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# Demographics, Regulatory Initiatives, and Expansions Driving a Period of Long Term Growth Ahead

## KSA Healthcare Sector I Sector Report


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# KSA Healthcare Sector Report



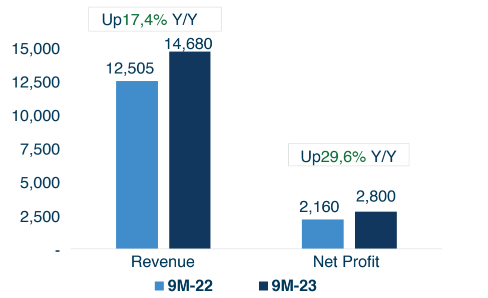
**KSA's Healthcare Sector witnessed a consolidated revenue growth of 17.4% Y/Y in 9M23, and punctuated by a 29.6% growth in the bottom line- lead by improvement in patient visits across the sector, ramping up previous expansions, and operational efficiencies. Consequentially, Q3-23 came to positively surprise the market, as our coverage beat market estimates by 16.2% despite the seasonal nature of Q3. With the topic of nationalized insurance revived, stock valuations across the sector have risen to re-reflect the undersupply of beds per capita in the Kingdom, as well as reflecting the expansions underway to tackle the increase in expected patient volumes from the national insurance reform plan which aims to raise private insurance coverage from the current 37.5% to nearly double to serve the entire population. To meet this demand, our coverage is forecasted to increase their beds capacity by 54.7% from FY22 to FY28. We therefore forecast our covered healthcare providers to grow their topline and net income at an FY22-28 CAGR of 14.2% and 18.9% respectively. While we remain bullish on the sector's prospects and fundamentals, we retain our 'Neutral' outlook over the sector's valuations, as the healthcare sector surged 27.5% YTD to reflect the positive developments.**

**Q3-23 marked another period of growth for our coverage; extending the sector's index return to outperform the market at 27.5% YTD:** The sector's Q3-23 results positively surprised consensus estimates by 16.2%, as the sector's net profits rose 43.6% Y/Y and 16.4% Q/Q. The sequential rise was a result of increased patient attractions and efficient operation initiatives. **Dallah** and **Care** posted the highest surprises at high double digit deviations: 65.4% and 47.6%, respectively. Dallah was supported by higher patient volumes, and SAR 3mn income from investments in associate investments (as compared to SAR 6mn in losses a year ago). Care's results were supported by core operations: 6% and 4% sequential rise in inpatient and outpatient admissions respectively, in addition to price increases, and operational efficiencies which decreased OPEX-to-Revenues to 6.5% from 14.1% in the previous year (also supported by an impairment reversal). **SGH** also posted a notable surprise as it benefited from its recent expansions coming to fruition and thus increasing its patient volumes. While its top line grew 31.0% Y/Y and 7.5% Q/Q, its operating margins reflected the firms cost optimization initiatives by increasing 530bps Q/Q and a significant 11.1% Y/Y, offsetting the increase in finance costs.

**Sector's prospects from demographic specifications, and regulatory initiatives on nationalized private healthcare insurance and PPP programs underpin the coming growth across all time horizons:** The Kingdom currently falls below an EU benchmark of beds-per-1,000 people at nearly half of the supply of beds as in the EU at 2.4 against 4.8. Highlighting the undersupply of private healthcare beds is the current capacity of private-beds-per-1,000 people of only 0.55 (and even lower for some regions). Furthermore, with plans to double Riyadh population within the decade, private HC providers' current beds capacity will face an overdemand from the increased population across the Kingdom. The Western region also currently faces a lack of presence of private healthcare providers, as Jeddah and Mecca host only 0.78 and 0.26 private beds per 1,000 people, respectively- a stark shortfall as compared to Riyadh's nearly 1 private bed per 1,000 people. The sector is however capitalizing on this shortfall by shifting more expansion plans towards the Western region. Also increasing the target audience for our coverage is the Vision 2030 initiative nationalizing private healthcare insurance to nearly triple the current 37.5% of the population which is privately insured. Furthermore, the withdrawal of the MoH from being a healthcare provider under the PPP plan for the sector leaves a vacuum which private providers have already began to compete for as in the projects opened for bidding in Riyadh and Dammam's health clusters. More immediate drivers on the sector are found in the expected increases in pilgrimages, the sector having a 19.6% share of the government's FY24 expenditure budget, as well as entertainment and outdoor venues with needs for healthcare facilities.

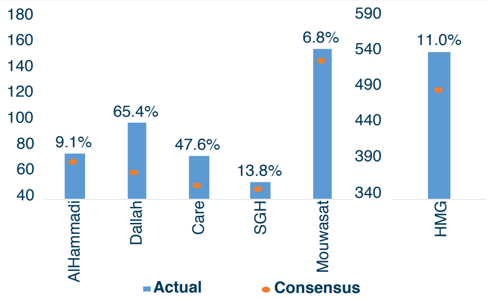
**The shifting landscape of the Kingdom's healthcare sector has prompted our coverage to set on plans to collectively expand their beds capacity by 54.7%:** To meet the influx of demand, the largest expansion plan is being led by **HMG** as it is forecasted to nearly double its beds capacity over FY22 by 96.5% to 3,462 beds by FY28, and with more expansions likely to be announced. **Care** is also forecasted to increase its beds capacity by 82.3% over the same period with an increased presence in the Western region. HMG's plans are reflected in their above-median TTM PE levels of 49x while Care sits under at 31x, respectively. **SGH** also has notable expansion plans at around 70% over FY22 bed capacities, as it increases its foothold in both the Western and Central regions. **Mouwasat** is forecasted to be the least to expand at only 29.6% of their FY22 bed capacities, and also reflected in their lackluster TTM PE of 29.9x. HMG and Mouwasat's net D/Es of 0.3 and 0.2, respectively, as well as FY18-22 FCF generation averages of 14.6% and 13.7% grant the providers the ability to support their expansions with internal financing.

**Fig 1. 9M-23 Y/Y Performance (SAR mn):**



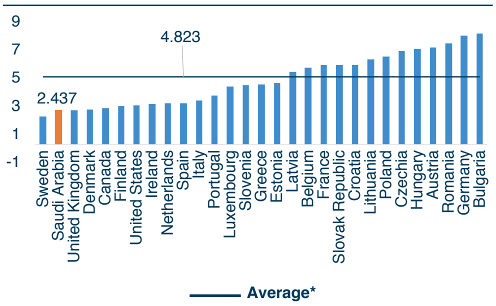

Sources: Bloomberg, AlJazira Capital

**Fig 2. Q3-23 Earnings Surprises (VS Market Consensus I SAR mn):**



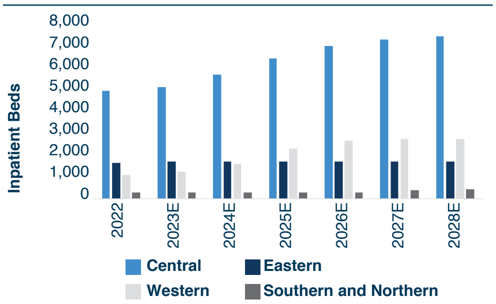

Sources: Argaam, AlJazira Capital

**Fig 3. Saudi Arabia supply of beds per 1,000 people lags EU average:**




Source: AlJazira Capital, OECD I *Chart includes USA, Canada, and UK for reference. Average includes EU nations only

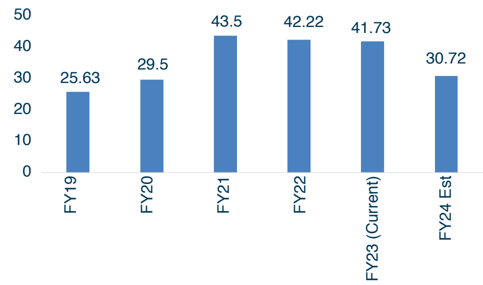
**Fig 4. Sector Hospitals Capacity Expansion:**




Source: Company Presentations, AlJazira Capital

**Sector Investment Thesis:** The sector's health readings indicate a forward period of sustainable growth, arising from a) the nationalized healthcare initiatives and PPP plan, b) favorable demographics, and c) expansion plans of nearly 54.7% to absorb the influx of demand. Increases in patient volumes have already been seen across our coverage, indicating demand in the immediate term for private healthcare, and as implied by sequential increases in private sector GOSI subscriptions. The supportive regulatory and demographic conditions lead our referenced expected net income FY23-28 CAGR of 18.9% for our coverage. Furthermore, nationalized private healthcare insurance is expected improve free cash flows and working capital conditions for our covered providers, as insurance and then cash clients will contribute more towards the sector's client mix. Yet as the Healthcare TASI Index's current and FY24E's PEs stand at 42.7x and 30.7x, respectively, developments in the sector are well reflected at current valuations as the sector's index crossed this year at a 27.5% YTD price return. We remain '**Neutral**' on the sector while current market valuations reflecting developments-however, investors can consider adding healthcare firms to their market exposures as a strategic neutral allocation to benefit from the many upside risks in the sector while firms are at near fair values. Furthermore, seasonal declines in sector valuations could warrant overweight recommendations should valuations subside.

**Fig 5. TASI Healthcare PE's Heightened to reflect growth expectations:**




Source: Bloomberg, AlJazira Capital

## AJC Views and Valuations:

**HMG:** HMG continues to leverage its solid brand awareness as it expands into the Western and Eastern regions as HMG enter underpenetrated regions where they pose a competitive risk to other providers. HMG's leads the sectors' expansion plans with a forecasted 96.5% increase in capacity by FY28 over FY22 levels. Two new facilities in Jeddah are expected to ramp up quicker than central expansions as well (16 months to break even vs. 24 months). Furthermore, the firm enjoys robust cash flow generation (5yr historical average at 14.6%), and is expected to expand FCF margins by 790bps to 23.9%, by FY28 post expansions. A favorable FY23E net debt/equity of 0.3x places the firm well to be able to competitively expand further. We maintain our '**Neutral**' recommendation on HMG with a **TP of SAR 260.0** per share. As the stock has appreciated 24.1% YTD.

**SGH:** The firm displayed a successful turnaround in its profitability after putting behind a period losses and is now expected to post an ROA expansion of 360bps from FY22's 1.8% to 5.4% in FY25. Opti-mization initiatives are supporting the firm's profitability, as we forecast the trend to continue at an FY22-25 EBITDA margin expan-sion of 790bps to 23.9% before it weathers some pressure during the firm's next round of expansions in FY26. The firm has a signifi-cant foothold in the Western region, and accreditations are set to improve revenue generation for its facilities further. MEH sits at the lowest P/B ratio in our coverage at 3.36x as it also hosts the second largest capacity, comparable with HMG's. We maintain our '**Neutral**' recommendation at a **TP of SAR 86.4** per share as the stock surged over 235.6% YTD to reflect developments.

**Care:** Now named Care Medical, the firm's rebranding came with a strategic shift towards improving patient experience, as well as cost optimization which began to kick off during Q3-23. Operating margins, excluding provisions improved Q/Q and Y/Y by 130bps and 120bps respectively. The acquisition of Chronic Care Hospital in Jeddah yields a 20-25% EBITDA margin, and is expected to add a SAR 15mn to the bottom line, excluding any synergies brought by Care. The facility is expected to raise its revenue generation of SAR 100mn by double digits rates owing to Care's accreditations. We forecast a delay in the Malaz expansion as a result of a client withdrawal that took up occupancy there. We earmark care to its nearer term developments, relative to its peers, and bellow median FY24E PE of 31.5x. We raise our **TP to SAR 169.0** per share with a '**Neutral**' recommendation as the stock surged 117.9% YTD.

**Mouwasat:** The firm's Q3-23 reportings recorded its highest Q3 revenue posted to date (at 16% Y/Y and 2.2% Q/Q growths), as a result of higher patient attraction, and a 23% surge in pharmaceutical sales. The firm is expected to keep revenue growth maintained at a FY22-28 CAGR of 11.8% as they seeks to expand hospital capacities by a 29.6% and away from its increasingly more competitive Eastern Region concentration. At a net debt-to-equity of 0.2x, and a robust above-median ROAA (TTM) of 13.8% and the highest GP margins through FY25-27 across the sector, we expect Mouwasat to whether the almost 30% expansion at a minute cost on net margins with a dip to 24.0% by FY25. Furthermore, Mouwasat enjoys solid financial metrics all around, summarized by a history ROE average of 23.3% (FY19-22). We expect the firm to expand its ROA to 17.3% post expansions by FY27 (from FY22 levels). We remain at a '**Neutral**' recommendation on the stock with a **TP of SAR 100** per share.

**Dallah:** Reached its highest ever revenue recorded in Q3-23, owing to its patient attraction and utilization rates. Further inpatient expansions are centered around the Riyadh region, with one in an untapped neighborhood which should experience faster ramp ups, and has further space to expand over its 205 beds capacity. We forecast a net income CAGR of 20.4% from FY22-28, supported by expansions and improving profits from associate companies. We expect Dallah's financing costs to subside as a result of lesser indebtedness (TTM D/A down over 900bps Y/Y) and costs of financing. We maintain our '**Neutral**' recommendation on Dallah with a **TP of SAR 162** per share while the stock is up 16.6% YTD.

**Hammadi:** Q3-23 for the firm was supported by its outpatient visits (up 5% Y/Y) despite a sharp decrease in inpatient admissions (down 12% Y/Y). Two late expansion at 433E beds will extend their capacity by nearly 40% by FY28. However we expect ramp ups to be in line with the modest rates in central Riyadh. We forecast a FY22-27 NI CAGR of 16.8% as a result of slow expansions into contested areas. We favor the firm's sharp decrease in Y/Y collection days (35 days). We forecast an average FCF margin for FY23-25E at 19.3% while recognizing a risks from delays in Olaya branch reopening and limited geographic diversification. While the stock is up over 46.8% YTD, we maintain our '**Neutral**' recommendation on Hammadi with a **TP of SAR 58** per share.

### Table of valuations

| Company | Recommendation | TP (SAR) | Up/ downside (%) | Net Income FY23E (SAR mn) | Net Income FY24E (SAR mn) | Beds Expansions from FY22-28E | EV/Beds (FY23) | Mkt Cap/Beds (FY23) | Dividend Yield (FY24E) | PE (FY23E) | PE (FY24E) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| HMG | "Neutral" | 260.0 | -4.7 | 2,072.6 | 2,236.3 | 96.5% | 50.0 | 51.8 | 1.6% | 46.2x | 42.9x |
| MEH | "Neutral" | 86.4 | 1.2 | 213.1 | 244.5 | 48.6% | 5.8 | 4.5 | 0.0% | 36.9x | 32.2x |
| Dallah | "Neutral" | 162.0 | -6.1 | 332.6 | 400.0 | 32.6% | 13.6 | 11.94 | 1.6% | 50.7x | 42.2x |
| Care | "Neutral" | 169.0 | 5.1 | 229.1 | 253.5 | 82.4% | 8.1 | 8.5 | 1.0% | 31.5x | 28.5x |
| Mouwasat | "Neutral" | 100.0 | -7.4 | 652.1 | 700.3 | 29.6% | 14.0 | 13.5 | 2.5% | 33.1x | 30.8x |
| Hammadi | "Neutral" | 58.0 | -1.5% | 328.3 | 343.9 | 40.2% | 25.6 | 25.2 | 2.6% | 28.7x | 27.4x |

Source: Company reports, AlJazira Capital | Prices as of 19th December 2023 closes

### Financial Performance

#### HMG:

Fig 6. Key Financials (SAR mn)

| | 2022 | 2023E | 2024E | 2025E |
|---|---|---|---|---|
| Revenues | 8,310.7 | 9,563.0 | 12,027.0 | 15,067.9 |
| Growth % | 14.6% | 15.1% | 25.8% | 25.3% |
| Gross Profit | 2,748.1 | 3,277.3 | 3,892.6 | 4,732.0 |
| Net Income | 1,650.8 | 2,072.6 | 2,236.3 | 2,616.2 |
| Growth % | 19.9% | 25.6% | 7.9% | 17.0% |
| EPS | 4.72 | 5.92 | 6.39 | 7.47 |
| DPS | 2.80 | 4.15 | 4.47 | 5.23 |

Source: Company financials, AlJazira Capital

#### SGH:

Fig 7. Key Financials (SAR mn)

| | 2022 | 2023E | 2024E | 2025E |
|---|---|---|---|---|
| Revenues | 2,151.7 | 2,645.0 | 2,970.8 | 3,103.7 |
| Growth % | 14.9% | 22.9% | 12.3% | 4.5% |
| Gross Profit | 680.0 | 995.5 | 1,113.7 | 1,180.1 |
| Net Income | 75.2 | 213.1 | 244.5 | 302.2 |
| Growth % | 337.1% | 183.5% | 14.7% | 23.6% |
| EPS | 0.82 | 2.32 | 2.66 | 3.28 |
| DPS | 0.00 | 0.00 | 0.00 | 0.00 |

Source: Company financials, AlJazira Capital

#### Care:

Fig 8. Key Financials (SAR mn)

| | 2022 | 2023E | 2024E | 2025E |
|---|---|---|---|---|
| Revenues | 917.9 | 1,066.8 | 1,278.0 | 1,481.9 |
| Growth % | 8.6% | 16.2% | 19.8% | 16.0% |
| Gross Profit | 289.7 | 357.8 | 415.9 | 474.8 |
| Net Income | 170.1 | 229.1 | 253.5 | 288.9 |
| Growth % | 24.7% | 34.7% | 10.6% | 14.0% |
| EPS | 3.79 | 5.11 | 5.65 | 6.44 |
| DPS | 1.00 | 1.40 | 1.60 | 1.89 |

Source: Company financials, AlJazira Capital

#### Mouwasat:

Fig 9. Key Financials (SAR mn)

| | 2022 | 2023E | 2024E | 2025E |
|---|---|---|---|---|
| Revenues | 2,334.1 | 2,638.1 | 2,776.2 | 3,114.4 |
| Growth % | 8.9% | 13.0% | 5.2% | 12.2% |
| Gross Profit | 1,098.9 | 1,260.9 | 1,353.0 | 1,478.2 |
| Net Income | 599.3 | 652.1 | 700.3 | 748.2 |
| Growth % | 3.7% | 8.8% | 7.4% | 6.8% |
| EPS | 3.00 | 3.26 | 3.50 | 3.74 |
| DPS | 2.75 | 2.75 | 3.00 | 3.25 |

Source: Company financials, AlJazira Capital

#### Dallah:

Fig 10. Key Financials (SAR mn)

| | 2022 | 2023E | 2024E | 2025E |
|---|---|---|---|---|
| Revenues | 2,488.0 | 2,922.0 | 3,151.3 | 3,509.1 |
| Growth % | 18.2% | 17.4% | 7.8% | 11.4% |
| Gross Profit | 895.1 | 1,064.3 | 1,163.7 | 1,313.1 |
| Net Income | 274.5 | 332.6 | 400.0 | 506.3 |
| Growth % | 6.1% | 21.2% | 20.2% | 26.6% |
| EPS | 3.05 | 3.41 | 4.09 | 5.18 |
| DPS | 2.00 | 2.25 | 2.75 | 3.25 |

Source: Company financials, AlJazira Capital

#### Hammadi:

Fig 11. Key Financials (SAR mn)

| | 2022 | 2023E | 2024E | 2025E |
|---|---|---|---|---|
| Revenues | 1,122.4 | 1,246.5 | 1,386.7 | 1,462.8 |
| Growth % | 17.9% | 11.1% | 11.2% | 5.5% |
| Gross Profit | 416.0 | 467.5 | 530.8 | 561.2 |
| Net Income | 257.3 | 328.3 | 343.9 | 376.2 |
| Growth % | 185.7% | 27.6% | 4.7% | 9.4% |
| EPS | 1.61 | 2.05 | 2.15 | 2.35 |
| DPS | 1.25 | 1.43 | 1.50 | 1.65 |

Source: Company financials, AlJazira Capital

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RESEARCH DIVISION

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RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

## Disclaimer