

KPJ paves the way for hospital REITs

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KPJ Healthcare Bhd's upcoming real estate investment trust (REIT) offering is expected to pave the way for other hospital groups to securitise their fixed assets such as hospitals, training centres and other buildings.

This will ensure that these companies streamline their operations to focus on their core business of providing healthcare services. More importantly, securitising the fixed assets will reduce cash-flow commitments.

KPJ has the largest network of hospitals in the country, with 13 in its stable. Other large healthcare companies are Pantai Medical Centre, which is wholly owned by Pantai Holdings Bhd; Singapore's Parkway Ltd, which

owns Gleneagles International Pte Ltd; and Sime Darby Bhd's Subang Jaya Medical Centre. The seven hospitals in the Gleneagles chain are spread throughout Asia, with two located in Malaysia.

The rumour mill has been in overdrive on the possibility of Pantai offering a REIT, an exercise that would probably see the company dispose of six of the seven hospitals in its portfolio. But whether this happens will depend largely on how KPJ's REIT fares.

If successful, KPJ will be offering the country's third REIT, with the first listed REIT being Axis REIT and the second being YTL Corp Bhd's proposed REIT, which recently obtained the green light from the Securities Commission (SC).

Of the 13 hospitals that KPJ operates, three

— Johor Specialist Hospital, Damansara Specialist Hospital and Puteri Specialist Hospital in Johor — are wholly owned. KPJ has a 99% interest in Ipoh Specialist Hospital.

The proposed REIT is to securitise four of KPJ's hospitals, according to a source close to the company. These four hospitals are tentatively Ampang Puteri Specialist Hospital, Damansara Specialist Hospital, Perdana Specialist Hospital and Puteri Specialist Hospital in Johor.

The four, according to the company's annual report for 2004, have net book values of RM81.5 million, RM86.2 million, RM35.6 million and RM28.5 million respectively, which adds up to a total net book value of RM203.3 million.

"Although the announcement was made

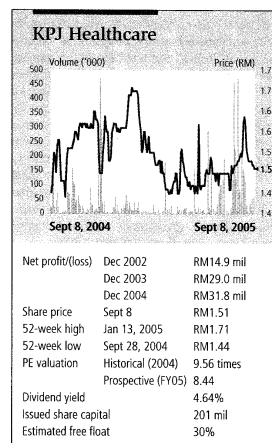
last week, we will be submitting our proposal to the SC, hopefully, by the end of the year because there are still many things to do, such as the sale and purchase agreements and so on," says the source.

"We have to value [the hospitals] and decide whether to add or take away any, and also wait for the regulatory approvals," the source adds.

In its announcement to Bursa Malaysia, KPJ said the rationale for the REIT was to raise funds for other investments and reduce borrowings and gearing.

"The real reasons are to securitise, monetise and convert our assets to cash," says the source. "Some of our hospitals have borrowings, which we can repay after the disposals."

For the six months ended June 30, 2005, KPJ recorded a net profit of RM16.9 million on a turnover of RM312.3 million. Its long-term and short-term borrowings stood at about RM306 million while cash balance was RM37.2 million.



According to an RHB Research note, the company's gearing stands at 0.81 times. It was reported that the company expects its gearing to drop to 0.4 times after the REIT exercise, but analysts are less optimistic, saying gearing will only be reduced to 0.6 times.

The research house, however, has an "outperform" on KPJ on account of it being the market leader in the local private hospital business, with some 14% of market share.

KPJ's chairman Tan Sri Muhammad Ali Hashim had reportedly said that the company expects to receive about RM200 million in cash and 100 million units of the REIT based on the RM300 million worth of assets injected into the REIT. He also said KPJ is not looking to securitise the full RM300 million worth of properties, planning to keep a 40% to 49% stake in the fund.

Considering that KPJ plans to retain nearly half the REIT, analysts expect the company to receive only RM150 million as a one-off, cash-flow injection.

Pending the success of the fund, which is to generate a yield of 6.5%, the company is expected to inject more properties into the fund in future. Currently, KPJ is "working to-

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Significant savings

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wards" arriving at rentals that are lower than its borrowing costs and yields.

It will also be able to benefit from a reduction of about 2% in its depreciation cost and an increase in its cash flow following lower interest cost. Based on its latest results, interest cost for the six months ended June 30, 2005, was RM9.7 million.

This means significant savings for the company. In addition, it gains from the non-imposition of real property gains tax on REITs in a bid to boost the popularity of such funds.

KPJ, which declared an interim dividend of seven sen per share in February 2005, will be able to declare higher dividends once its assets have been floated because its cash flow would remain strong, while interest payments would have dropped.

The future

The first Malaysian REIT, Axis REIT, was launched on Aug 3 and opened at an 18.4% premium over its offer price of RM1.25.

The SC has revealed that as many as four trusts will be listed by the end of the year, with another five, valued at some RM2 bil-

lion, expected to commence trading next year.

Notable parties jumping on the REIT bandwagon include YTL Corp, Sunway City Bhd, Landmarks Bhd and Guocoland Bhd.

Although REITs are just taking off in Malaysia, the US has about 12 healthcare REITs, which do not confine their underlying properties to hospitals; they even include properties such as nursing facilities, retirement centres and medical office buildings. As a REIT is a defensive investment, it requires diversification to keep volatility at bay.

But what KPJ is offering is a hospital REIT, which may be too specific in terms of investment, very unlike its American counterparts.

Nevertheless, some analysts argue that the Malaysian REIT market is not so sophisticated that it requires much diversification. Furthermore, a hospital is a necessity, making its demand inelastic. Thus, the value of the building will not see significant depreciation.

"This is an institution, it [a hospital] is like a university. It's a necessity and it is long term," says the source. //

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