Securities

AFFIN HWANG CAPITAL

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Sector Update

Healthcare

OVERWEIGHT (Upgrade)

Healthy prospects ahead

We upgrade our call on the Healthcare sector to Overweight as we upgraded IHH Healthcare to Buy post 4Q17 result. Companies within the sector reported satisfactory FY17 numbers, with 2 above and 2 in line with expectations. Going into FY18, hospital operators should deliver robust earnings growth on the back of new hospital openings, recovery in private healthcare spending, lower start-up losses and benign competition. The pharmaceutical outlook remains positive, supported by secular demand for prescription drugs and strong monthly export numbers. Our top picks are KPJ and Apex Healthcare.

Recovery of inpatient volume growth

KPJ's inpatient admissions registered 2.4% yoy growth in FY17 after 2 years of flattish growth, while IHH's inpatient admissions in its Malaysia operations grew by 2.3% yoy (vs. 5% in FY16 and 0% in FY15). This may signal a recovery in private healthcare spending after seeing the private hospital's inpatient market share decline from the peak of 32.1% in 2013 to 29.4% in 2016. Hospital expansions and greenfield projects from both KPJ and IHH in FY18 should lead to increases in operating beds. We estimate 4% yoy and 6% yoy inpatient volume growth for KPJ and IHH respectively.

Manageable competition and increased insurance coverage

Our studies show that the average number of hospital beds (public and private) was c. 1.9 per 1,000 population in FY17, which is below the global average of 2.6. Figures for some states were as low as 1.1-1.4, suggesting that there is room for secular demand growth. In addition, rising income per capita and increased insurance coverage are key drivers to support private healthcare expenditures in the long run.

Pharmaceutical's outlook remains positive

YSP and Apex Healthcare's FY17 revenue grew by 10% yoy and 7% yoy respectively, underpinned by stable growth of c. 9% yoy growth in the pharmaceutical market. We saw a rising contribution of local generic drugs to substitute patented and imported drugs. Monthly export numbers of pharmaceutical products from Malaysia continue to show steady growth in the past few months. We believe all these positive factors support our upgraded Overweight view on the pharmaceutical sector.

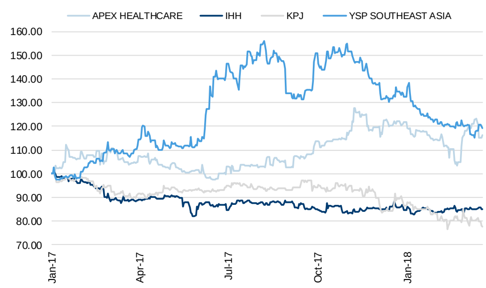
Upgrade Healthcare sector to Overweight

Despite the underperformance of IHH and KPJ's share prices YTD, we think that the sector's earnings prospects are being overlooked. We believe IHH's earnings growth should return when its new hospitals mature, while KPJ's new hospital openings should draw higher patient volume growth. We maintain our BUY rating on YSP due to its growing exports in the SEA region. Apex Healthcare's earnings in FY18E should be supported by steady demand for pharmaceutical products while contributions from SPP NOVO by year-end will be a growth catalyst in the medium term.

Absolute Performance (%)

	1M	3M	12M
IHH	-1.5	2.9	0.2
KPJ	-5.8	-10.5	-11.2
ApexH	11.3	1.5	14.6
YSPSAH	-0.4	-4.6	14.3

Relative Performance (%)



Source: Affin Hwang, Bloomberg

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Peer Comparison

	Rating	Sh Pr	TP	Mkt Cap	Core PE (x)		EPS growth (%)		EV/EBITDA	P/B	ROE (%)		Div. Yield (%)	
		LC	LC	(USDm)	CY18E	CY19E	CY18E	CY19E	CY18E	CY18E	CY18E	CY19E	CY18E	CY19E
KPJ Healthcare	BUY	0.9	1.22	1,022	23.2	20.1	0.8	14.9	12.2	2.2	9.3	10.1	2.0	2.1
IHH Healthcare	HOLD	6.09	7.10	12,790	51.1	37.1	63.5	39.1	17.3	2.1	4.1	5.5	0.5	0.7
YSP Southeast Asia	BUY	2.49	3.24	89	11.5	9.7	18.9	18.4	5.7	1.1	10.0	11.0	2.4	3.7
Apex Healthcare	BUY	5.73	6.40	175	14.3	11.6	5.7	23.3	9.1	1.8	13.0	15.0	3.0	3.0

Source: Bloomberg, Affin Hwang forecasts Note: Pricing as of 21/03/2018

FY17 result review

4Q17 results were satisfactory

4Q17 core net profit for four healthcare companies under our coverage fell by 7% yoy, ending FY17 with a core net profit decline of 22% yoy. KPJ and Apex Healthcare's results came in above expectations while IHH and YSP's results were in line with our expectations.

The drag on the sector's earnings was mainly due IHH's poor earnings performance arising mainly from higher depreciation expense, higher interest expense, and start-up losses for new hospitals, such as Gleneagles Hong Kong and Acibadem Altunizade. Nevertheless, we are expecting IHH's earnings to recover in FY18E when new hospitals start to ramp up and contribute more meaningfully. Meanwhile, KPJ's FY17 core net profit increased by 8% yoy to RM165.6m, 8-12% above our and consensus's full-year estimates. This was on the back of 7% yoy revenue growth.

In the pharmaceutical sector, YSP reported FY17 revenue and core net profit growth of 10% yoy and 17% yoy respectively on the back of higher sales volume and better product mix in domestic and export markets. On the other hand, Apex Healthcare's FY17 core net profit earnings grew by 28% yoy in FY17 and came in above our expectations. This was due to higher-than-expected profit from its associate company, Straits Apex, which engages in the contract manufacturing of orthopaedic devices. Straits Apex saw increased capacity utilisation and improved production efficiency and we expect it to maintain its traction in FY18.

Figure 1: Core net profit summary

(RM m)	4Q17	4Q16	YoY %	FY17	FY16	YoY %
IHH	181.9	217.6	-16%	595.3	851.3	-30%
KPJ	61.3	52	18%	165.6	153.6	8%
YSP	7.7	6.6	17%	25.8	22	17%
Apex	13.2	6.8	94%	44.4	34.8	28%
	264.1	**283**	**-7%**	**831.1**	**1061.7**	**-22%**

Source: Company, Affin Hwang

We summarise our recent changes to earnings, ratings, and target prices post the 4Q17 results in Figure 2.

Figure 2: Healthcare stocks 4Q17 wrap up

Subsector	Company	Quarter under review	Variance in core net profit: Affin Hwang estimates	Variance in core net profit: Street estimates	Earnings revision	Rating: Before	Rating: After	TP (RM): Before	TP (RM): After
Hospital	IHH	4Q17	In line	Below	⇧	HOLD	BUY	6.04	7.10
	KPJ	4Q17	Above	Above	⇔	BUY	BUY	1.22	1.22
Pharma	YSP	4Q17	In line	In line	⇔	BUY	BUY	3.24	3.24
	Apex	4Q17	Above	Above	⇧	BUY	BUY	6.10	6.40

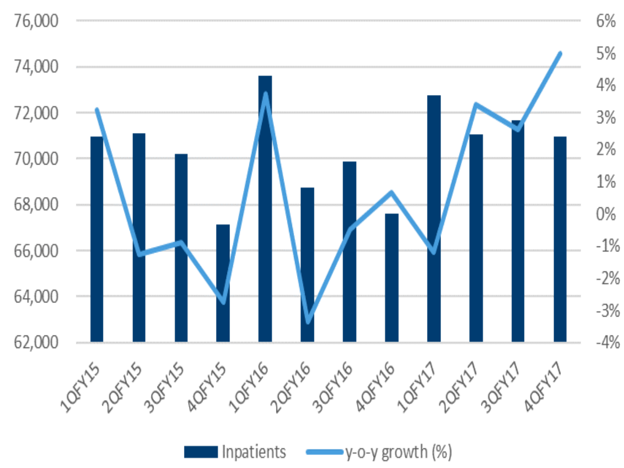
Source: Company, Affin Hwang

Hospital Sector: Better prospects ahead

Signs of inpatient volume recovery

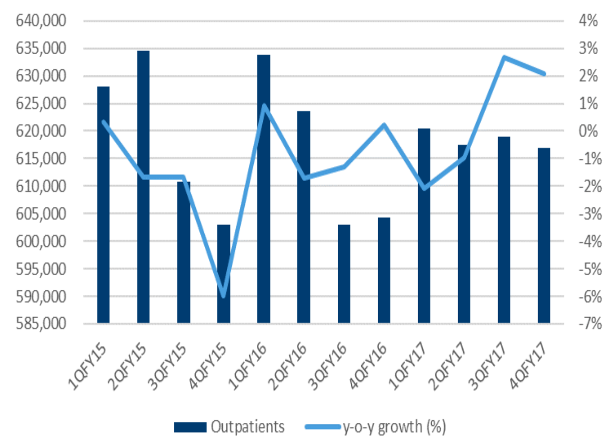
After seeing weak inpatient admission numbers in FY15 and FY16, we started to see signs of recovery in private healthcare expenditures in 2017, with KPJ posting 2.4% yoy growth in inpatient admissions and IHH posting 2.3% yoy growth. Post the implementation of GST that dampened consumer sentiment, we believe that consumers have adjusted their consumption behaviour and are coming back to private healthcare services given the better timeliness and quality of services. This is concurred by KPJ management's view that it has started to see the return of cash-paying patients (accounting for c.30% of patient mix) in certain hospitals. With a better economic outlook and stronger MYR, we believe that the recovery of inpatient admissions will likely be sustained in 2018, growing in tandem with the secular demand growth for private healthcare services in Malaysia.

Figure 3: KPJ's inpatients grew by 2.4% yoy to 286,465 after 2 years of muted growth



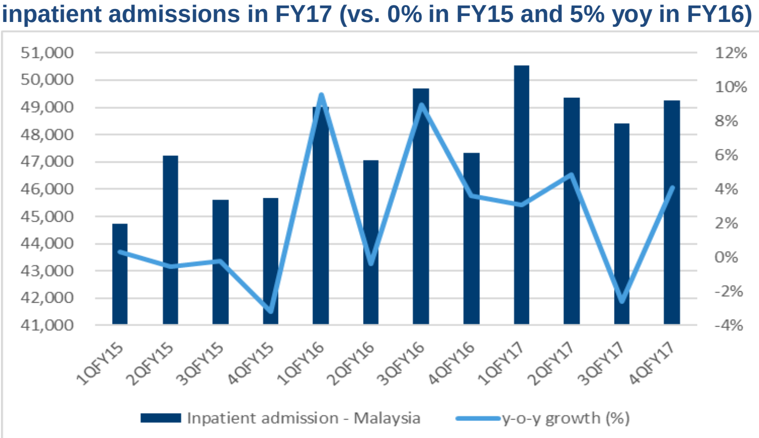
Source: Company, Affin Hwang

Figure 4: Similarly, KPJ's outpatient admissions grew marginally by 0.4% yoy to 2,473,851 compared to -2.3% yoy in FY15 and 0% in FY16



Source: Company, Affin Hwang

Figure 5: IHH's Malaysian operation reported 2.3% yoy growth in inpatient admissions in FY17 (vs. 0% in FY15 and 5% yoy in FY16)

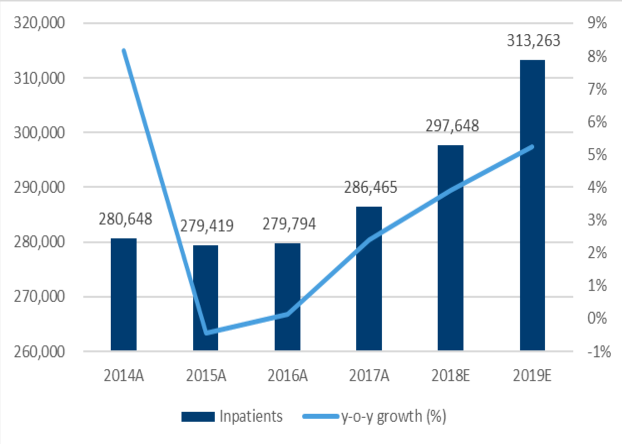


Source: Company, Affin Hwang

Expecting better patient admissions in FY18

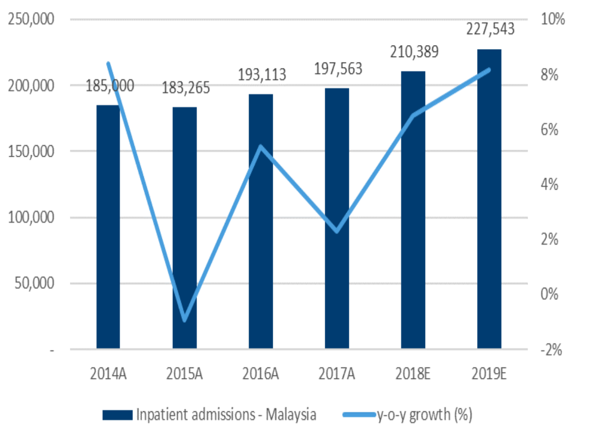
We are hopeful to see stronger inpatient admissions growth for KPJ and IHH's hospital operations in Malaysia, mainly driven by structural demand in private healthcare in Malaysia. In addition, greenfield and brownfield expansions should help to deliver sustainable growth in the long run. We are forecasting KPJ and IHH to show 4-5% yoy and 6-8% yoy inpatient admission growth in FY18-19E respectively.

Figure 6: Forecasting KPJ's inpatient admissions to grow at 4-5% yoy in FY18-19E…



Source: Company, Affin Hwang estimates

Figure 7: … and 6-8% yoy for IHH's Malaysian operation



Source: Company, Affin Hwang estimates

Expansion updates

Figure 8 indicates KPJ's new hospitals and expansion plans for the next few years. We estimate this will add bed capacity by c.1,000 from the current level of c. 3,600 (28% increase).

Figure 8: KPJ's new hospital plans (2018-21)

New Hospital Projects	Location	Total Capacity	Operating beds	Completion	Opening
Tg Lumpur	Pahang	190	88	4Q2015	May-16
Perlis	Perlis	90	60	3Q2017	4Q2017
Kuching	Sarawak	150	114	4Q2018	1Q2019
BDO	Johor	150	90	1Q2018	2Q2018
Miri	Sawarak	96	61	3Q2018	4Q2018
UTM	Johor	150	90	TBA	TBA
K/Bayuemas	Selangor	90	90	TBA	TBA
Nilai	Negeri Sembilan	96	61	TBA	TBA
		1012	**654**		

Source: Company, Affin Hwang

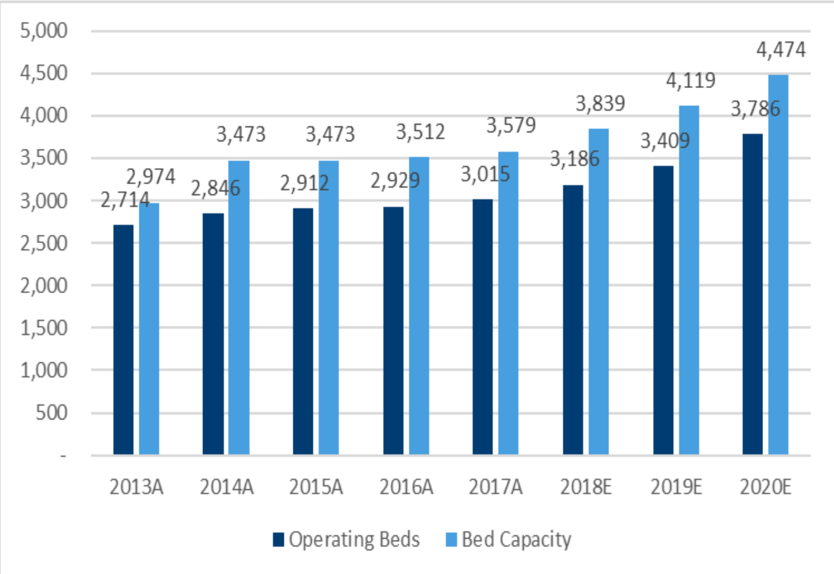
Figure 9: KPJ's existing hospital expansion plans (2018-21)

Hospital Expansion	Description	Capacity	Completion	Opening
KPJ Selangor	Clinics	54	Oct-16	1Q2017
KPJ Seremban	Beds	90	1Q2017	2Q2018
Taiping	Clinics	16	2Q2018	3Q2018
Sri Manjung	Beds	30	2Q2018	3Q2018
KPJ Johor	Beds	31	1Q2018	2Q2018
KPJ Puteri	Beds	66	2Q2019	3Q2019
KPJ Penang	Beds	138	1Q2021	2Q2021
KPJ Ampang	Beds	150	2Q2018	3Q2018
KPJ Ampang	Clinics	33	2Q2018	3Q2018
	Total Beds	**505**		
	Total Clinics	**103**		

Source: Company, Affin Hwang

On average, we are looking at a 7-8% CAGR over 2017-20E. This would provide strong inorganic growth for KPJ's top line, given that it has not had any new hospitals opening since 2014.

Figure 10: KPJ's expansion roadmap should deliver sustainable long-term growth



Source: Company, Affin Hwang

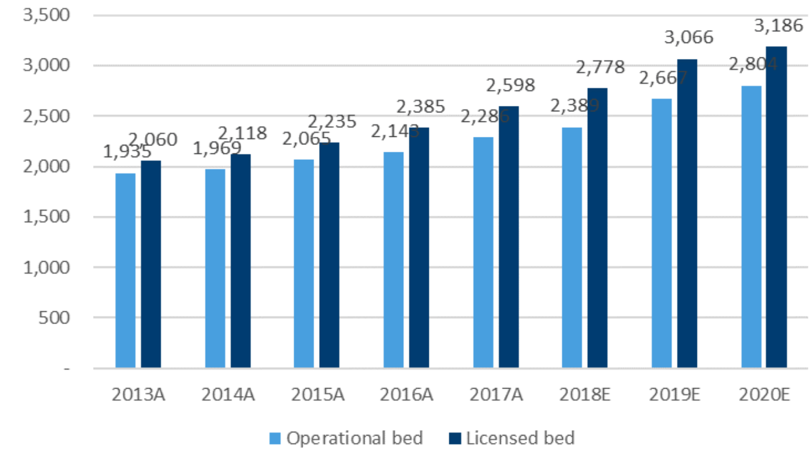
Likewise, we are expecting IHH's operating beds in Malaysia to grow at 7%. While IHH does not have major greenfield projects in Malaysia due to its focus on overseas expansion (such as China and Turkey), we are expecting its existing hospitals to increase operating beds, especially the new ones such as (Gleneagles Medini, Gleneagles KK, and Pantai Hospital Manjung).

Figure 11: IHH's expansion plans (2018-21)

Country	Type	Hospital	Description	Completion
Malaysia	Expansion	Pantai Hospital KL	Phase 2; 120 beds capacity	2018
Turkey	Expansion	Acibadem Maslak	195 bed capacity	2018
China	Greenfield	Gleneagles Chengdu	350 bed capacity	2018
China	Greenfield	Gleneagles Shanghai	450 bed capacity	2019
Malaysia	Expansion	Pantai Hospital Ayer Keroh	160 bed capacity	2020
China	Greenfield	Gleneagles Nanjing	70 bed capacity	2020
Turkey	Greenfield	Acibadem Kartal, Istanbul	120 bed capacity	2021
Turkey	Greenfield	Acibadem Atasehir, Istanbul	128 bed capacity	To be evaluated
Malaysia	Expansion	Pantai Hospital Klang	140 bed capacity	planning stage

Source: Company, Affin Hwang

Figure 12: IHH's expansion is estimated to grow operational beds at a 7% CAGR over 2017-20



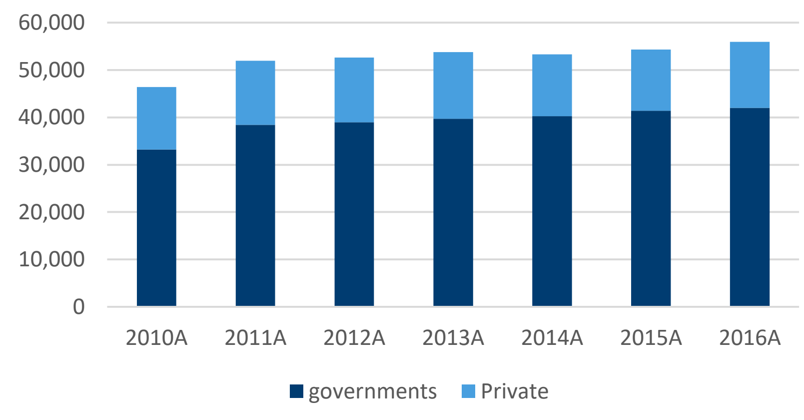
Source: Company, Affin Hwang estimates

Competition risk is not as feared

Interestingly, the common feedback we gather from investors is the concern on competition risks. Over the past few years, we saw a decline in private hospitals' market share as patients sought treatment in public hospitals. Some opined that with rising medical costs, it may deter the growth of patient admissions in the private sector. Also, new private hospital openings may pose competition risks which reduce the attractiveness of the healthcare sector in the long run.

Based on the 2016 data released by the Ministry of Health (MoH) recently, the total number of hospitals (inclusive of private hospitals and public hospitals) has grown at a CAGR of 3% over the period of 2010-16. We think this growth rate is reasonable compared to the 3.2% CAGR in inpatient admissions over the same period nationwide.

Figure 13: 3% CAGR in total hospital beds is manageable

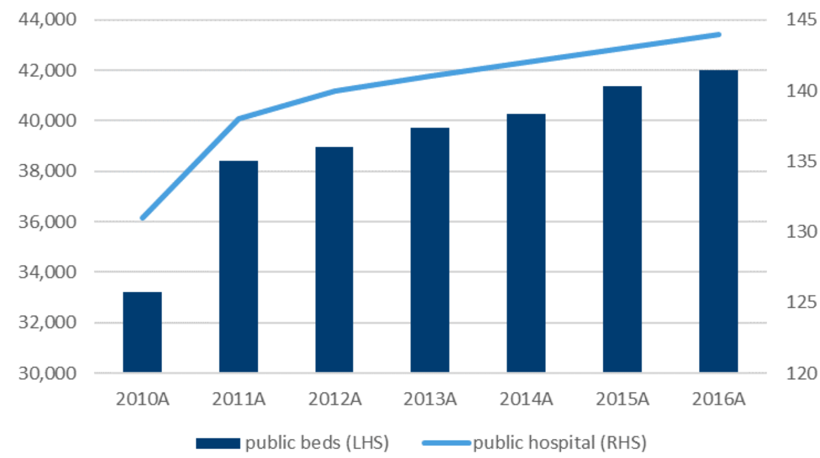


Source: MoH, Note: 2017 data is not available yet

What about competition risk in the future?

We have not seen a significant increase in the number of public hospitals and operating beds for the past few years. We believe a major expansion in public sector facilities is unlikely, given the development budget allocated for public healthcare has not seen a significant increase for years.

Figure 14: No major increase in public hospitals' beds for several years



Source: MoH, Note: 2017 data is not available yet

Expansion plans among private hospitals

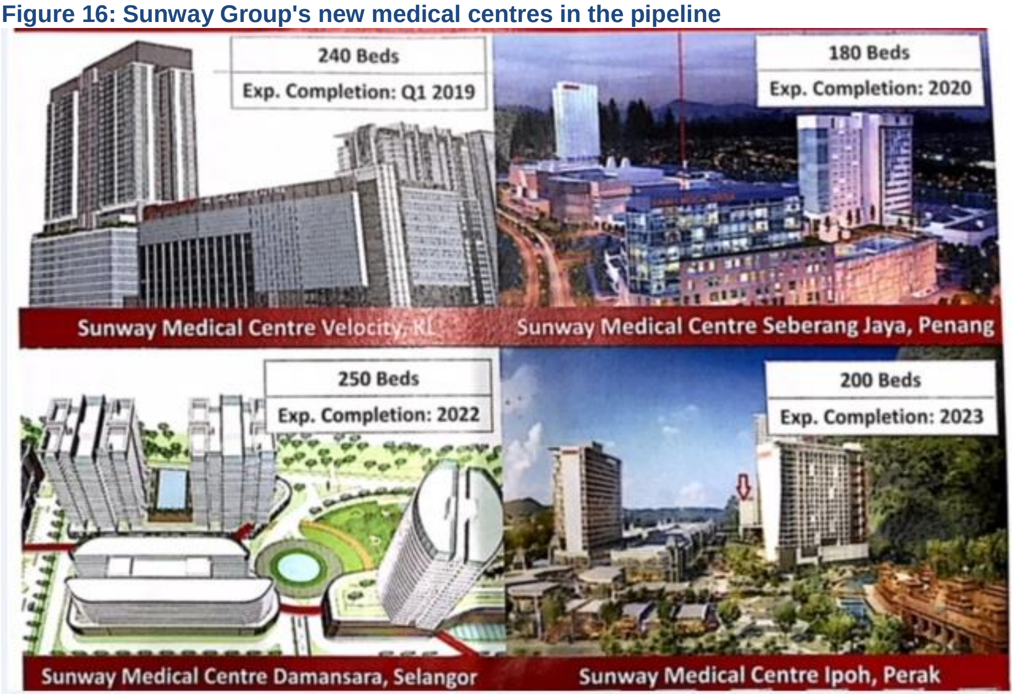
Major private healthcare players in Malaysia include IHH, KPJ, Columbia Asia, Ramsay Sime Darby, HMI, TDM and Sunway. As of now, we understand that KPJ and Sunway Group are more aggressive in terms in expansion in Malaysia. As pointed out in Figures 8 and 9, KPJ aims to open at least 7 new hospitals and increase operating beds by 1,000 within 5 years. Sunway Group, on the other hand, is expected to complete phase 3 expansion of Sunway Medical Centre, which will increase its beds from 373 to 618. On top of that, Sunway will be adding 4 hospitals with total bed count of 870 over the period 2019-23.

Figure 15: Major players' comparison in 2017

Company	hospitals	beds
KPJ	25	3052
IHH	14	2300
Columbia Asia	12	837
TDM	4	365
Sime Darby	3	913
HMI	2	506

Source: Company, Affin Hwang estimates

Figure 16: Sunway Group's new medical centres in the pipeline

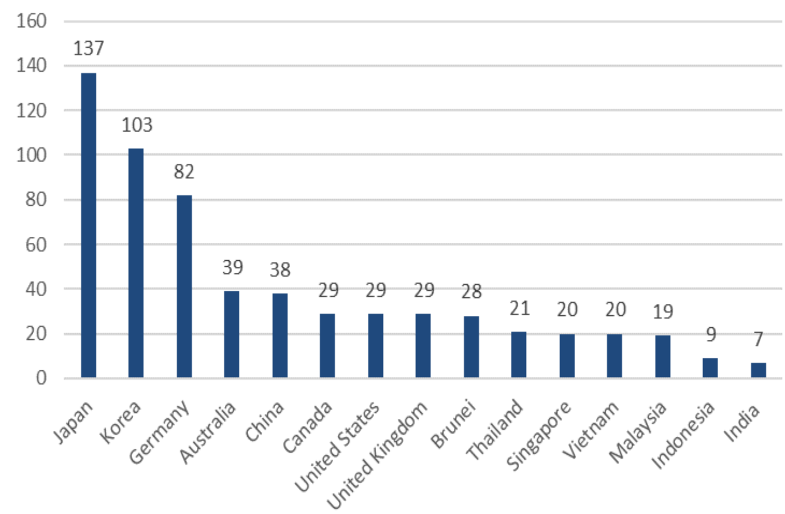


Source: Company

Are we able to accommodate more new hospitals?

Based on the number of current hospital beds in Malaysia, we believe that Malaysia still has room for hospital expansions without inducing intense competition. Based on World Health Organization (WHO) estimates, the average number of hospital beds (public and private) was c. 19 per 10,000 populations in Malaysia, which was still below the global average of 26.

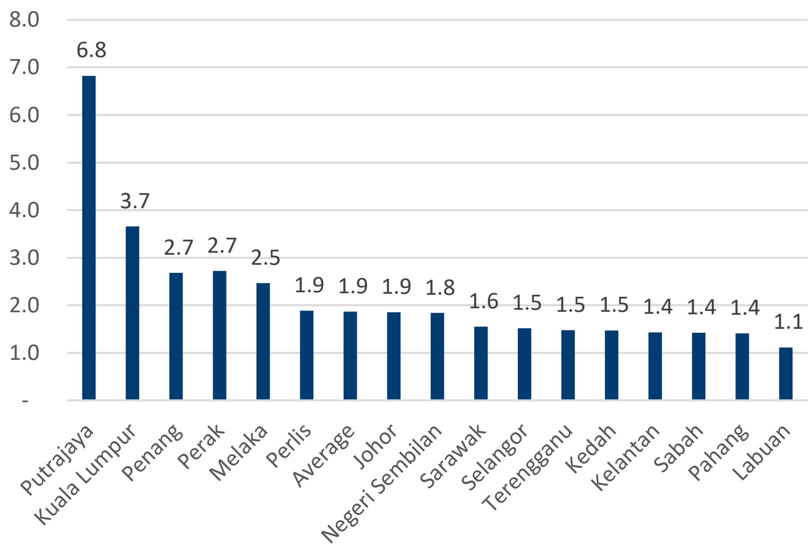
Figure 17: Hospital beds per 10,000 populations as of 2014



Source: WHO

At the state level, our analysis shows that there is much potential for further market penetration by the private healthcare services. We see that at least 9 states' bed density is below the country's average, most of which range from 1.1-1.6 hospital beds per 1,000 populations (Figure 18). This shows that private healthcare investment is still much needed to support growing healthcare demand in Malaysia. Although Kuala Lumpur, Penang and Perak have 2.7-3.7 hospital beds per 1,000 (above country average of 1.9), we are still comfortable with the density levels. Nevertheless, further expansion in these regions may lead to competition risks in the future. With that being said, we like KPJ's expansion plan where it expands in states with lower bed density. For example, KPJ will be opening the first private hospital in Perlis sometime in 1H18 and it targets to open 2 new hospitals in Sarawak within the next 12 months (Figure 8).

Figure 18: Hospital beds per 1,000 population as of 2017

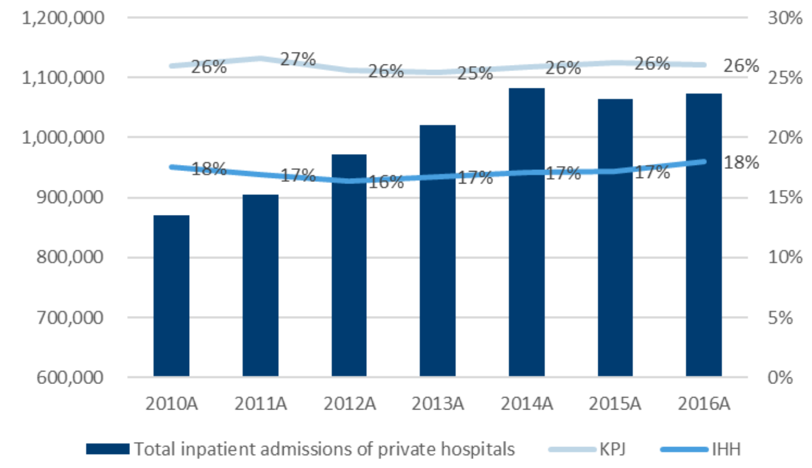


Source: MoH, Company, Affin Hwang estimates

The advantage of size

Being one of largest private hospital operators, we believe that KPJ and IHH will be able to weather through competition risks. In the period between 2010-16, KPJ and IHH were able to defend their market shares in private hospitals' inpatient admissions (Figure 19). The scale advantage, to a certain extent, benefits them in terms of material procurement and attracting doctors. We understand that they are able to enjoy lower material costs due to their large purchase quantities. With higher patient visitations, they are also able to entice doctors to practise medical services with them to earn more consultation fees. Therefore, KPJ and IHH should be able to maintain the lead against their competitors going forward.

Figure 19: Steady market shares in inpatient admissions



Source: MoH, Company, Affin Hwang

Long-term positive view remains intact

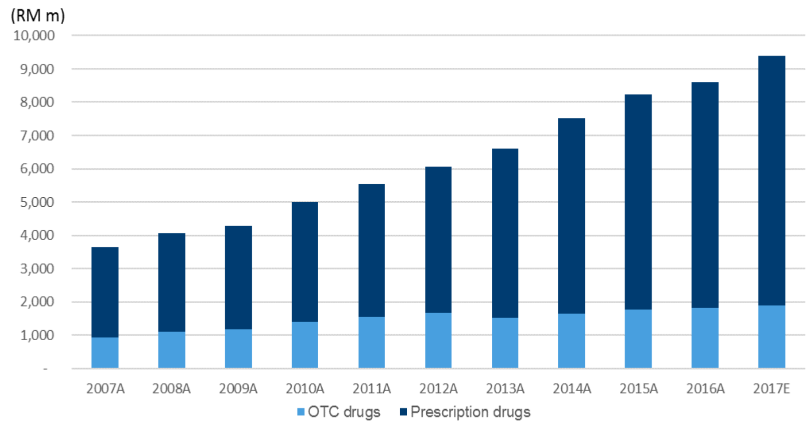
Although private hospitals' patient admissions have been impacted for the past two years, we started to see signs of recovery in 2017. We expect the recovery will likely be sustained on the back of positive long-term drivers;

1) Ageing population. According to the Population and Housing Census, the population above 65 years old accounted for 6.2% of the total population in 2016 compared to 5% in 2010. We expect the figure to rise further to 7% in 2020.
2) Rising income per capita. Total health expenditure per capita has increased at a CAGR of 8% to US$450 over the period of 2009-14. This growth should be supported by rising affluence in Malaysia.
3) Increase in insurance coverage. According to the Life Insurance Association of Malaysia (LIAM)'s annual report, medical claim benefits increased by 8% yoy to RM3.41bn and the number of policies increased by c.100k to 12.6m in 2016. Growing awareness of the importance of insurance and reduced reliance on out-of-pocket spending will underpin the growth in private healthcare sector.

Pharmaceutical sector: More to go

We estimate that the pharmaceutical sales (prescription and OTC drugs) in Malaysia have grown steadily at a 10-year CAGR of 10% to c. RM9.4bn in 2017. Note that the sales in prescription drugs are growing faster than OTC drugs. We expect this trend to continue rising, driven by rising income, ageing demographics and improving healthcare spending per capita.

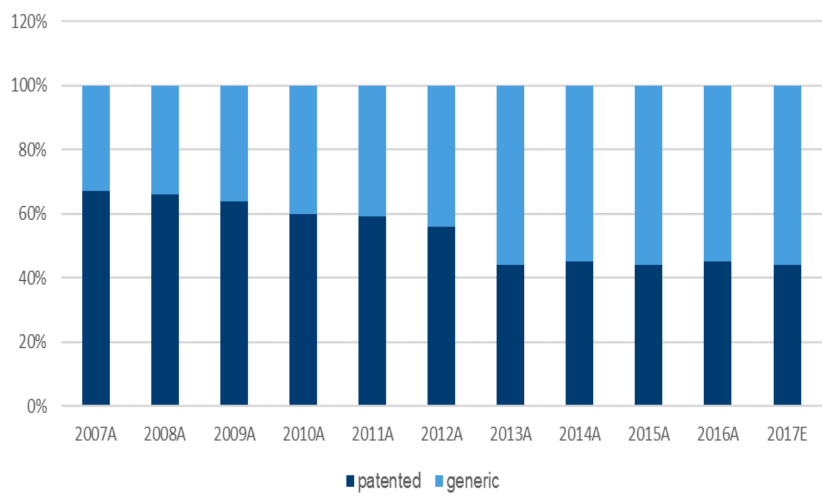
Figure 20: 10-year CAGR of 10% in Malaysia's pharmaceutical market



Source: Malaysia Competition Commission (MyCC), Affin Hwang estimates

To cope with rising cost of pharmaceutical products, generic drugs have emerged as a solution to substitute expensive patented drugs. Generic drugs' market share in value has grown from c.33% in 2007 to c.56% in 2017 (Figure 21). In terms of sales in volume, Malaysia's generic drugs accounted for c.70% and we expect a greater use of generic drugs going forward, whereby its market share by volume should increase closer to developed countries' 80-90% level. Hence, the benefit should flow through directly to local pharmaceutical players such as YSP and Apex Healthcare.

Figure 21: Rising contribution of generic drugs in terms of sales value

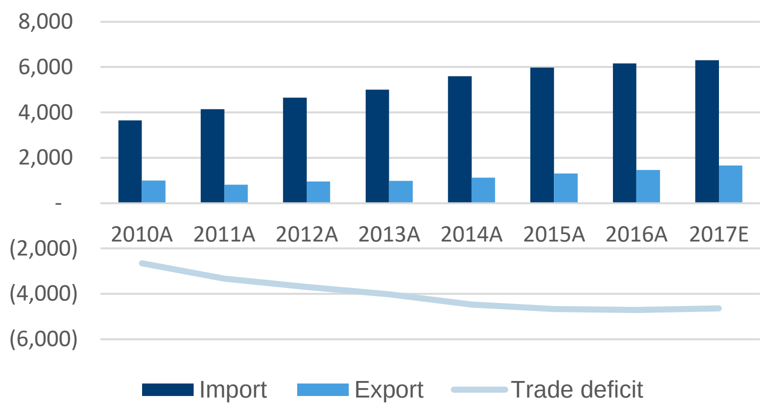


Source: Malaysia Competition Commission (MyCC), Affin Hwang estimates

Opportunities for local generic drug companies

Currently Malaysia's pharmaceutical sector still relies heavily on imports of patented and generic drugs that accounted for c. 67% of the total mix in 2017. Due to Malaysia's position as a net importer of pharmaceutical products, we see the trade deficit gap on pharmaceutical-related products widening. This highlights the need to grow the local generic pharmaceutical market.

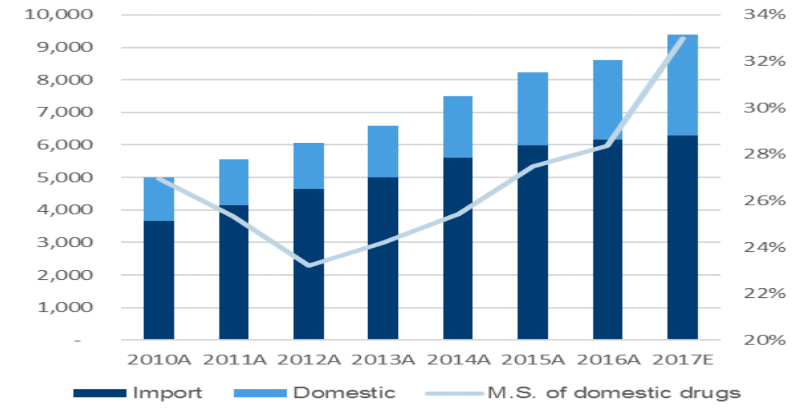
Figure 22: Import and export of pharmaceutical products in Malaysia



Source: Malaysia Competition Commission (MyCC), Affin Hwang estimates

The Malaysian government identifies healthcare as a National Key Economic Area under the Economic Transformation Programme (ETP) and pharmaceutical industry is one of the key focus areas. Under the ETP, the Government encourages local pharmaceutical companies to leverage on patent cliffs and prioritize the generic drugs produced domestically in procurements for public hospitals. If a pharmaceutical company is able to develop new generic drugs that are off-patent, they are given off-take agreements to supply the MoH for 3 years and get another 2 years' extension upon submission of proof and sales of products abroad. Also, we understand that private clinics are increasing usage of generic drugs as a means to control drug costs. Hence, the contribution of domestically produced generic drugs has risen to 33% of Malaysia's pharmaceutical market in 2017.

Figure 23: Rising contribution of domestically produced drugs due to lower selling prices

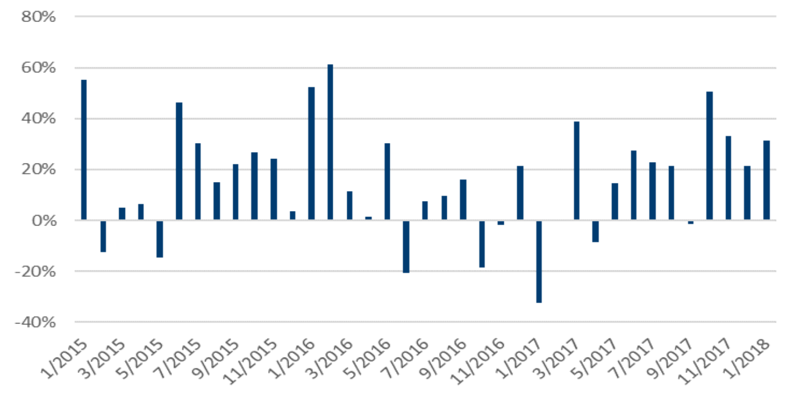


Source: Malaysia Competition Commission (MyCC), Affin Hwang estimates

Updates on monthly exports

According to the recent data published by the Ministry of International Trade and Industry (MITI), the monthly exports of medicinal and pharmaceutical products from Malaysia continued to show robust growth until January 2018. We view this positively as we think that the strong monthly growth number should be a good gauge of local pharmaceutical companies' export sales.

Figure 24: Growth of monthly exports of medicinal and pharmaceutical products (yoy)



Source: Ministry of International Trade and Industry

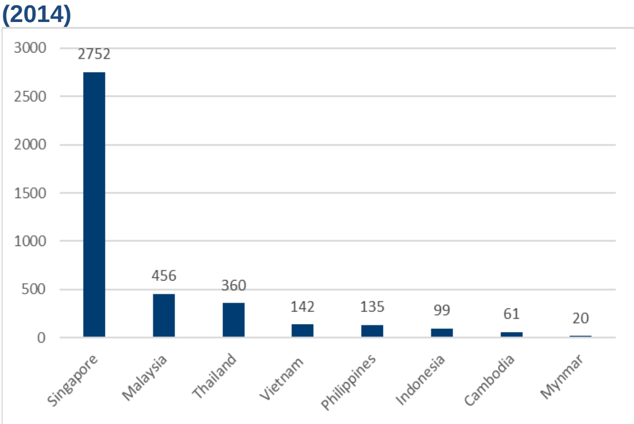
Positive implications for YSP and Apex Healthcare

YSP and Apex Healthcare are two of the pharmaceutical companies listed in Malaysia. Given the projected high single-digit growth of the pharmaceutical market and rising demand for generic drugs, we maintain our revenue growth forecasts of 9-12% yoy for YSP and Apex Healthcare in 2018.

Note that 70% of Apex Healthcare's sales are from Malaysia, with its business model involved in the wholesale and distribution of third-party pharmaceuticals mostly to private hospitals, clinics and pharmacies. Steady growth of the industry is favourable to Apex Healthcare. Also, Apex Healthcare has its manufacturing division that produces in-house products predominantly under the Xepa brand, which benefits from the structural demand growth of generic drugs in Malaysia.

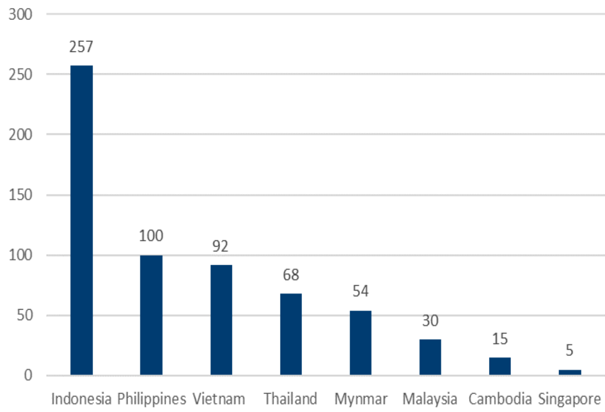
On the other hand, YSP focuses on growth in overseas markets (accounted for 29% total FY16's total sales) where the CAGR of export sales was 18% over 2010-16 as compared 8% growth for its domestic sales. As most of its export markets are in the South East Asia region, we believe the relatively underpenetrated market in these countries and larger population size provide decent growth opportunities for YSP.

Figure 25: Total healthcare expenditure/capita in US$ (2014)



Source: WHO

Figure 26: Population size (2015)



Source: WHO

Valuations and Recommendations

Upgrade Healthcare sector to Overweight

We upgrade the Healthcare sector from Neutral to Overweight mainly due to our upgrade in recommendation for IHH, a large-cap healthcare company in the sector. The sector's share-price performance was unexciting in FY17 due to the lack of earnings growth, but we think the sector should perform better in FY18 on the back of an earnings recovery. We expect IHH's earnings to recover in FY18 as the new hospitals' bed occupancy rates improve and start-up losses narrow. Also, the industry data and competitive landscape of the sector indicate that healthcare sector is defensive and the structural demand growth remains intact.

We continue to like the pharmaceutical sector for its consistent growth. In terms of valuation, the pharmaceutical sector trades at a lower valuation compared to hospital operators. We believe this could be due to a lack of coverage, and lower entry barriers of generic drugs compared to patented drugs. Nevertheless, we should not overlook the stable demand for pharmaceutical products and higher usage of generic drugs in the midst of rising medical charges that should lead to sustainable earnings growth for the sector. We believe the relatively lower PER valuation for the pharmaceutical sub-sector provides a cheaper exposure to the defensive healthcare sector compared to the hospital sub-sector.

Figure 27: Hospital sector peer comparison

	Rating	Sh Pr	TP	Mkt Cap	Core PE (x)		EPS growth (%)		EV/EBITDA	P/B	ROE (%)		Div. Yield (%)	
		LC	LC	(USDm)	CY18E	CY19E	CY18E	CY19E	CY18E	CY18E	CY18E	CY19E	CY18E	CY19E
KPJ Healthcare*	BUY	0.90	1.22	1,022	23.2	20.11	0.8	14.9	12.2	2.2	9.3	10.1	2.0	2.1
IHH Healthcare*	HOLD	6.09	7.10	12,790	60.1	37.07	63.5	39.1	17.3	2.1	4.1	5.5	0.5	0.7
Bangkok Dusit Medical	N/R	22.70	N/R	11,261	38.3	29.9	-2.4	10.5	23.4	5.3	13.9	14.4	1.7	1.4
Bumrungrad Hospital	N/R	208.00	N/R	4,854	37.2	25.5	33.4	8.4	22.9	8.1	24.2	23.5	1.4	1.4
Apollo Healthcare	N/R	1037.10	N/R	2,212	44.5	32.5	58.5	48.5	18.0	3.5	8.3	2.3	0.4	0.6
Raffles Medical	N/R	1.16	N/R	1,559	31.4	37.4	-3.4	-7.1	22.6	2.7	8.7	7.9	1.9	1.8
Siloam International	N/R	8147.61	N/R	963	98.7	100.0	17.6	33.3	14.1	2.1	2.7	2.8	0.0	0.2
Mitra Keluarga Karyasehat	N/R	2139.42	N/R	2,262	38.9	46.6	0.0	0.0	30.0	7.8	19.8	19.8	1.5	1.3
Ramsay Healthcare	N/R	63.15	N/R	9,863	21.8	19.6	25.5	9.6	11.6	5.1	24.2	23.7	1.9	2.4
Healthscope	N/R	1.97	N/R	2,626	18.8	17.6	29.3	10.6	11.7	1.4	7.3	3.7	3.3	3.7
Bangkok Chain Hospital	N/R	16.90	N/R	1,350	38.7	25.5	28.3	14.3	20.5	7.0	18.8	19.4	1.5	1.5
Average				**50,761**	**41.0**	**35.6**	**22.8**	**16.6**	**18.6**	**4.3**	**12.8**	**12.1**	**1.5**	**1.5**

Source: Affin estimates, Bloomberg Note: Pricing as of 21/03/2018*

Figure 28: Pharmaceutical sector peer comparison

	Rating	Sh Pr	TP	Mkt Cap	Core PE (x)		EPS growth (%)		EV/EBITDA	P/B	ROE (%)		Div. Yield (%)	
		LC	LC	(USDm)	CY18E	CY19E	CY18E	CY19E	CY18E	CY18E	CY18E	CY19E	CY18E	CY19E
YSP Southeast Asia*	BUY	2.49	3.24	89	11.5	9.7	18.9	18.4	5.7	1.1	10.0	11.0	2.4	3.7
Apex Healthcare*	BUY	5.73	6.40	175	14.3	11.6	5.7	23.3	9.1	1.8	13.0	15.0	3.0	3.0
Pharmaniaga Berhad	N/R	4.20	N/R	280	17.5	16.3	32.9	7.8	9.7	2.1	11.3	13.0	4.0	3.6
CCM Duopharma Biotech Bh	N/R	2.85	N/R	203	10.7	10.2	13.9	5.0	8.0	1.7	8.8	9.2	3.2	3.7
Average				**748**	**13.5**	**11.9**	**17.8**	**13.6**	**8.1**	**1.7**	**10.8**	**12.1**	**3.1**	**3.5**

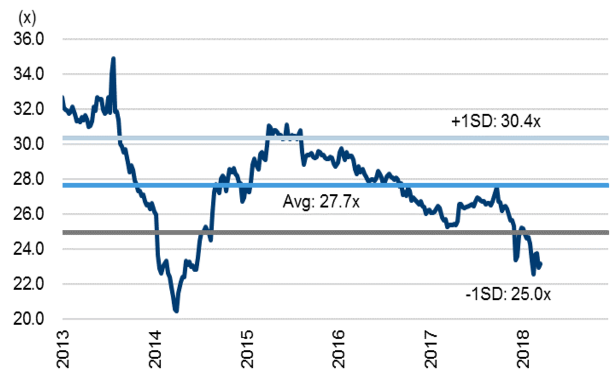
Source: Affin estimates, Bloomberg Note: Pricing as of 21/03/2018*

Top picks for the sector: KPJ and Apex Healthcare

We continue to like **KPJ (BUY, TP: RM1.22)** for its leading position as a private healthcare provider in Malaysia and it should benefit directly from a recovery in private healthcare spending (its operations are predominantly in Malaysia). Also, KPJ will have new hospital openings in states where healthcare is still relatively underinvested. The new hospitals will allow KPJ to ride on the structural demand growth of the domestic healthcare sector in the long run. Management estimates that the total start-up loss of new hospitals would be around RM25m at the PBT level and it should be mitigated by the contribution of mature hospitals. We favour KPJ over IHH due to: i) KPJ's cheaper valuation vs. IHH and regional peers, ii) KPJ has a relatively higher exposure than IHH to Malaysia's private healthcare spending recovery, and iii) KPJ's less-aggressive expansion compared to IHH reduces the high start-up losses during the gestation period for new hospitals. Our unchanged RM1.22 TP for KPJ is based on SOTP valuation, with implied 23x FY18E EPS.

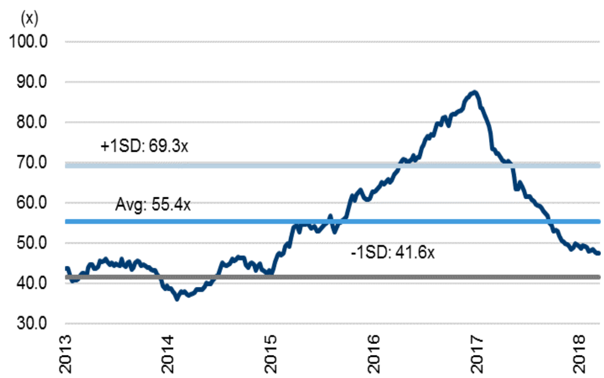
As mentioned, **IHH**'s FY17 core net profit was dragged mainly due to start-up losses and depreciation expenses of new hospitals, and the street downgraded IHH's earnings several times in 2017. However, we think that IHH's earnings may have bottomed out, given that GHK has shown some operational improvement since its opening in March 2017. Its outpatient and inpatient volume showed average growths of 15% mom and 22% mom respectively in 2H18. As a result, GHK's 4Q17 EBITDA loss narrowed to RM65m from RM69m in 3Q17. We expect IHH's new hospitals to continue to ramp up and narrow losses. Also, IHH's home markets, Malaysia and Singapore, showed stronger-than-expected EBITDA margin expansion due to better revenue intensity/patient. Hence, we revised up FY18-19E core net profit by 14-15% post 4Q17 result, and upgraded our rating to **BUY** from with a **TP of RM7.10** based on our DCF valuation.

Figure 29: KPJ's 5-year forward PER



Source: Company, Affin Hwang estimates

Figure 30: IHH's 5-year forward PER

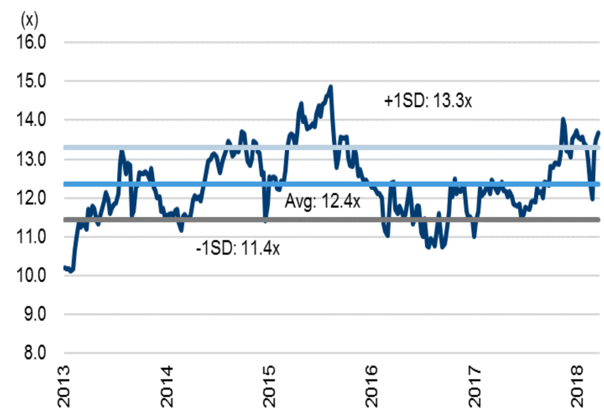


Source: Company, Affin Hwang estimates

Apex Healthcare (BUY, TP: RM6.40) is our top pick in the pharmaceutical sector. We like it for: i) its solid execution in the past, ii) favourable outlook driven by its new SPP NOVO plant, iii) business strategy to expand its foray into the European pharmaceutical market, and iv) healthy balance sheet (net cash of RM0.69/share). Note that SPP NOVO's completion will double Apex Healthcare's production capacity in oral solid products. Its production is expected to begin in 4Q18 and it will be the key earnings driver for the company from 2019 onwards. Our unchanged TP of RM6.40 is based on an unchanged 16x FY18E EPS.

We maintain BUY rating and target price on **YSP (BUY, TP: RM3.24)** based on 14.2x FY18E EPS. Trading at 11.5x FY18E EPS currently, we find its valuation attractive among the pharmaceutical peers listed in Bursa Malaysia, which trade at a weighted average PE of 13.5x (Figure 28). We maintain our forecast of a 2017-2019E EPS CAGR of 17% on the back of generic pharmaceutical growth in Malaysia and overseas sales. We like its focus to expand in the Southeast Asia region where the addressable market is much larger than the domestic market. While the overseas sales contribution is c.30% currently, it has been growing at double digits due to i) sales teams set up in those countries, ii) low base, and iii) less competitive and relatively underdeveloped pharmaceutical markets in these countries.

Figure 31: Apex Healthcare's 5-year forward PER



Source: Company, Affin Hwang estimates

Figure 32: YSP's 5-year forward PER

Source: Company, Affin Hwang estimates

Sector and company-specific downside risks

Hospital sub

i) Sharp slowdown in patient volume;
ii) Regulatory changes in the healthcare industry; and
iii) Higher-than-expected start-up losses for new hospitals.

Pharmaceuticals

i) Price erosion driven by competition due to relatively low barriers to entry for generic drugs compared to patented drugs.
ii) Perception issues related to the quality of generic drugs. Most private hospitals still prefer to use branded imported drugs despite higher price points. This is because branded drugs are commonly perceived to be superior in quality and medical fees of private hospitals' patients are usually covered by medical insurance and hence less price-sensitive.
iii) Operational risk in foreign countries. The entry into foreign markets requires compliance with domestic and foreign regulations.

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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