Al-'Aqar REIT a good proxy to rising healthcare sector

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Al-'Aqar Healthcare REIT (May 7, RM1.20)
Not rated: Al-'Aqar Healthcare REIT is the fifth largest Malaysian REIT (MREIT) in terms of asset size and is the only one focused on healthcare. It owns 24 healthcare-related assets, including three overseas. Al-'Aqar is sponsored by KPJ Healthcare Bhd.

The value of Al-'Aqar's investment assets stands at RM1.36 billion, with hospitals representing about 82% of total portfolio gross floor area. All assets are single tenanted and are operated by KPJ subsidiaries.

Lease renewal risks are minimal over the short term, as all assets are under long-term 15+15-year leases (earliest renewal date: 2021).

The management plans to expand its international presence over the longer term. While its overseas assets only contributed about 6% to FY11 revenue, we estimate that contribution from these assets will be up to 17% by FY12, as FY12 will see the maiden full-year contribution from the assets that were acquired in 2HFY11.

We believe the healthcare sector should continue to trade at premium valuations to the market, as: (i) we expect the Malaysian healthcare sector to grow by 8% to 10% per year, above GDP growth of 5% next year; (ii) the sector's defensive nature suits the current market theme; (iii) the upcoming listing of Integrated Healthcare Holdings should further spur investor interest in the sector; and (iv) there is a scarcity of healthcare-related stocks on Bursa Malaysia.

KPJ's current valuations of 23 times FY12 price-earnings ratio reaffirm our expectation and we view Al-'Aqar as a good proxy to the rising healthcare sector.

The flow of assets in the pipeline is ensured with KPJ's aggressive expansion plans. It plans to build seven more hospitals over the next three years and the management plans to inject more nursing homes into its portfolio.

It believes the demand for nursing homes will gain momentum, as the longer average lifespan has led to a larger ageing population in developed countries like Australia and Japan.

The risks include high gearing that is approaching the stipulated 0.5 times cap.

We are estimating a flattish earnings per unit of 8.5 sen for FY12/FY13 and 8.7 sen for FY14, after taking into account rental growth of 1.5% to 3% per year and the incremental income and new units from its ongoing acquisition.

We value Al-'Aqar at RM1.42, based on dividend discount model (DDM) with cost of equity of 7.4%, implying an 18% upside to its current share price of RM1.20.

Although current valuations appear rather rich for Al-'Aqar, as its price-to-net asset value (P/NAV) of 1.07 times is at a premium to the MREIT sector average of 1.03 times, its valuations are still cheaper than regional healthcare REITs, First REIT and Parkway Life REIT, which trade at P/NAV of 1.12 times and 1.24 times, respectively. ð *RHB Research Institute, May 7*