilization rate as of FY 2021, given the lack of information. This will aid the company in increasing the churn of its existing assets. Overall, we estimate revenue to clock a 10% CAGR during FY 2021-2026 (FY 2017-2021 CAGR: 15%).

## Increased focus on efficiency improvement, and better utilization of assets to aid in margins expansion

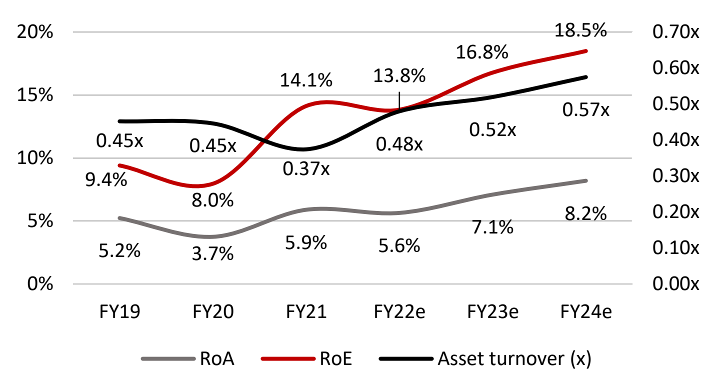
Although DHC has expanded its revenue at a strong pace, earnings growth was volatile. While net profit CAGR during FY 2017-2021 was negative 3%, it registered a 22% average annual growth during FY 2018-2021. This resulted from some exceptional periods and adjustments, like a closing of nonprofitable operations in Dallah Pharma boosted profit in FY 2017, while a jump in receivables impairment during COVID in FY 2020 partially impacted the profitability adversely. The Increase in costs resulting from acquisitions and expansions, and the time required in the ramp-up of new facilities also likely weighed on profitability, in our view.

**Fig. 65: Margins had been impacted during COVID…**




**Source: Company Reports, U Capital Research**

**Fig. 66: …but likely to improve, boosting return to shareholders**




**Source: Company Reports, U Capital Research**

However, we expect the profitability to stabilize relatively going forward, with the company focusing on improving efficiency as well as increasing the utilization of its assets. With no major capex likely over our forecast horizon, and with a forecasted improvement in profitability, we estimate the company to gradually lower its leverage levels thereby further boosting margins.

## A sharp increase in debt balance over the past few years amid uneven cash flows, but estimated to decrease going forward with a likely reduction in capex requirements

DHC's business over the past few years has grown both through the inorganic and organic routes. The company's balance sheet expanded at 20% CAGR during FY 2018-2021. However, as pointed out earlier, this hasn't translated into similar growth in the earnings and cash flows which remained somewhat uneven over the last 4-5 years, and hence net worth growth was tepid at 5% CAGR during this period. The company's debt balance, on the other hand, clocked a 38% CAGR during FY 2018-2021, which, we believe resulted from a rise in acquisition and expansion funding requirements, given the volatile cash flows. Consequently, DHC's debt/equity reached 1.0x at FY 2021-end from 0.4x at FY 2018-end.



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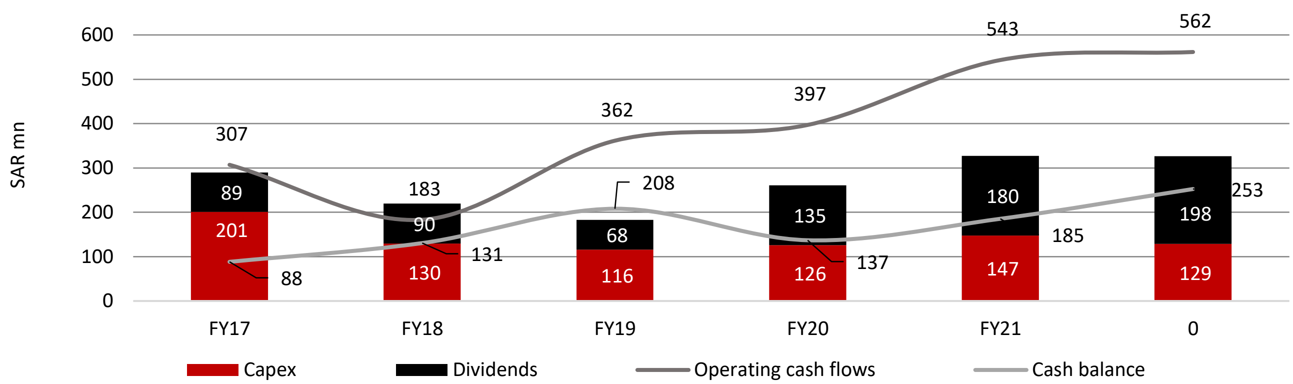
The average blended utilization of the company's medical facilities (hospitals and clinics) during FY 2021 was in the range of 50-60%, and we opine this provides the company ample leeway to scale up its operations without investing much in augmenting capacities in the near future. Dallah's near-term business growth plans include renovating Al Nakheel hospital and expanding the capacity of Namar hospital, as well as buying an additional 18.98% stake in International Medical Center Company (IMC) by issuing new shares in DHC worth ~SAR 77mn, increasing its stake in NMC to 27.18% after getting the necessary approvals. The company also intends to buy an additional 68.79% stake in its associate Dr. Mohammed Rashed Alfagih Company, in which it already holds a 31.2% share, though it is in the negotiations phase currently. Similarly, there are three hospital projects in the pipeline – Dallah Hospital Jeddah, Dallah North of Riyadh Hospital, and Dallah Medical Tower – but they seem to be in the conceptualization phase at present. Thus, overall, we estimate the company's capex requirements to remain low (vs. historical trend) over the next few years and expect DHC to manage these through internal resources and existing debt facilities, which should aid it in bringing down its leverage levels and help offset some of the adverse impacts of rising interest costs. We estimate the company's D/E ratio to fall to pre-COVID levels over the next couple of years and reach ~0.5x by FY26e.

**Fig. 67: The top-line growth with profitability improvement to boost cash flows, aiding in lowering reliance on debts for business needs**




**Source: Company Reports, U Capital Research**

## Neutral stance as sharp up move in the stock this year already exhausts potential business growth, in our view

The recent results (1H 2022) show improvement in the financial metrics is sustaining. Margins have moved up further on average during 1H 2022 from FY 2021, while the D/E ratio has also decreased back-to-back during 1Q 2022 and 2Q 2022. We see this as a validation of our assumptions that post the recent capacity additions and relatively low current utilization levels, DHC should post better numbers on profitability, and cash flows through boosting asset utilization, while relatively lower capex will leave more sum for debt repayments, thereby saving on the debt servicing costs. However, the street seems to have already factored in these potential business upsides as the stock has generated more than 120% return YTD till 17$^{th}$ November, the highest among the healthcare companies under our coverage. Thus, we assign a **HOLD** rating on the stock with a target price of SAR 170.50 (2.2% upside).

## About DHC

DHC is a private hospital operator based in Saudi Arabia, having an operating history of over three decades. The company commenced operations in 1987 with the opening of Al Nakheel hospital and got listed on Tadawul in 2012. DHC currently operates four hospitals, including outpatient clinics, with most of them located in Riyadh. During 2021, the company registered total patient traffic exceeding 1.8mn, more than tripling from nearly 600 patients in 2010. Medical services provide the company with a majority of its revenue (c. 79% during 1H 2022). Some other business activities being undertaken by the company are manufacturing, distribution, and trading of medicines and operation and management of third-party hospitals.

**Fig. 68: DHC: Shareholding Structure**



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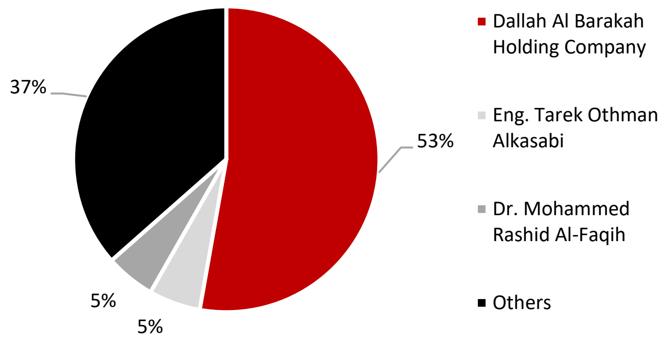


**Source: Company filings**



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**Key financials**

| In SAR mn, except stated otherwise | FY19 | FY20 | FY21 | FY22e | FY23e | FY24e |
|---|---|---|---|---|---|---|
| **Income Statement** | | | | | | |
| Revenue | 1,252 | 1,318 | 2,105 | 2,434 | 2,753 | 2,971 |
| Cost of revenue | (804) | (869) | (1,345) | (1,545) | (1,732) | (1,859) |
| **Gross profit** | **448** | **450** | **760** | **889** | **1,020** | **1,112** |
| General & administrative expenses | (262) | (281) | (375) | (435) | (489) | (524) |
| Selling & marketing expenses | (24) | (26) | (41) | (52) | (56) | (59) |
| Impairment losses on trade receivables/expected credit los: | (8) | (18) | (17) | (11) | (15) | (12) |
| **Operating profit** | **154** | **125** | **328** | **391** | **460** | **516** |
| The company's share in income of associates | (4) | (21) | (31) | (44) | (25) | (12) |
| Finance charges | (25) | (25) | (42) | (57) | (65) | (62) |
| **Profit before zakat** | **152** | **148** | **292** | **305** | **390** | **464** |
| Zakat expense | (5) | (13) | (17) | (22) | (29) | (34) |
| **Profit attributable to shareholders of the company** | **147** | **132** | **259** | **264** | **340** | **404** |
| **Balance Sheet** | | | | | | |
| Cash and cash equivalents | 88 | 131 | 208 | 137 | 185 | 253 |
| Trade receivables | 329 | 580 | 625 | 710 | 755 | 815 |
| Prepaid expenses and other assets | 84 | 82 | 106 | 131 | 149 | 161 |
| Right of use assets | 27 | 25 | 30 | 26 | 15 | 8 |
| Property and equipment | 2,076 | 2,743 | 2,768 | 2,798 | 2,843 | 2,865 |
| **Total assets** | **2,916** | **4,130** | **4,645** | **4,726** | **4,854** | **5,014** |
| Accrued expenses and other liabilities | 67 | 134 | 147 | 181 | 203 | 218 |
| Short term lease liabilities | 19 | 15 | 22 | 22 | 13 | 7 |
| Trade payables | 111 | 193 | 222 | 258 | 269 | 289 |
| **Total liabilities** | **1,394** | **2,122** | **2,549** | **2,523** | **2,488** | **2,443** |
| Share capital | 750 | 900 | 900 | 900 | 900 | 900 |
| Retained earnings | 725 | 794 | 840 | 898 | 1,006 | 1,145 |
| **Equity Attributable to Shareholders** | **1,522** | **1,795** | **1,867** | **1,955** | **2,097** | **2,276** |
| **Cash Flow Statement** | | | | | | |
| Net cash generated from operating activities | 307 | 183 | 362 | 397 | 543 | 562 |
| Net cash generated from investing activities | (221) | (428) | (425) | (136) | (147) | (129) |
| Net cash (used in) provided by financing activities | (44) | 287 | 141 | (332) | (348) | (366) |
| **Cash and cash equivalents at the end of the period** | **88** | **131** | **208** | **137** | **185** | **253** |
| **Key Ratios** | | | | | | |
| Gross margin (%) | 35.8% | 34.1% | 36.1% | 36.5% | 37.1% | 37.4% |
| EBITDA margin (%) | 19.7% | 16.7% | 21.0% | 21.0% | 20.9% | 21.2% |
| Operating margin (%) | 12.3% | 9.5% | 15.6% | 16.1% | 16.7% | 17.4% |
| Net margin (%) | 11.7% | 10.0% | 12.3% | 10.9% | 12.3% | 13.6% |
| ROA | 5.2% | 3.7% | 5.9% | 5.6% | 7.1% | 8.2% |
| ROE | 9.4% | 8.0% | 14.1% | 13.8% | 16.8% | 18.5% |
| Current Ratio (x) | 1.5x | 1.4x | 1.3x | 1.3x | 1.4x | 1.5x |
| Capex/Sales | 16.1% | 9.8% | 5.5% | 5.2% | 5.3% | 4.3% |
| Debt-Equity Ratio | 0.7x | 0.9x | 1.0x | 0.9x | 0.8x | 0.7x |
| EPS | 1.6 | 1.5 | 2.9 | 2.9 | 3.8 | 4.5 |
| BVPS | 16.9 | 19.9 | 20.7 | 21.7 | 23.3 | 25.3 |
| DPS | 1.0 | 0.8 | 1.5 | 2.0 | 2.2 | 2.5 |
| Dividend Payout Ratio | 61.3% | 51.1% | 52.2% | 68.1% | 58.3% | 55.6% |
| Dividend Yield (%) | 2.6% | 1.6% | 2.0% | 1.2% | 1.3% | 1.5% |
| P/E (x) | 23.9x | 32.9x | 26.1x | 56.8x | 44.2x | 37.1x |
| P/BV (x) | 2.3x | 2.4x | 3.6x | 7.7x | 7.2x | 6.6x |
| EV/EBITDA (x) | 17.6x | 26.9x | 19.2x | 32.9x | 29.0x | 26.3x |
| Price as at period end* | 39.0 | 48.3 | 75.1 | 166.8 | 166.8 | 166.8 |

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



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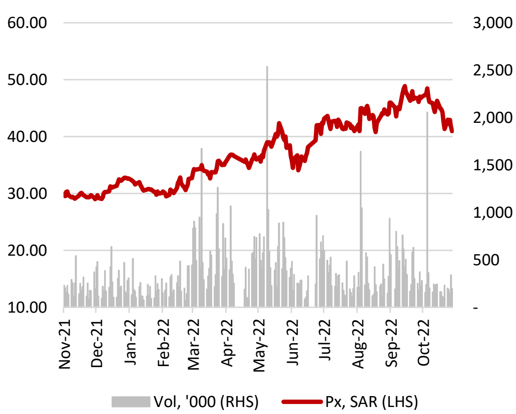
# Al Hammadi Holding

**Target Price: SAR 47.50/share**
**Upside/(downside): 15.9%**

| **Recommendation** | **Accumulate** |
|---|---|
| Bloomberg Ticker | ALHAMMAD AB |
| Current Market Price (SAR) | 41.00 |
| 52wk High / Low (SAR) | 50.00/26.81 |
| 12m Average Vol. (000) | 373.3 |
| Mkt. Cap. (USD/OMR mn) | 1,745/6,560 |
| Shares Outstanding (mn) | 160.0 |
| Free Float (%) | 66% |
| 3m Avg Daily Turnover (SAR'000) | 16,880.1 |
| 6m Avg Daily Turnover (SAR'000) | 17,520.6 |
| P/E'23e (x) | 24.4 |
| EV/EBITDA'23e (x) | 15.6 |
| Dividend Yield '23e (%) | 2.9% |
| | |
| **Price Performance:** | |
| 1 month (%) | (12.4) |
| 3 month (%) | - |
| 12 month (%) | 34.0 |

***Source: Bloomberg, valued as of 17 November 2022***

**Price-Volume Performance**




***Source: Bloomberg***

- **HHC's operations are limited to Riyadh with two hospitals currently in services**
- **Cumulative capacity as of now is slightly over 1,000 hospital beds and 128 outpatient clinics. Capacity is estimated to rise in FY26 with the opening of the new Olaya hospital**
- **Earnings registered a strong growth of over 100% YoY during 9M22, with more than 10bp margin expansion, which is commendable and suggests improving business conditions**
- **A healthy balance sheet with low debt/equity. Free cash flows on a rising trend during the last three years with likely improvement in debtors' profile and a decrease in capex**

We initiate coverage on Al Hammadi Holding Co. (HHC) and assign an **Accumulate** rating with a target price of SAR 47.50 per share, offering an upside of 15.9%. The stock currently trades at FY23e P/E of 24.4x. Historically, while HHC posted decent revenue growth (FY17-21 CAGR: 8%), earnings faltered (-4% CAGR) on operating cost pressures, and an increase in debtors' impairment. Nevertheless, the company has posted strong bottom line growth during 9M22, even with two hospitals operating vs. three during 9M21, which suggests more efficient utilization of assets amid better-operating conditions. Margins have also improved considerably, and we expect them to sustain going forward, driven by a further forecasted increase in demand as the government is investing heavily to transform Riyadh. The start of the new Olaya hospital in early FY26 would further augment the earnings potential of the company.

## Investment Thesis

**Valuation and risks:** Our target price is based on blended valuation methodologies – (i) Discounted Cash Flow (DCF) and (ii) Relative Valuation (using P/E multiple). Key downside risks to our valuation include i) lower-than-estimated utilization of the medical facilities ii) below-expected growth rate of the revenue per utilized bed and/or effective clinic, iv) below-expected margins, and iv) expected improvement in receivables' collection not materializing. Key upside risks to our valuation include i) higher-than-estimated addition and/or utilization of hospital beds and/or clinics ii) above-expected margins, iii) better than estimated receivables' collection, and iv) lower than forecasted capex.

**Improvement expected:** Despite operating at a single location i) HHC posted healthy revenue growth. Revenue is likely to remain on an uptrend (9% CAGR – FY21-26e) as conditions seem more conducive post-COVID ii) Operating margin averaged ~27% during 9M22 after falling to 13.8% in FY21. We expected it to improve further as operations normalize following the closure of Olaya hospital last year iii) Healthy balance sheet with growing cash flows. Better profitability, coupled with improving debtors' collections to aid cash flows to grow further iv) Capex forecasted to rise over the next few years with the development of the new Olaya hospital vi) Assured 60% minimum quarterly dividend payout policy starting 3Q 2022.

| Year | FY19 | FY20 | FY21 | FY22e | FY23e | FY24e |
|---|---|---|---|---|---|---|
| Revenues (SAR mn) | 974.1 | 764.1 | 951.9 | 1,071.1 | 1,120.5 | 1,174.8 |
| Net income (SAR mn) | 93.0 | 130.8 | 90.1 | 243.7 | 268.8 | 286.0 |
| Gross margin | 29.0% | 33.1% | 38.2% | 37.5% | 37.4% | 37.4% |
| Net profit margin | 9.5% | 17.1% | 9.5% | 22.8% | 24.0% | 24.3% |
| RoE | 6.1% | 8.0% | 5.4% | 14.5% | 15.4% | 15.6% |
| FCF (SAR/share) | 0.8 | 0.9 | 1.1 | 1.1 | 1.9 | 1.8 |
| DPS (SAR/share) | 0.4 | 0.4 | 0.5 | 1.2 | 1.2 | 1.2 |
| Dividend Yield | 2.4% | 1.7% | 1.5% | 2.9% | 2.9% | 3.0% |
| P/E (x) | 27.1x | 26.5x | 53.7x | 26.9x | 24.4x | 22.9x |
| P/BV (x) | 1.6x | 2.0x | 2.9x | 3.8x | 3.7x | 3.5x |

*Source: Company Reports, U Capital Research* **P/E, P/B, and dividend yield from 2022 onwards calculated on price of 17/11/2022*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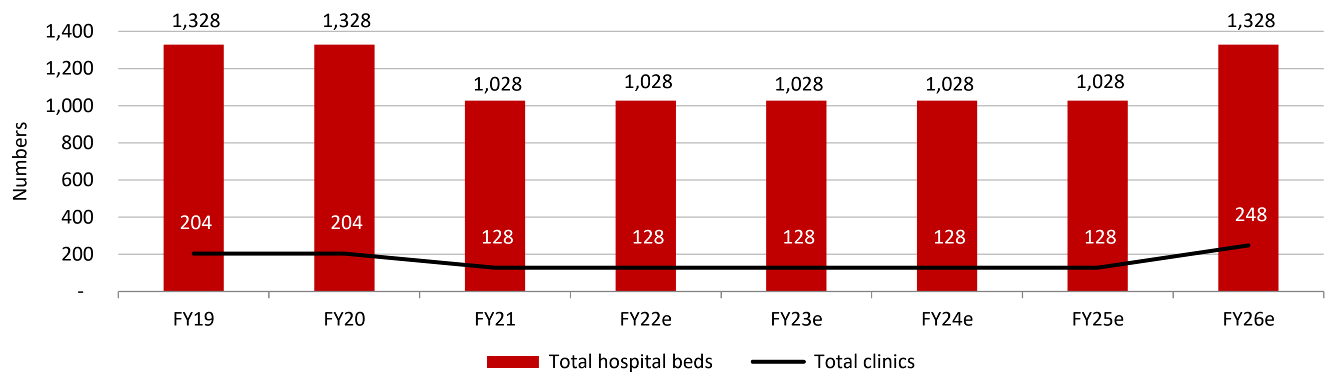
## Capacity decreases post closure of 300 beds Olaya hospital; likely to remain flat till the opening of the new Olaya hospital in FY26

Al Hammadi's operations in Saudi Arabia are limited to Riyadh only, unlike some of its counterparts who have a more widespread network. The company has two hospitals running at present i) Al Hammadi Hospital Al Suwaidi, which commenced operations in August 2015 and has 428 beds and 64 outpatient clinics, and ii) Al Hammadi Hospital Al Nuzha, which started in 2018 and currently has 600 beds and 64 clinics. The flagship Al Hammadi Hospital Olaya opened in 1985, which had the capacity of 300 beds and 76 clinics, stopped operating in 3Q 2021. The company is constructing the 'New Al Hammadi Olaya Hospital' as its replacement which is expected to start working from 1Q 2026. Upon completion, the hospital will add 300 beds and 120 clinics, thereby increasing the cumulative capacity of the company's portfolio of hospitals to 1,328 beds and 248 clinics by FY 2026 as compared to 1,028 beds and 128 clinics at present.

**Fig. 69: Opening of the new Olaya hospital in FY26 to reinstate hospitals beds capacity at FY20 levels**




**Source: Company Reports, U Capital Research**

Apart from the new hospital under development in Olaya, the company does not have any other project in the pipeline and hence we do not expect any organic capacity expansion to happen till FY 2025e. Al Hammadi, though, signed a contract in March 2022 to purchase a land plot measuring about 19,000 square meters costing c. SAR 115.6mn to build a hospital. However, in the absence of any further details available, we assume the prospective hospital would come into existence only beyond the end of our forecast period in FY 2026.

## Commendable performance during 9M22 despite comparatively lower capacity suggests operating conditions are turning conducive, which should aid in HHC achieving healthy top-line growth going forward

Like the other healthcare companies in the Kingdom, Al Hammadi also generates its revenues through two avenues, i.e., medical services, and pharmaceutical sales. Medical services, on average, have generated around 70% of total revenue over the past five years, with their revenue share growing gradually. Al Hammadi's top line rebound strongly in FY 2021, after declining in FY 2020 by 21.6%, and has maintained strong growth during 1H 2022 (+18.4% YoY). A point worth noting here is that the company has adjusted the past year's financials by excluding contributions from Al Hammadi Olaya hospital, which stopped receiving patients by the end of 3Q 2021. Even after including Al Hammadi Olaya's 1H 2021 revenue, 1H 2022 revenue is down only slightly by 2.5% YoY, which indicates the operating environment is improving with the opening of the economy and an increase in visitors, who are required to have valid health insurance.

**Fig. 70: Revenue expected to remain on a rising trend…**

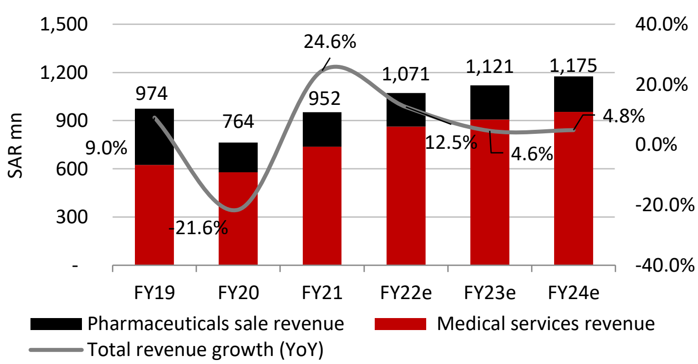
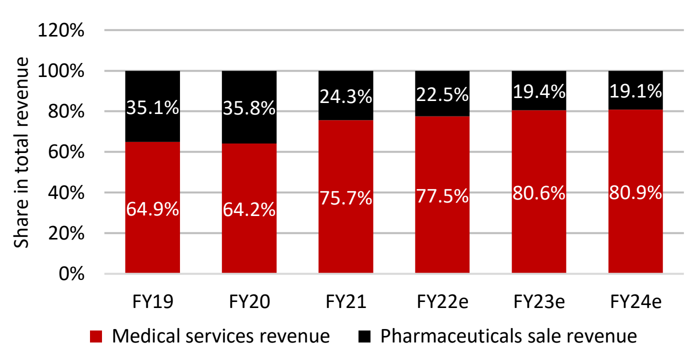



**Fig. 71: …driven by the medical services segment**



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Source: Company Reports, U Capital Research

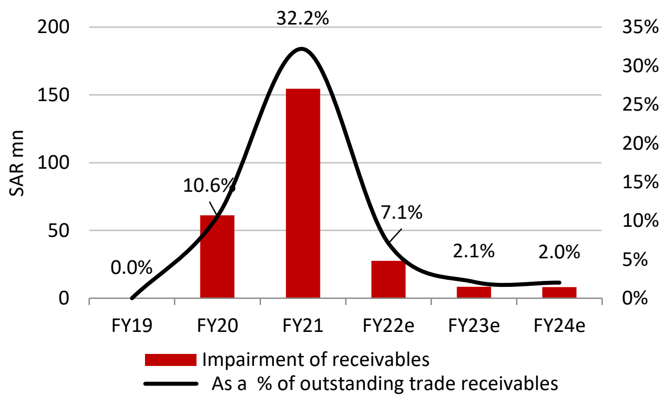
Source: Company Reports, U Capital Research

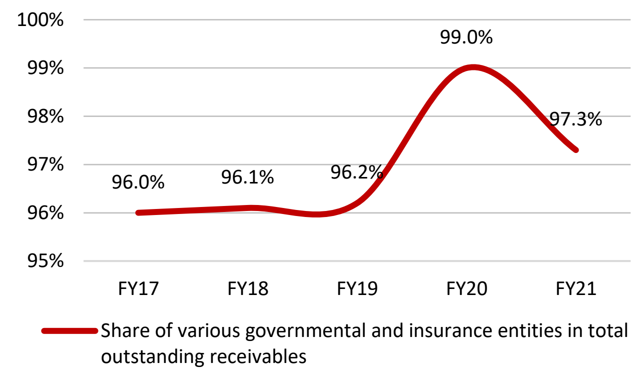
With the Kingdom's economy remaining on a strong growth path, we expect healthcare demand in the country to increase further as the government implements several large-scale projects which might lead to an increase in the population of foreign nationals, in our view. The government's plan to invest over USD 20bn over the next 8 years to transform Riyadh into one of the world's leading economic cities, as part of its Vision 2030, also bodes well for Al Hammdi's prospects as the capital city is its primary market. Hence, we estimate the company to remain on a healthy growth path, with its revenue growing at ~9% CAGR during FY 2021-2026 (FY 2017-2021: 8% CAGR).

## Improving customers' credit profile on favorable macroeconomy to aid in lowering receivables' impairment

Government and insurance entities account for the bulk of the company's trade receivables (97.3% of total receivables in FY 2021, and 99.0% in FY 2020). Since FY 2019, the company has booked increasing sums toward expected credit loss provision, implying a deterioration in the quality of its accounts receivables, which has partially led to an erosion in its operating margin to 13.8% in FY 2021 from ~20% in FY 2017. In our opinion, a general economic slowdown followed by the COVID-19 pandemic likely led to a weakening in the credit profile of the government and corporate, thereby impacting the quality of the company's receivables. However, Al Hammadi's operating margin has improved considerably, nearly doubling to 27% in 1H 2022 as compared to 14% in 1H 2021, with a 64% YoY decrease in the expected credit loss provision. We attribute this dip in the receivables' impairment provision to an improvement in the government finances following a strengthening in crude oil prices and economic recovery post-easing of the pandemic situation. With the forecasts about the Kingdom's economy to remain on a solid growth path amid firm crude oil prices, we estimate impairment expenses to decrease further. This, along with the expected growth in the top line, should aid the company in maintaining margins at around the current high levels.

**Fig. 72: HHC's impairment expense rose in FY20 & FY21 as weak economic activity likely impacted the paying capacity of its major customers**




Source: Company Reports, U Capital Research

Source: Company Reports, U Capital Research

## Prudent financial management despite pressure on earnings

Al Hammadi's earnings have fluctuated over the past five years, impacted by various factors such as the opening of a hospital in Al Nuzha in 2018 which pushed operating costs, an increase in receivables impairment provisions, and suspension of operations of Olaya hospital during FY 2021. Outstanding receivables days increased significantly from 129 days in FY 2017 to 276 days in FY 2021, indicating pressure on customers' finances, which was also reflected in an increase in the impairment expense as highlighted in our previous point. These factors led to an uneven cash balance for the company, in our view. Yet, the company was able to reduce its debt burden, with the D/E ratio falling to 0.18x in June 2022 end from 0.45x at the end of FY 2018, partly aided by a decrease in capex requirement as no new hospitals were added after FY 2018.

**Fig. 73: Debtors' days likely peaked in FY21**

**Fig. 74: HHC has consistently repaid its debt**



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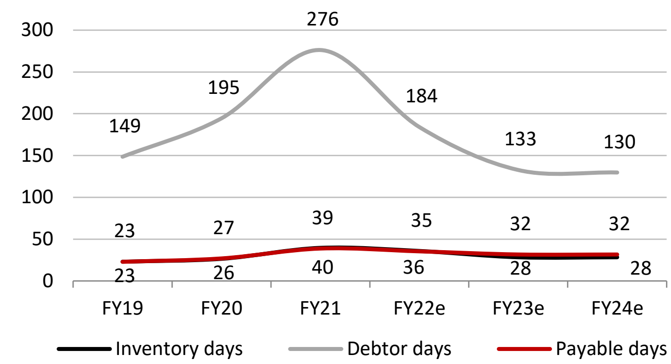
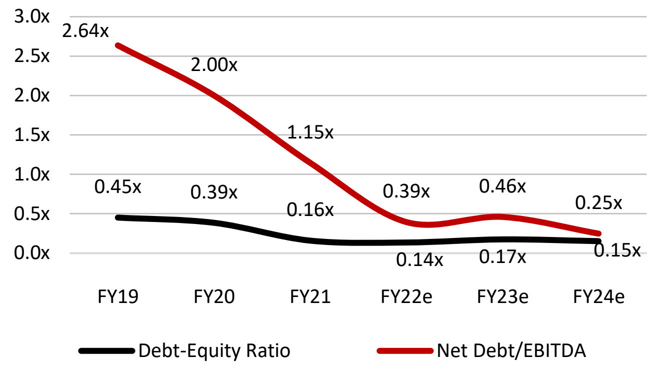


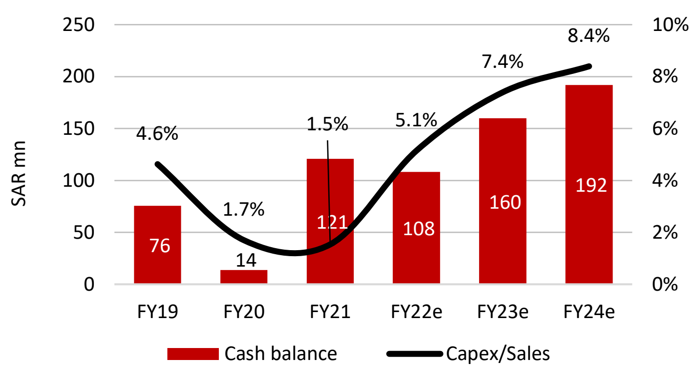

Source: Company Reports, U Capital Research




Source: Company Reports, U Capital Research

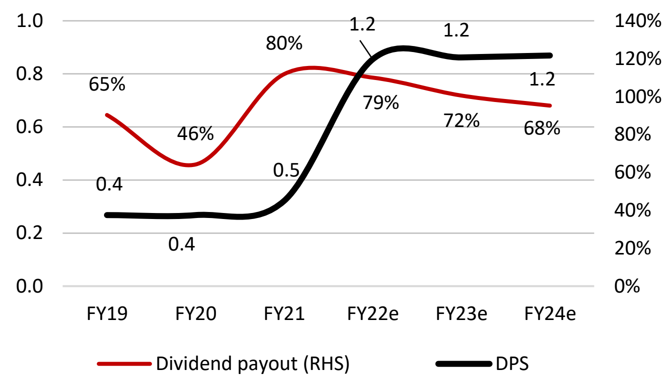
Going forward, we expect Al Hammadi's cash balance to smoothen relatively on the back of projected top-line growth coupled with stable profitability. Capex requirements are expected to increase over the next few years owing to the development of the new Al Hammadi Olaya Hospital, reaching the range of 8-9% of revenue by FY2024-2025e, as compared to 1-2% range over the last 2.0-2.5 years. However, we estimate cash flows from the existing operations to adequately fund the additional capex requirements while also maintaining its dividend payouts.

**Fig. 75: Rising cash balance to help in meeting capex**




Source: Company Reports, U Capital Research

**Fig. 76: DPS is likely to at least double in FY22 from FY21**




Source: Company Reports, U Capital Research

## Assured quarterly dividend policy might be attractive for consistent income-seeking investors

That said, regarding future dividend payouts, the company's board of directors approved in August 2022 the dividend policy for the next three years, starting from 3Q 2022. The policy commits to pay at least 60% of each quarter's net profit as dividends. For 3Q 2022, the BoD has recommended SAR 0.3 per share dividend. Considering the dividend declared for 1Q 2022 and 2Q 2022, the 9M 2022 dividend shows an 83% increase from FY 2021 DPS of SAR 0.60, and hence we expect FY 2022 dividend to be at least twice the dividend declared in FY 2021. This, in our view, should be viewed favorably by regular income-seeking investors.

## Initiate with Accumulate

Overall, we have an optimistic stance on HHC's business prospects in the backdrop of a healthy recovery that the company has registered so far this year viz-a-viz last year indicating operating environment is turning favorable, improvement in its financial metrics, and a positive outlook for the geography where the company operates. Hence, we allocate an '**Accumulate**' rating on the stock as of now with SAR 47.50 target price, indicating an upside of 15.9%.

## About Al Hammadi Holding

Al Hammadi Holding Co. (previously Al Hammadi Company for Development & Investment) is located in Saudi Arabia's capital Riyadh, where it is engaged in the provision of medical services through a network of hospitals containing inpatient and outpatient departments. The company is currently operating two hospitals in Riyadh, with a combined bed capacity of slightly over 1,000 and



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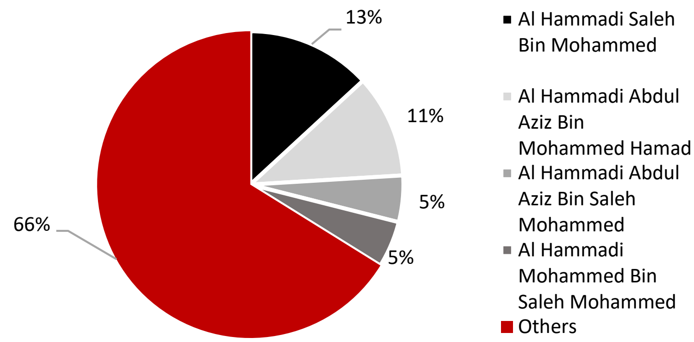
128 clinics. The company came into existence in 1985 as a sole proprietorship with the name Al Hammadi Hospital. Al Hammadi was converted into a limited liability company in 2004 and was later changed to a Saudi closed joint stock company under the name Al Hammadi Company for Development & Investment. In 2014, the company got approval from the Capital Market Authority and launched its Initial Public Offering (IPO) for listing on Tadawul. Al Hammadi's current share capital stands at SAR 1,600mn divided into 160mn shares.

**Fig. 77: HHC: Shareholding Structure**




**Source: Bloomberg**



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**Key financials**

| In SAR mn, except stated otherwise | FY19 | FY20 | FY21 | FY22e | FY23e | FY24e |
|---|---|---|---|---|---|---|
| **Income Statement** | | | | | | |
| Revenue | 974 | 764 | 952 | 1,071 | 1,121 | 1,175 |
| Cost of revenue | (691) | (511) | (588) | (669) | (702) | (735) |
| **Gross profit** | **283** | **253** | **364** | **402** | **419** | **440** |
| General & administrative expenses | (123) | (81) | (79) | (91) | (97) | (101) |
| Selling & marketing expenses | (30) | (6) | (5) | (3) | (3) | (3) |
| Other operating income | 17 | 10 | 16 | 17 | 19 | 19 |
| **Operating profit** | **147** | **109** | **131** | **298** | **329** | **347** |
| The company's share in income of associates | - | - | 2 | 6 | 6 | 7 |
| Finance charges | (37) | (25) | (16) | (21) | (21) | (19) |
| **Profit before zakat** | **109** | **84** | **118** | **284** | **315** | **335** |
| Zakat expense | (16) | (20) | (19) | (40) | (46) | (49) |
| **Profit attributable to shareholders of the company** | **93** | **131** | **90** | **244** | **269** | **286** |
| **Balance Sheet** | | | | | | |
| Cash and cash equivalents | 76 | 14 | 121 | 108 | 160 | 192 |
| Trade receivables | 561 | 596 | 364 | 415 | 398 | 408 |
| Inventories | 49 | 62 | 54 | 50 | 54 | 55 |
| Right of use assets | - | 20 | 12 | 4 | 5 | 6 |
| Property and equipment | 1,762 | 1,652 | 1,535 | 1,505 | 1,501 | 1,511 |
| **Total assets** | **2,538** | **2,435** | **2,262** | **2,361** | **2,400** | **2,458** |
| Accrued expenses and other liabilities | 37 | 27 | 23 | 23 | 25 | 26 |
| Short term lease liabilities | 22 | 18 | 9 | 1 | 1 | 2 |
| Trade payables | 56 | 53 | 61 | 55 | 61 | 64 |
| **Total liabilities** | **972** | **736** | **602** | **650** | **614** | **580** |
| Share capital | 1,200 | 1,200 | 1,200 | 1,600 | 1,600 | 1,600 |
| Retained earnings | 315 | 434 | 386 | 75 | 124 | 187 |
| **Equity Attributable to Shareholders** | **1,566** | **1,699** | **1,659** | **1,711** | **1,787** | **1,878** |
| **Cash Flow Statement** | | | | | | |
| Net cash generated from operating activities | 183 | 329 | 435 | 272 | 375 | 368 |
| Net cash generated from investing activities | (45) | (27) | (133) | (151) | (83) | (99) |
| Net cash (used in) provided by financing activities | (106) | (363) | (194) | (134) | (240) | (238) |
| **Cash and cash equivalents at the end of the period** | **76** | **14** | **121** | **108** | **160** | **192** |
| **Key Ratios** | | | | | | |
| Gross margin (%) | 29.0% | 33.1% | 38.2% | 37.5% | 37.4% | 37.4% |
| EBITDA margin (%) | 26.3% | 28.7% | 25.6% | 37.2% | 37.7% | 37.6% |
| Operating margin (%) | 15.0% | 14.3% | 13.8% | 27.8% | 29.4% | 29.5% |
| Net margin (%) | 9.5% | 17.1% | 9.5% | 22.8% | 24.0% | 24.3% |
| ROA | 3.7% | 5.3% | 3.8% | 10.5% | 11.3% | 11.8% |
| ROE | 6.1% | 8.0% | 5.4% | 14.5% | 15.4% | 15.6% |
| Current Ratio (x) | 2.3x | 2.2x | 2.5x | 3.0x | 3.1x | 3.3x |
| Capex/Sales | 4.6% | 1.7% | 1.5% | 5.1% | 7.4% | 8.4% |
| Debt-Equity Ratio | 0.4x | 0.2x | 0.1x | 0.2x | 0.2x | 0.1x |
| EPS | 0.6 | 0.8 | 0.6 | 1.5 | 1.7 | 1.8 |
| BVPS | 9.8 | 10.6 | 10.4 | 10.7 | 11.2 | 11.7 |
| DPS | 0.4 | 0.4 | 0.5 | 1.2 | 1.2 | 1.2 |
| Dividend Payout Ratio | 64.5% | 45.9% | 79.9% | 78.6% | 71.8% | 68.1% |
| Dividend Yield (%) | 2.4% | 1.7% | 1.5% | 2.9% | 2.9% | 3.0% |
| P/E (x) | 27.1x | 26.5x | 53.7x | 26.9x | 24.4x | 22.9x |
| P/BV (x) | 1.6x | 2.0x | 2.9x | 3.8x | 3.7x | 3.5x |
| EV/EBITDA (x) | 12.1x | 17.2x | 20.0x | 16.8x | 15.6x | 14.8x |
| Price as at period end* | 15.8 | 21.7 | 30.2 | 41.0 | 41.0 | 41.0 |

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


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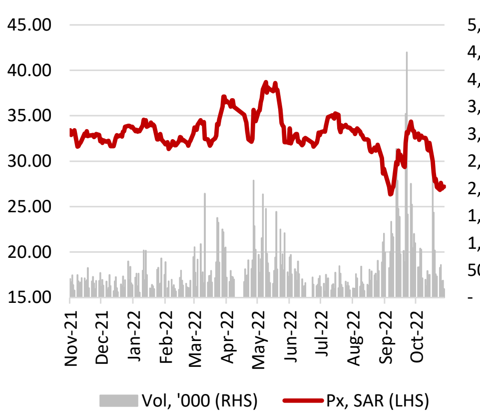
# Middle East Healthcare

**Target Price: SAR 25.50/share**
**Upside/(downside): (6.2%)**

| **Recommendation** | **Hold** |
|---|---|
| Bloomberg Ticker | MEH AB |
| Current Market Price (SAR) | 27.20 |
| 52wk High / Low (SAR) | 39.35/25.90 |
| 12m Average Vol. (000) | 555.1 |
| Mkt. Cap. (USD/OMR mn) | 666/2,503 |
| Shares Outstanding (mn) | 92.04 |
| Free Float (%) | 44% |
| 3m Avg Daily Turnover (SAR'000) | 25,758.2 |
| 6m Avg Daily Turnover (SAR'000) | 22,661.8 |
| P/E'23e (x) | 33.4 |
| EV/EBITDA'23e (x) | 17.6 |
| Dividend Yield '23e (%) | 0.0% |
| | |
| **Price Performance:** | |
| 1 month (%) | (18.3) |
| 3 month (%) | (19.2) |
| 12 month (%) | (19.8) |

***Source: Bloomberg, valued as of 17 November 2022***

**Price-Volume Performance**




***Source: Bloomberg***

- **MEH's healthcare facilities are situated across Saudi Arabia in almost all major cities**
- **By the FY22 end, MEH is expected to have the highest number of hospital beds and second highest number of clinics among the five healthcare firms under our coverage**
- **During FY22, operational hospital beds are estimated to increase by 295 which bodes well for top-line growth as inpatient services generate 55-60% of the total revenue**
- **While the top line grew at a decent 6% CAGR during FY17-21, weak operational efficiency has taken a toll on earnings which clocked a negative 52% CAGR in the same period**

MEH's hospital beds and clinics capacity in FY22 is likely to grow by much more than what it achieved during FY17-21. Coupled with an expected increase in patients' numbers (total patients in 1H22: +31% YoY), this is estimated to lift total revenue by over 12% in FY22 vs. the 7% growth achieved in FY21. MEH's earnings during 9M22 grew by ~18% YoY while the margin was stable, which is a positive given that the company has witnessed a continued and sharp decline in its bottom line during FY17-21. Accordingly, we expect MEH's earnings to rebound this year, likely reaching c. SAR 53mn vs. c. SAR 17mn in FY21. We also expect the company to sustain this improvement going forward as the utilization of newly added facilities rises. However, we reckon the company's FY23e P/E of ~33x exceeds some of its better-placed peers, and considering its weak financial track record in the past, we prefer to initiate Middle East Healthcare (MEH) with a **Hold** rating (SAR 25.50 per share target price)

## Investment Thesis

**Valuation and risks:** Our target price is based on blended valuation methodologies – (i) Discounted Cash Flow (DCF) and (ii) Relative Valuation (using P/E multiple). Key downside risks to our valuation include i) delay in the expected opening of new hospitals/clinics, ii) lower-than-estimated utilization of hospitals and clinics iii) below-expected growth rate of the revenue per utilized bed and/or effective clinic, iv) below-expected margins, and iv) higher than estimated leverage levels. Key upside risks to our valuation include i) higher-than-estimated utilization of the medical facilities ii) below-expected growth rate of the revenue per utilized bed and/or effective clinic iii) above-expected margins, and iv) lower-than-forecasted debt levels.

**Weak fundamentals:** i) MEH's top-line grew at 6% CAGR during FY17-21, driven both by inpatient (FY21: 58.7% of revenue) and outpatient (FY21: 26.2% of revenue) segments. ii) Operating and net margin posted a negative 35% and 52% CAGR during this period, iii) Net margin contracted to 0.9% in FY21 from 21.8% in FY17, though 9M22 net margin improved marginally to 2.7% (9M21: 2.6%). Iv) High D/E of ~1.6x at 2Q22-end, though an easing is likely post FY23 with relatively lower capex needs v) Zero dividend payouts after FY17. We have not estimated any dividend going forward.

| Year | FY19 | FY20 | FY21 | FY22e | FY23e | FY24e |
|---|---|---|---|---|---|---|
| Revenues (SAR mn) | 1,496.6 | 1,750.6 | 1,872.6 | 2,110.3 | 2,276.4 | 2,455.6 |
| Net income (SAR mn) | 97.6 | 82.0 | 17.2 | 53.4 | 74.9 | 116.6 |
| Gross margin | 31.6% | 33.0% | 32.5% | 31.1% | 31.6% | 32.2% |
| Net profit margin | 6.5% | 4.7% | 0.9% | 2.5% | 3.3% | 4.7% |
| RoE | 6.6% | 5.3% | 1.2% | 4.2% | 5.6% | 8.1% |
| FCF (SAR/share) | (3.8) | (5.8) | (3.9) | (2.4) | 1.5 | 1.0 |
| DPS (SAR/share) | - | - | - | - | - | - |
| Dividend Yield | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| P/E (x) | 28.0x | 39.3x | 169.4x | 46.9x | 33.4x | 21.5x |
| P/BV (x) | 1.8x | 2.0x | 2.3x | 1.9x | 1.8x | 1.7x |

*Source: Company Reports, U Capital Research* **P/E, P/B, and dividend yield from 2022 onwards calculated on price of 17/11/2022*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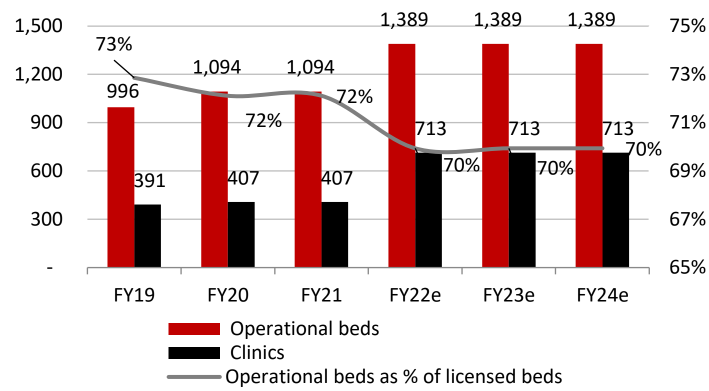
## Hospital beds and clinics are to rise sharply during FY22 while the next addition is expected in FY26

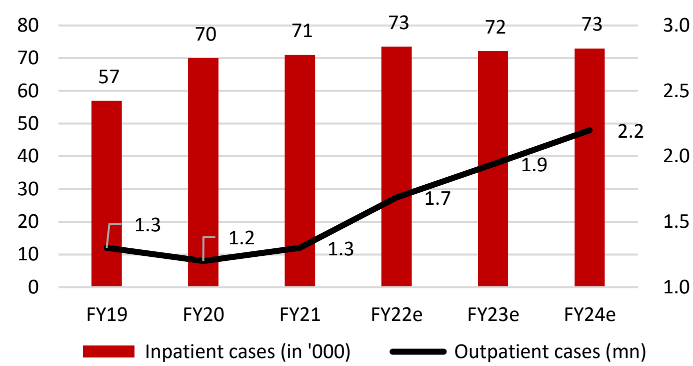
MEH operates in Saudi Arabia through owned properties at six locations — Jeddah, Asser, Riyadh, Madinah, Hail, and Dammam and runs one hospital on lease in Jeddah. In addition, it manages three hospitals in the UAE and one hospital each in Egypt and Yemen under the Management Agreement. During the last five years, the company opened one hospital in Dammam in FY 2020 which led to an increase in its licensed bed capacity by 150 from 1,367 to 1,517 and operational beds from 996 to 1,094. The company opened One Day Surgery Hospital in Jeddah during 2Q 2022 which increased licensed and operational beds capacity further to 1,552 and 1,129, respectively. In addition, MEH also had 453 outpatient clinics as of the end of 2Q 2022 (vs. 371 in FY 2017).

**Fig. 78: FY22 to see a notable increase in beds and clinics**




Source: Company Reports, U Capital Research

**Fig. 79: Both inpatients and outpatients continue to grow**



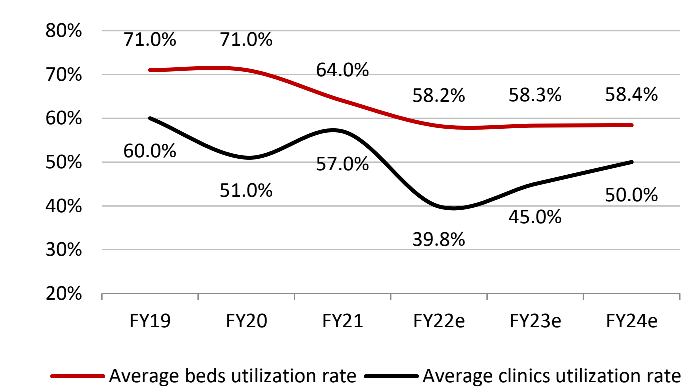

Source: Company Reports, U Capital Research

The company continues to expand organically and has launched operations of a hospital in Makkah in September 2022 with a licensed capacity of 300 beds and 100 outpatient clinics. However, based on the past trend, we have only considered 60% of beds (180) to be operational. Capacity is slated to increase further as the company is likely to open Riyadh Outpatient Tower with a licensed capacity of 134 beds and 160 clinics. Post that, based on the currently available information, capacity is likely to remain stable at 1,986 licensed beds and 713 clinics till FY 2026 when the company is expected to launch the second expansion of its Jeddah hospital, lifting its licensed beds capacity by 207 to 2,193 and outpatients' clinics capacity by 14 to 727.

## Increase in capacity plus utilization expected to push revenues higher in the future

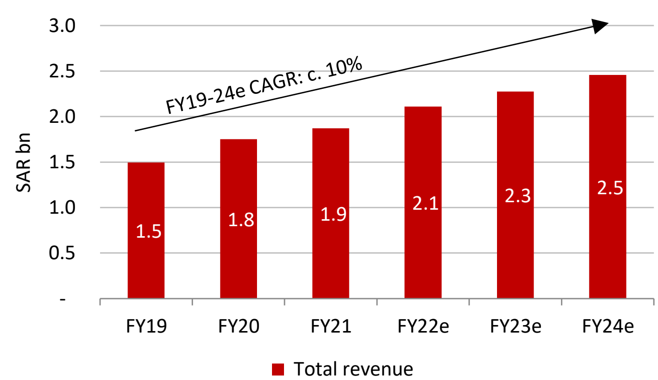
MEH generates more than 50% of its revenue through inpatient services which have increased from about 53% in FY 2017 to c. 59% in FY 2021. Between 25-30% of revenue comes from outpatient services, whereas the rest is mostly from pharmacy sales. Although the company has raised its capacity once during FY 2017-2021, it has achieved decent revenue growth of 6% CAGR during this period. This has mostly been driven through inpatient services and has been supported by a mix of increases in the utilization of healthcare facilities and revenue per bed. In FY 2021, while the utilization of beds decreased, the utilization of clinics improved which was in accordance with the easing of the COVID situation.

**Fig. 80: Increase in capacity in FY22 will drag utilization**




Source: Company Reports, U Capital Research

**Fig. 81: Increase in capacity with higher patients no. to lift revenue**




Source: Company Reports, U Capital Research

Owing to the launch of new projects during FY 2022, operational beds are expected to increase by 27% and clinics by a sharp 75% as compared to FY 2021. As the new healthcare facilities initially run at lower utilization levels, overall utilization will decrease. However,



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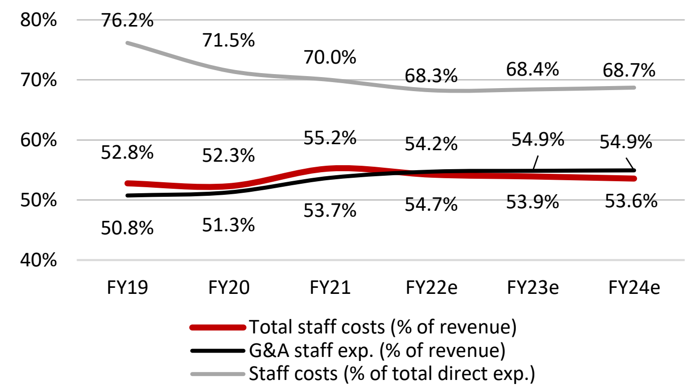
this is still expected to drive the total number of patients higher, both in hospitals and dispensaries. Accordingly, we expect a c. 13% YoY top-line growth in FY 2022. Further, as the new facilities gradually nudge towards optimum operational levels, we expect the top line to continue growing at a healthy pace, thereby clocking around 10% CAGR till FY 20206e. A point worth noting here is that the company also manages some hospitals, and it is pursuing several management contracts for the same in Egypt, Pakistan, and Morocco, which, if successful, would provide the company with additional revenue growth opportunities (not modeled).

## Management's restructuring and efficiency enhancement efforts are likely to ease the stress on profitability

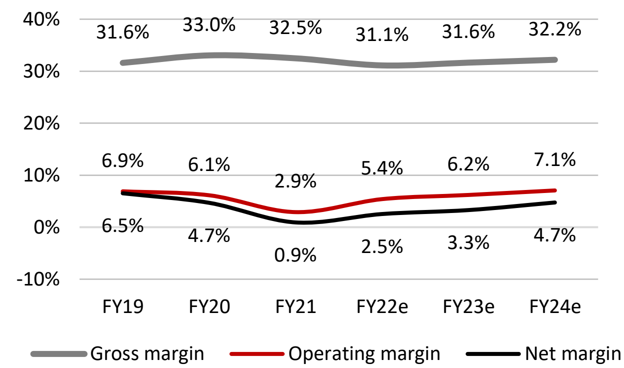
While the company has registered decent revenue growth, poor efficiency levels have devoid it of reaping its full benefits. While the gross margin has stabilized somewhat during FY 2019-2021, the operating margin has contracted significantly, reaching 2.9% in FY 2021 from 20.2% in FY 2017. This has primarily resulted from higher G&A expenses, particularly staff-related costs, that have weighed on the operating profit growth. In our opinion, this increase in G&A expenses is partly attributable to the addition of some new projects during the last five years. However, in the backdrop of normalizing circumstances, and the company focusing on restructuring and efficiency enhancements, we expect operating profitability to improve gradually towards the pre-COVID level.

**Fig. 82: Staff costs have the most weight among other costs**




**Source: Company Reports, U Capital Research**

**Fig. 83: Operating and net margins have contracted significantly**

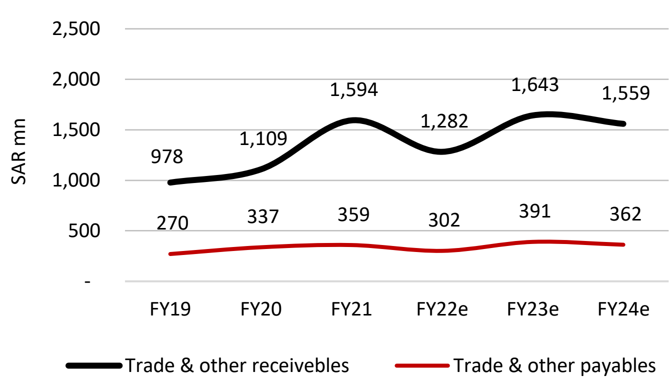



**Source: Company Reports, U Capital Research**

## Weakening profitability and poor receivables collection adversely impact liquidity, lifting D/E significantly…

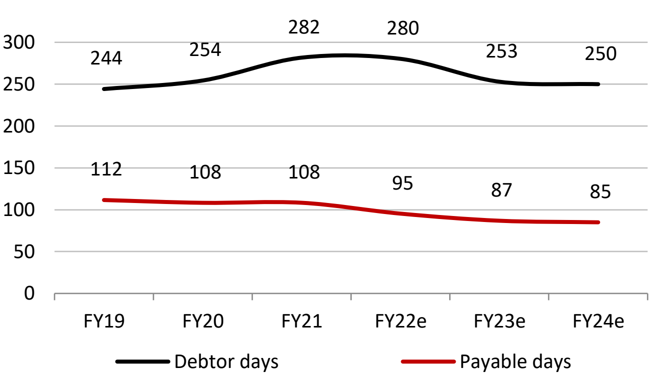
Apart from an erosion in profitability, the company also faced pressure on receivables collection, with the receivables' days stretching to 280 days in FY 2021 as compared to 220 in FY 2017. This also adversely impacted MEH's liquidity as its free cash flows have turned negative in four out of the last five years. Understandably, the company had to resort to debt funding to tide over its liquidity problems, which led to a swelling in its debt balance (D/E: 1.65x at the end of 2Q 2022 as compared to 0.21x at the end of FY 2017). A weakening operating profit along with rising debt servicing costs took a heavy toll on the bottom line which posted a negative CAGR of 52% during FY 2017-2021.

**Fig. 84: Outstanding receivables swelled…**




**Source: Company Reports, U Capital Research**

**Fig. 85: …as the company faced pressure on collections**

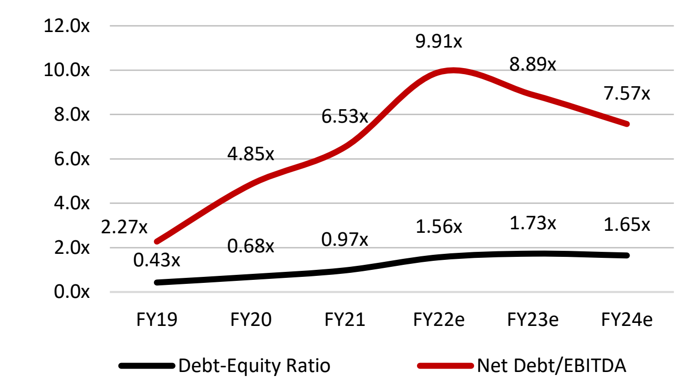



**Source: Company Reports, U Capital Research**

## …but a projected improvement in profitability coupled with reduced capex requirements post a significant rise in capacity this year estimated to aid in better cash flow generation, and lower the current high debt levels

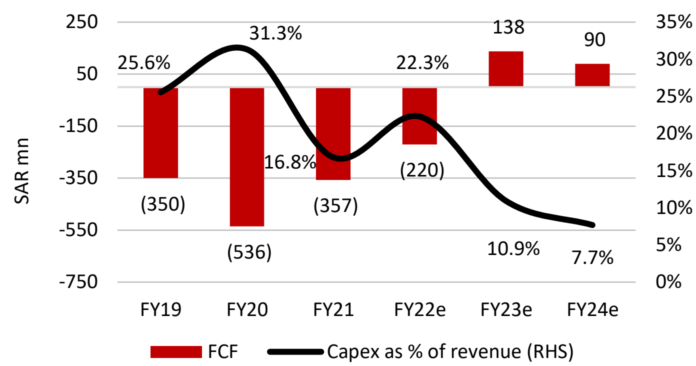
That said, with an improving economic environment, a projected acceleration in the company's top line, and an estimated revival in profitability, we expect the company to get relatively better off in its cash flow generation. Over the last two-three years, MEH's capex has increased since it was implementing new or expansion projects which generally take around three years to achieve completion. However, with most of these projects completed, or nearing completion now, we expect MEH's capex requirements to come down going forward, given that there will remain only one project under construction, i.e., Jeddah hospital expansion, that will likely come online by FY 2026. Consequently, we expect an improvement in the company's cash position from here.

**Fig. 86: Net debt/EBITDA shoots up amid erosion in profitability**




**Source: Company Reports, U Capital Research**

**Fig. 87: Falling capex to partially aid in cash flow improvement**




**Source: Company Reports, U Capital Research**

Owing to the significant deterioration in its profitability, the company stopped paying a dividend after FY 2017. While we expect the financial position to turn better over the coming years, we have not assumed a resumption of dividend distribution, as we opine the company should utilize higher liquidity in reducing its debt balance. This we feel would be a better strategy, under the current tightening interest rate environment, to boost its net margins as well as return to shareholders, which fell to a paltry 1.2% during FY 2021, but has improved to 4.8% on an annualized basis during 1H 2022.

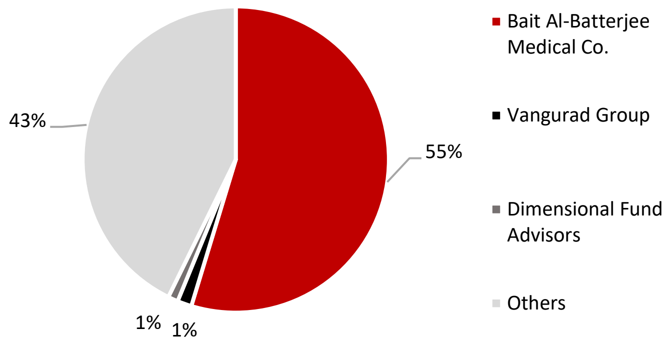
## Allocate the "Hold" rating given the uncertainty shrouding the forecasted business improvement

MEH's management has talked about business restructuring and enhancing operational efficiency to tide over its financial issues of consistent erosion in margins, rising debt balance, and high receivables collection period of around 8-9 months. We believe this is crucial to ensure the company remains capable of carrying out its operations over the coming periods. Although financial results for the first three-quarters of FY22 do show some green shoots of recovery, the management's financial track record of the recent past does not instill much confidence. Therefore, we would like to exercise caution until we get more clarity that a business turnaround is working, and hence allocate a "**Hold"** rating on the stock, with a target price of SAR 25.50, indicating a downside of 6.2% from the current levels.

## About MEH

Middle East Healthcare (MEH) started operations in 1988 with the opening of the first hospital in Jeddah. Since then, the company has gradually expanded its hospitals and clinics in almost all the major cities of Saudi Arabia —Riyadh, Dammam, Madinah, Makkah, among others. In addition, the company also has its presence in the wider MENA region as it manages hospitals in the UAE, Egypt, and Yemen and is pursuing more hospitals through this route in Egypt, Morocco, and Pakistan. The company got CMA approval for a public offering in 2015 and got listed on Tadawul in March 2016. The company had more than 1,500 licensed hospital beds and over 450 clinics by the end of 2Q 2022, which are set to increase to around 1,900 and 700, respectively, by FY 2022 end, as per the available information. MEH's hospitals and clinics employ around 6,400 staff, including ~1,100 doctors and ~2,100 nurses.

**Fig. 88: MEH: Shareholding Structure**




Source: Bloomberg



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**Key financials**

| In SAR mn, except stated otherwise | FY19 | FY20 | FY21 | FY22e | FY23e | FY24e |
|---|---|---|---|---|---|---|
| **Income Statement** | | | | | | |
| Revenue | 1,497 | 1,751 | 1,873 | 2,110 | 2,276 | 2,456 |
| Cost of revenue | (1,024) | (1,172) | (1,264) | (1,454) | (1,556) | (1,665) |
| **Gross profit** | **473** | **578** | **608** | **657** | **720** | **791** |
| General & administrative expenses | (355) | (440) | (508) | (511) | (546) | (583) |
| Selling & marketing expenses | (15) | (31) | (46) | (32) | (33) | (34) |
| **Operating profit** | **103** | **107** | **54** | **114** | **141** | **174** |
| Other income (expenses), net | 17 | 7 | 12 | 17 | 19 | 20 |
| Finance charges | (25) | (34) | (47) | (74) | (79) | (68) |
| **Profit before zakat** | **95** | **81** | **19** | **57** | **81** | **125** |
| Zakat expense | (5) | (6) | (8) | (9) | (12) | (19) |
| **Profit attributable to shareholders of the company** | **98** | **82** | **17** | **53** | **75** | **117** |
| **Balance Sheet** | | | | | | |
| Cash and cash equivalents | 54 | 17 | 28 | 54 | 162 | 232 |
| Trade receivables | 1,109 | 1,594 | 1,282 | 1,643 | 1,559 | 1,615 |
| Prepaid expenses and other assets | 74 | 85 | 112 | 138 | 137 | 135 |
| Right of use assets | 30 | 26 | 33 | 28 | 22 | 16 |
| Property and equipment | 1,909 | 2,074 | 2,357 | 2,459 | 2,503 | 2,547 |
| **Total assets** | **3,305** | **3,957** | **3,975** | **4,501** | **4,558** | **4,727** |
| Accrued expenses and other liabilities | 107 | 135 | 140 | 238 | 233 | 250 |
| Short term loans and borrowings | 384 | 698 | 931 | 964 | 969 | 974 |
| Trade payables | 337 | 359 | 302 | 391 | 362 | 388 |
| **Total liabilities** | **1,744** | **2,325** | **2,680** | **3,157** | **3,146** | **3,209** |
| Share capital | 920 | 920 | 920 | 920 | 920 | 920 |
| Retained earnings | 421 | 477 | 144 | 190 | 265 | 381 |
| **Equity Attributable to Shareholders** | **1,523** | **1,590** | **1,258** | **1,304** | **1,379** | **1,495** |
| **Cash Flow Statement** | | | | | | |
| Net cash generated from operating activities | 99 | (229) | 77 | (31) | 267 | 233 |
| Net cash generated from investing activities | (469) | (294) | (417) | (230) | (175) | (179) |
| Net cash (used in) provided by financing activities | 380 | 486 | 352 | 287 | 17 | 16 |
| **Cash and cash equivalents at the end of the period** | **54** | **17** | **28** | **54** | **162** | **232** |
| **Key Ratios** | | | | | | |
| Gross margin (%) | 31.6% | 33.0% | 32.5% | 31.1% | 31.6% | 32.2% |
| EBITDA margin (%) | 13.5% | 13.4% | 10.4% | 11.7% | 12.2% | 12.8% |
| Operating margin (%) | 6.9% | 6.1% | 2.9% | 5.4% | 6.2% | 7.1% |
| Net margin (%) | 6.5% | 4.7% | 0.9% | 2.5% | 3.3% | 4.7% |
| ROA | 3.2% | 2.3% | 0.4% | 1.3% | 1.7% | 2.5% |
| ROE | 6.6% | 5.3% | 1.2% | 4.2% | 5.6% | 8.1% |
| Current Ratio (x) | 1.7x | 1.6x | 1.2x | 1.3x | 1.3x | 1.3x |
| Capex/Sales | 31.3% | 16.8% | 22.3% | 10.9% | 7.7% | 7.3% |
| Debt-Equity Ratio | 0.7x | 1.0x | 1.6x | 1.7x | 1.6x | 1.5x |
| EPS | 1.1 | 0.9 | 0.2 | 0.6 | 0.8 | 1.3 |
| BVPS | 16.5 | 17.3 | 13.7 | 14.2 | 15.0 | 16.2 |
| DPS | - | - | - | - | - | - |
| Dividend Payout Ratio | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Dividend Yield (%) | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| P/E (x) | 28.0x | 39.3x | 169.4x | 46.9x | 33.4x | 21.5x |
| P/BV (x) | 1.8x | 2.0x | 2.3x | 1.9x | 1.8x | 1.7x |
| EV/EBITDA (x) | 19.6x | 21.5x | 26.2x | 20.1x | 17.6x | 15.3x |
| Price as at period end* | 29.7 | 35.1 | 31.7 | 27.2 | 27.2 | 27.2 |

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


P.O.BOX 1137, PC 111 – CPO, Sultanate of Oman I CR No. 1279406 I Tel: +9682494 9000 I Fax: +968 2494 9099 I Email: info@u-capital.net I Web: www.u-capital.net

# 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% |

U Capital
Ubhar Capital اوبار كابيتال

**Ubhar Capital SAOC (U Capital)**

Website: www.u-capital.net
PO Box 1137
PC 111, Sultanate of Oman
Tel: +968 2494 9000
Fax: +968 2494 9099
Email: research@u-capital.net