

Kanghua Healthcare (3689 HK)

Acquisition enhances growth prospects; maintain BUY

- Revenue grew 12.0% YoY in FY17; more specifically, revenue from hospital management services jumped 170% YoY; revenue from cardiovascular, internal medicine, and medical aesthetic-related disciplines grew over 20% YoY
- GPM at 23.8% and NPM at 11.3% in FY17. GPM of different segments were stable except for hospital management services, whose GPM surged to 45.4% in FY17 from 31.7% in FY16
- The Group announced acquisition of equity interest in Anhui Hualin, which specializes in operating rehabilitation hospitals
- Maintain **BUY**; current TP represents 15.28x/12.86x 18E/19E P/E, and 2.45x/2.16x 18E/19E P/B

Revenue up 12% YoY. Revenue from inpatient healthcare and outpatient healthcare segments grew 12.0% YoY and 10.7% YoY. Notably, revenue from hospital management jumped 170.0% YoY, suggesting Zhonglian Cardiovascular Hospital recorded a strong revenue growth in FY17. By medical department, cardiovascular, internal medicine, and medical aesthetic-related disciplines saw revenue growth of over 20% YoY. Revenue from orthopedics discipline increased 18.8% YoY in FY17 from 4.9% YoY in FY16.

GPM was stable at 23.8%. Overall GPM edged down 0.1 ppt, mainly due to GPM decline in inpatient healthcare services from 16.9% in FY16 to 16.2% in FY17 despite improved margins in outpatient, physical examination and hospital management segments... Directors' emoluments leaped 85% YoY while staff costs increased 19.6% YoY.

Acquisition of a 57% equity interest in Anhui Hualin. The Group would acquire a 57% of equity interest in Anhui Hualin at RMB 78.66mn, implying a valuation of RMB 138mn and 25.6x 17 P/E (of the target). RMB58.66 mn would be paid through equity transfer (a 49.71% equity interest to be transferred from the seller to Kanghua after cash payment) and RMB 20mn would be settled by means of capital injection. Specialized in operating rehabilitation hospital operation, Anhui Hualin is expected to develop a network of rehabilitation institutions with class III rehabilitation hospitals. We believe this acquisition reflects the Group's commitment in expanding through acquisition of specialized healthcare providers, which should help expand Kanghua national presence.

Steady margin improvement in the next few years. Based on our estimates, FY18E revenue would increase 19% YoY due to the acquisition of Anhui Hualin. For FY19E/20E, revenue growth would be stable at ~12% YoY. We expect GPM to improve to 26% in FY20E due to enhanced efficiency and increasing margin contribution from third-party hospital management services.

Maintain BUY with TP at HK\$ 13.46. We remain optimistic on Kanghua based on improving margins and encouraging growth prospect driven by the recent acquisition. Our DCF derived TP represents 15.28x/12.86x 18E/19E P/E, and 2.45x/2.16x 18E/19E P/B.

Risk factors: 1) Policy & regulatory risk; 2) Low float risk; 3) Litigation/operation risk; 4) M&A execution risk; 5) Credit risk; 6) Asset concentration risk.

Results and Valuation

FY ended Dec 31	2016A	2017A	2018E	2019E	2020E
Revenue (RMB mn)	1,240	1,389	1,659	1,873	2,105
Chg (% YoY)	16.61	11.99	19.41	12.92	12.38
Net Profit (RMB mn)	141	157	235	280	326
Chg (% YoY)	18.86	10.85	50.23	18.88	16.41
Basic EPS (RMB cent)	53.80	46.83	70.35	83.63	97.35
Chg (% YoY)	13.26	(12.96)	50.23	18.88	16.41
P/E (x)	27.50	31.59	21.03	17.69	15.20
BVPS (RMB cent)	351.39	385.59	439.67	497.63	564.60
P/B (x)	4.21	3.84	3.37	2.97	2.62
DPS (RMB cent)	14.00	16.00	21.10	25.09	29.20
Yield (%)	1.18	1.35	1.79	2.12	2.47
ROAA (%)	10.78	9.70	12.64	13.60	14.05
ROAE (%)	20.37	12.94	17.82	19.08	19.59

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Apr 4, 2018

Rating: BUY

TP: HK\$ 13.46

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Share price (HK\$)	11.82
52Wk H/L(HK\$)	14.2/10.3
Est. share price return	13.86%
Est. dividend yield	1.18%
Est. total return	15.04%
Previous Rating&TP	BUY;HK\$12.60
Previous report date	Sep 5, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

Issued shares (mn)	334.394
H-shares (mn)	84.39
H-share mkt cap (HK\$m)	997.54
3-mth ADT (HK\$m)	5.87
Shareholding (%)	
Unlisted shares:	74.76
- Kanghua Group	59.1
- Xingye Group	7.5
- Xingda Property	8.2
Total H shares:	25.2

Source(s): Bloomberg, HKEX

% of total revenue	FY18E
Inpatient	53.43
Outpatient	35.07
Physical exam	5.49
Others	6.00

Source(s): ABCI Securities estimates

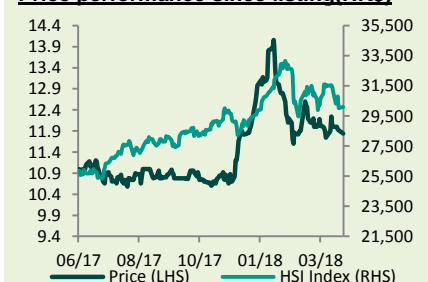
Sector Performance (%)

	Absolute	Relative*
1-mth	(1.50)	(0.38)
3-mth	(9.08)	(8.25)
6-mth	9.65	1.81

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Price performance since listing(HK\$)



Source(s): Bloomberg, ABCI Securities

* All pricing data as of end of Apr 3, 2018

Exhibit 1: Operation details of Kanghua Hospital and Renkang Hospital

	2014	2015	2016	2017
Kanghua Hospital				
Inpatient healthcare services				
Patient visits	36,538	37,393	43,119	47,425
Avg. spending per visit (RMB)	13,087.9	13,856.7	14,257.1	14,634.2
Outpatient healthcare services				
Patient visits	900,102	952,125	1,062,728	1,167,545
Avg. spending per visit (RMB)	297.1	314.1	342.70	346.9
Renkang Hospital				
Inpatient healthcare services				
Patient visits	15,070	13,906	13,471	13,718
Avg. spending per visit (RMB)	7,105.2	7,903.3	8493.6	8,959.8
Outpatient healthcare services				
Patient visits	397,545	367,059	365,457	374,937
Avg. spending per visit (RMB)	178.4	202.2	217.8	229.3

Source(s): Company, ABCI Securities

Exhibit 2: Special services operation details

	2015	2016	2017
Total special services revenue (RMB k)	81,849	117,140	134,001
VIP healthcare services			
Revenue (RMB k)	35,899	54,617	62,207
Inpatient healthcare services			
Patient visits	1,365	1,308	1,295
Avg. spending per visit (RMB)	10,359.7	20,776.8	26,118.2
Outpatient healthcare services			
Patient visits	42,350	55,056	58,339
Avg. spending per visit (RMB)	513.8	498.4	486.5
Reproductive medicine			
Revenue (RMB k)	35,374	51,301	57,862
Patient visits	41,334	51,981	57,878
Plastic and aesthetic surgery			
Revenue (RMB k)	4,711	4,520	5,393
Laser treatment			
Revenue (RMB k)	5,865	6,702	8,539

Source(s): Company, ABCI Securities

Exhibit 3: Revenue growth of disciplines (YoY %)

	2014	2015	2016	2017
O&G related disciplines	26.07	5.31	33.92	14.32
Cardiovascular related disciplines	10.78	14.21	26.54	20.16
Internal medicine related disciplines	10.33	6.80	18.08	21.13
General surgery related disciplines	5.00	9.61	10.69	10.95
Emergency medicine related disciplines	13.94	14.98	17.75	10.08
Neurology related disciplines	8.93	15.35	18.59	13.55
Orthopedics related disciplines	9.45	3.91	4.85	18.78
Pediatrics related disciplines	3.09	(4.18)	13.50	3.34
Physical examination	8.50	1.38	6.26	6.81
Oncology related disciplines	23.96	(13.15)	(27.43)	(10.52)
Medical aesthetic related disciplines	15.56	0.54	1.64	29.58
Nephrology related disciplines	56.16	17.33	11.27	12.28
Other disciplines	19.46	16.38	15.48	(4.75)

Source(s): Company, ABCI Securities

Exhibit 4: Managed and Controlled Entities by Anhui Hua

#	Entity	Principal business description	Sponsor	Date of establishment
1	Hefei Jingu Rehabilitation Hospital* (合肥金谷康復醫院)	A class II rehabilitation Hospital in Hefei City, Anhui Province	Anhui Hualin	29-Mar-10
2	Bengbu Renkang Hospital* (蚌埠仁康醫院)	A class I general hospital in Bengbu City, Anhui Province	Hefei Xingu	30-Dec-12
3	Yuhui District Rehabilitation Centre for the Disabled* (禹會區殘疾人康復中心)	A disability rehabilitation centre in Bengbu City, Anhui Province	Hefei Xingu	11-Oct-11
4	Luyang District Rehabilitation Centre for the Disabled* (廬陽區殘疾人康復中心)	A disability rehabilitation centre in Hefei City, Anhui Province	Hefei Xingu	6-Jul-07
5	Chaohu Jingu Rehabilitation Centre for the Disabled* (巢湖金谷殘疾人康復中心)	A disability rehabilitation centre in Chaohu City, Anhui Province	Hefei Xingu	1-Sep-15
6	Jinzhai County Rehabilitation Centre for the Disabled* (金寨縣殘疾人康復中心)	A disability rehabilitation centre in Lu'an City, Anhui Province	Hefei Jingu Rehabilitation Hospital* (合肥金谷康復醫院)	6-Jan-16
7	Huoshan County Rehabilitation Centre for the Disabled* (霍山縣殘疾人康復中心)	A disability rehabilitation centre in Lu'an City, Anhui Province	Hefei Jingu Rehabilitation Hospital* (合肥金谷康復醫院)	5-Aug-14
8	Luijiang County Rehabilitation Centre for the Disabled* (廬江縣殘疾人康復中心)	A disability rehabilitation centre in Hefei City, Anhui Province	Hefei Jingu Rehabilitation Hospital* (合肥金谷康復醫院)	11-Dec-13
9	Changfeng Jingu Rehabilitation Centre for the Disabled* (長豐金谷殘疾人康復中心)	A disability rehabilitation centre in Hefei City, Anhui Province	Hefei Jingu Rehabilitation Hospital* (合肥金谷康復醫院)	2-Jun-16
10	Bengbu City Bengshan District Rehabilitation Centre for the Disabled* (蚌埠市蚌山區殘疾人康復中心)	A disability rehabilitation centre in Bengbu City, Anhui Province	Hefei Xingu	11-Jul-17
11	Hefei Haihua Rehabilitation Centre for the Disabled* (合肥海華殘疾人康復中心)	A disability rehabilitation centre under development in Hefei City, Anhui Province	Luyang District Rehabilitation Centre for the Disabled* (廬陽區殘疾人康復中心)	6-Nov-17
12	Hefei Jingu Vocational Training School* (合肥金谷職業培訓學校)	A vocational training school for the disabled, re-employment, agricultural workers and youth in Hefei City, Anhui Province	Anhui Hualin	17-Jan-08

Source(s): Company, ABCI Securities

Consolidated income statement (2016A-2020E)

FY ends at Dec 31 (RMB mn, except per share data)	2016A	2017A	2018E	2019E	2020E
Revenue	1,240	1,389	1,659	1,873	2,105
- Inpatient healthcare services	729	817	886	976	1,073
- Outpatient healthcare services	444	491	582	666	763
- Physical examination services	66	71	91	107	125
- Hospital management services	1	3	7	11	15
COGS	(943)	(1,058)	(1,246)	(1,394)	(1,553)
Gross profit	297	331	413	479	552
- Inpatient healthcare services	123	132	172	201	234
- Outpatient healthcare services	136	155	161	177	196
- Physical examination services	37	41	58	72	88
- Hospital management services	0	1	3	6	8
Admin expenses	(109)	(127)	(131)	(147)	(165)
Others	18	14	30	36	39
Operating profit	206	218	312	368	426
Finance cost	(7)	0	0	0	0
Pretax profit	198	218	312	368	426
Tax	(53)	(57)	(68)	(76)	(86)
Net profit	146	161	244	292	340
- Owners of the company	141	157	235	280	326
- Minority interest	4	5	9	12	15
Dividend	47	54	71	84	98
EPS (RMB cent)	53.80	46.83	70.35	83.63	97.35
DPS (RMB cent)	14.00	16.00	21.10	25.09	29.20

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2016A-2020E)

FY ends at Dec 31 (RMB mn)	2016A	2017A	2018E	2019E	2020E
Cash and cash equivalent	936	384	698	680	1,037
Accounts and other receivables	190	215	272	235	359
Inventories	43	45	63	58	77
Others	35	558	550	546	545
Current assets	1,205	1,201	1,583	1,519	2,018
PP&E	361	434	514	577	626
Others	30	93	43	54	53
Non-current assets	391	527	557	631	680
Total assets	1,596	1,727	2,140	2,149	2,697
Accounts and other payables	386	413	635	449	764
ST Bank borrowings	0	0	0	0	0
Others	35	30	35	37	45
Current liabilities	421	443	670	485	809
Total liabilities	421	443	670	485	809
Shareholders' equity	1,155	1,265	1,375	1,557	1,766
Minority interest	20	24	95	107	122
Total equity	1,175	1,289	1,470	1,664	1,888
Total liabilities and equity	1,596	1,732	2,140	2,149	2,697

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2016A-2020E)

FY ends at Dec 31 (RMB mn)	2016A	2017E	2018E	2019E	2020E
Pretax profit	198	218	312	368	426
Depreciation of PP&E	41	50	51	57	62
Change in working capital	(114)	17	145	(143)	173
Others	29	(71)	(24)	(28)	(32)
Cash flow from operating activities	155	214	485	253	629
CapEx	(81)	(123)	(131)	(121)	(113)
Others	434	(588)	40	69	73
Cash flow from investing activities	353	(711)	(91)	(52)	(40)
Bank borrowing	(342)	0	0	0	0
Amount raised through IPO	865	0	0	0	0
Dividend	0	(47)	(54)	(71)	(84)
Others	(197)	(2)	(1)	0	0
Cash flow from financing activities	326	(49)	(54)	(71)	(84)
Net change in cash	835	(546)	340	131	505
Cash and cash equivalent - end	931	384	725	855	1,361

Source(s): Company, ABCI Securities estimates

Key operating and financial ratios (2016A-2020E)

FY ends at Dec 31	2016A	2017A	2018E	2019E	2020E
Growth (YoY %)					
Revenue	16.61	11.99	19.41	12.92	12.38
- Inpatient healthcare services	16.10	12.04	8.50	10.13	9.95
- Outpatient healthcare services	18.89	10.66	18.46	14.51	14.53
- Physical examination services	6.26	6.81	28.65	17.58	16.23
- Hospital management	N/A	170.03	110.00	72.00	32.00
- Pharmaceutical sales	N/A	N/A	21.94	21.94	21.94
Gross profit	24.02	11.44	24.82	15.96	15.25
- Inpatient healthcare services	32.66	7.23	29.76	16.83	16.42
- Outpatient healthcare services	22.83	13.94	3.80	10.03	10.66
- Physical examination services	4.04	10.34	42.59	24.45	21.00
- Hospital management	N/A	286.96	131.75	72.12	33.27
- Pharmaceutical sales	N/A	N/A	25.65	25.54	25.43
EBIT	(4.65)	5.90	43.17	17.84	15.89
EBITDA	(2.95)	8.19	35.83	16.81	15.03
Pretax Profit	33.37	9.88	43.17	17.84	15.89
Net profit (to owners of the company)	18.86	10.85	50.23	18.88	16.41
Profitability ratios (%)					
GPM	23.94	23.82	24.90	25.57	26.22
- Inpatient healthcare services	16.93	16.21	19.38	20.56	21.77
- Outpatient healthcare services	30.67	31.58	27.67	26.59	25.69
- Physical examination services	55.76	57.60	63.84	67.57	70.34
- Hospital management	31.70	45.42	50.13	50.16	50.65
- Pharmaceutical sales	N/A	16.43	16.93	17.43	17.93
OPM	16.60	15.70	18.82	19.64	20.26
EBITDA margin	19.95	19.27	21.92	22.67	23.21
Pretax	16.00	15.70	18.82	19.64	20.26
NPM (to owners of the company)	11.39	11.27	14.18	14.93	15.46
Revenue contribution (%)					
- Inpatient healthcare services	58.79	58.81	53.43	52.12	50.99
- Outpatient healthcare services	35.78	35.35	35.07	35.56	36.24
- Physical examination services	5.34	5.10	5.49	5.72	5.92
- Hospital management	0.09	0.23	0.40	0.60	0.71
- Pharmaceutical sales	N/A	0.52	0.53	0.57	0.62
Return ratios (%)					
ROAA	10.78	9.70	12.64	13.60	14.05
ROAE	20.37	12.94	17.82	19.08	19.59
ROIC	11.77	11.96	13.06	14.73	15.79
Liquidity ratio (x)					
Current ratio	2.86	2.71	2.36	3.13	2.49
Quick ratio	2.76	2.61	2.27	3.01	2.40
Cash ratio	2.31	0.90	1.05	1.41	1.28
Cash conversion cycle (days)					
Days of outstanding receivable	21	21	21	21	21
Days of inventory on hand	16	16	16	16	16
Days of outstanding payable	163	150	145	141	142
CCC	(126)	(113)	(108)	(104)	(105)
Leverage ratios (%)					
Total debt /Equity	0.00	0.00	0.00	0.00	0.00
Total debt/Total assets	0.00	0.00	0.00	0.00	0.00
Net cash/(debt) to Equity	82.66	30.91	47.89	41.03	55.04
Net cash/(debt) to Total assets	60.86	23.07	32.90	31.76	38.52

Source(s): Company, ABCI Securities estimates

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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.

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