



Kanghua Healthcare (3689 HK)

Flagship hospital and VIP service lead the way

- Performance in FY16 meets expectation; margin expansion shows increased efficiency; average charge of VIP inpatient service doubled; the flagship Kanghua Hospital and VIP healthcare service are the major growth engines
- Dividend at RMB 0.14/ share, representing a payout ratio of 33.1%
- Impact of the new drug pricing policy should be mitigated by its premium service, growing reputation, and expertise
- Maintain **BUY**, current TP represents FY17E/18E P/E of 19.73x/16.95x, and FY17E/18E P/B of 3.12x/2.77x

FY16 result meets expectation. Total revenue grew by 16.61% YoY. Expansion of VIP service and the increased premium charged for VIP patients enabled GP and NP to grow by 24.02% YoY and 13.26% YoY. GPM and NPM expanded to 23.94% and 11.39%.

Average charges on VIP inpatient services doubled. High-end healthcare service contributed to 9.4% of the Group's revenue in FY16 (FY15: 7.7%) and grew by 43.1% YoY. The VIP service revenue increased to RMB 54.6mn, and its average charge of inpatient service increased by 100.6% YoY. The FY16 figures prove the Group's ability to add premium charges on VIP patients and the strong demand for such service.

Strong growth of its flagship hospital. Outpatient and inpatient visits of Kanghua Hospital, the Group's portfolio hospital with a Class III Grade A rating, increased by 11.6% YoY and 15.3% YoY; its average outpatient/inpatient spending increased by 9.1% YoY /2.9% YoY. Average inpatient days of Kanghua Hospital also decreased by 0.7 day to 7.9 days, showing increased efficiency.

Dividend payout ratio at 33.1%. The Group announced a dividend of RMB 46.815mn, or DPS of RMB 0.14. As the Group's business and profitability improves with the increasing revenue from VIP healthcare and other premium services, we are confident that it would be able to maintain consistent dividend payout in the future.

Impact from new drug pricing policy to be mitigated. While the new policy that prohibits public hospitals from overpricing medicines may lead to higher patient visits in public hospitals, we believe the Group can mitigate such a policy change with its track record in providing premium service, expanding reputation and medical expertise.

Maintain BUY, TP at HK\$13.85. We expect the Group to maintain decent growth momentum due to increasing capacity, higher utilization rate, and additional revenue stream from the management hospital and/or acquired hospitals. The increasing premium for quality healthcare service would also help margin to further expand. Maintain **BUY**. Our current TP represents FY17E/18E P/E of 19.73x/16.95x, and FY17E/18E P/B of 3.12x/2.77x .

Risk factors: 1) Policy & regulatory risk; 2) Geographical concentration risk; 3) Litigation/operation risk; 4) M&A execution risk; 5) Credit risk; 6) Assets concentration risk;

Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (RMB mn)	1,063.70	1,240.39	1,460.92	1,706.37	1,985.73
Chg (% YoY)	7.98	16.61	17.78	16.80	16.37
Net Profit (RMB mn)	118.85	141.26	208.09	242.25	281.61
Chg (% YoY)	16.25	18.86	47.31	16.42	16.25
Basic EPS (RMB cent)	47.50	53.80	62.23	72.45	84.22
Chg (% YoY)	16.14	13.26	15.67	16.42	16.25
P/E (x)	25.83	22.81	19.72	16.94	14.57
BVPS (RMB cent)	98.70	351.39	393.76	442.81	497.82
P/B (x)	12.43	3.49	3.12	2.77	2.46
DPS(RMB cent)	0.00	14.00	18.67	21.73	25.26
Yield (%)	0.00	1.29	1.72	2.00	2.32
ROAA (%)	7.95	10.27	11.76	12.32	12.59
ROAE (%)	61.72	19.87	16.70	17.32	17.91

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Mar 30, 2017

Rating: BUY

TP: HK\$ 13.85

Analyst: Paul Pan

Tel: (852) 2147 8829

Email: paulpan@abci.com.hk

Share price (HK\$)	10.88
Est. share price return	27.30%
Est. dividend yield	1.29%
Est. total return	28.58%
Previous Rating&TP	BUY;HK\$13.85
Previous report date	Feb 20, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

Issued shares (mn)	334.394
H-shares (mn)	84.394
H-share mkt cap (HK\$m)	918.21
3-mth ADT (HK\$m)	1.01
Shareholding (%)	
Unlisted shares:	74.8
- Kanghua Group	59.1
- Xingye Group	7.5
- Xingda Property	8.2
Total H shares:	25.2
- Huzhou Feipeng Capital	6.0
- Others	19.2

% of total revenue	FY17E
Inpatient	58.68
Outpatient	35.59
Physical exam	5.22

Source(s): ABCI Securities estimates

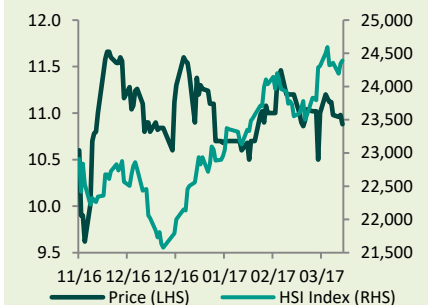
Sector Performance (%)

	Absolute	Relative*
1-mth	(2.86)	(5.73)
3-mth	(2.16)	(14.65)
6-mth	N/A	N/A

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Price performance since listing(HK\$)



Source(s): Bloomberg, ABCI Securities

* All pricing and market data as of closing of Mar 29, 2017

Consolidated income statement (2015A-2019E)

FY ends at Dec 31 (RMB mn, except per share data)	2015A	2016A	2017E	2018E	2019E
Revenue	1,064	1,240	1,461	1,706	1,986
- Inpatient healthcare services	628	729	857	995	1,152
- Outpatient healthcare services	373	444	520	617	729
- Physical examination services	62	66	76	86	98
- Management of third-party hospital	0	1	7	7	7
COGS	(824)	(943)	(1,107)	(1,287)	(1,499)
Gross profit	239	297	353	420	487
- Inpatient healthcare services	93	123	151	183	214
- Outpatient healthcare services	111	136	155	184	213
- Physical examination services	36	37	43	49	55
- Management of third-party hospital	0	0	4	4	4
Admin expenses	(84)	(109)	(117)	(135)	(158)
Others	3	0	6	7	9
Operating profit (excluding non-operating and one-off items)	159	188	243	292	339
Net non-operating gain/(loss) and one-off-items	57	18	18	15	20
Finance cost	(67)	(7)	0	0	0
Pretax profit	149	198	262	307	358
Tax	(30)	(53)	(53)	(62)	(72)
Net profit	119	146	209	245	286
- Owners of the company	119	141	208	242	282
- Minority interest	0	4	0	3	4
Dividend	0	47	62	73	84
EPS (RMB cent)	47.50	53.80	62.23	72.45	84.22
DPS (RMB cent)	0.00	14.00	18.67	21.73	25.26

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2015A-2019E)

FY ends at Dec 31 (RMB mn, except per share data)	2015A	2016A	2017E	2018E	2019E
Cash and cash equivalent	96	936	1,086	1,103	1,491
Accounts and other receivables	88	190	115	255	168
Inventories	38	43	53	58	71
Others	553	85	215	154	191
Current assets	775	1,255	1,469	1,571	1,920
PP&E	322	361	402	449	478
Others	9	30	22	22	34
Non-current assets	331	391	424	470	512
Total assets	1,106	1,646	1,893	2,041	2,432
Accounts and other payables	393	386	555	522	739
ST Bank borrowings	342	0	0	0	0
Others	124	60	21	39	28
Current liabilities	859	446	576	560	768
Total liabilities	859	446	576	560	768
Shareholders' equity	232	1,155	1,297	1,458	1,638
Minority interest	15	20	20	23	27
Total equity	247	1,175	1,317	1,481	1,665
Total liabilities and equity	1,106	1,621	1,893	2,041	2,432

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2015A-2019E)

FY ends at Dec 31 (RMB mn, except per share data)	2015A	2016E	2017E	2018E	2019E
Pretax profit	149	198	262	307	358
Depreciation of PP&E	39	41	47	50	55
Change in working capital	9	(114)	235	(180)	292
Others	2	29	(28)	(27)	(34)
Cash flow from operating activities	199	155	516	150	671
CapEx	(96)	(81)	(93)	(98)	(86)
Others	969	434	(80)	104	34
Cash flow from investing activities	873	353	(173)	5	(52)
Bank borrowing	(577)	(342)	0	0	0
Amount raised through IPO	0	865	0	0	0
Dividend	0	0	(47)	(62)	(73)
Others	(437)	(197)	(28)	(1)	0
Cash flow from financing activities	(1,013)	326	(75)	(64)	(73)
Net change in cash	58	835	268	92	546
Cash and cash equivalent - end	96	931	1,198	1,290	1,836

Source(s): Company, ABCI Securities estimates

ABCI estimates vs. actual results

	2016A	2016E	AvE (%)
Revenue (RMB mn)	1240	1239	0.08
- Inpatient healthcare services	729	738	(1.22)
- Outpatient healthcare services	444	429	3.50
- Physical examination services	66	72	(8.33)
Gross profit (RMB mn)	297	284	4.58
- Inpatient healthcare services	123	117	5.13
- Outpatient healthcare services	136	126	7.94
- Physical examination services	37	40	(7.50)
OP (RMB mn)	188	180	4.44
NP (for owners of the Group) (RMB mn)	141	149	(5.37)
GPM (%)	23.94	22.90	1.04
- Inpatient healthcare services	16.93	15.88	1.05
- Outpatient healthcare services	30.67	29.41	1.26
- Physical examination services	55.76	56.19	(0.43)
OPM (%)	15.19	14.54	0.65
EBITDA margin	18.53	18.25	0.28
NPM (for owners of the Group)	11.39	11.99	(0.60)
Operating data			
Inpatient healthcare services			
# of patient visits	56,590	54,817	3.23
ASPV (RMB)	12,885	13,462	(4.29)
Outpatient healthcare services			
# of patient visits	1,428,185	1,403,624	1.75
ASPV (RMB)	311	306	1.63

Source(s): Company, ABCI Securities estimates

Key operating and financial ratios (2015A-2019E)

FY ends at Dec 31	2015A	2016A	2017E	2018E	2019E
Growth (YoY %)					
Revenue	7.98	16.61	17.78	16.80	16.37
- Inpatient healthcare services	7.31	16.10	17.57	16.10	15.71
- Outpatient healthcare services	10.34	18.89	17.18	18.72	18.06
- Physical examination services	1.38	6.26	14.99	13.25	13.30
Gross profit	7.03	24.02	19.05	18.78	15.97
- Inpatient healthcare services	0.04	32.66	22.32	21.18	17.00
- Outpatient healthcare services	14.55	22.83	13.96	18.36	16.24
- Physical examination services	4.75	4.04	16.03	13.78	12.58
EBIT	6.99	18.54	29.05	20.13	15.98
EBITDA	6.28	16.17	26.10	18.05	15.05
Pretax Profit	10.06	33.37	31.76	17.40	16.67
Net profit (to owners of the company)	16.25	18.86	47.31	16.42	16.25
Profitability ratios (%)					
GPM	22.51	23.94	24.19	24.60	24.52
- Inpatient healthcare services	14.82	16.93	17.62	18.39	18.59
- Outpatient healthcare services	29.68	30.67	29.82	29.73	29.28
- Physical examination services	56.95	55.76	56.26	56.53	56.16
OPM	14.94	15.19	16.64	17.11	17.06
EBITDA margin	18.60	18.53	19.84	20.05	19.82
Pretax	13.99	16.00	17.90	17.99	18.04
NPM (to owners of the company)	11.17	11.39	14.24	14.20	14.18
Revenue contribution (%)					
- Inpatient healthcare services	59.04	58.79	58.68	58.33	58.00
- Outpatient healthcare services	35.09	35.78	35.59	36.18	36.70
- Physical examination services	5.87	5.34	5.22	5.06	4.93
Return ratios (%)					
ROAA	7.95	10.27	11.76	12.32	12.59
ROAE	61.72	19.87	16.70	17.32	17.91
ROIC	7.50	11.30	19.04	19.63	20.06
Liquidity ratio (x)					
Current ratio	0.90	2.81	2.55	2.80	2.50
Quick ratio	0.86	2.72	2.46	2.70	2.41
Cash ratio	0.18	2.29	2.26	2.24	2.19
Cash conversion cycle (days)					
Days of outstanding receivable	21.37	21.32	21.34	21.33	21.34
Days of inventory on hand	15.91	15.75	15.83	15.79	15.81
Days of outstanding payable	163.16	149.96	153.87	152.11	152.20
CCC	(125.88)	(112.89)	(116.70)	(114.99)	(115.06)
Leverage ratios (%)					
Total debt /Equity	138.52	0.00	0.00	0.00	0.00
Total debt/Total assets	30.91	0.00	0.00	0.00	0.00

Source(s): Company, ABCI Securities estimates

Disclosures

Analyst Certification

I, PAN Hongxing, Paul, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

Disclosures of Interests

ABCI Securities Company Limited and/or its affiliates, within the past 12 months, have investment banking relationship with one or more of the companies mentioned in the report.

Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return $- 6\% \leq$ Stock return $<$ Market return rate
Sell	Stock return $<$ Market return $- 6\%$

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 1.5
Low	180 day volatility/180 day benchmark index volatility $<$ 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index. Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

Disclaimers

This report is for our clients only and is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expresses or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. ABCI Securities Company Limited is under no obligation to update or keep current the information contained herein. ABCI Securities Company Limited relies on information barriers to control the flow of information contained in one or more areas within ABCI Securities Company Limited, into other areas, units, groups or affiliates of ABCI Securities Company Limited. The compensation of the analyst who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of ABCI Securities Company Limited as a whole, of which investment banking, sales and trading are a part. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither ABCI Securities Company Limited nor any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Additional information will be made available upon request.

Copyright 2017 ABCI Securities Company Limited

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of ABCI Securities Company Limited.

**Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.
Tel: 852) 2868 2183**