

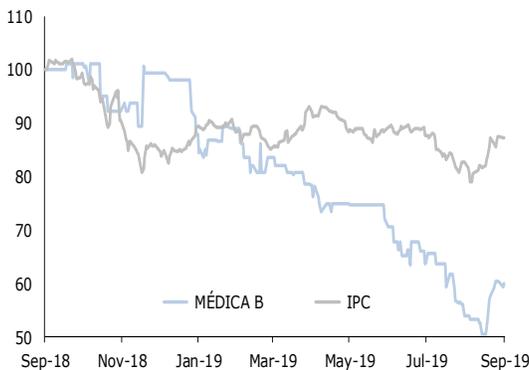
MÉDICA: Initiation of Coverage

One of Mexico’s Best High-End Hospital Companies

BUY	
2019E Target Price (MXN\$) [1] [2]	\$ 26.50
Current Price (MXN\$)	\$ 20.80
Max / Min (L12M)	\$17.50 - 37.38
Expected Dividend (MXN\$)	\$ 11.25
Expected Return	27.4%
Market Cap (MXN\$ Mn)	2,564
Enterprise Value (MXN\$ Mn)	3,931
Oustanding Shares (Mn)	123.3
Float	49.9%
ADTV (MXN\$ Mn)	\$ 0.50

[1] Including LMS

[2] MXN\$40.40 including real estate assets



We are initiating coverage on MÉDICA SUR, S.A.B. DE C.V. ("MÉDICA"), one of México's largest hospital companies, with a BUY recommendation and a year - end target price of MXN\$26.50/share (MXN\$40.40/share including real estate properties) for a potential 27.4% return in local currency. Our recommendation is mainly based on the company's solid fundamentals, favorable growth potential and low valuation.

Investment Thesis

Solid fundamentals. This includes MÉDICA's position as one of México's leading high-end hospital companies, well-known medical and management team, state-of-the-art technology, strong brand recognition, attractive growth potential, solid finances and the company's affiliation to the Mayo Clinic Care Network and the accreditation of the Joint Commission International (JCI) which enhances MÉDICA's position.

Attractive growth potential. We expect MÉDICA's revenues, EBITDA and net profits to increase at a CAGR of 4.1%, 8.2% and 3.7%, respectively, over the 2019-2024 period fueled by a higher consumption of health services.

LMS restructuring. On April 30, 2019, MÉDICA's shareholders approved a corporate restructuring under which they will receive a dividend in kind paid with LMS shares with an initial value of MXN\$11.2530/share. This transaction is scheduled to take place during the next few months.

September 10, 2019

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Report prepared by Miranda Global Research for Vector Casa de Bolsa, S.A. de C.V.

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Valuation

MÉDICA's shares currently trade at a forward EV/EBITDA of only 5.0x, a projected P/E of 15.4x and a P/BV of 0.7x. These multiples compare against the averages of 22.6x, 42.8x and 3.7x, respectively, of emerging market hospital chains, and against the averages of 8.4x, 14.0x, and 7.6x, respectively, of developed markets hospital companies. Although we believe that MÉDICA deserves to trade at a discount to its international peers due to its dependence on one hospital, we believe that the current discount is very high.

We set our year-end target price of MXN\$26.50/share for MÉDICA's shares through a discounted cash flow (DCF) model which includes a 2.7% perpetuity growth rate in nominal terms and an 12.0% WACC. To calculate the WACC, we used a 13.5% cost of equity, a pre-tax cost of debt of 10.3% and a year-end debt to equity ratio of 24.1%.

Our current target price of MXN\$26.50/share does not include MÉDICA's vast real estate properties, which we estimate have a market value of around MXN\$1.7-2.0 billion, equivalent to MXN\$13.90/share. However, we believe that such value will only be realized once they are sold, which in our view is unlikely to take place during the rest of the current year given current macroeconomic conditions.

Main Risks

We believe that MÉDICA's main risks include the following: i) macroeconomic volatility; ii) intense competition in the sector; iii) adverse changes in health or fiscal regulations; iv) changes in the medical or management team; v) technological changes; vi) dependence on a single hospital; vii) low capitalization stock and low-liquidity of the shares; and/or viii) unexpected large investments in the development of the real estate properties.

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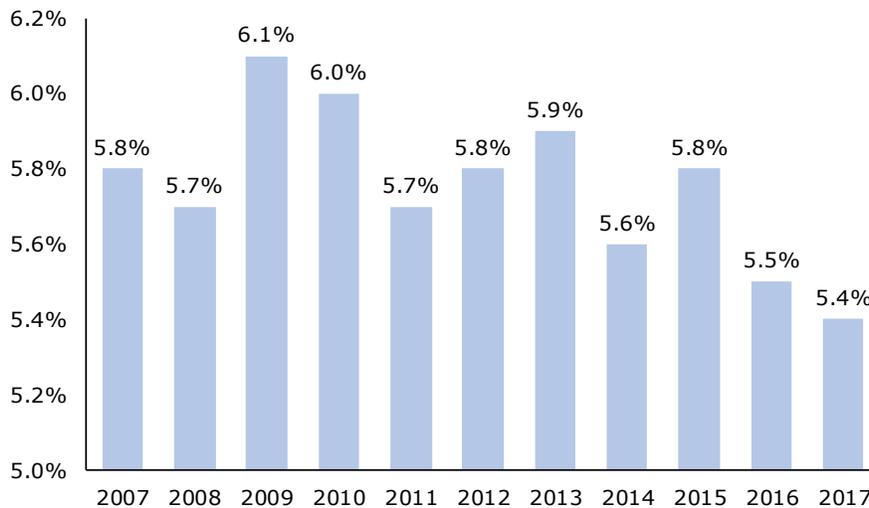
THE MEXICAN HEALTHCARE INDUSTRY

Low Penetration of Healthcare Services

The contribution of healthcare expenditures to Mexico's GDP declined from a peak of 6.1% in 2009 to 5.4% in 2017, according to the Mexican Association of Insurance Institutions (AMIS). We believe this occurred as a result of price increases above the inflation rate which were implemented by the industry.

The contribution of the public sector to health spending has risen from 44% in 2007 to 53% in 2013 and has remained at around 52% during the last few years. We expect healthcare expenditures to represent around 6.5% of the country's GDP by 2030 due to the population growth and aging, the expansion of Mexico's middle class and a higher disposable income of such segment of the population.

Graph 1.- Percentage of GDP Spent on Healthcare (2007 - 2017)



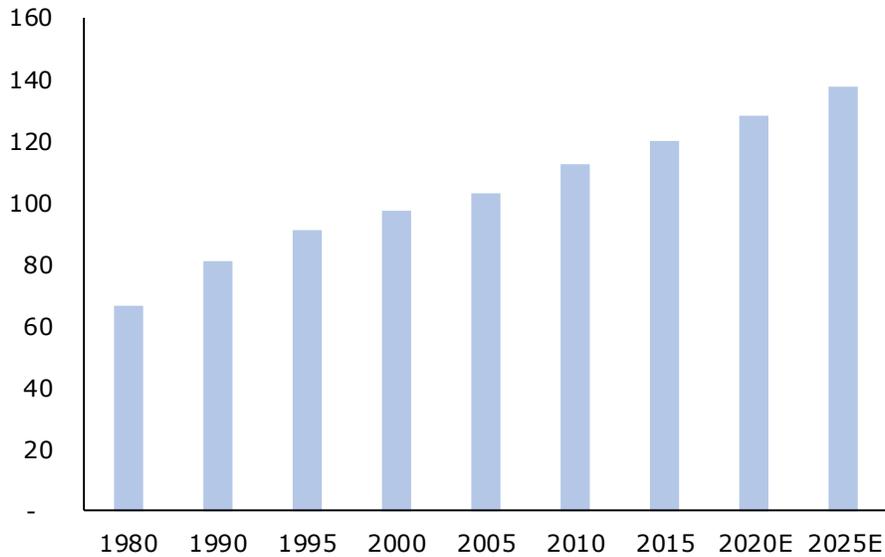
Source: AMIS

Mexico's Growing and Aging Population

According to the last INEGI census, Mexico's population expanded at a 1.7% CAGR over the 1980-2015 period to 120 million. Going forward, we anticipate a 1.4% annual growth to 138 million by the year 2025.

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Graph 2.- Mexico's Population (1980- 2025E)



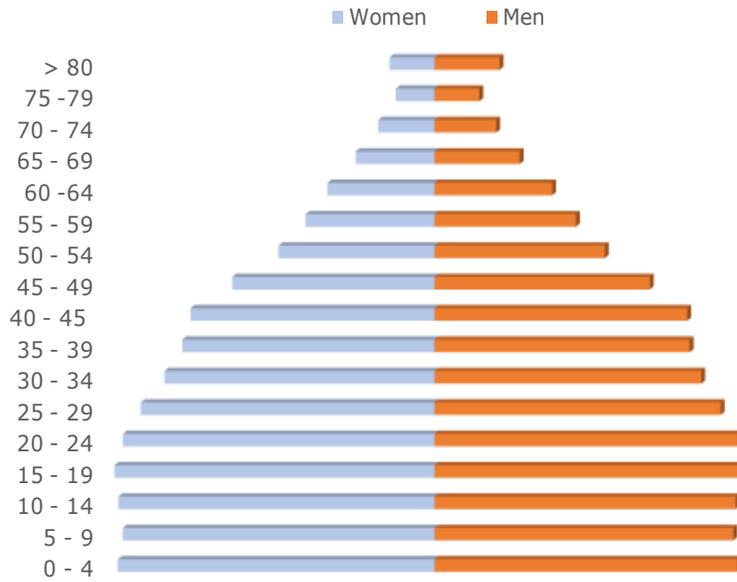
Source: INEGI, Miranda Global Research

With respect to Mexico's demographic pyramid, the highest percentages were concentrated on the 15-19 years and 20-24 years brackets at the end of 2017, according to INEGI. Going forward, we believe that the Mexican population pyramid will tend to look more like that of developed countries, which is more concentrated in those brackets with older people.

Women life expectancy is expected to reach 79.6 years in 2030, from the current 78.0 years, according to the National Population Council (CONAPO). Men life expectancy is expected to increase to 73.8 years in 2030, from 72.2 years currently. In our opinion, the combination of these two processes, population growth and aging, will most likely boost the need of medical services in the country.

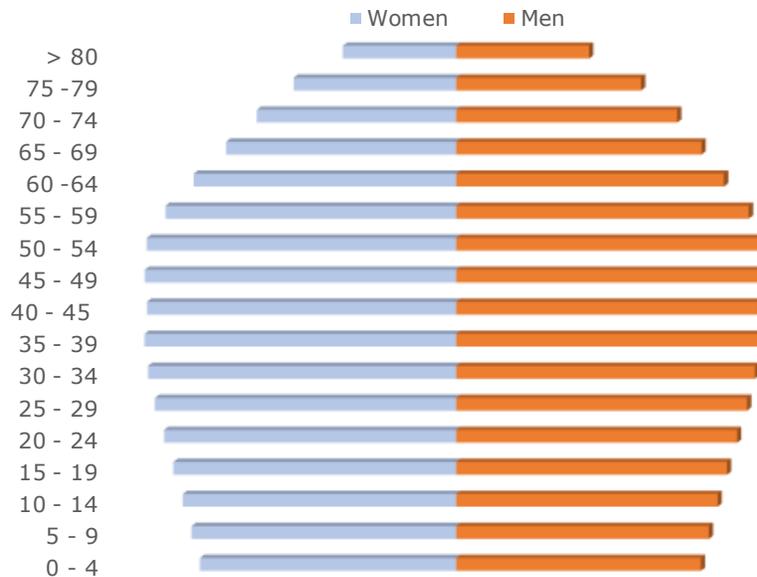
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Graph 3.- Mexico's Demographic Pyramid (2017)



Source: INEGI

Graph 4.- Mexico's Demographic Pyramid (2050)



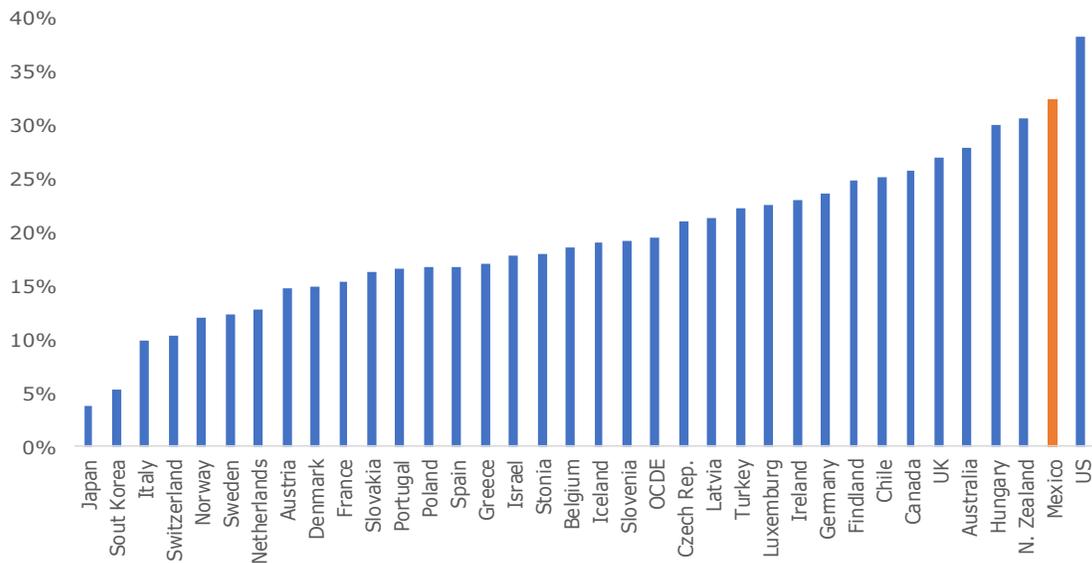
Source: CONAPO

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Mexicans Suffer from Developed Countries' Illnesses

In 2017, Mexico had the second largest percentage of obese adults within the OECD, at 32%. Consequently, the most common causes of death in the country, also in 2017, were heart disease, which is mainly caused by the lack of exercise and bad eating habits, followed by mellitus diabetes and malign tumors, according to INEGI. This also makes Mexico the country with the highest percentage of adults with diabetes (15.8%) of the OECD. However, obesity, both in adults and infants, is more prevalent in Mexico's low and middle-income individuals, so is more likely to be treated in public hospitals.

Graph 5.- Percentage of Obese Adults in OECD Countries (2017)



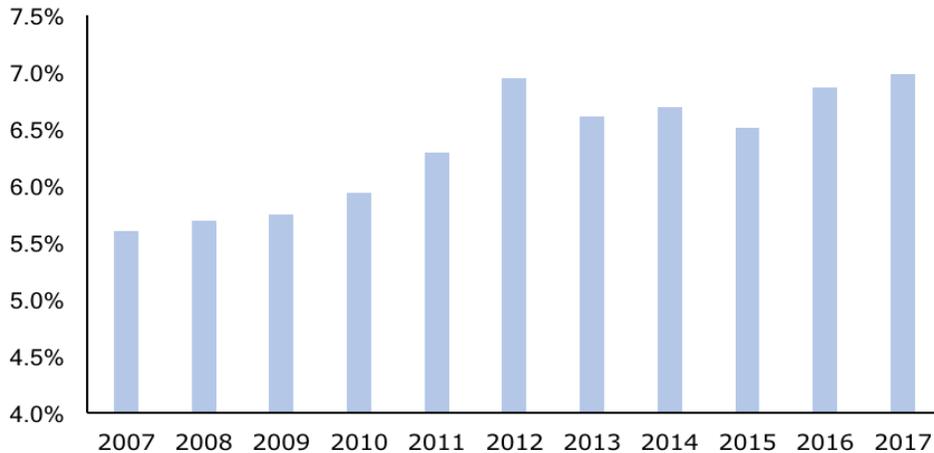
Source: OCDE

Insurance for Major Medical Expenses, an Important Growth Engine

A relevant share of Mexican private hospital's revenues comes from payments received by insurance of major medical expenses, a type of insurance which has notably grown in the past years. In 2007, only 5.9 million people (representing 5.6% of the population) were covered by major medical expenses insurance, while in 2017 this number increased to 8.6 million people (6.9% of the population). This means that the number of individuals covered by major medical expenses insurance rose by 45% during such period, equivalent to a 4% average annual rate. We believe that the growth potential is significant since only 7.3% of private healthcare costs are covered by insurance plans.

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Graph 6.- Percentage of People Insured Against Major Medical Expenses (2007-2017)



Source: SESA, Accidentes y Enfermedades

Low Hospital Penetration

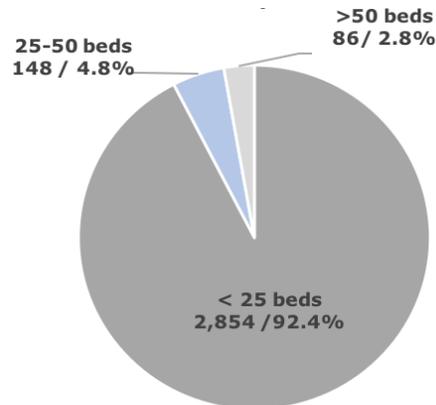
The supply of hospitals in Mexico is somewhat limited at only 1.6 beds for every 1,000 inhabitants. This figure is substantially lower compared to that of similar Latin American countries like Uruguay (2.8), Brazil (2.2), and Chile (2.2) and is in line with that of Ecuador (1.5). Among existing beds in Mexico, 72% belong to the public sector and 28% to the private sector.

There are around 3,088 private hospitals in the country. Worth noting is that 92.4% of these hospitals offer less than 25 beds, 4.8% offer between 25 and 50 beds, and only 2.8% offer more than 50 beds. MÉDICA has 190 beds, making it one of the biggest private hospitals in the country.

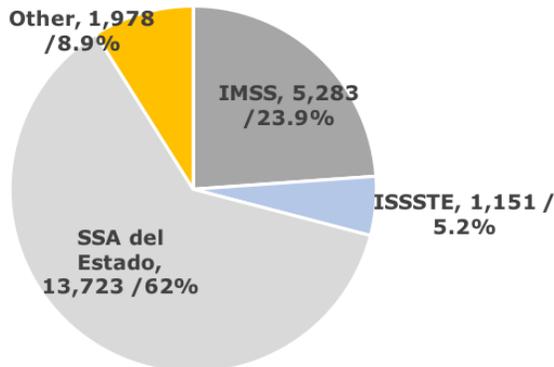
As a reference, in the US there are 5,008 hospitals, of which only 8.0% have less than 25 beds, 23.2% have between 25 and 50 beds and 68.7% have more than 50 beds.

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Graph 7.- Percentage of Private Hospitals by Number of Beds



Graph 8.- Size of Public Hospitals by Number of Units



Source: INEGI

Mexico's largest private hospital chain, *Hospitales Ángeles*, which is owned by large-scale company Grupo Ángeles, has over 2,000 beds spread across their 23 locations, according to the "National Association of Private Hospitals". The company holds a competitive advantage due to its more extended geographical coverage. With 354 beds, Hospital ABC is the closest competitor to MÉDICA, since they also focus on the Mexico City region.

MEDICAL differentiates itself by being a High Specialty hospital at a competitive price which gives it access to a greater number of patients.

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Table 1.- Key Players in Mexico's Private Hospital Industry

Company	Cities	Hospitals	Beds
Grupo Ángeles	15	24	2,600
Star Médica	10	13	800
Grupo Oca-DH Hospital	1	2	590
Christus Muguerza	7	15	400
Sociedad Benéf. Española	7	7	400
ABC	1	2	354
Hospitales Tec de Monterrey	1	2	303
Dalinde + San Angel Inn + HMG	1	6	289
Puerta de Hierro	3	5	200
Hospital San Javier	3	4	200
Médica Sur	1	1	190
Hospiten	3	5	90
H+	3	3	54
Amerimed	2	2	30

Source: Asociación Nacional de Hospitales Privados

Wholesale Pharmaceutical Distribution

NADRO and Marzam are the country's largest wholesale distributors of medicines to private hospitals. Public hospitals have a different and completely independent distribution network, which is currently being reorganized by the Ministry of Finances (SHCP). Under the previous government, pharmaceuticals were bought through a bidding process, and there was a distributor who acted as an intermediary between the laboratories and the government. From 2012 to 2018 there were three main distributors which accounted for 62.4% of the public market: Grupos Fármacos Especializados, Distribuidora Internacional de Medicamentos and Maypo. President Lopez Obrador and the SHCP created a new scheme under which the government acquires pharmaceutical products on a consolidated basis. Such scheme included the removal of the intermediary, thus decreasing costs by around 30%.

Medical Tourism

According to Baja California's tourism ministry, there were 1.3 million tourists that arrived to that state in 2018 in search for medical services with a total spending of US\$1 billion. This took place because patients were not covered by medical insurance in their home country and also due to cheaper prices in Mexico. In fact, 80% of tourists seeking medical treatment come from the United States, and usually go to bordering cities like Tijuana, but also to Monterrey, Mexico City and Mazatlán. Tijuana received 1.7 million patients in 2018, both national and international, mainly coming from the United States, Canada and bordering Mexican states. Some of the most demanded medical treatments by foreign patients were gastric bypasses, rhinoplasty, angioplasty, dental implants, among others. In their vast majority, they are cosmetic surgeries which require patients to stay 1-3-nights in the hospital. Thus, medical tourism offers a significant growth potential for the Mexican hospital industry.

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MÉDICA'S MAIN COMPETITIVE ADVANTAGES

One of Mexico's Best Hospital Companies

MÉDICA has positioned itself as one of Mexico's best high-specialty hospital companies. The company has achieved this by incorporating some of the country's most experienced and talented doctors, its state-of-the-art technology, its focus on patient service, its strong brand recognition and its strategic location in south of Mexico City.

Since 2013, MÉDICA is affiliated to the *Mayo Clinic Care Network*, which is a peer collaboration network of the *Mayo Clinic*, one of the world's most renowned hospitals. It brings together more than 40 health organizations in the United States, Mexico, Puerto Rico, Singapore and the United Arab Emirates.

Such membership generates direct benefits for patients, since doctors have scientific and technical support through consultations and information about last-minute advances in health procedures. It also represents benefits for doctors in the academic area since there are exchanges of experiences and medical collaborations.

Since 2014, MÉDICA is one of Mexico City 2 hospitals and 4 in the country that have been accredited by the *Joint Commission International (JCI)* that certifies that its processes comply with world-class standards in terms of safety in the management of its patients; the quality of the medical care; the safety of hospital facilities. It is part of the continuous improvement processes that MÉDICA implements for the benefit of its patients.

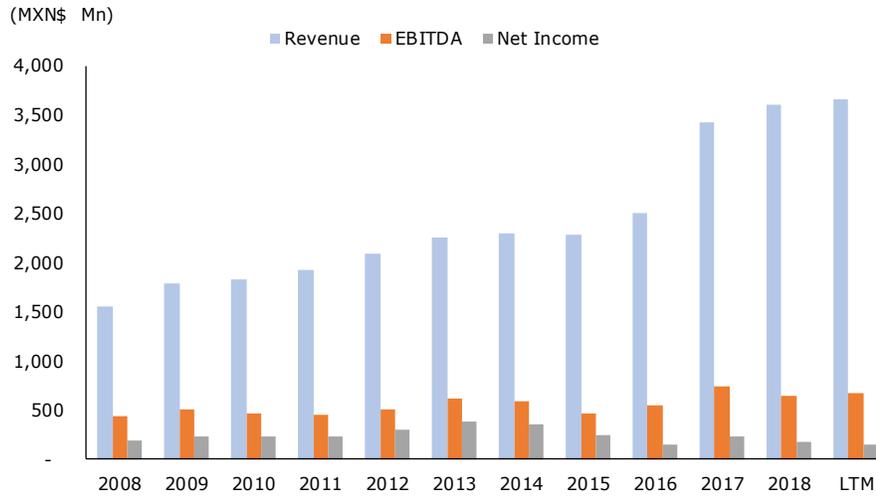
Highly Experienced Medical and Management Teams

MÉDICA's medical team includes some of the country's most respected and talented physicians. They have been responsible for attending more than 13,000 patients in 2018 with successful results. In addition, the company supports the investigation activities, which is a major differentiator against other hospital groups.

With respect to the administrative team, we believe that their track record of value creation is very solid. The clear evidence is that they have grown MÉDICA's revenues, EBITDA and net profit at CAGR of 8.1%, 4.1% and 2.4%, respectively, during the 2008-2019 period.

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Graph 9.- Revenue, EBITDA and Net Income (2008-LTM)

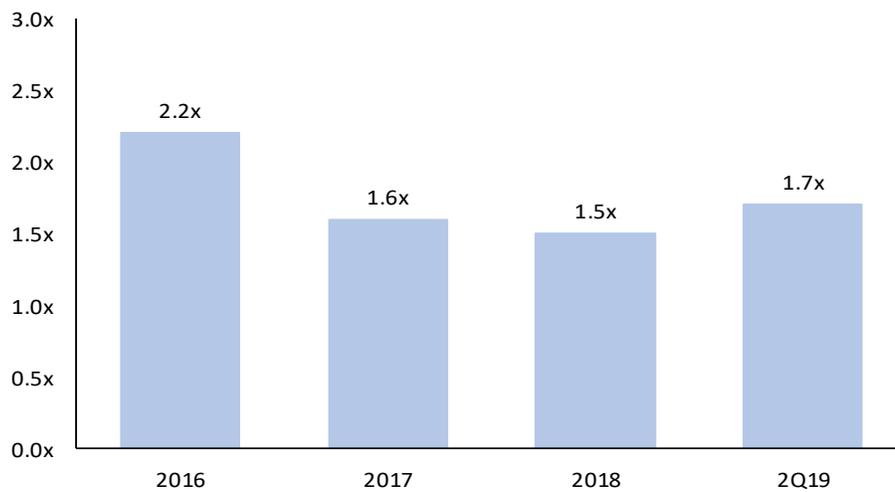


Source: MÉDICA

Solid Financial Structure

MÉDICA reported a Net Debt/EBITDA ratio of 1.7x at the end of 2Q19, which is in line with historical levels.

Graph 10.- Net Debt/ EBITDA Ratio (x)



Source: MÉDICA

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State-of-the-Art-Technology

The company is equipped with some of the world's most advanced medical equipment, such as a Stereotactic Body Radiation Therapy (SBRT) unit, a *Varian Clinac IX* lineal accelerator for radiotherapy, a *Gamma Knife Perfexion* radio surgery unit, green light laser, an *Axiom Artis* diagnosis unit, a *Pentero 900* microscope for nuclear medicine, laparoscopy towers with 4K resolution, a *Lasik* device for myopia and astigmatism correction, cardiovascular rehabilitation and ischemia evaluation systems, a robotic line of clinical analysis, an *OPMI Lumera 700* microscope, Tomography, Magnetic Resonance, and the recently acquired *PET-CT mCT Flow*, an *YSiO MAX* X-ray equipment, new surgery rooms with *endosuite*, and fully renovated hospitalization rooms.

MÉDICA was the first hospital center outside of the US to be integrated into the "*Mayo Clinic Care Network*", which provides it with access to world class technology and knowledge.

MÉDICA'S FAVORABLE OUTLOOK

We believe that MÉDICA's growth prospects are favorable, as we expect its revenues, EBITDA and net income to grow at an average annual rate of 4.1%, 8.2% and 3.7%, respectively, during the 2019-2024 period.

MÉDICA's revenues will be driven by price increases in line with inflation and by a slightly larger volume of patients treated. We believe that the company will benefit from the growth and aging of the Mexican population, which will continue to suffer from developed countries' diseases such as diabetes. This will be partially offset by an intense competition in the sector.

We believe that MÉDICA'S EBITDA margin will gradually expand to 21.9% in 2024, from 17.3% in 2019, mainly as a result of economies of scale, the headcount reduction that the company implemented at the end of last year and a strict cost and expenses policy mainly in its administrative areas.

It is worth mentioning that around 10% of MEDICA's costs and expenses are denominated in US dollars, which means that the company is slightly vulnerable to a devaluation of the Mexican peso. However, in our model, we assumed that the exchange rate gradually adjusts to MXN\$22.0 by the end of 2024, which will limit the impact on the company's cost and expense structure.

We expect the company to record a tax rate of 30.0% in the future. This will generate a net profit growth at an average annual rate of 3.7%, as we mentioned above.

We believe that MÉDICA's capital investments will be around MXN\$150 million in 2019 (which will represent 4% of revenues), which will mainly be used for the acquisition of equipment and continuous modernization of the facilities. This indicator will probably reach MXN\$240 million in 2024, which will represent 5% of sales.

We anticipate that MÉDICA will generate positive free cash flow over the next few years. This will allow the company to reduce leverage from the current levels of 1.7x (2Q19) to only 1.6x at the end of 2024. We rule out the acquisition of new companies, as we expect MÉDICA to

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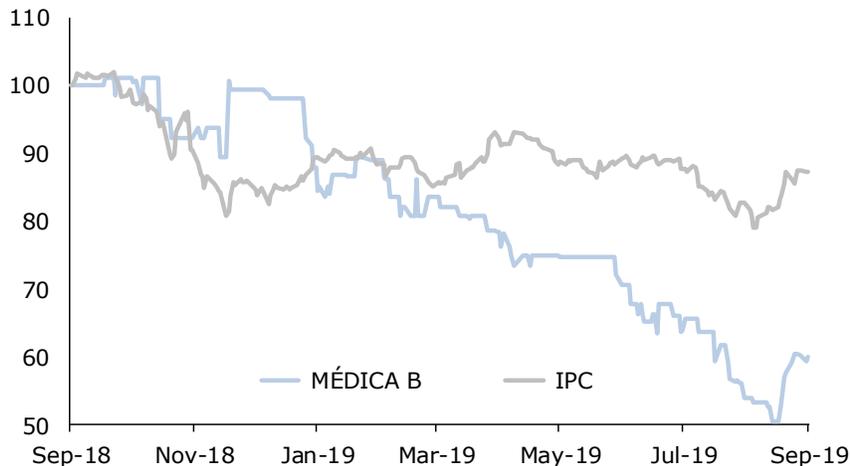
focus on the LMS restructuring through the dividend in kind which will likely take place in the near future. In the medium and long term, we anticipate that MÉDICA will focus on further improving its hospital operations.

VALUATION

Performance vs. the IPC Index

MÉDICA's shares have underperformed the IPC index during the last 12 months, we believe as a result of institutional investors who are moving away from Mexican mid and low-cap stocks, which are a risky asset under the current macroeconomic conditions. However, we believe that MÉDICA's shares have already reached a very attractive valuation. Thus, they will likely outperform the IPC index in the medium term.

Graph 11.- MÉDICA B vs. IPC Index



Source: Bloomberg

Comparison Against Global Peers

MÉDICA's shares currently trade at a forward EV/EBITDA of only 5.0x, a projected P/E of 15.4x and a P/BV of 0.7x. These multiples compare against the averages of 22.6x, 42.8x and 3.7x, respectively, of emerging market hospital chains, and against the averages of 8.4x, 14.0x, and 7.6x, respectively, of developed markets hospital companies. Although we believe that MÉDICA deserves to trade at a discount to its international peers due to its dependence on one hospital, we believe that the current discount is very high.

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Table 2.- Valuation of Global Hospital Chains

Company	Country	Price (USD) 10-Sep-19	Mkt. Cap. (USD Mn)	EV/EBITDA			P/E			EBITDA Δ%	Net EBITDA	ROE	EBITDA Margin 1Q19	Div. Yield	
				L12M	2019E	2020E	L12M	2019E	2020E						
<i>Emerging Markets</i>															
Médica Sur	México	\$ 1.07	131	5.8x	5.0x	4.9x	17.4x	15.4x	17.3x	20%	3%	1.7x	4.1	21.2	n.a.
Aier Eye Hospital Group	China	\$ 4.82	14,939	48.3x	43.5x	33.9x	48.2x	78.5x	59.5x	25%	28%	(0.1x)	21.7	23.5	0.4
Bangkok Dusit Medical Services	Thailand	\$ 0.80	12,556	17.8x	23.2x	20.9x	27.9x	37.9x	34.2x	10%	10%	0.9x	20.3	30.3	1.8
IHH Healthcare Bhd	Malaysia	\$ 1.38	12,151	21.1x	18.6x	16.4x	73.7x	51.5x	40.6x	24%	12%	2.2x	2.8	21.6	0.5
Ryman Healthcare LTD	New Zealand	\$ 8.54	4,269	97.3x	29.4x	26.4x	19.2x	25.5x	22.8x	236%	13%	17.0x	15.9	20.4	1.7
Bumrungrad Hospital Public Compa	Thailand	\$ 4.54	3,309	17.0x	15.3x	14.8x	27x	25.0x	23.8x	2%	6%	(1.0x)	21.6	32.3	2.1
Apollo Hospitals Enterprise Ltd.	India	\$ 20.80	2,893	22.2x	17.1x	14.7x	85.7x	56.4x	40.9x	27%	15%	n.a.	n.a.	n.a.	0.4
Mitra Keluarga Karyasehat Tbk	Indonesia	\$ 0.17	2,466	34.5x	33.7x	30.2x	54.6x	50.8x	46.3x	13%	10%	(1.1x)	16.3	34.5	0.8
Bangkok Chain Hospital	Thailand	\$ 0.52	1,303	20.6x	18.2x	16.6x	37.6x	33.0x	29.6x	16%	10%	2.0x	19.9	26.9	1.4
KPJ Healthcare Bhd	Malaysia	\$ 0.22	926	11.7x	10.4x	9.9x	21.7x	21.1x	19.3x	11%	6%	4.3x	10.2	15.7	2.2
China Resources Medican Holdings	China	\$ 0.66	862	7.6x	8.0x	6.9x	14.3x	15.6x	13.8x	(9%)	12%	(2.4x)	7.3	28.4	2.3
Chularat Hospital PCL	Thailand	\$ 0.08	855	28.5x	23.9x	20.8x	48.8x	38.9x	34.1x	13%	14%	1.0x	16.0	21.5	2.9
Medikaloka Hermina Tbk	Indonesia	\$ 0.25	741	20.0x	15.1x	12.4x	84.7x	52.1x	42.6x	26%	21%	0.9x	9.3	n.a.	0.3
Total / Average Emerging Markets			57,401	24.0x	22.6x	19.9x	37.8x	42.8x	36.5x	21%	13%	2.1x	14.7	25.1	1.4
<i>Developed Markets</i>															
HCA Healthcare Inc	US	\$ 130.10	44,362	8.5x	8.2x	7.7x	12.2x	12.3x	11.4x	9%	5%	3.6x	n.a.	19.7	1.2
Universal Health Services	US	\$ 155.37	13,749	10.7x	9.6x	9.2x	17.1x	15.1x	14.4x	14%	4%	2.5x	14.9	15.5	0.5
Korian SA	France	\$ 38.72	3,202	13.6x	11.1x	10.3x	23.6x	21.3x	18.1x	8%	9%	9.3x	4.8	18.7	1.7
The Ensign Group Ltd.	US	\$ 48.35	2,581	14.7x	14.1x	12.7x	25.0x	20.2x	17.6x	56%	11%	3.8x	11.8	12.1	0.4
Tenet Healthcare Corp.	US	\$ 24.20	2,503	9.1x	7.2x	6.7x	(156.5x)	9.9x	8.0x	17%	5%	6.6x	n.a.	12.5	n.a.
Terveystalo Oyj	Finland	\$ 9.66	1,237	11.8x	10.2x	9.4x	20.2x	19.0x	15.9x	31%	7%	4.1x	10.6	15.8	n.a.
Target Hospitality Corp.	US	\$ 7.00	737	28.1x	6.6x	5.2x	(563.8x)	16.6x	9.5x	n.a.	19%	9.6x	(0.6)	24.4	n.a.
Community Health Systems	US	\$ 3.30	390	15.7x	8.6x	8.5x	(0.4x)	(1.9x)	(2.7x)	79%	2%	14.0x	n.a.	7.0	n.a.
American Renal Associates	US	\$ 10.94	356	8.1x	8.8x	8.3x	(12.5x)	(80.7x)	(59.8x)	(12%)	5%	n.a.	n.a.	n.a.	n.a.
Total / Average Developed Markets			69,117	9.7x	8.4x	8.0x	18.4x	14.0x	12.6x	17%	5%	6.7x	8.3	15.7	1.0

Source: Miranda Global Research; n.a. = not available

Note: All figures are in USD

Discounted Cash Flow Model (DCF)

We set our year-end target price of MXN\$26.50 for MÉDICA's shares (including LMS) through a discounted cash flow (DCF) model which includes a 2.7% perpetuity growth rate in nominal terms and an 12.0% WACC. To calculate the WACC, we used a 13.5% cost of equity, a pre-tax cost of debt of 10.3% and a year-end debt to equity ratio of 24.1%. We also used a Beta of 1, which is higher than MÉDICA's current Beta of 0.243 to be conservative with respect to the WACC calculation.

Our current target price of MXN\$26.50/share does not include MÉDICA's vast real estate properties, which we estimate have a market value of MXN\$1.7-2.0 billion, equivalent to MXN\$13.90/share. However, we believe that such value will only be realized once they are sold, which in our view is unlikely to take place during the rest of the current year given current macroeconomic conditions.

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Table 3.- Discounted Cash Flow Model

(Figures in Millions of MXN\$)	2020E	2021E	2022E	2023E	2024E	Perp.
OPERATING PROFIT	459	488	524	565	602	618
Tax Rate	30%	30%	30%	30%	30%	30%
Tax Shield	-138	-146	-157	-170	-181	-185
NOPLAT	321	341	367	396	422	433
Depreciation	336	352	368	384	400	411
Working Capital Changes	-38	-40	-40	-39	-40	-41
CAPEX	-160	-180	-200	-220	-240	-300
FCFF	459	473	495	521	542	502
Perpetuity Growth Rate						2.7%
PV of Explicit Period (2020 - 2024E)						1,778
Perpetuity Value						5,392
PV of Perpetuity Value						2,733
Enterprise Value						4,511
Net Debt						1,243
Minority Interest						1
Market Value						3,267
<i>Outstanding Shares</i>						123
Target Price						P\$ 26.50
Current Market Price						P\$ 20.80
Potential Return Incl. Dividends						27.4%
Forward EV/EBITDA						5.8x
Forward P/E						22.3x
Average Cost of Debt						10.3%
LT Tax Rate						30.0%
After-Tax Cost of Debt						7.2%
Cost of Equity						13.5%
Market Risk Premium						6.0%
Risk-Free Rate						7.5%
Beta						1.00
% Total Debt						24.1%
% Capital						75.9%
WACC						12.0%

Source: Miranda Global Research

Sensitivity Analysis

We carried out a sensitivity analysis of MEDICA's target price based on different levels of EBITDA, net profits and target multiples. We are comfortable with our target price of MXN\$26.50/share as it implies that MÉDICA's shares will trade at a forward EV/EBITDA of only 5.8x and a projected P/E of 22.3x at the end of the current year, which compares against the five-year averages of 9.5x and 21.0x, respectively.

MÉDICA: Initiation of Coverage

Table 4.- Sensitivity Analysis, EBITDA vs. EV/EBITDA

	-10%	-5%	<i>Original</i>	+5%	+10%
Projected EBITDA	717	755	795	834	876
Target EV/EBITDA					
4.3x	14.14	15.45	16.84	18.22	19.67
4.8x	17.05	18.52	20.06	21.60	23.22
5.3x	19.96	21.58	23.28	24.99	26.78
5.8x	22.87	24.64	26.50	28.37	30.33
6.3x	25.77	27.70	29.73	31.75	33.88
6.8x	28.68	30.76	32.95	35.14	37.44

Source: Miranda Global Research

Table 5.- Sensitivity Analysis, Net Profit vs. P/E

	-10%	-5%	<i>Original</i>	+5%	+10%
Projected Net Profit	132	139	146	154	161
Target P/E					
19.3x	20.71	21.80	22.95	24.09	25.30
20.3x	21.78	22.93	24.13	25.34	26.61
21.3x	22.85	24.05	25.32	26.58	27.91
22.3x	23.92	25.18	26.50	27.83	29.22
23.3x	24.99	26.31	27.69	29.08	30.53
24.3x	26.06	27.43	28.88	30.32	31.84

Source: Miranda Global Research

COMPANY DESCRIPTION

MÉDICA owns the MÉDICA Tlalpan hospital, located in the south of Mexico City. This hospital has 190 beds, 15 operating rooms, 15 intensive care units (ICU), 13 emergency units for adults, 3 pediatric cubicles, one for orthopedics and 542 medical offices distributed in three towers.

The company has specialized departments, such as the Integral Oncology Center, the Radiotherapy Unit, the Center for Neurology and Neurosurgery, Gastroenterology, Urology, Hemodynamics, Hemodialysis, positron emission tomography, imaging, magnetic resonance and the Comprehensive Diagnostic Center and treatment, among others.

MÉDICA offers teaching and training to young doctors, and participates and publishes scientific research, through its unit of researchers attached to CONACYT. MÉDICA shares were listed on the Mexican Stock Exchange in 1994.

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Real Estate

MÉDICA also owns the following real estate properties:

- a 5 hectares property which is adjacent to their hospital in the Tlalpan neighborhood in Mexico City. The company had originally sold part of this piece of land to Grupo Sordo Madaleno (GSM), an upscale real estate company. However, such transaction was cancelled last May 2nd derived from the cancellation of the performance polygons in Mexico City. We estimate that such property has a market value of around MXN\$1.5-1.7 billion (with a fiscal cost of MXN\$931 million as of the end of 2018).
- The company owns 10,654 square meters in the Tlalpan neighborhood, near the Periférico highway, where its corporate offices are located. This property has a market value of around MXN\$100-130 million (with a fiscal cost of MXN\$122 million).
- MÉDICA also owns a 3,576 M2 land property in the Lomas upscale neighborhood. We estimate that the market value of such asset is around MXN\$110-140 million (with a fiscal cost of MXN136 million).

Laboratories

MÉDICA's owns 126 clinical analysis laboratories. The company will keep 9 laboratory units and the main branch within the hospital complex, as well as the sample processing center. The other units will be spun-off as part of the restructuring process through the LMS share dividend.

They compete with other clinical laboratories such as "Laboratorio Médico el Chopo", "Salud Digna", "Quest" and "Biomédica", among others. "Laboratorio Médico del Chopo" has 200 laboratories and 23 speciality centers across the country, making it the largest network. "Salud Digna" has 60 laboratories in Mexico and the US, "Quest" has 34 in Mexico and "Biomédica" has 12 also in Mexico. Price competition in this sector is very intense as some chains, like "Salud Digna", are owned by non-profit foundations.

Board of Directors / Corporate Governance

MÉDICA's Board has 20 Directors of which 12 are independent, thus complying with Mexico's Securities Market Law, which states that at least 25% of the Directors have to be independent.

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Table 6.- MÉDICA's Board of Directors

Name	Position	Independence
Lic. Enrique Castillo Sánchez Mejorada	Proprietary	Independent
Lic. Joaquín Vargas Guajardo	Proprietary	Independent
Dr. Carlos Elizondo Mayer-Serra	Proprietary	Independent
Lic. Santiago Garza Borde	Proprietary	Independent
Lic. Alonso de Garay Gutiérrez	Proprietary	Independent
C.P. Manuel Sánchez y Madrid	Proprietary	Independent
Dr. Xavier Soberón Mainero	Proprietary	Independent
Dra. Xochitl Castañeda	Proprietary	Independent
Lic. Daniel Antonio del Rio Loaiza	Proprietary	Independent
Lic. Alejandro Quiroz Pedrazzi	Proprietary	Independent
Lic. Eduardo A. Henkel Pérez-Castro	Proprietary	Independent
Mtro. Francisco D. González Albuerne	Proprietary	Independent
Dr. Misael Uribe Esquivel	Proprietary	Related
Dr. Eduardo González Pier	Proprietary	Related
Dra. Martha Helena Ramos Ostos	Proprietary	Related
Dr. Octavio Gonzalez Chon	Proprietary	Related
Lic. Juan Carlos Griera Hernando	Proprietary	Related
Dr. José Manuel Correa Roveló	Proprietary	Related
Ing. Genaro Borrego Estrada	Proprietary	Related
Ing. Mario Federico Sicilia Bernard	Proprietary	Related
Lic. Cuauhtémoc R. Santa-Ana Otero	Secretary, Non Board Member	

Source: MÉDICA

In addition, MÉDICA has an Audit Committee, which includes four members, 3 of them independent, and a Corporate Practices Committee that includes 5 members, 3 of them independent. These committees ensure compliance with existing regulations and help supervise the company's operations.

Management Team

MÉDICA has a solid management team which includes very talented physicians and executives. Juan Carlos Griera Hernando, the CEO, has been a Director to the Board since 2004. Marisol Vazquez Mellado Mollón, the CFO, has a 27-year experience in publicly-traded companies. The Medical director is Dr. Octavio González Chon, who has specialties in internal medicine, critical medicine, anesthesiology and cardiovascular anesthesiology, and has been a Board Director for 21 years.

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Table 7.- MÉDICA's Main Executives -Medical and Management Team

Name	Position
Dr. Misael Uribe Esquivel	Chairman of the Board of Directors
Lic. Juan Carlos Griera Hernando	CEO
C.P. Marisol Vázquez Mellado Mollón	CFO
Dr. Octavio González Chon	Chief Doctor
Dra. Sandra María del Carmen García López	Chief of Medicine and Hospitalization
Dr. José Manuel Correa Rovelo	COO
Dr. Rodolfo Barragán García	Director of Surgery
Dr. Pedro Yeverino Suárez	Chief of Urgencies
Dr. Silvio Antonio Ñamendys Silva	Chief of Intense Therapy
Dr. Mario Luis Roca Cabrera	Chief of Respiratory Therapy
Dr. Héctor Baptista González	Chief of Blood Bank
Dr. Luis Assad Simón Pereira	Chief of Gynecological and Obstetrics Service
Dr. Carlos Federico Ortiz Hidlago	Chief of Pathological Anatomy
Dra. María José García Pasquel	Chief of Neonatology
Dr. Eduardo Emir Cervera Ceballos	Chief of Oncological Center
Dra. Adela Poitevin Chacón	Chief of Radiotherapy
Dr. Ramiro del Valle Robles	Chief of Gamma Knife Unit
Dr. Norberto Carlos Chávez Tapia	Head of Gastroenterology, Hepatology and Endoscopy
Dr. Bernardo Gabilondo	Chief of Urology
Dr. Alejandro Zavala Reina	Head of Neurophysiology Unit
Dr. Álvaro Lomelí Rivas	Head of Rehabilitation Medicine
Dra. Martha Elena Ramos Ostos	Director of the Clinical Diagnosis Center
Dr. Luis Felipe Alva López	Head of Imaging Unit
Dr. Rodrigo Hernández Ramírez	Head of Nuclear Medicine
Lic. Ana Lara	Head of Nutrition
Dr. Luis Enrique Soto Ramírez	Chief of Infectology and UVEH
Dr. Francisco Sánchez Girón	Director of Process Centers
Dr. Eduardo Gonzalez Pier	CEO of Medica Sur Clinical Foundation
Dr. Misael Uribe Ramos	Director of Medical Tourism
Dra. Carmen García	Academic Director
Lic. Francisca Vázquez	Nursing Director
Lic. Concepción Guadalupe Arriaga Ruiloba	Director of Marketing, Communications and Special Events
Ing. José Luis Torres Infante	CTO
Lic. Cuauhtémoc Rafael Santa-Ana Otero	General Counsel
Dr. Jorge Hernández Ortiz	Director of the Procurement Committee

Source: MÉDICA

Ownership Structure

MÉDICA's capital is represented by 123,281,750 shares. They have a low liquidity since their average daily traded value (ADTV) of the last six months was MXN\$216 thousand (around US\$11,364).

MÉDICA is majority-owned by Neuco S.A.P.I. de C.V. which holds 50.01% of outstanding shares. The remaining 49.9% of shares are free-floating.

MÉDICA: Initiation of Coverage

2Q19 Results: EBITDA Improves due to IFRS 16 but Net Profit Falls

MÉDICA's sales were up 3.1% YoY to MXN\$938.3 million, supported by an increased hospital and surgical activity, as well as higher revenues in clinical services and in diagnostic areas.

The number of patients rose 4.3% YoY to 3,376. The average stay decreased to 2.90 days, from 3.04 days. As a result, the occupancy rate fell 0.2% YoY to 56.7%, which is equivalent to 107.7 average bed days. However, the Diagnostic and Clinical Analysis area experienced fewer patients in the quarter.

The cost of sales advanced 2.4% YoY, which generated a gross margin of 31.3% in 2Q19, from 30.8% in 2Q18. Administrative and sales expenses were up 3.2% YoY, while other operating expenses decreased 57.3% YoY. This translated into an EBITDA margin of 21.7% in 2Q19, from 18.0% in 2Q18. EBITDA was 24.3% higher YoY to MXN\$203.7 million. This included a MXN\$25.4 million benefit related to the IFRS 16 implementation in the current quarter.

The integral cost of financing grew 63.4% YoY to MXN\$53.6 million mainly as a result of the extraordinary interests related to the reimbursement of the deposit to GSM, as well as the IFRS 16 implementation. Quarterly net income was down 19.7% YoY to MXN\$40.9 million.

Debt Profile / Maturities

MÉDICA presented a total debt and leases of MXN\$1,552 million at the end of 2Q19. The bank debt was MXN\$1,224 million, of which 43% had a fixed rate of 9.745% and 57% had a variable rate of TIIE plus 125-360 bp. It is fully denominated in pesos while its average cost was 10.3%. The maturity profile is well structured, since the company only faces MXN\$131 million in 2019, with the rest expiring between 2020 and 2024.

The cash and temporary investments amounted to MXN\$171.4 million at the end of the quarter, which translated into a net debt to EBITDA ratio of 1.7x.

Dividend Payments

MÉDICA has paid cash dividends with an average 2.1% yield during the last 10 years. We believe that post-LMS dividend, the company will continue to distribute cash dividends with a similar rate.

MÉDICA: Initiation of Coverage

Table 8.- MÉDICA's Historical Dividends and Yields

Year	Per Share Amount (MXN\$)	Total Amount (MXN\$ Mn)	Dividend Yield
2008	\$ 0.54	\$ 63.00	2.4%
2009	\$ 0.58	\$ 68.00	2.3%
2010	\$ 0.58	\$ 68.00	2.3%
2011	\$ 0.55	\$ 67.80	2.3%
2012	\$ 0.86	\$ 106.50	2.9%
2013	\$ 0.84	\$ 103.60	2.4%
2014	\$ 0.85	\$ 104.80	1.5%
2015	\$ 0.68	\$ 83.80	1.7%
2016	\$ 0.70	\$ 86.30	1.8%
2017	\$ 0.61	\$ 75.00	1.5%
2018	\$ 0.62	\$ 76.60	1.8%

Source: MÉDICA

THE UPCOMING RESTRUCTURING OF LABORATORIOS MÉDICA SUR (LMS)

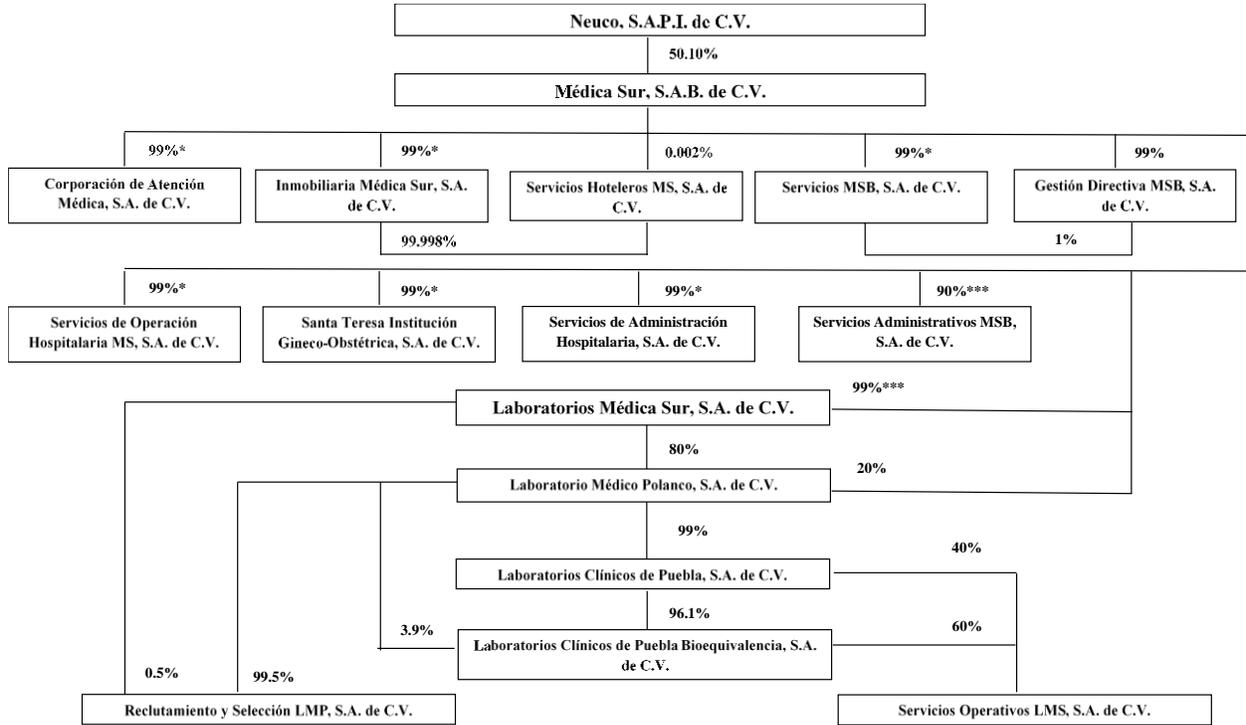
Last April 30th, MÉDICA's shareholders approved a corporate restructuring whereby the company will spin-off 116 laboratories and will keep the remainder 10 under the MS brand. The deadline for this transaction is January 2020, otherwise it will be cancelled.

As a result, MÉDICA's shareholders will receive the LMS share dividend with a value of MXN11.253/share according to the "Information Brochure" of the transaction. The company told us that this price is equivalent to a L12M EV/EBITDA 10.2x multiple. We expect the market value of LMS's shares to change according to the prevailing market conditions when the restructuring takes place.

Once the transaction occurs, Neuco S.A.P.I. de C.V. will remain as the controlling shareholder of both MÉDICA and LMS, with 50.1% of outstanding shares. The float of the two new companies will thus be 49.9% after such transaction.

MÉDICA: Initiation of Coverage

Graph 12.- MÉDICA's Current Corporate Structure



Notes:

* The remaining shares are owned by Neuco, S.A.P.I. de C.V.

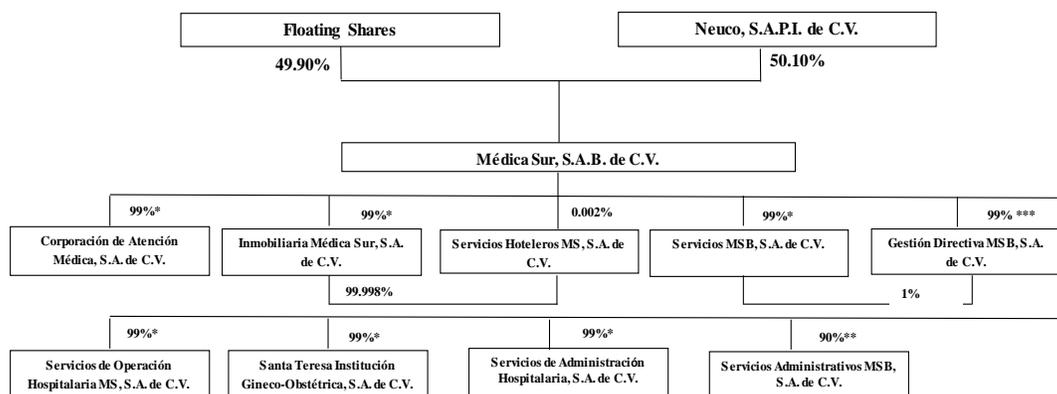
** The remainder 49.9% of Médica Sur, S.A.B. de C.V.'s shares are distributed among diverse investors

*** The remaining shares are owned by Corporación de Atención Médica, S.A. de C.V.

Source: MÉDICA

MÉDICA: Initiation of Coverage

Graph 13.- MÉDICA's Corporate Structure After the LMS Restructuring



Notas:

* The remaining shares are owned by Neuco, S.A.P.I. de C.V.

** The remaining shares are owned by Corporación de Atención Médica, S.A. de C.V.

*** The remaining shares are owned by Servicios MSB, S.A. de C.V.

Table 9.- LMS Price Depending on Different Multiple Levels

	EV/EBITDA	Price
	L12M	Per Share
	14.0x	\$ 11.63
	13.0x	\$ 11.11
	12.0x	\$ 10.59
Initial Valuation =>	10.2x	\$ 11.25
	10.0x	\$ 9.56
	9.0x	\$ 9.05
	8.0x	\$ 8.53
	7.0x	\$ 8.02
	6.0x	\$ 7.50
	5.0x	\$ 6.98

Source: MÉDICA, Miranda Global Research

MÉDICA: Initiation of Coverage

Table 10.- MÉDICA's Valuation Post-LMS Share Dividend

	MÉDICA's Pre-Restructuring Share Price	LMS Initial Price	MÉDICA's Post-Restructuring Share Price	MÉDICA's Post-Restructuring 2019E EV/EBITDA
	\$ 15.00	\$ 11.25	\$ 3.75	2.4x
	\$ 16.00	\$ 11.25	\$ 4.75	2.6x
	\$ 17.00	\$ 11.25	\$ 5.75	2.8x
	\$ 18.00	\$ 11.25	\$ 6.75	3.0x
	\$ 19.00	\$ 11.25	\$ 7.75	3.2x
	\$ 20.00	\$ 11.25	\$ 8.75	3.5x
Current Price =>	\$ 20.80	\$ 11.25	\$ 9.55	3.6x
	\$ 21.00	\$ 11.25	\$ 9.75	3.7x
	\$ 22.00	\$ 11.25	\$ 10.75	3.9x
	\$ 23.00	\$ 11.25	\$ 11.75	4.1x
	\$ 24.00	\$ 11.25	\$ 12.75	4.4x

Source: MÉDICA, Miranda Global Research

MAIN INVESTMENT RISKS

Intense Competition. The Mexican hospital industry is highly competitive in terms of price, quality, services, location and reputation. MÉDICA competes not only with other hospitals, but with laboratories and clinics across the country. The latter may offer lower prices, but do not compete in terms of quality with MÉDICA.

Macroeconomic Volatility. The performance of the health services industry is linked to the Mexican and international economy. The demand for MÉDICA's services can be affected by volatility in the exchange rate, interest rates and/or the inflation rate. Around 10% of MÉDICA's costs and expenses are denominated in US Dollars. The mitigant is that the company can transfer the cost increases in a relatively short period.

Adverse Changes in Health or Fiscal Regulations. MÉDICA is subject to strict health, hygiene and environmental standards. The biggest risk a hospital faces is not complying with such regulations, which could jeopardize its reputation. The company is also exposed to changes in the government's fiscal policies.

Dependence on the Medical Team. MÉDICA depends largely on the quality and performance of its medical team. Any medical error or equipment malfunction can damage the company's reputation or generate lawsuits.

Dependence on a Single Hospital. MÉDICA depends on the performance of the Tlalpan hospital, which is located near other competitors' hospitals. Any incident at this facility or in the surrounding area can have a negative effect on the company's results.

Changes in Medical Insurance Conditions. This could affect MÉDICA's profitability and could generate a patient migration to cheaper hospitals.

MÉDICA: Initiation of Coverage

Continuous Technological Advances. The medical equipment usually requires expensive maintenance. There is a limited number of manufacturers of such equipment, and any failure or interruption can have negative effects on hospital performance. Any damage to the information systems can affect the way in which the company treats its patients and stores data.

Low Market Capitalization and Low Liquidity of the Shares. MÉDICA's current market capitalization stands at US\$121 million with an average daily traded value of only MXN\$502,087 (around US\$26,342) during the last six months.

Unexpected Investments in the Development of Real Estate Properties. In order to expand in a significant way, MÉDICA has to acquire another hospital or develop a new one in its real estate properties, which can be burdensome. However, we rule out that this will happen in the medium term because MÉDICA has sufficient capacity at the moment.

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FINANCIAL PROJECTIONS – MÉDICA SUR

(Figures in Millions of MXN\$)

INCOME STATEMENT	2018	2019E	2020E	2021E	2022E	2023E	2024E	2018	2019E	2020E	2021E	2022E	2023E	2024E
Revenues	3,608	3,731	3,888	4,051	4,221	4,399	4,585	5%	3%	4%	4%	4%	4%	4%
Cost of Sales	-2,487	-2,589	-2,689	-2,787	-2,888	-2,995	-3,110	10%	4%	4%	4%	4%	4%	4%
Gross Profit	1,121	1,142	1,199	1,264	1,333	1,404	1,475	-4%	2%	5%	5%	5%	5%	5%
Gross Margin	31.1%	30.6%	30.8%	31.2%	31.6%	31.9%	32.2%							
General Expenses	-737	-697	-708	-740	-769	-795	-825	11%	-5%	2%	5%	4%	3%	4%
Operating Profit	400	432	459	488	524	565	602	-22%	8%	6%	6%	7%	8%	7%
Operating Margin	11.1%	11.6%	11.8%	12.0%	12.4%	12.8%	13.1%							
Depreciation and Amortization	-225	-325	-336	-352	-368	-384	-400	2%	44%	4%	5%	5%	4%	4%
EBITDA	625	757	795	840	892	949	1,002	-15%	21%	5%	6%	6%	6%	6%
EBITDA Margin	17.3%	20.3%	20.4%	20.7%	21.1%	21.6%	21.9%							
Financial Gains	16	7	-41	-45	-49	-53	-53	174%	-55%	-690%	10%	9%	8%	0%
Financial Cost	-145	-194	-208	-221	-232	-242	-249	2%	34%	7%	6%	5%	4%	3%
Pre-Tax Profit	271	245	209	222	243	270	300	-28%	-10%	-15%	6%	10%	11%	11%
Income Tax & Profit Sharing	-101	-79	-63	-66	-73	-81	-90	-16%	-22%	-20%	6%	10%	11%	11%
Tax & Profit Sharing Rate	37.4%	32.1%	30.0%	30.0%	30.0%	30.0%	30.0%							
Net Profit	169	166	146	155	170	189	210	-27%	-2%	-12%	6%	10%	11%	11%
Outstanding Shares	123	123	123	123	123	123	123	0%	-0%	0%	0%	0%	0%	0%
EPS	P\$ 1.37	P\$ 1.35	P\$ 1.19	P\$ 1.26	P\$ 1.38	P\$ 1.53	P\$ 1.70	-27%	-2%	-12%	6%	10%	11%	11%
BALANCE SHEET	2018	2019E	2020E	2021E	2022E	2023E	2024E	2018	2019E	2020E	2021E	2022E	2023E	2024E
TOTAL ASSETS	5,464	5,964	6,145	6,328	6,511	6,696	6,881	-2%	9%	3%	3%	3%	3%	3%
Current Assets	1,050	846	908	970	1,034	1,098	1,164	-5%	-19%	7%	7%	7%	6%	6%
Cash & Temp. Inv.	171	190	190	190	190	190	190	-21%	11%	0%	0%	0%	0%	0%
LT Assets	4,413	5,117	5,237	5,357	5,477	5,597	5,717	-2%	16%	2%	2%	2%	2%	2%
P, P & E	2,783	2,841	2,961	3,081	3,201	3,321	3,441	-2%	2%	4%	4%	4%	4%	4%
TOTAL LIABILITIES	1,922	2,274	2,387	2,496	2,596	2,681	2,752	-11%	18%	5%	5%	4%	3%	3%
ST Liabilities	792	950	1,064	1,173	1,272	1,358	1,428	10%	20%	12%	10%	8%	7%	5%
LT Liabilities	1,130	1,323	1,323	1,323	1,323	1,323	1,323	-21%	17%	0%	0%	0%	0%	0%
TOTAL DEBT	1,126	1,433	1,523	1,610	1,685	1,746	1,791	-18%	27%	6%	6%	5%	4%	3%
NET DEBT	955	1,243	1,333	1,420	1,495	1,556	1,601	-18%	30%	7%	7%	5%	4%	3%
TOTAL CAPITAL	3,542	3,708	3,776	3,849	3,933	4,032	4,147	3%	5%	2%	2%	2%	3%	3%
Stockholder's Equity	3,541	3,707	3,775	3,848	3,932	4,031	4,146	3%	5%	2%	2%	2%	3%	3%
Minority Interest	1	1	1	1	1	1	1	6%	4%	2%	2%	2%	3%	3%
CASH FLOW STATEMENT	2018	2019E	2020E	2021E	2022E	2023E	2024E	2018	2019E	2020E	2021E	2022E	2023E	2024E
PRE-TAX PROFIT	169	204	209	222	243	270	300	-27%	21%	2%	6%	10%	11%	11%
Inv. Related Activities	322	364	328	345	360	377	393	-6%	13%	-10%	5%	5%	4%	4%
Pre-Tax Cash Flow	497	397	180	209	244	283	324	-11%	-20%	-55%	16%	17%	16%	14%
Working Capital Changes	-191	-150	-38	-40	-40	-39	-40	-45%	-22%	-74%	4%	-0%	-2%	2%
Operating Cash Flow	306	248	142	169	204	244	284	43%	-19%	-43%	19%	21%	20%	16%
Investment Cash Flow	-24	-146	-154	-174	-194	-214	-234	-72%	517%	5%	13%	11%	10%	9%
Financing Cash Flow	-328	-83	12	5	-10	-30	-50	1,762%	-75%	-115%	-60%	-309%	197%	67%
Net Incr. (Decr.) in Cash & Temp. Inv.	-45	19	0	0	0	0	0	-140%	-141%	n.a.	n.a.	n.a.	n.a.	n.a.
Beg. of Period Cash and Temp. Inv.	217	171	190	190	190	190	190	108%	-21%	11%	0%	0%	0%	0%
End of Period Cash and Temp. Inv.	171	190	190	190	190	190	190	-21%	11%	0%	0%	0%	0%	0%

Source: Miranda Global Research Research

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