Securities

AFFIN HWANG CAPITAL

Out think. Out perform.

A defensive shelter amid market uncertainties

The recent coronavirus outbreak is likely to have minimal impact to the Malaysia healthcare sector in the near term. Nevertheless, long term, we believe the rising healthcare awareness arising from the outbreak should be positive for the sector. We maintain our Overweight rating on the Healthcare sector and recommend investors to position defensively in the sector. Our top pick is Apex Healthcare. On a positive note, a possible retraction of the proposed medicine price controls, potentially due to the already competitive pricing in Malaysia and the fear of losing access to the latest and most innovative single-source medicines, could be a positive catalyst to the private hospital operators.

Coronavirus outbreak likely to have minimal impact to the sector

We think that the coronavirus outbreak is likely to have only a muted impact on the private hospital operators as the private hospitals are required to report and refer such cases to public hospitals and the national infection centre based on MoH guidelines. While we note that the pharmaceutical players could potentially benefit from a surge in demand for products related to the prevention of seasonal viral diseases with similar symptoms, the impact to their respective bottom lines is likely to be minimal.

Relatively resilient amid market uncertainties

Although not entirely recession-proof, healthcare spending is relatively inelastic and less prone to market uncertainties. Healthcare stocks under our coverage have long-term adjusted betas of <1, displaying the low sensitivity of the sector to global growth.

Proposed medicine price controls likely to be called off

We gather that the proposed medicine price controls may not materialise in the near term, possibly because medicine prices in Malaysia are already relatively competitive and due to the risk of losing access to the latest and most innovative medicines. Alternatively, declaration of prices may be encouraged to improve transparency and encourage competition. We think that the possible calling off of the proposed medicine price controls could help to mitigate the current overhang on the private hospital operators.

Maintain Overweight, with Apex Healthcare as our top pick

We maintain our Overweight view on the sector with Apex Healthcare as our preferred pick. We continue to like the sector for its defensiveness and long-term growth prospects. Going into 2020, we recommend positioning in the pharmaceutical space as a potential earnings recovery play and beneficiary of the government's initiatives to liberalise the drug distribution in the country. Key downside risks include sharp declines in patient volumes, higher-than-expected start-up losses for new hospitals, execution risk, currency risk, product recall risk and regulatory risk.

Sector Update

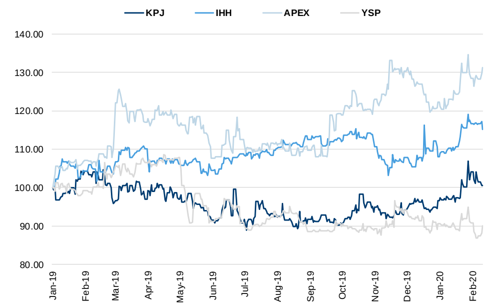
Healthcare

OVERWEIGHT (Maintain)

Absolute Performance (%)

	1M	3M	12M
IHH	1.8	4.8	1.8
KPJ	1.1	3.8	-8.6
APEX	4.0	2.2	14.2
YSP	-2.2	-3.0	-17.3

Relative Performance (%)



Source: Affin Hwang, Bloomberg

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Peer Comparison

Company Name	Rating	Share Pr (RM)	TP (RM)	Mkt Cap (RMbn)	Year end	Core PE (x) CY19E	Core PE (x) CY20E	Core EPS growth (%) CY19E	Core EPS growth (%) CY20E	EV/EBITDA (x) CY19E	EV/EBITDA (x) CY20E	P/BV (x) CY19E	ROE (%) CY19E	Div Yield (%) CY19E	Div Yield (%) CY20E
APEX HEALTHCARE	BUY	2.35	2.67	1,109.8	Dec	19.9	15.0	(7.4)	32.2	13.2	10.0	2.6	13.2	1.6	2.1
IHH HEALTHCARE	BUY	5.70	6.20	50,011.7	Dec	51.0	45.5	4.0	12.0	19.4	17.6	2.2	4.3	0.5	0.5
KPJ HEALTHCARE	HOLD	0.96	0.97	4,106.9	Dec	22.5	21.5	4.7	4.3	11.6	11.0	2.0	8.8	2.0	2.0
YSP SOUTHEAST ASIA	BUY	2.26	3.00	315.5	Dec	12.1	10.6	(20.2)	14.6	5.9	5.2	1.0	7.9	3.3	3.8
Average				**55,543.9**		**44.6**	**39.9**	**2.9**	**11.9**	**17.9**	**16.3**	**1.9**	**4.9**	**1.8**	**2.1**

Source: Bloomberg, Affin Hwang forecasts   Note: Pricing as of 11 February 2020

Screening for impact from coronavirus outbreak

No significant impact to the private hospital operators…

As at latest count, the coronavirus has spread to 28 countries with over 43,000 confirmed cases and more than 1,000 deaths. Malaysia has recorded 18 confirmed coronavirus infections, while its neighbour, Singapore, has reported 47 confirmed cases. We do not expect the outbreak to have any significant impact to the private hospital operators in the near term. We understand that, for any pandemic case, private hospitals are required to report and refer these cases to public hospitals and the national infection centre, according to the Ministry of Health (MoH) guidelines.

… as well as patient volume growth

So far the private hospital operators have not seen any significant surge in patient volume. While some may expect a surge in patient volume as patients with virus-like symptoms would likely seek doctor consultancy or treatment during this critical period, there are also patients who may defer non-urgent and non-essential cases to avoid the possibility of getting cross-infected in hospitals, which may in turn lead to lower patient volume. There is no meaningful historical data for comparison as KPJ's strong patient volume growth during SARS in 2002-2003 was mainly driven by acquisitions of existing hospitals (number of hospitals increased from 2 to 12; inpatient volume grew 223%), while IHH was not listed back then. All in, at this juncture, we believe the impact of the outbreak to private hospital operators is likely to be minimal.

Potential spill-over benefit to pharmaceutical players…

Given that the speed of contagion is nearly double that of its predecessor SARS, we noticed there is an obvious trend of rising health awareness which has led to higher demand for products related to prevention of seasonal viral diseases with similar symptoms such as flu, cough and fever. A lot of people are rushing to pharmacies, convenience stores and Chinese medicine shops to stock up on face masks, hand sanitisers, consumer health products and herbal products, especially those that could help boost the immune system such as Vitamin C and liquorice. We think that this could potentially benefit the pharmaceutical players that are involved in the production, wholesale, distribution and/or retail of the abovementioned products. Based on our channel checks, most of the pharmaceutical players have seen a strong surge in demand for these products.

… but could be minimal to bottom line

That said, we note that it is difficult to quantify these potential positives given the lack of available data, i.e., a breakdown of the revenue contributions from these products to the groups. Based on our estimates, the contributions from these products to the pharmaceutical players are not very significant, hence the impact to bottom line from the surge in demand for consumer health products is likely to be minimal relative to the group as a whole. Nevertheless, long term, we believe the rising health consciousness should be positive to the sector as people are increasingly aware of the need to stay healthy and keep their immune system strong.

Fig 1: Local listed pharmaceutical players

Local listed pharmaceutical players	Details
Apex Healthcare (BUY, TP: RM2.67)	Involved in the distribution and wholesale of face masks such as surgical masks and N95 masks. The group also operates a retail pharmacy store, Apex Pharmacy, in Melaka.
Y.S.P. Southeast Asia (BUY, TP: RM3.00)	Involved in the manufacturing of consumer health products and TCM which contributed 1% and 9% to the group's revenue respectively. Of the consumer health products, YSP produces Vitamin C under its own brand, ***Shine***.
Duopharma Biotech (Not rated)	Involved in the manufacturing of consumer health products which include Vitamin C. Duopharma is a market leader for Vitamin C products via ***Flavettes*** (for adults) and ***Champs*** (for children).
Pharmaniaga (Not rated)	Involved in the manufacturing of consumer health products which include Vitamin C under its own brand, ***Citrex***. The group also operates 6 retail pharmacy outlets named RoyalePharma Pharmacy.
Bioalpha Holdings (Not rated)	Involved in the manufacturing of consumer health products, including those that help to improve respiratory health, strengthen the immune system and provide relief for coughs and colds such as ***Apotec B-Ligno*** and ***Apotec Probiotics***. The group also operates 21 Constant pharmacies in Malaysia, which sell face masks, hand sanitisers and Vitamin C.
Caring Pharmacy (Not rated)	The largest local listed retail pharmacy operator with around 125 outlets across Malaysia. The group sells different brands of face masks, hand sanitisers as well as consumer health products at its pharmacy outlets.
Kotra Industries (Not rated)	Involved in manufacturing of Vitamin C under its own brand, ***Appeton***.

Source: Companies, Affin Hwang

Fig 2: Vitamin C brands manufactured by local listed pharmaceutical players

Source: Companies, Affin Hwang

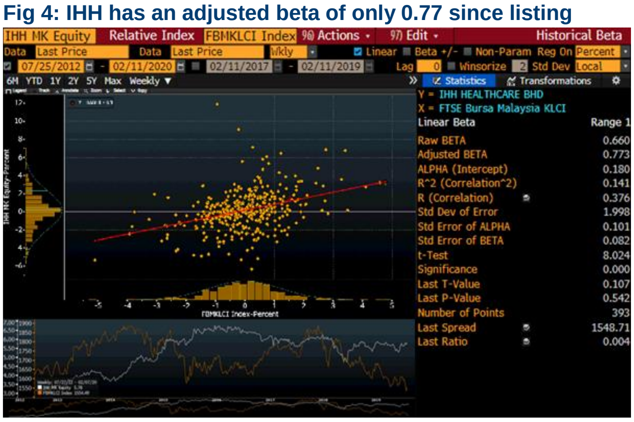
Relatively resilient amid market uncertainties

Although not entirely recession-proof as a slowdown in the economy may also affect patient volume, with patients deferring non-urgent and non-essential cases, healthcare spending is relatively inelastic and less prone to market uncertainties. Hence we believe the sector provides a defensive shelter for investors in which to diversify. Healthcare stocks under our coverage have an average long-term adjusted beta of only 0.65 (10-year) and 0.77 (since listing) based on the latest data on Bloomberg, displaying the low sensitivity of the sector to global growth. Overall, we believe that the healthcare sector will continue to enjoy relatively resilient growth, underpinned by: i) ageing population, ii) rising affluence, iii) rising healthcare awareness, iv) growing healthcare expenditure, v) rising medical insurance, and vi) increasing life expectancy.

Fig 3: Adjusted beta of healthcare stocks under our coverage (all <1)

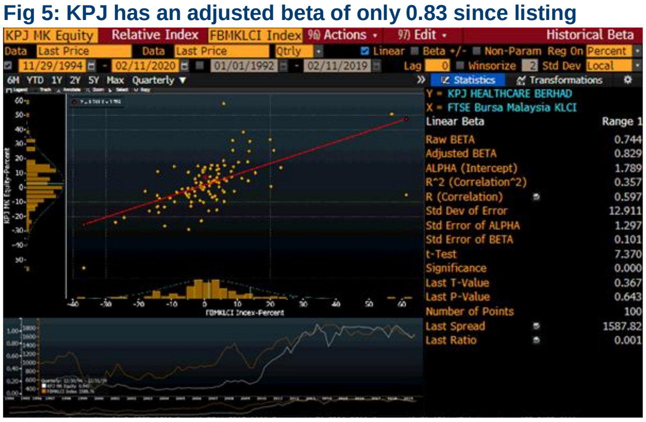
Source: Bloomberg, Affin Hwang

Fig 4: IHH has an adjusted beta of only 0.77 since listing



Source: Bloomberg

Fig 5: KPJ has an adjusted beta of only 0.83 since listing



Source: Bloomberg

Fig 6: APEX has an adjusted beta of only 0.76 since listing

Source: Bloomberg

Fig 7: YSP has an adjusted beta of only 0.70 since listing

Source: Bloomberg

Potential positive catalyst to private hospitals

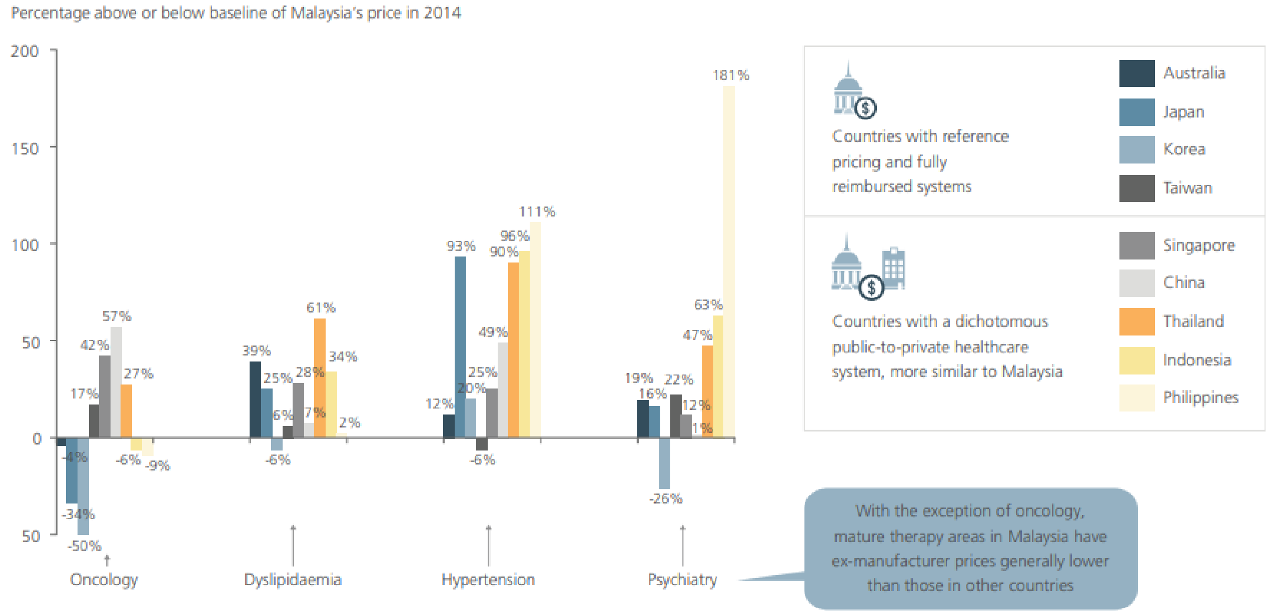
Proposed medicine price controls could potentially be called off

We gather that the proposed medicine price controls, which aim to ensure affordable medications, may not materialise any time soon, possibly because medicine prices in Malaysia are already competitive as compared to the benchmarked countries. Moreover, based on the comparative pricing analysis of the top five therapeutic areas in selected Asia Pacific countries by the Pharmaceutical Association of Malaysia (PhAMA) in 2015, pricing of medications in Malaysia does not appear excessive (Fig 8), and may not warrant a price-control mechanism. In addition, a price-control mechanism, if it were to materialise, may pose a risk to patient access to the latest and most innovative medications, as multinational single-source medicine producers may be discouraged from introducing products in a market deemed less lucrative.

Retraction of proposed medicine price controls positive for hospitals

As an alternative, private hospitals, general practitioner clinics and pharmacies may be required to publish their prices to improve market transparency and encourage more competition in the market. With greater transparency, patients will have the option to choose the brand and price of drugs that are within their budget. While the hospital operators may raise other non-regulated charges to cushion the adverse impact from medicine price controls (if materialised), we think that an announcement of a possible call-off of the proposed medicine price controls by the MoH could help to mitigate uncertainties and should be positive for the hospital operators.

Fig 8: Ex-manufacturer drug price differential of other countries vs. Malaysia



Note: Includes prescription products from all channels, including private and public sectors
Source: Pharmaceutical Association of Malaysia (PhAMA), IMS 2014

4Q19 results preview

For the upcoming release of 4Q19 results, we continue to expect the private hospital players, namely IHH and KPJ, to record healthy patient volume growth. However, on the bottom line, we expect IHH to report a lower core net profit due to the start-up expenses from Gleneagles Chengdu (opened doors in October 2019). For pharmaceutical players under our coverage, we expect both Apex and YSP to continue to record margin recoveries, mainly driven by the commercial production of a new plant for the former and the improvement in efficiency of new production lines for the latter.

Maintain Overweight, with Apex as our top pick

We maintain our Overweight view on the sector with Apex as our preferred pick. We continue to like the sector for its defensiveness and long-term growth prospects. Going into 2020, we recommend positioning in the pharmaceutical space as a potential earnings recovery play and beneficiary of the government's initiatives to liberalise the drug distribution in the country. Key downside risks include sharp declines in patient volumes, higher-than-expected start-up losses for new hospitals, execution risk, currency risk, product recall risk and regulatory risk.

Important Disclosures and Disclaimer

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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