Malaysian Healthcare: Reforms in Motion

Key Takeaways

- We expect significant healthcare reforms in Budget 2025, including the establishment of a National Health Fund, the expansion of private wings in public hospitals, and expansion of health-related taxes, particularly sugar tax.
- While the introduction of a Social Health Insurance scheme is unlikely during the current government term, we foresee increased discussion and advocacy for its implementation.
- Companies with substantial exposure to the public healthcare sector, such as **DPHARMA**, **UMEDIC**, and **PHARMA**, are well-positioned to benefit from enhanced financial allocations to the Ministry of Health.
- Private hospital operators like **IHH** and **KPJ** may face long-term competitive pressure due to the potential expansion and strengthening of the public healthcare system. Beverage manufacturers such as **F&N**, **NESTLE**, and **PWROOT** could be hit by sugar tax hike.

Positive Implications (+)

(+) Duopharma Biotech (DPHARMA)
(+) UMediC (UMC)
(+) Pharmaniaga (Pharma)

Negative Implications (-)

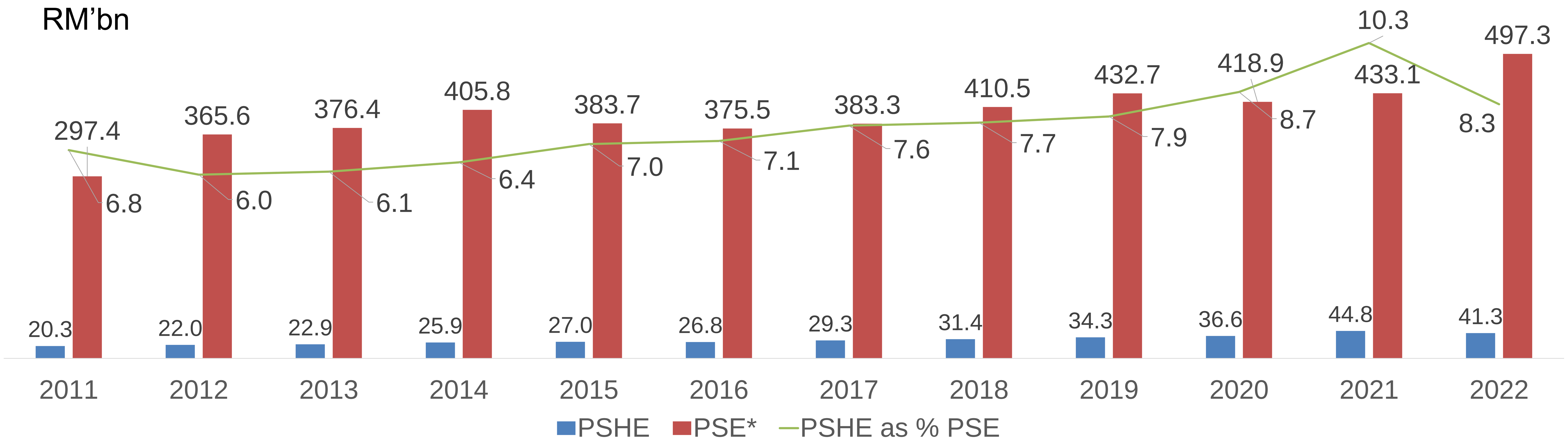
(-) KPJ Healthcare (KPJ)
(-) IHH Healthcare (IHH)

Fundamental Context

A Reform of Malaysia's Public Healthcare System is Long Overdue

Despite achieving universal healthcare coverage and being consistently ranked among the world's best, Malaysia's public healthcare system faces long-term sustainability challenges, particularly in terms of financing. As shown in Figure 1, government healthcare spending has more than doubled over the past decade, consuming an ever-increasing portion of the national budget.

Figure 1: Public Sector Health Expenditure (PSHE) vs. Public Sector Total Expenditure (PSE)

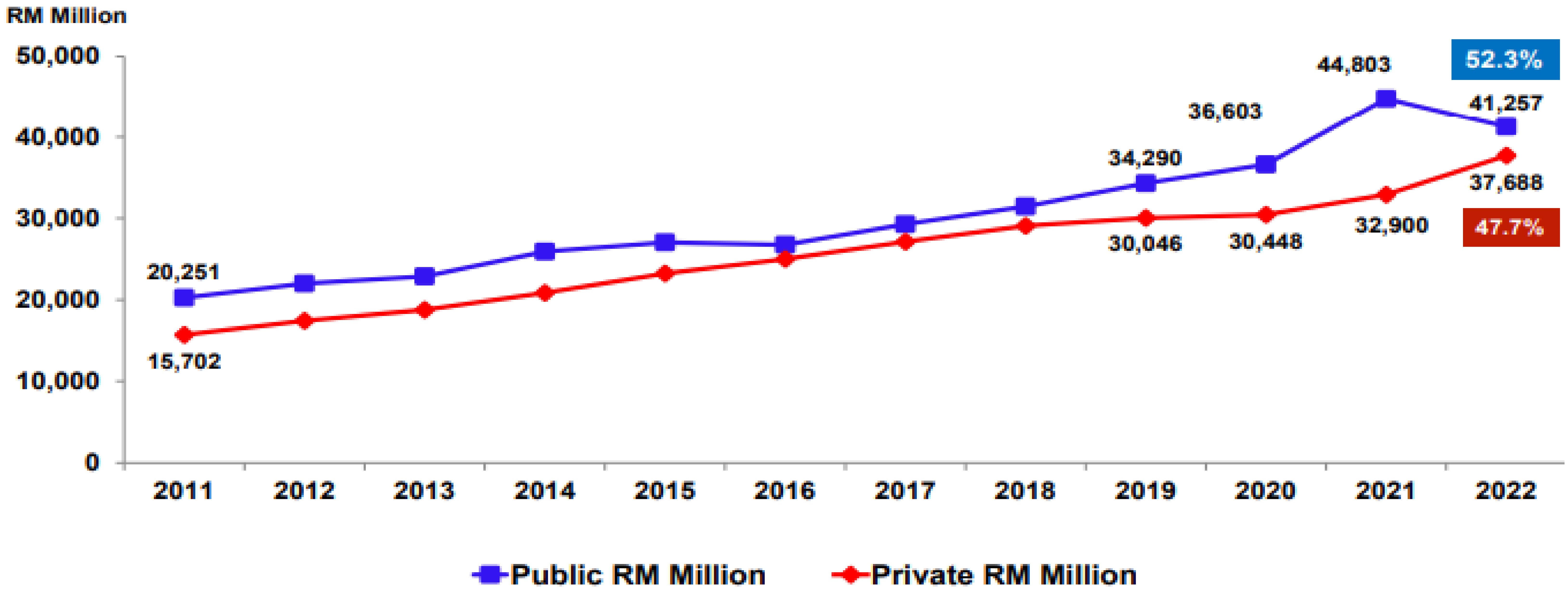


Sources: Ministry of Health, Bank Negara Malaysia

Underinvestment in Public Healthcare System Has Become a Chronic Issue

Despite the sharp and steady rise in public healthcare expenditure, it remains insufficient to meet the growing demands of an aging population. Malaysia's public healthcare spending accounts for only 2.1% of GDP, significantly lower than the 4.4% average among other upper-middle-income countries. This disparity is particularly concerning as the public healthcare system bears the brunt of the nation's healthcare needs, accounting for nearly 58% of total healthcare expenditure, as highlighted in Figure 2.

Figure 2: Total Health Expenditure by Public and Private Sources of Financing



Sources: Ministry of Health

Public Healthcare Spending is Nearly Fully Subsidized

Revenue from fees collected by public hospitals contributes only about 1% of the total public healthcare expenditure, leaving the Ministry of Health (MoH) almost entirely dependent on government fiscal allocations. This not only aggravated our nation's fiscal deficit issue, but also distorted the public perception on the true cost of healthcare.

Reform Efforts Hampered by Political Instability

In 2009, the Najib Razak administration proposed a social health insurance scheme called 1Care, modeled after the UK's National Health Service. The scheme would have mandated a 10% monthly salary deduction to fund national health insurance, but the plan was shelved following the 2018 general election. Successive health ministers, including Dr. Dzulkefly Ahmad (the current minister), Khairy Jamaluddin, and Dr. Zaliha Mustafa, also pushed for similar initiatives, but their efforts were curtailed by short and unstable tenures.

Figure 3: Healthcare Reform Attempts Since 2009

Year	Minister of Health	Administration	Scheme Mooted
2009	Liow Tiong Lai	Najib Razak (BN)	1Care
2017	Subramaniam Sathasivam	Najib Razak (BN)	Voluntary Health Insurance
2018	Dzulkefly Ahmad	Mahathir Mohamad (PH)	Social Health Insurance
2022	Khairy Jamaluddin	Ismail Sabri Yaakob (BN)	Social Health Insurance / Co-payments
2023	Zaliha Mustafa	Anwar Ibrahim (PH)	National Health Insurance
2024	Dzulkefly Ahmad	Anwar Ibrahim (PH)	National Health Fund

Sources: Tradeview Research

Nonetheless, Consensus have Finally been Reached with the Passage of Health White Paper

Politicians from Both Sides of the Divides have approved the Health White Paper which was tabled in parliament in 2023. Among the key reforms outlined are the establishment of a National Health Fund, enhanced collaboration between the public and private sectors, and the decentralization of healthcare services. Implementation of these measures is currently overseen by the Health Transformation Office under the purview of the MoH.

Establishment of National Health Fund Could Occur as Early as Budget 2025

As the first step towards realizing the goal of boosting funding for public healthcare to 5% of GDP – as outlined in the Health White Paper, such arrangement is necessary for the MoH to segregate and pool financing from various sources, in our opinion. Revenue from an expanded sugar tax and Full-Paying Patient program will likely be among the first to be rechanneled into the fund, aside from the usual fiscal budget allocation.

Sugar Tax Likely to Increase, Scope Could Expand

MoH is seeking to hike sugar-sweetened beverage taxes to 20% of retail prices, aligning with the World Health Organization's (WHO) recommendation. This would represent a significant shift from the current rate of RM0.50 per litre (Figure 4). In tandem with this, we anticipate that the removal of the sugar subsidy and the lifting of the ceiling price for sugar could be implemented as part of broader subsidy rationalization efforts. While the proposed tax hike is widely expected by the market, we believe there is potential for the scope of the tax to expand. This could be done by lowering the sugar content threshold, as the WHO's guidelines advocate for taxing all sugary beverages, regardless of sugar content limits.

Figure 4: Current Structure of Sugar Sweetened Beverage Tax

Product Category	Tax Rate	Minimum Sugar Threshold
Carbonated/Flavoured/Non-Alcoholic	RM0.50/litre	5g per 100 ml
Milk-based Drinks	RM0.50/litre	7g per 100 ml
Fruit and Vegetable Juices	RM0.50/litre	12g per 100 ml
Beverage Premixes Excluding Plain Milk and Infant/Children Formulated Milk Powder	RM0.47/100g	33.3g per 100g
Flavoured Milk Powder	RM0.47/100g	46.7g per 100g

Source: Tradeview Research, Federation of Malaysian Manufacturers, Royal Malaysian Customs Department

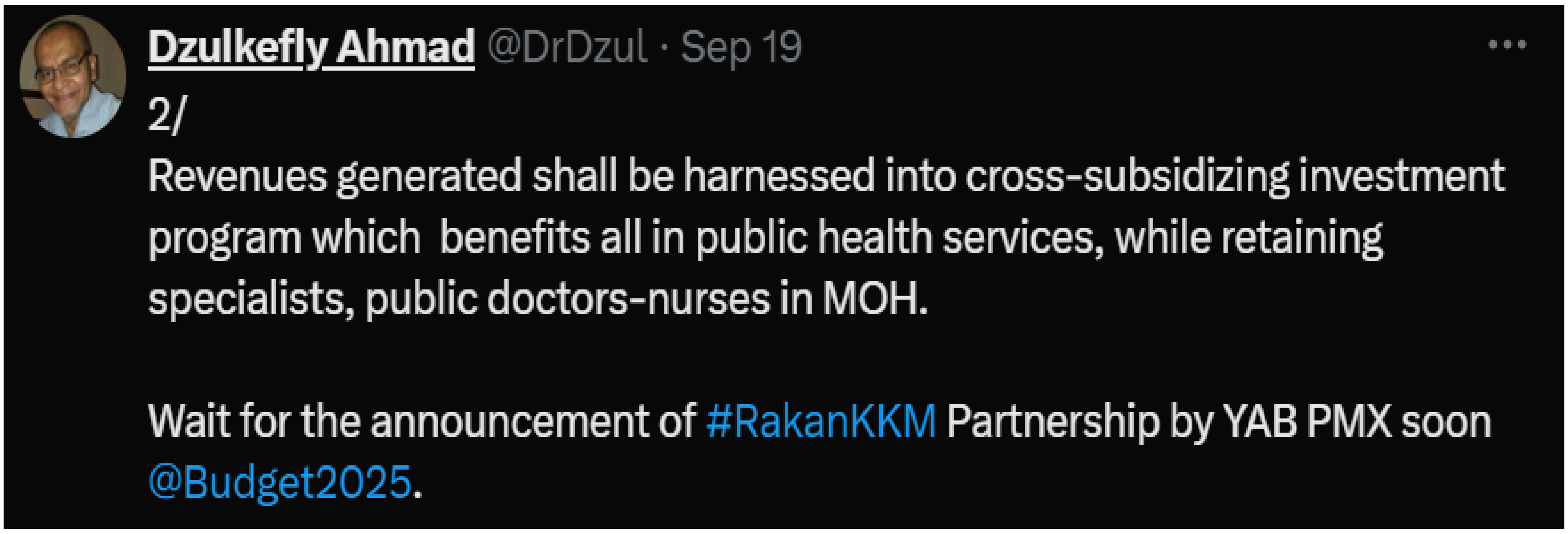
Beverages Producers Could Face Negative Impact

Names including **Fraser & Neave (F&N), Nestlé Malaysia (NESTLE),** and **Power Root (PWROOT)** are the potential losers from broadening sugar taxes. While product reformulation could help mitigate the impact, these efforts may be constrained if the sugar threshold is reduced. Meanwhile, **MSM Malaysia (MSM)** might be seen as another potential loser if the sugar subsidy is removed. However, we believe the financial impact could be offset by the removal of price controls, which may neutralize the net effect on the company's margins.

Rejuvenation of Full-Paying Patient Program (FPP) Likely to be Introduced

Health Minister Dr. Dzulkefly Ahmad recently unveiled plans to expand private wings within MoH government hospitals under the initiative termed RakanKKM (Figure 5). This program aims to rejuvenate the full-paying patient model, generating additional revenue for MoH while also helping to retain specialists within the public healthcare system.

Figure 5: Social Media Comment by Health Minister

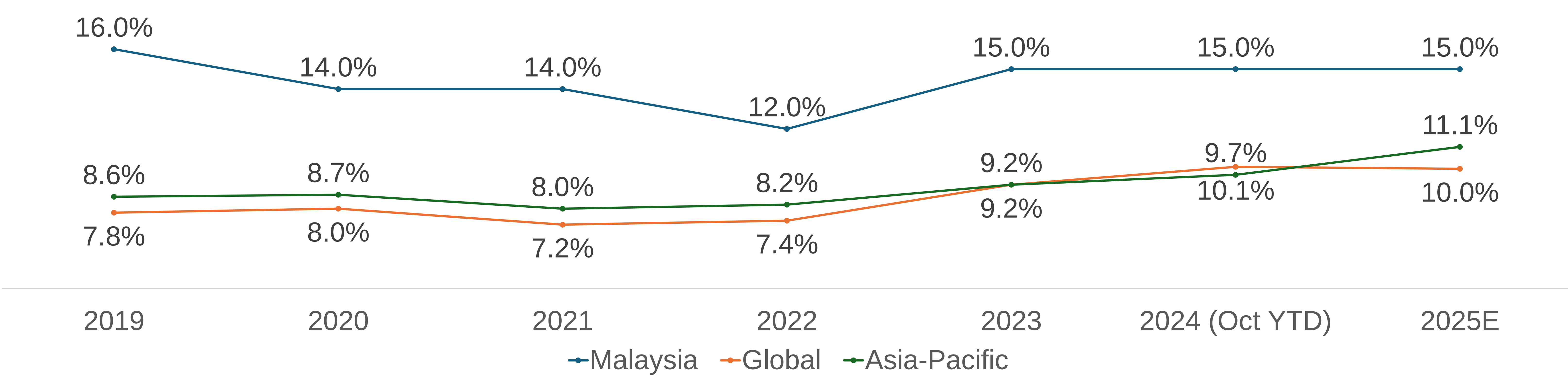


Source: X

Curbing Medical Inflation is Another Key Reason for the FPP Program

We believe RakanKKM is intended to counter the impact of medical inflation faced by the M40 population. As shown in Figure 6, medical inflation in Malaysia has been consistently running ahead of the regional and global average over the past five years – and it is expected to be sustained at 15% in 2024 and 2025. This worrying trend has persisted although the regulatory price cap on doctors' consultation and procedure fees in private hospitals have not been revised since 2013. The "outperformance" of our nation's medical inflation stems from other non-regulated hospital charges such as room & board, laboratory, nursing care, equipment and operation room, and drugs.

Figure 6: Medical Inflation Trends in Malaysia



While FPP Struggled in the Past, This Time Could Be Different

According to a recent article by CodeBlue, of the 10 MoH hospitals that previously offered FPP services, three have since discontinued the program due to post-pandemic issues like construction delays and bed shortages. However, the new RakanKKM initiative could see a turnaround, as it involves investment from government-linked investment companies, which we believe could help address these bottlenecks.

We See Long-Term Competitive Concerns for Private Hospital Operators

From a patient's perspective, the Full-Paying Patient (FPP) program offers treatments at lower costs than private hospitals, with better facilities and the ability to choose specialists—advantages not typically available in public hospitals. If the new RakanKKM initiative can address issues like long waiting times, we believe it could become an attractive option for the M40 population, especially those without medical insurance. This could pose a long-term competitive threat to private hospital operators such as **IHH Healthcare (IHH) and KPJ Healthcare (KPJ).**

Outsourcing of Public Hospital Services Could Provide Private Hospitals with an Alternative Revenue Stream

To alleviate long waiting times for high-demand procedures, the Ministry of Health (MoH) is expanding Public-Private Partnerships (PPP), as outlined in the Health White Paper. This involves outsourcing selected services to private, university, and military hospitals. These arrangements are not new, having been implemented during the pandemic when the MoH outsourced non-Covid-19 patients to reduce pressure on public hospitals.

Existing Outsourcing Programs Provide a Model for Future Expansion

Although Covid-19-related congestion has subsided, the MoH has maintained these outsourcing programs post-pandemic. On 18 July 2024, the MoH launched a new initiative through ProtectHealth, a non-profit company wholly owned by the ministry, to outsource selected high-volume, high-value procedures (Figure 7). The program, with an allocated budget of RM144 million, is set to run through the end of 2024.

Figure 7: Procedures/Services Outsourced

Cardiothoracic	Adult Open-Heart Surgery • Coronary Artery Bypass Graph • Valve Replacement Paediatrics Open-Heart Surgery
Cardiology	Cardiology Investigation • Holter • Echocardiogram • Exercise Stress Test • Dobutamine Stress Test Cardiology Intervention • Coronary Angiogram • Percutaneous Coronary Intervention Paediatrics Cardiology
Radiology	CT Scan MRI MRI Cardiac Ultrasound
Nephrology	Atrio Venous Fistula Surgery
Nuclear Medicine	PET Scan

Source: Tradeview Research, ProtechHealth

Nonetheless, Outsourcing Program Will Likely be Competitively Priced

Unlike the traditional fee-for-service model commonly used by private hospitals, the Health White Paper suggests that MoH's outsourcing program will adopt value-based payment models. This approach is similar to the existing ProtectHealth outsourcing program, where pricing is bundled, with a fixed fee covering the entire procedure, regardless of variations during the course of treatment. As a result, private hospitals participating in the program may face lower profitability compared to their current fee-for-service offerings, in our opinion.

Social Health Insurance Could Be a Game Changer

While we do not expect such measures to be implemented in the near term, any rollout is likely to occur only after five years, as outlined in the Health White Paper. However, the White Paper also recommends the study and proposal of a 'national contributory scheme' within the first five years. Increased discussion around this scheme could have a significant impact on the share prices of private healthcare providers, given the potential game-changing effects it may introduce.

Mandatory Contributions Likely

Bandar Kuching MP Dr. Kelvin Yii, who also serves as Special Advisor to the Minister of Health, has previously outlined an example of a national health insurance scheme funded through payroll contributions, similar to EPF and EIS, with both employees and employers contributing 5% of income (Figure 8). While official contributory structure is still in infancy, we believe that any proposed Social Health Insurance scheme will almost certainly involve mandatory contributions, despite the potential political challenges and unpopularity.

Figure 8: Excerpt of Dr. Kelvin's Speech from Hansard Dated 23 October 2023

Tetapi seperti saya katakan tadi, ini haruslah diimplementasikan secara berfasa dan tidak untuk memotong pendapatan terlalu tinggi. Jika kita mula dengan contohnya lima peratus daripada sumbangan penduduk dan tambahan lima peratus daripada majikan, kita boleh mendapat RM15 hingga RM17 bilion dalam setahun. Ini hampir separuh daripada belanjawan kesihatan.

Sebenarnya kalau HSI ini dilakukan dengan betul, ia dapat dimulakan terlebih dahulu secara berperingkat dengan pekerja-pekerja GLC kerajaan. Sebenarnya pekerja GLC mereka sudah ada satu sistem insurans swasta di mana mereka memberikan perlindungan kepada pekerja mereka. Jadi kita sebenarnya tidak perlu *reinvent the wheel.*

Source: Parlimen Malaysia

Private Insurers and Hospital Operators Could be Negatively Impacted

The introduction of Social Health Insurance, with enhanced funding, quality, and accessibility, could lead to a shrinking market share for private hospitals, particularly among middle-income patients. Without a substitution model—where individuals opting for private health insurance are exempt from contributing to the SHI—many may choose to abandon private insurance. This could result in a significant loss of potential customers for both private insurers and hospital operators, as the public healthcare system becomes a more attractive and cost-effective option.

Selected Pharmaceutical Suppliers Are Set to Benefit

A more well-funded public healthcare system stands to benefit pharmaceutical and medical device suppliers serving the MoH. We anticipate MoH may increase its allocations for pharmaceutical products and medical equipment, which amounted to RM3.5 billion and RM341.8 million, respectively, in 2022. **Pharmaniaga (PHARMA)**, as a key drug manufacturer and exclusive concession holder for medical supply logistics to MoH, appears well-positioned to benefit. Other key players with substantial exposure to the public healthcare market, such as **Duopharma Biotech (DHARMA)** and **UMediC Group (UMC)**, are also likely to see gains, in our view.

Risk Factors

The following represent the greatest risks to our investment thesis:

- A potentially stricter procurement process for pharmaceuticals and medical devices by the Ministry of Health (MoH), which could pressure pricing despite higher budget allocations
- Product failures or political opposition that could delay or significantly reduce the scope of the RakanKKM program
- The risk of a regime change in the next general election, which may impact the likelihood of implementing a Social Health Insurance scheme

Company Implications

Positive

Pharmaniaga Berhad (PHARMA), majority-owned by LTAT, stands out as one of the most direct plays on the Health Care Financing Reform theme, in our view. The company holds an exclusive seven-year concession agreement with the Ministry of Health (MoH), which runs until 2030, for the procurement, supply, and distribution of medical products listed under the Approved Products Purchase List (APPL) to MoH hospitals. Notably, 41% of MoH's medicine procurement in 2022 was through the APPL with PHARMA, while the remaining 59% was sourced via national tenders and local purchase orders by MoH facilities. The concession business contributed about 43% of PHARMA's FY2023 underlying EBITDA, with potential upside if procurement volumes via APPL increase, given the company's handling-fee model. Additionally, PHARMA has a well-established pharmaceutical manufacturing segment, which contributed around 32% of EBITDA and stands to benefit from potential MoH purchases. However, the company's ongoing proposed regularization plan could result in significant dilution for existing shareholders, a key risk to watch.

Duopharma Biotech (DPHARMA) specializes in the development, manufacturing, and marketing of generic drugs and healthcare products in Malaysia. We think the firm will benefit substantially from a better funded MoH, as local public healthcare is the biggest market for DPHARMA, accounting for around 51% of its 1H FY24 sales. The firm has successfully obtained new contracts to supply MoH with 86 products under new APPL until end-2026, and we believe that the strengthening of MYR also bodes well for its margin as more than 50% of its cost of goods sold are denominated in USD

UMediC (UMC) generates 67% of its FY2023 revenue from the marketing and distribution of medical devices, while the remaining revenue comes from its manufacturing of pre-filled humidifiers, a type of medical consumable. We estimate that over 60% of UMC's sales from the marketing and distribution segment come from public hospitals, positioning the company to benefit from an increased procurement budget by MoH. Meanwhile, although only about 10% of its manufactured consumables are currently sold to domestic customers, we see this segment as a key growth driver in the near term. UMC's ongoing capacity expansion aims to increase production of pre-filled humidifiers to 600,000 bottles per month by December 2024, up from 420,000 bottles per month in April 2024.

Company Implications

Negative

IHH Healthcare (IHH) is Malaysia's largest private hospital operator, managing prominent brands like Gleneagles, Pantai, Prince Court, and Timberland. Malaysia is the group's third-largest market, contributing approximately 21% of its FY2023 EBITDA from its core hospital and healthcare operations. IHH primarily caters to the affluent segment, which may be less affected by competition from the public healthcare sector. However, this focus on premium services could also reduce the group's incentive to participate in MoH'S hospital service outsourcing programs, in our view.

KPJ Healthcare (KPJ), with 29 hospitals in Malaysia and two hospitals in Bangladesh and Thailand, is more exposed to potential public healthcare reforms. As 98% of KPJ's FY2023 revenue were derived from its Malaysian operations, it could be more vulnerable to shifts in the local healthcare landscape. Furthermore, KPJ's focus on the mass market segment poses a risk of customer attrition, as the revamped full-paying patient services by MoH could attract some of KPJ's clientele in the long term.