



## Kanghua Healthcare (3689 HK)

### Growing on premium services and brand value

- Profit growth outpaced revenue growth and margin expanded on premium services, increasing operational efficiency, rising brand reputation, and the ability to minimize the impact of policy-led reduction in pharmaceutical sales
- VIP healthcare services grew 17% YoY on higher inpatient average spending per visit ; impressive growth was observed in certain medical disciplines
- Strong cash position and efficient working capital management in 1H17
- Maintain **BUY**, current TP represents 18.90x/16.86x FY17E/18E P/E, and 2.67x/2.41x FY17E/18E P/B

**Steady growth supports higher margin.** Revenues from inpatient healthcare segment and outpatient healthcare segment grew 7.4% YoY and 8.8% YoY, and the overall revenue rose 8% YoY. GP and NP (to owners of the company) rose sharply by 18.4% YoY and 12.7% YoY, driving up GPM to 25.3% (1H16: 23.1%) and NPM (to owners of the company) to 11.3% (1H16: 10.9%) in 1H17. We believe margin expansion was mainly supported by the increased proportion of premium services, higher operational efficiency, a strong brand premium, and the ability to minimize negative impacts of policy-led reduction in pharmaceutical sales.

**Premium service further supported growth.** In 1H17, VIP inpatient services recorded a slight increase in patient visits (+0.2% YoY) while the average spending per visit jumped 28.5% YoY to RMB 19,905.3. For the VIP outpatient services, patient visits grew 1.9% YoY while average spending rose 5.4% YoY. Hence, revenue of VIP healthcare services rose 17.0% YoY, contributing to 4.3% of total revenue (1H16: 4.0%). In addition, overall revenue growth for special services was 14.4% YoY, supported by strong growth in plastic and aesthetic surgery (+25.7% YoY) and laser treatment (+24.9% YoY).

**Certain medical disciplines saw higher growth.** The O&G (Obstetrics & Gynaecology)-related discipline saw a revenue growth of 22.8% YoY in 1H17, supported by the strong demand induced by the two-child policy and increasing demand of VIP services. In addition, the medical aesthetic-related discipline saw a revenue growth of 33.5% - the fastest-growing area among all disciplines.

**Strong cash position and working capital management.** The Group was in a net cash position of RMB 466mn with no debt by end-1H17. In addition, CCC was -100 days, with an extensive payable turnover of 141 days, a stable inventory turnover of 18 days, and a receivable turnover of 22 days. Strong cash position and working capital management would continue to provide more flexibility in daily operation.

**Maintain BUY with TP at HK\$ 12.60.** 1H17 results show a steady growth momentum supported by quality services and rising demand in the market. The Group has been able to leverage on the "Kanghua" brand for higher service premium. The 16% decline in EPS in 1H17 was solely due to the issuance of H-shares. Maintain **BUY**, but lower TP to HK\$ 12.6 to reflect lower growth expectation. Current TP represents 18.90x/16.86x FY17E/18E P/E, and 2.67x/2.41x FY17E/18E P/B.

**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)	1,064	1,240	1,395	1,562	1,748
Chg (% YoY)	7.98	16.61	12.46	11.97	11.94
Net Profit (RMB mn)	119	141	186	208	243
Chg (% YoY)	16.25	18.86	31.61	12.13	16.68
Basic EPS (RMB cent)	47.50	53.80	55.60	62.34	72.74
Chg (% YoY)	16.14	13.26	3.34	12.13	16.68
P/E (x)	27.26	24.07	23.29	20.77	17.80
BVPS (RMB cent)	98.70	351.39	393.75	436.05	482.78
P/B (x)	13.12	3.68	3.29	2.97	2.68
DPS (RMB cent)	0.00	14.00	16.68	18.70	21.82
Yield (%)	0.00	1.30	1.54	1.73	2.02
ROAA (%)	7.95	10.78	10.96	11.23	11.83
ROAE (%)	66.99	20.37	15.16	15.26	16.09

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

Sep 5, 2017

Rating: BUY

TP: HK\$ 12.60

Analyst: Paul Pan

Tel: (852) 2147 8829

Email: paulpan@abci.com.hk

Share price (HK\$)	10.80
52Wk H/L (HK\$)	12.7/9.6
Est. share price return	16.67%
Est. dividend yield	1.30%
Est. total return	17.96%
Previous Rating&TP	BUY; HK\$13.85
Previous report date	Mar 30, 2017

Source(s): Bloomberg, ABCI Securities

### Key Data

Issued shares (mn)	334.394
H-shares (mn)	84.394
H-share mkt cap (HK\$m)	911.46
3-mth ADT (HK\$m)	2.25
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

Source(s): Bloomberg, HKEX

% of total revenue	FY17E
Inpatient	58.89
Outpatient	35.72
Physical exam	5.24

Source(s): ABCI Securities estimates

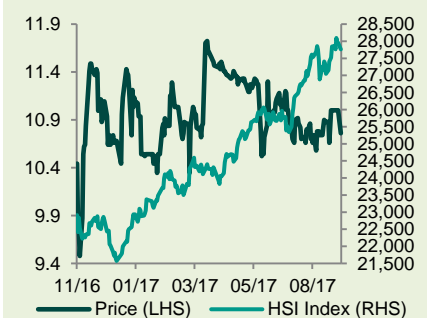
### Sector Performance (%)

	Absolute	Relative*
1-mth	0.56	(0.75)
3-mth	(4.20)	(13.57)
6-mth	(2.14)	(23.46)

\*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 Sep 4, 2017



**Exhibit 1: Operation of two hospitals**

	2014	2015	2016	1H16	1H17
<b>Kanghua Hospital</b>					
Inpatient healthcare services					
Patient visits	36,538	37,393	43,119	20,241	21,703
Avg. spending per visit (RMB)	13,087.90	13,856.70	14,257.10	14,628.60	14,760.50
Outpatient healthcare services					
Patient visits	900,102	952,125	1,062,728	511,103	544,169
Avg. spending per visit (RMB)	297.1	314.1	342.70	340	350.6
<b>Renkang Hospital</b>					
Inpatient healthcare services					
Patient visits	15,070	13,906	13,471	6,518	6,505
Avg. spending per visit (RMB)	7,105.20	7,903.30	8,493.60	8,628.40	8,903.60
Outpatient healthcare services					
Patient visits	397,545	367,059	365,457	176,781	174,583
Avg. spending per visit (RMB)	178.4	202.2	217.80	217.7	229.7

Source(s): Company, ABCI Securities

**Exhibit 2: Special services operation details**

	2015	2016	1H16	1H17
Total special services revenue (RMB k)	81,849	117,140	52,720	60,303
<b>VIP healthcare services</b>				
Revenue (RMB k)	35,899	54,617	23,285	27,239
Inpatient healthcare services				
Patient visits	1,365	1,308	675	676
Avg. spending per visit (RMB)	10,359.7	20,776.8	15,487.4	19,905.3
Outpatient healthcare services				
Patient visits	513.8	498.4	27,548	28,083
Avg. spending per visit (RMB)	42,350	55,056	465.8	490.8
<b>Reproductive medicine</b>				
Revenue (RMB k)	35,374	51,301	24,223	26,537
Outpatient visits	41,334	51,981	25,036	26,670
<b>Plastic and aesthetic surgery</b>				
Revenue (RMB k)	4,711	4,520	2,017	2,535
<b>Laser treatment</b>				
Revenue (RMB k)	5,865	6,702	3,195	3,992

Source(s): Company, ABCI Securities

**Exhibit 3: Revenue growth of disciplines (YoY %)**

	2014	2015	2016	1H17
O&G related disciplines	26.07	5.31	33.92	22.75
Cardiovascular related disciplines	10.78	14.21	26.54	4.19
Internal medicine related disciplines	10.33	6.80	18.08	11.26
General surgery related disciplines	5.00	9.61	10.69	6.28
Emergency medicine related disciplines	13.94	14.98	17.75	(3.83)
Neurology related disciplines	8.93	15.35	18.59	9.90
Orthopedics related disciplines	9.45	3.91	4.85	16.43
Pediatrics related disciplines	3.09	(4.18)	13.50	(12.02)
Physical examination	8.50	1.38	6.26	5.35
Oncology related disciplines	23.96	(13.15)	(27.43)	(29.56)
Medical aesthetic related disciplines	15.56	0.54	1.64	33.45
Nephrology related disciplines	56.16	17.33	11.27	11.73
Other disciplines	19.46	16.38	15.48	(0.56)

Source(s): Company, ABCI Securities



**Consolidated income statement (2015A-2019E)**

<b>FY ends at Dec 31 (RMB mn, except per share data)</b>	<b>2015A</b>	<b>2016A</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>	<b>1H16</b>	<b>1H17</b>
<b>Revenue</b>	<b>1,064</b>	<b>1,240</b>	<b>1,395</b>	<b>1,562</b>	<b>1,748</b>	<b>588</b>	<b>635</b>
- Inpatient healthcare services	628	729	806	886	973	352	378
- Outpatient healthcare services	373	444	508	582	666	212	231
- Physical examination services	62	66	78	91	106	24	25
- Hospital management services	0	1	3	3	3	0	1
COGS	(824)	(943)	(1,052)	(1,170)	(1,299)	(453)	(475)
<b>Gross profit</b>	<b>239</b>	<b>297</b>	<b>343</b>	<b>392</b>	<b>449</b>	<b>136</b>	<b>161</b>
- Inpatient healthcare services	93	123	147	172	200	56	68
- Outpatient healthcare services	111	136	148	161	177	68	80
- Physical examination services	36	37	47	58	71	12	13
- Hospital management services	0	0	1	1	1	0	0
Admin expenses	(84)	(109)	(112)	(123)	(137)	(50)	(58)
Others	60	18	22	18	23	9	(0)
<b>Operating profit</b>	<b>216</b>	<b>206</b>	<b>253</b>	<b>287</b>	<b>335</b>	<b>95</b>	<b>102</b>
Finance cost	(67)	(7)	0	0	0	(6)	0
Pretax profit	149	198	253	287	335	89	102
Tax	(30)	(53)	(66)	(76)	(88)	(24)	(28)
<b>Net profit</b>	<b>119</b>	<b>146</b>	<b>186</b>	<b>211</b>	<b>247</b>	<b>65</b>	<b>74</b>
- Owners of the company	119	141	186	208	243	64	72
- Minority interest	0	4	0	2	4	1	2
Dividend	0	47	56	63	73	0	0
<b>EPS (RMB cent)</b>	<b>47.50</b>	<b>53.80</b>	<b>55.60</b>	<b>62.34</b>	<b>72.74</b>	<b>25.60</b>	<b>21.50</b>
<b>DPS (RMB cent)</b>	<b>0.00</b>	<b>14.00</b>	<b>16.68</b>	<b>18.70</b>	<b>21.82</b>	<b>0.00</b>	<b>0.00</b>

Source(s): Company, ABCI Securities estimates

**Consolidated balance sheet (2015A-2019E)**

<b>FY ends at Dec 31 (RMB mn)</b>	<b>2015A</b>	<b>2016A</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>	<b>1H17</b>
Cash and cash equivalent	96	936	647	812	1,029	451
Accounts and other receivables	88	190	240	218	256	210
Inventories	38	43	48	53	59	50
Others	553	35	457	453	450	460
<b>Current assets</b>	<b>775</b>	<b>1,205</b>	<b>1,393</b>	<b>1,536</b>	<b>1,795</b>	<b>1,172</b>
PP&E	322	361	367	377	379	364
Others	9	30	44	38	47	108
<b>Non-current assets</b>	<b>331</b>	<b>391</b>	<b>411</b>	<b>415</b>	<b>426</b>	<b>471</b>
<b>Total assets</b>	<b>1,106</b>	<b>1,596</b>	<b>1,804</b>	<b>1,950</b>	<b>2,221</b>	<b>1,643</b>
Accounts and other payables	393	386	456	451	565	356
ST Bank borrowings	342	0	0	0	0	0
Others	124	35	31	41	42	38
<b>Current liabilities</b>	<b>859</b>	<b>421</b>	<b>487</b>	<b>492</b>	<b>607</b>	<b>394</b>
<b>Total liabilities</b>	<b>859</b>	<b>421</b>	<b>487</b>	<b>492</b>	<b>607</b>	<b>394</b>
Shareholders' equity	232	1,155	1,297	1,436	1,588	1,227
Minority interest	15	20	20	22	26	22
<b>Total equity</b>	<b>247</b>	<b>1,175</b>	<b>1,317</b>	<b>1,458</b>	<b>1,614</b>	<b>1,249</b>
<b>Total liabilities and equity</b>	<b>1,106</b>	<b>1,596</b>	<b>1,804</b>	<b>1,950</b>	<b>2,221</b>	<b>1,643</b>

Source(s): Company, ABCI Securities estimates



**Consolidated cash flow statement (2015A-2019E)**

<b>FY ends at Dec 31 (RMB mn)</b>	<b>2015A</b>	<b>2016E</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>	<b>1H17</b>
Pretax profit	149	198	253	287	335	102
Depreciation of PP&E	39	41	47	49	52	22
Change in working capital	9	(114)	15	12	69	(57)
Others	2	29	(30)	(29)	(36)	(29)
<b>Cash flow from operating activities</b>	<b>199</b>	<b>155</b>	<b>285</b>	<b>319</b>	<b>420</b>	<b>38</b>
CapEx	(96)	(81)	(58)	(61)	(55)	(25)
Others	969	434	65	44	66	(474)
<b>Cash flow from investing activities</b>	<b>873</b>	<b>353</b>	<b>7</b>	<b>(17)</b>	<b>11</b>	<b>(499)</b>
Bank borrowing	(577)	(342)	0	0	0	0
Amount raised through IPO	0	865	0	0	0	0
Dividend	0	0	(47)	(56)	(63)	0
Others	(437)	(197)	(3)	(0)	0	(2)
<b>Cash flow from financing activities</b>	<b>(1,013)</b>	<b>326</b>	<b>(50)</b>	<b>(56)</b>	<b>(63)</b>	<b>(2)</b>
<b>Net change in cash</b>	<b>58</b>	<b>835</b>	<b>242</b>	<b>246</b>	<b>369</b>	<b>(463)</b>
<b>Cash and cash equivalent - end</b>	<b>96</b>	<b>931</b>	<b>1,173</b>	<b>1,419</b>	<b>1,788</b>	<b>468</b>

Source(s): Company, ABCI Securities estimates



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

<b>FY ends at Dec 31</b>	<b>2015A</b>	<b>2016A</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>	<b>1H17</b>
<b>Growth (YoY %)</b>						
Revenue	7.98	16.61	12.46	11.97	11.94	8.00
- Inpatient healthcare services	7.31	16.10	10.54	9.97	9.80	7.36
- Outpatient healthcare services	10.34	18.89	14.51	14.48	14.51	8.79
- Physical examination services	1.38	6.26	18.12	16.34	16.40	5.35
- Hospital management	N/A	N/A	115.33	10.00	10.00	N/A
Gross profit	7.03	24.02	15.41	14.29	14.67	18.42
- Inpatient healthcare services	0.04	32.66	18.90	17.02	16.36	21.25
- Outpatient healthcare services	14.55	22.83	8.95	8.55	10.03	17.51
- Physical examination services	4.75	4.04	26.88	23.99	22.61	7.59
- Hospital management	N/A	N/A	83.42	5.93	10.00	N/A
EBIT	1.82	(4.65)	22.71	13.39	16.88	6.90
EBITDA	2.07	(2.95)	20.99	12.10	15.39	7.16
Pretax Profit	10.06	33.37	27.31	13.39	16.88	14.01
Net profit (to owners of the company)	16.25	18.86	31.61	12.13	16.68	12.72
<b>Profitability ratios (%)</b>						
GPM	22.51	23.94	24.57	25.07	25.69	25.29
- Inpatient healthcare services	14.82	16.93	18.22	19.38	20.54	17.93
- Outpatient healthcare services	29.68	30.67	29.18	27.67	26.59	34.61
- Physical examination services	56.95	55.76	59.90	63.84	67.24	50.51
- Hospital management	N/A	31.70	27.00	26.00	26.00	25.90
OPM	20.30	16.60	18.11	18.34	19.15	16.05
EBITDA margin	23.97	19.95	21.46	21.48	22.14	19.55
Pretax	13.99	16.00	18.11	18.34	19.15	16.05
NPM (to owners of the company)	11.17	11.39	13.33	13.35	13.91	11.34
<b>Revenue contribution (%)</b>						
- Inpatient healthcare services	59.04	58.79	57.78	56.75	55.66	59.54
- Outpatient healthcare services	35.09	35.78	36.43	37.24	38.10	36.35
- Physical examination services	5.87	5.34	5.61	5.83	6.07	3.93
- Hospital management	0.00	0.09	0.18	0.18	0.17	0.19
<b>Return ratios (%)</b>						
ROAA	7.95	10.78	10.96	11.23	11.83	9.15
ROAE	66.99	20.37	15.16	15.26	16.09	12.09
ROIC	7.51	11.77	14.31	13.29	14.81	11.95
<b>Liquidity ratio (x)</b>						
Current ratio	0.90	2.86	2.66	2.92	2.69	2.97
Quick ratio	0.86	2.76	2.58	2.82	2.60	2.85
Cash ratio	0.18	2.31	2.39	2.36	2.40	1.18
<b>Cash conversion cycle (days)</b>						
Days of outstanding receivable	21	21	21	21	21	22
Days of inventory on hand	16	16	16	16	16	18
Days of outstanding payable	163	150	145	141	142	141
CCC	(126)	(113)	(108)	(104)	(105)	(100)
<b>Leverage ratios (%)</b>						
Total debt /Equity	138.52	0.00	0.00	0.00	0.00	0.00
Total debt/Total assets	30.91	0.00	0.00	0.00	0.00	0.00
Net cash/(debt) to Equity	(75.94)	82.66	50.09	56.20	64.05	37.31
Net cash/(debt) to Total assets	(16.94)	60.86	36.56	42.01	46.56	28.36

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**