

Mouwasat Medical Services Company

Modest net income growth on the back of higher operating costs

18 June 2020

Mouwasat's net income edged up by 0.8% Y-o-Y as higher operating costs erased the impact of top-line growth. We expect a dip in Mouwasat's utilization rates and profit in Q2 2020 before it normalizes in Q3 2020. Mouwasat is expected to weather the impact of short-term risks from COVID19 thanks to the essentiality of healthcare services. Its expansion plans are also set to support top-line recovery in 2021. We revise our recommendation for Mouwasat to Overweight, with a target price of SAR101.5/share.

Mouwasat's revenues grew by 6.8% Y-o-Y backed by the growth in all operating segments; inpatient (+12.9%), outpatient (+1.5%), and pharmaceuticals (+3.7%). Gross profit expanded by 4.4% Y-o-Y thanks to higher revenue, yet gross margins tightened by 100bps likely due to higher labor costs and lower operational volume starting mid-March. EBIT edged up by only 0.8% Y-o-Y given higher provisions of doubtful debts, while EBIT margin contracted by 150bps Y-o-Y. Lower zakat and finance costs failed to translate to higher net income growth, which in return increased by 0.8%.

Mouwasat witnessed lower patient visits in its hospitals starting mid-March and April, due to lockdown rules and precautionary measures. The impact of COVID-19 is expected to reflect more evidently in Q2 2020 results due to low utilization rates in April and May. Mouwasat witnessed improvement in footfall in June 2020; the recovery trend is expected to continue throughout the year, yet full recovery still depends on the easing of curfew measures. We expect a dip in both inpatient and outpatient services in Q2 2020, as clinic visits and surgeries are delayed before it starts normalizing in Q3 2020. The sector is currently witnessing a backlog of postponed surgeries and clinic visits, rather than cancellations, meaning hospitals might be facing increased demand in H2 2020.

Mouwasat is expected to commence the trial operations of Dammam hospital expansion and Medina hospital replacement during 2020, which is set to expand Mouwasat's operational capacity by around 25%. We expect Mouwasat's margins to remain under pressure in the short term until new hospitals' utilization rates reach sustainable levels and breakeven. On the other hand, Al Khobar hospital, which was still witnessing losses until Q4 2019, is expected to be profitable during 2020, mitigating the downside risk on short term profits.

We maintain our positive outlook for Mouwasat, despite short term risks from COVID19, as it is expected to weather the impact of lower footfall in Q2 2020. The essentiality of healthcare services, coupled with Mouwasat's planned capacity expansion in H2 2020, will aid in fast top-line recovery. Mouwasat continues to deliver superior profitability of more than 20%, which is double the sector's average. Favorable demographics (expected rise in population and changing population structure towards elderly people) in the Kingdom, combined with mandatory health insurance, remain key long-term catalysts for Mouwasat and the sector. **We revise our recommendation for Mouwasat to Overweight with a 52 weeks target price of SAR101.5/share.**

Recommendation

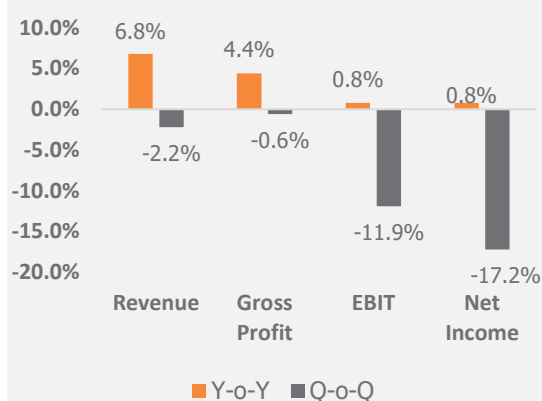
Overweight

Previous Recommendation	Buy
Current Price (17-06-2020)	SAR88.2
Target Price (52 Weeks)	SAR101.5
Upside/ (Downside)	15.0%
Shariah Compliance	Pass

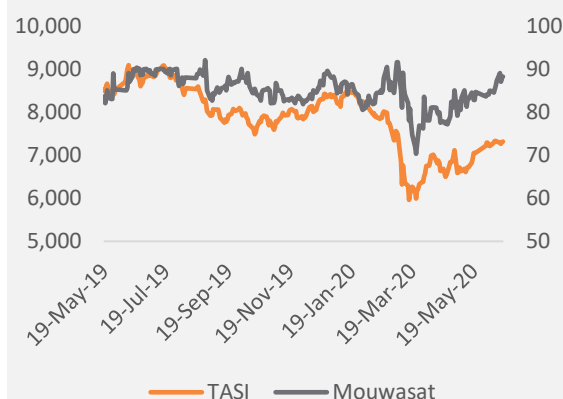
Key Financial Ratios

Ratio	Q1 2020	Q1 2019	Q4 2019
Revenue Growth	6.8%	9.5%	10.7%
Gross Margin	44.7%	45.7%	45.6%
EBIT Margin	24.9%	26.4%	27.7%
Net Margin	21.9%	23.2%	25.8%

Key Financial Results (Q1 2020)



Share Price Performance



Financial Projection

DCF Valuation

	2020 E	2021 F	2022 F	2023 F	2024 F
EBITDA	508	650	694	735	779
Operating CF	544	587	714	728	767
Capex	(255)	(219)	(150)	(148)	(132)
FCFF	289	368	564	580	635
Stub Period (FCF to be discounted)	218	368	564	580	635
PV (FCFF)	206	322	455	431	434
WACC	7.7%				
Perpetuity Growth	3.0%				
PV-FCFF	1,848	We have valued Mouwasat using DCF approach, considering a WACC is equal to 7.7% (based on a risk-free rate of 4.4%, market risk premium 7.3%, Beta of 0.56).			
PV-TV	8,948				
Net Debt	(498)	Based on the DCF valuation, the fair price Mouwasat share price is SAR101.5, which is higher than the traded value by 15.0%.			
Less: End of services benefits	(102)				
Add: Investments	58				
Less: Minority interest	(107)				
Intrinsic Value	10,147				
Shares Outstanding (million shares)	100				
Equity value per share	101.5				
CMP (17-06-2020)	88.2				
Upside / (Downside%)	15.0%				

Financial Ratios

	2018A	2019A	2020E	2021F	2022F	2023F	2024F
Return on Average Assets (%)	13.9%	13.6%	10.1%	13.6%	14.2%	14.6%	14.7%
Return on Average Equity (%)	22.7%	23.3%	16.6%	21.0%	20.3%	19.7%	19.1%
Earnings Before Zakat Margin (%)	24.4%	24.9%	22.0%	24.0%	24.8%	25.4%	25.8%
Net Income Margin (%)	22.9%	24.2%	21.1%	23.1%	23.8%	24.3%	24.8%
Revenue Growth (%)	10.0%	10.7%	-9.6%	27.7%	6.1%	6.8%	6.6%
EPS	3.8	4.5	3.5	4.9	5.4	5.9	6.4

Income Statement

	2018A	2019A	2020E	2021F	2022F	2023F	2024F
Revenues	1,677	1,857	1,678	2,143	2,274	2,430	2,591
Cost of Revenues	(904)	(1,028)	(938)	(1,176)	(1,240)	(1,322)	(1,407)
Gross Profit	773	829	741	967	1,033	1,107	1,184
SG&A	(369)	(359)	(366)	(450)	(470)	(496)	(522)
Zakat	(24)	(13)	(15)	(21)	(23)	(25)	(27)
Net Income	384	449	354	494	541	591	642

Balance Sheet

	2018A	2019A	2020E	2021F	2022F	2023F	2024F
Current Assets	1,041	1,261	1,164	1,331	1,540	1,826	2,194
Non-Current Assets	2,013	2,262	2,359	2,405	2,371	2,367	2,346
Total Assets	3,053	3,523	3,523	3,736	3,911	4,193	4,540
Current Liabilities	565	738	746	832	784	777	805
Non-Current Liabilities	681	733	571	403	306	243	180
Total Equity	1,807	2,052	2,206	2,501	2,822	3,174	3,556
Total Liabilities and Equity	3,053	3,523	3,523	3,736	3,911	4,193	4,540

Guide to Ratings and Disclaimer

Guide to Ratings

Buy	An upside potential of more than 20% in 52-week period
Overweight	An upside Potential of more than 10% in 52-week period
Neutral	Will stay in the range of it value (up/down 10%) in a 52-week period
Underweight	A downside potential of more than 10% in 52-week period
Sell	A downside potential of more than 20% in 52-week period

Itqan Capital

The HQBP Tower, Corniche Road, Al Shatea District,
PO Box 8021, Jeddah 21482,
Kingdom of Saudi Arabia

Tel: 966 12 510 6030

Fax: 966 12 510 6033

info@itqancapital.com

www.itqancapital.com

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