National Medical Care Co

Healthcare : Industrial
CARE AB: Saudi Arabia
27 March 2023

US$1.076bn	50.78%	US$4.99mn
Market Cap	Free Float	Avg. Daily Volume

Target price	83.00	7.7% below current
Current price	90.00	as at 27/03/2023

Existing rating

Underweight | **Neutral** | Overweight

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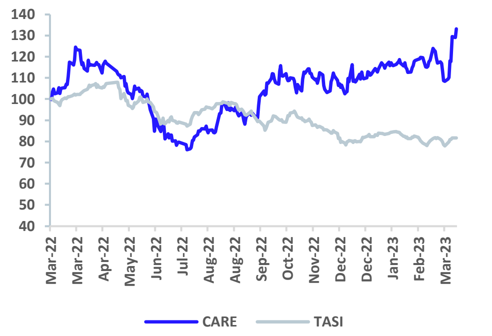
National Medical Care Co.

Valuation discount is justified in our view

Care's 2022 operating results were the best in the last decade with margins touching its highest level in a decade (gross margins of 31.6%, 10 year average has been 25%). The sharp growth in the utilization levels for both its hospitals aided the company, in Q4 2022 the utilization levels touched 94%, for the year it was 84%. This was fuelled by a recovery in construction activity (helped GOSI patients), mainly in H2 2022, and the sharp growth in insured lives of class B and C customers. The growth in revenues was led by both GOSI referrals as well as insurance clients. Going forward, in 2023, we estimate a topline growth of 8% led by slightly better utilization (in Q1 2022 utilization was weak, thus should improve), contribution from addition of beds at CNH (129 new beds), and some contribution from Jiwar in H2 2023. However, we assume slight pressure on margins due to rising manpower costs, higher depreciation related to medical equipments, and costs related to CNH expansion. As we incorporate the latest results as well as the expansion plans in our model, we raise our target price to SAR 83/share (from SAR 65/share). The implied P/E on our target price is 22x based on our adjusted blended average EPS of 2023/2024 (adjusted for credit loss provisions explained below). Despite the sector average about 35x, we believe Care should trade at a discount for the reasons mentioned in the note.

Performance (Rebased to 100)



Earnings

(SARmn)	2022A	2023E	2024E
Revenue	918	991	1,134
Revenue growth	9%	8%	14%
Gross profit	290	307	355
Gross margin	32%	31%	31%
Operating Profit	189	194	222
Op. margin	21%	20%	20%
Net profit	170	176	195
Net margin	19%	16%	16%
EPS	3.79	3.92	4.35
Adjusted EPS*	NA	3.59	3.97
DPS	1.00	1.00	1.25
Payout ratio	26%	26%	29%
EV/EBITDA	14.1x	12.4x	10.7x
P/E	23.7x	23.0x	20.7x
Adjusted P/E	NA	25.1x	22.7x
RoE	14.2%	13.3%	13.5%

Note: *Adjusted EPS includes normalised credit loss provision
Source: Company data, Al Rajhi Capital.

Why should Care trade at a discount?

- **Adjusted P/E higher if accounted for full provisions:** Care does not provide for expected credit losses resulting from its GOSI receivables, as it is a major shareholder in the company. If GOSI receivables had to be treated in a similar way as receivables from the other entities, then provisions should increase. If we assume 2.5% (industry standard 2-3%) as the provision for expected credit loss, then the provisions will rise to SAR 25 m (current estimate: SAR 10 m) and SAR 28 m (SAR 11 m) in 2023e and 2024e, respectively. On an adjusted basis, the blended average EPS of 2023/2024e will decline to SAR 3.78/share from SAR 4.13/share, implying a target P/E multiple of almost 22x instead of 20x.
- **Industry P/E skewed by Habib:** The healthcare industry trades at a P/E of 35x (blended average EPS for 2023/2024e). However, if we remove Habib and consider only Mouwasat, Dallah and Hammadi, then based on our EPS estimates, the industry P/E will drop to 30x. Given that Dallah and Mouwasat are expected to post double digit growth, they deserve to trade at high valuations compared to its history. Thus, the right comparable is Hammadi that trades at 26x P/E. Hammadi is expected to grow by 7% versus Care's 6% for the next three years. However, the medium-term potential of Hammadi (once Olaya hospital is ready) is much better than Care, we expect net income CAGR of 17% for Hammadi during 2026-28e once the Olaya hospital is ready. Both the hospitals have bought land in Narjes, thus growth from new hospital in Narjes should be similar. Moreover, Hammadi's Nuzha hospital is one of the most efficiently run hospitals, has manageable working capital requirement and has scope for increasing prices to drive the topline and margins.

We believe Care should trade at a discount to Hammadi. On an adjusted P/E (adj. for credit loss provisions), Care's implied P/E at our target price of SAR 84/share is 22x, 17% discount to the current multiple of Hammadi and 25% discount to our target multiple of Hammadi (29.5x).

- **High working capital requirement:** Due to the high receivable period, the company needs notable working capital (net working capital days between 150-200 days). As the company has not invested in the recent times, its high cash balance is aiding it to manage its working capital needs and does not require financing. However, as the company plans to acquire companies and make investments related to Narjes hospital, the cash balance will decline, and the company will have to resort to working capital financing. Thus, the impact of high working capital requirement will be visible in the P&L in the form of financing costs in the coming years.

- **GOSI Receivables:** In 2022, around 36% of the revenues were generated from GOSI patients. The company has about SAR 542 m of receivables pending from GOSI, of which bulk is over 270 days. Although, the company has confirmed that they will receive the entire amount and has no plan to account for any write offs, the concern over receivables should remain an overhang on the valuations, in our view.

- **Low return ratios and low future growth:** The company has a track record of weak return ratios. During 2017-2021, the return on equity averaged around 9.0%, below its cost of equity. In the last couple of years, the RoE's have improved, in 2022e it touched 14% when the company generated its best operating results. The healthcare industry in KSA generates a RoE of about 20% (ex- Saudi German hospital). In terms of growth also, Care is a laggard, it is expected to grow its net income by 6.0% in the next three years versus 13% for the industry (15% growth if Hammadi excluded).

Valuations: As mentioned above, we value Care at a P/E multiple of 22x on its adjusted EPS for 2023/2024 (blended average). We are adjusting for the increase in credit loss provisions if the company treats GOSI receivables in the similar way as it treats other entities. We see Hammadi as the right comparable for the company. We assign a discount of 25% to our target multiple for Hammadi of 29.5x, that results in the 22x P/E multiple for Care. Based on the relative valuation methodology, our fair value for Care is SAR 83/share, that implies a downside of 7.7% from the current levels. Thus, we maintain our neutral recommendation on the stock.

Relative valuation methodology	
Forward P/E	*22.0x*
2023e/2024E adj. EPS	3.8
Value per share	**83**
CMP (as of 27 March 2023)	90
Upside/(Downside)	**-7.7%**

Source: Al Rajhi Capital Estimates

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"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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