MCGS Alert – 2Q2023 Better Than Feared on Lower Medication & Surgical Costs; Maintain Market Perform

- **Medicare Group (MCGS) 2Q2023 net profit declined 4.0%/6.8% YoY/QoQ to QR17.5mn, but it was better than our estimate of QR15.3mn.** Cost of sales, like in 1Q2023, was the primary source of the deviation – but this time with an opposite effect. Specifically, 2Q2023 medication and surgical costs came in below estimates – in 1Q2023 it caused a divergence by printing significantly above both estimates and trend. While management had guided that medication and surgical costs should normalize after the spike in 1Q2023, the 2Q2023 decline of 15.0%/21.5% YoY/QoQ which translates to a cost margin of 16.5% was markedly below trend. This is the lowest this ratio has been since at least 2020 and we think it is unlikely to be sustained: We hypothesize that the company may have received a rebate to compensate for 1Q. We will seek more color from management, however. Consequently, the GP margin came in higher at 37.7% compared with the 36.1% we had expected. Other line items came largely in line with our expectations.
- **Meanwhile, MCGS's 2Q2023 revenue declined 7.2% both YoY and QoQ to QR118.9mn, in-line with our expectations of QR118.1mn.** While largely in-line with expectations, the slight difference between our revenue estimate and the actual print further contributed to our bottom-line estimate miss.
- **We reiterate our Market Perform rating while maintaining our TP of 7.144.** We see the stock trading sideways for the foreseeable future given the lack of near-term growth drivers plus across assets, yields remain relatively more attractive. **However, we still expect MCGS to get a cash windfall from the long overdue National Health Insurance Company (Seha) receivable** despite recent newsflow where the Court of Cassation referred back the case to the Court of Appeal – following Seha's challenge of the January 24 Court of Appeal judgement. This now means the process will be drawn out and less certainty is now built in the quantum and timing of the payment. We estimate a net impact of QR0.13/share should MCGS decide to completely write-off the Seha receivable. **Background**: On 24 January a Court of Appeal judgement awarded MCGS a total of QR130.7mn against Seha. In its books, MCGS has already written down QR76.2mn of the original QR114.1mn Seha receivable but the court ruling implies that MCGS will receive an additional QR16.6mn of damages/comprehensive compensation. We estimate a net positive impact of QR0.33/share but this is not in our base model.
- **We see several tailwinds and headwinds canceling out each other to render a relatively neutral prognosis on MCGS's near-term outlook.** In the short- to medium-term, we see the following variables driving the outlook: muted bed growth due to suspended bed-expansion plans, superior service level & product quality, favorable public health policy, increased healthcare spend, low beta, tariff controls, and increasing competition. In the medium- to longer-term, things are looking up with some of the following factors expected to become more dominant in shaping prospects: an above-average population growth, disease burden and expected change in the composition of expats (to a more white-collar workforce).

QNB FINANCIAL SERVICES

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Recommendations *Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price*	
OUTPERFORM	Greater than +20%
ACCUMULATE	Between +10% to +20%
MARKET PERFORM	Between -10% to +10%
REDUCE	Between -10% to -20%
UNDERPERFORM	Lower than -20%

Risk Ratings *Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*	
R-1	Significantly lower than average
R-2	Lower than average
R-3	Medium / In-line with the average
R-4	Above average
R-5	Significantly above average

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