Middle East Healthcare Co.(SAUDI GERMAN HEALTH)

Investment Update

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

Maintaining its turnaround story via improvements in its core business, ramp up, and capacity expansions; upgrade to "Overweight"

MEH continues to ramp up its expansions as it seeks to also extend its operational beds by a scheduled 250 beds to roll out during FY24. Along with a 194 bed brownfield expansion in its flagship Jeddah facility, we see revenue in support to grow by an FY23-28E CAGR of 9.6%. A foothold in the Western region and holy sites is another source of revenue support amid Vision 2030 initiatives. Furthermore, we expect margins to improve in the long run on the back of ramping up facilities and cost efficiency initiatives by the firm. We expect GP margins to remain in a range of 38.5% to 39.9% from FY24-28 before improving gradually onwards. Similarly we expect operating margins to reach 15.4% (FY28) from 12.9%, yet facing some pressures during FY26's Jeddah expansion. MEH still holds the highest net D/E in the sector, and we expect its financing cost to peak in FY24 at historical highs before deleveraging gradually over the coming years. We see that their debt needs will wind down amid improved financial performance to reach 0.3x D/E in FY28E from 1.6x in FY23. However, as government entities constitute 97% of the firm's receivables, delays in payments could spur financing needs towards working capital. We find the stock on its way to its continued turnaround, with significant upside risk if margins recover to past levels seen during 2014-16. At FY25 forward PE of 24.5x we upgrade our recommendation to "Overweight" at a revised TP of SAR 92.0 per share.

Planned beds capacity expansions to drive revised immediate-term and medium term revenue growth outlook- and amid Vision 2030 pilgrimage targets: MEH's FY24E's revenue is driven by a 250 bed operational addition in its existing Riyadh (+50 beds), and Dammam (+100 beds), and Makkah (+100 beds) capacities. We estimate a 14.0% growth in its current capacity of 1,434 beds by FY24's end. Some of the 250 bed expansions are expected to roll out gradually into the next year as well; translating into an FY23-25E revenue CAGR of 12.1%, reaching SAR 3,333mn in FY25 from SAR 2,653mn in FY23. Furthermore, Jeddah's FY26 brownfield expansion will add a planned 194 beds at the group's figurehead facility. The group's foothold in the Western region, where 50% of its revenue is generated, is also expected to benefit from increased footfall in the region amid Vision 2030 pilgrim targets of 30mn visitors (from 13.6mn in FY23). We estimate the group to generate an 9.6% revenue CAGR from FY23-28E driven by expansions and supported by Western region footfall.

Value based health care model to improve GP margins gradually as facilities ramp up; significant upside risk if margins recover to past levels seen during FY14-16: We expect the cost efficiency focus at MEH to edge GP Margins towards near FY17 levels while facing pressures of expansions along the way. We anticipate GP margins to expand by c. 90bps from FY23 to reach 39.1% in FY25 before facing some pressures during FY26 amid the brownfield expansion in Jeddah building new capacities. We expect GP margins to remain in a range of 38.5% to 39.9% from FY24-28 before improving gradually onwards We belive that the stock offers significant upside risk to investors should margins recover to past levels seen during FY14-16, which were reported in the ranges of early 50's (%). Should MEH tend closer to these ranges, as due to a combination of price increases, operational efficiency, and successful ramp ups and utilization; the stock can benefit tremendously from changes in margins. A hypothetical 50% GP margin for FY28 (which has been previously surpassed), could result in an additional SAR 4.6 EPS to that year from our estimates. Furthermore, we expect a similar trajectory from operating margins, expanding 1.6 percentage points from FY23-25E to reach 14.5%, from 12.9%, before dipping to 13.8% in FY26 and improving gradually thereafter. We are anticipating OPEX to revenues to reach 24.5% in FY28, at a gradual improvement from FY23's 25.3%, while treating Q1-24's SAR 33.1mn ECL reversal as a one off event.

Highly leveraged balance sheet amid Sukuk issuance; finance costs expected to peak at highest levels; further deleveraging and decrease in finance costs could unlock value for shareholders: We expect finance costs for MEH to peak in FY24 to reach SAR 204.1mn post its SAR 1bn Sukuk issuance. However, the firm's leverage needs are expected to begin winding down amid improvements in its CFO generation, yet still requiring a need for debt ahead of the expansions scheduled. Debt to equity levels are anticipated to fall from 1.6x in FY23 to 1.3x in FY24 before unwinding at a quicker rate thereafter. Furthermore, should MEH redeems its Sukuk earlier than maturity, or partially redeems it amid the emergence of deflationary global macro data, MEH's interest rate costs could decrerase further; MEH carries the highest net debt to equity in the sector among its peers at 1.42x, as compared to the 0.29x sector median.

Recommendation	Overweight
Target Price (SAR)	92.0
Upside / (Downside)*	10.2%

Source: Tadawul *prices as of 24th of June 2024

Key Financials

SARmn (unless specified)	FY22	FY23	FY24E	FY25E
Revenues	2,152	2,653	3,009	3,333
Growth %	14.9%	23.3%	13.4%	10.7%
Net Income	75.2	180.2	239.6	313.4
Growth %	337.1%	139.7%	33.0%	30.8%
EPS	0.82	1.96	2.60	3.41

Source: Company reports, Aljazira Capital

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	31.6%	38.2%	38.6%	39.1%
Net Margin	3.5%	6.8%	8.0%	9.4%
RoA	1.8%	3.7%	4.6%	5.9%
RoE	5.6%	12.1%	14.2%	16.0%
P/E (x)	31.2	42.6	32.1	24.5
P/B (x)	1.7	5.0	4.4	3.7
EV/EBITDA (x)	16.8	19.5	16.3	14.7
Dividend Yield	0.0%	0.0%	0.0%	0.0%

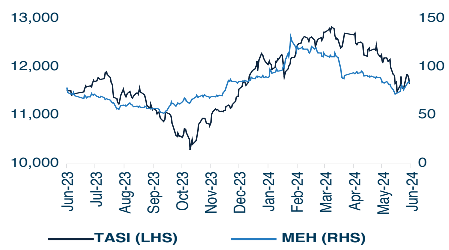
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	7.67
YTD%	-4.6%
52 weeks (High)/(Low)	134.4 /51.5
Share Outstanding (bn)	92.04

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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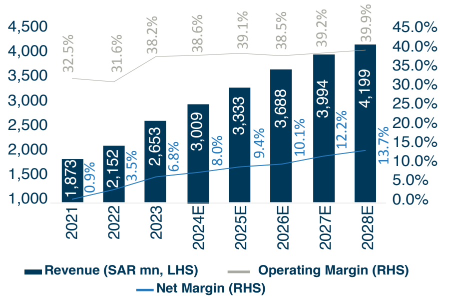
Working capital faces risk from MOH delayed repayments and could spur further need for working capital funding: Government agencies make up nearly 97% of MEH's receivables despite the MOH making up only 54% of revenues; an MOH payment delay was then able to caused FY23 receivable days to increase to 270.7 days from 247.4 the year before. However, we see the working capital risk under control when stepping back to observe a decrease in its cash conversion cycle days for that same period (171.3 days from 179.6 days) as a result of improved inventory and payable efficiency. While MOH payment days remain a risk on the firm's cash needs, and could warrant further needs for debts, the frim saw a repayment from its MOH receivables to record a SAR 33.1mn reversal in ECL while holding an ECL to receivables at 3.0%, down from 4.1% at FY23's end.

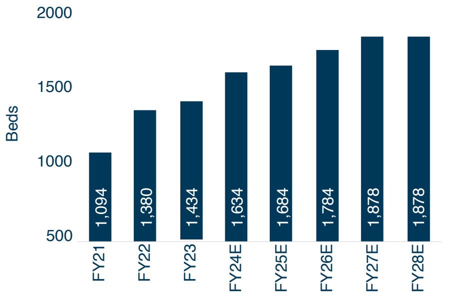
AJC view and valuation: MEH presents investors as a stock with a turnaround story to become a more financially attractive vehicle; the firm is a large scale provider hosting the second highest number of beds in the sector, with expansion plans further underway to increase its expected capacity by 31% from its current 1,434 beds to reach an expected 1878 beds by FY27's end. Therefore, we categorize the coming years of MEH as a period of ramping up and turning around from its previously strained performance from greenfield and brownfield capacity expansion. As a result, the coming periods can be summarized by its expected expansions in ROAE from 12.1% in FY23 to 17.9% in FY28, attributed to margin efficiencies and increased revenue driven by urban area operational capacity expansions and footfall in the Western region. We expect the improved conditions at MEH could possibly spur a dividend payout of SAR 1.0 per share by FY27. We value the stock using a blended, 60% DCF valuation (WACC = 8.2% and terminal growth rate = 2.5%) and 40% on PE valuations (31.0x on FY25E estimates) to arrive at an "**Overweight**" recommendation at an upgraded TP of **SAR 92.0 per share**.

Fig 1. Performace to be carried by expansions and margin efficiency, in support of decreased financing costs



Sources: AlJazira Capital, Company Financials

Fig 2. Expected beds and roll out; capacity expansions to come from brownfield and operational beds increases



Sources: AlJazira Capital, Company Disclosures

Key Financial Data

Amount in SAR mn, unless otherwise specified	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E	FY28E
Income statement									
Revenues	1,750.6	1,872.6	2,151.7	2,653.2	3,009.4	3,332.6	3,688.0	3,994.3	4,198.7
Y/Y	**17.0%**	**7.0%**	**14.9%**	**23.3%**	**13.4%**	**10.7%**	**10.7%**	**8.3%**	**5.1%**
Cost	(1,172.2)	(1,264.4)	(1,471.7)	(1,638.8)	(1,848.6)	(2,030.9)	(2,269.2)	(2,429.9)	(2,523.4)
Gross profit	**578.4**	**608.2**	**680.0**	**1,014.4**	**1,160.8**	**1,301.7**	**1,418.9**	**1,564.4**	**1,675.3**
Selling & distribution expense	(31.1)	(46.0)	(30.4)	(51.1)	(58.3)	(65.1)	(71.8)	(77.9)	(81.9)
General & administration expense	(439.8)	(508.0)	(509.3)	(620.8)	(662.6)	(752.9)	(839.9)	(896.5)	(947.4)
Operating profit	**107.4**	**54.2**	**140.3**	**342.5**	**439.9**	**483.7**	**507.1**	**589.9**	**646.0**
Y/Y	**4.0%**	**-49.5%**	**158.7%**	**144.0%**	**28.4%**	**9.9%**	**4.8%**	**16.3%**	**9.5%**
Other income	7.5	12.0	9.5	14.7	33.8	37.4	41.4	44.8	47.1
Financial charges	(34.2)	(47.0)	(68.7)	(155.6)	(204.1)	(171.6)	(132.8)	(92.1)	(59.2)
Profit before zakat & minority interest	**80.7**	**19.2**	**81.2**	**201.6**	**269.5**	**349.4**	**415.7**	**542.6**	**633.9**
Non-controlling interest	6.8	5.5	3.6	3.5	3.2	4.6	5.7	7.4	8.7
Profit before zakat	75.2	11.7	71.6	183.6	242.8	318.0	378.3	493.8	583.2
Zakat	(5.5)	(7.5)	(9.6)	(18.0)	(26.7)	(31.4)	(37.4)	(48.8)	(50.7)
Net income	**82.0**	**17.2**	**75.2**	**180.2**	**239.6**	**313.4**	**372.6**	**486.4**	**574.4**
Y/Y	**-16.0%**	**-79.0%**	**337.1%**	**139.7%**	**33.0%**	**30.8%**	**18.9%**	**30.5%**	**18.1%**
EPS (SAR)	**0.9**	**0.2**	**0.8**	**2.0**	**2.6**	**3.4**	**4.0**	**5.3**	**6.2**
DPS (SAR)	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**1.00**	**1.50**
Balance sheet									
Assets									
Cash & bank balance	17	28	16	44	80	41	53	53	284
Other current assets	1,476	1,548	1,941	2,530	2,421	2,575	2,765	2,909	2,993
Property & Equipment	2,074	2,357	2,471	2,502	2,623	2,718	2,736	2,729	2,721
Other non-current assets	33	40	71	96	78	69	60	51	41
Total assets	**3,599**	**3,972**	**4,499**	**5,173**	**5,202**	**5,403**	**5,614**	**5,742**	**6,039**
Liabilities & owners' equity									
Total current liabilities	1,188	1,367	1,631	2,003	1,308	1,400	1,430	1,463	1,418
Long-term loans	847	1,028	1,181	1,310	1,835	1,618	1,405	999	850
Total other non-current liabilities	290	282	280	295	254	268	289	303	312
Non-controlling interest	43	38	43	46	46	46	46	46	46
Paid -up capital	920	920	920	920	920	920	920	920	920
Statutory reserves	192	194	201	219	243	274	312	360	418
Retained earnings	119	144	243	377	593	875	1,210	1,648	2,073
Total owners' equity	1,232	1,258	1,364	1,517	1,757	2,070	2,443	2,929	3,411
Total equity & liabilities	**3,599**	**3,972**	**4,498**	**5,171**	**5,200**	**5,401**	**5,612**	**5,740**	**6,037**
Cashflow statement									
Operating activities	(229)	77	76	191	466	474	502	662	782
Investing activities	(294)	(417)	(249)	(242)	(262)	(284)	(216)	(198)	(206)
Financing activities	486	352	161	80	(168)	(229)	(274)	(464)	(346)
Change in cash	(37)	11	(13)	29	36	(39)	11	1	230
Ending cash balance	**17**	**28**	**16**	**44**	**80**	**41**	**53**	**53**	**284**
Key fundamental ratios									
Liquidity ratios									
Current ratio (x)	1.3	1.2	1.2	1.3	1.9	1.9	2.0	2.0	2.3
Quick ratio (x)	1.1	1.0	1.1	1.2	1.8	1.8	1.9	1.9	2.2
Profitability ratios									
GP Margin	33.0%	32.5%	31.6%	38.2%	38.6%	39.1%	38.5%	39.2%	39.9%
Operating Margins	6.1%	2.9%	6.5%	12.9%	14.6%	14.5%	13.8%	14.8%	15.4%
EBITDA Margin	13.4%	10.4%	13.3%	20.1%	20.8%	20.4%	19.3%	20.1%	20.7%
Net Margin	4.7%	0.9%	3.5%	6.8%	8.0%	9.4%	10.1%	12.2%	13.7%
Return on assets	2.4%	0.5%	1.8%	3.7%	4.6%	5.9%	6.8%	8.6%	9.8%
Return on equity	5.8%	1.3%	5.6%	12.1%	14.2%	16.0%	16.2%	17.8%	17.9%
Leverage ratio									
Debt / equity (x)	1.2	1.5	1.5	1.6	1.3	1.0	0.7	0.5	0.3
Market/valuation ratios									
EV/sales (x)	2.7	2.6	2.1	3.8	3.3	2.9	2.6	2.3	2.0
EV/EBITDA (x)	20.8	26.1	16.8	19.5	16.2	14.6	13.6	11.4	10.0
EPS (SAR)	0.9	0.2	0.8	2.0	2.6	3.4	4.0	5.3	6.2
BVPS (SAR)	13.4	13.7	14.8	16.5	19.1	22.5	26.6	31.8	37.1
Market price (SAR)	35.1	31.7	25.5	83.3	83.5	83.5	83.5	83.5	83.5
Market-Cap (SAR mn)	3,226	2,913	2,347	7,667	7,685	7,685	7,685	7,685	7,685
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.2%	1.8%
P/E ratio (x)	39.3	169.4	31.2	42.6	32.1	24.5	20.6	15.8	13.4
P/BV ratio (x)	2.6	2.3	1.7	5.0	4.4	3.7	3.1	2.6	2.3

Sources: AlJazira Capital, Company Financials

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RESEARCH DIVISION

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RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer