

## Company

27 July 2009 | 9 pages

# Fortis Healthcare (FOHE.BO)

 Equity 

## Sell: Inline 1Q; Good Traction

- No surprises** — Fortis' 1Q results were in line with our expectations on the revenue & EBIDTA levels, while net income came in marginally higher. We believe Fortis is making good progress in its plans to emerge as a national player in the healthcare delivery space. Valuations, however, remain challenging and could limit upside in the near term.
- 1Q: Inline** — Revenues were up 29% YoY, on the back of robust growth across hospitals (Escorts Delhi & Jaipur being the main ones) as occupancy levels & case mix improved. EBIDTA margins also continued to expand (up 218 bps YoY) benefiting from operating leverage. Net income (up 700% YoY) was a tad ahead of our expectations due to lower loss in associates & minority interest.
- Update on key hospitals** — Revenues & EBITDA margins were up across most key hospitals led by Escorts Delhi, with 54% higher revenues & 917bps expansion in EBITDA margins. Growth was aided by addition of new facilities/programs in existing hospitals – stroke clinic in Noida, new emergency & dialysis wings at Escorts Faridabad, a neurosurgery program at Jaipur & an oncology program at Escorts Amritsar.
- Other conference call takeaways** — a) Shalimar Bagh & Gurgaon projects on track to be operational by end FY10 & FY11 respectively; b) Key operating metrics – **Occupancy: 69%** (62% in 1Q09), **ALOS: 3.62 days** (4.02 in 1Q09), **Average rev / op. bed: Rs8m** (Rs6.9m in 1Q09); c) Integration of Fortis Clinic Darne, Mauritius into the operating network completed – network revenues of Rs2.4bn in 1QFY10; d) Budget impact – savings of Rs14m from abolishment of FBT, cRs8m higher tax at 2 subsidiaries due to higher MAT rate.

<b>Sell/High Risk</b>	<b>3H</b>
Price (27 Jul 09)	Rs103.00
Target price	Rs59.00
Expected share price return	-42.7%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>-42.7%</b>
Market Cap	Rs23,347M US\$485M

### Price Performance (RIC: FOHE.BO, BB: FORH IN)



### Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2007A	-963	-5.63	-96.1	-18.3	4.8	-27.9	0.0
2008A	-376	-1.66	70.5	nm	2.1	-5.0	0.0
2009E	114	0.50	130.2	nm	2.0	1.0	0.0
2010E	361	1.59	217.8	64.7	2.0	3.1	0.0
2011E	813	3.58	125.3	28.7	1.9	6.7	0.0

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

## Inline 1Q; Good Traction

Fortis' 1Q results were in line with our expectations on the revenue & EBIDTA levels, while net income came in marginally higher. We believe Fortis is making good progress in its plans to emerge as a national player in the healthcare delivery space. Valuations, however, remain challenging and could limit upside in the near term.

### 1QFY10 results snapshot

Figure 1. FHL – 3QFY09 Earnings Summary (Rupees in Million, Percent)

YE Mar 31	1Q FY09	1Q FY10	%Ch YoY	4Q FY09	% Ch QoQ	CIRA Comments
<b>Net Operating Income</b>	<b>1,439</b>	<b>1,854</b>	<b>28.9</b>	<b>1,728</b>	<b>7.3</b>	<b>In line with expectations – both on revenues &amp; EBIDTA. Marginally ahead on net income</b>
Material Costs	419	543	29.7	550	(1.3)	
as a % of revenues	29.1	29.3	18 bps	31.8	-256 bps	Revenues up 29% YoY driven by strong growth across hospitals led by Escorts Delhi & Jaipur.
Staff Costs	360	425	18.0	353	20.3	
as a % of revenues	25.0	22.9	-213 bps	20.4	247 bps	
Other Expenditure	473	606	28.0	566	7.1	Margin improvement driven by higher occupancies (69% vs. 62% in 1Q09) & improved ALOS (3.62 vs. 4.02 in 1Q09)
as a % of revenues	32.9	32.7	-23 bps	32.7	-9 bps	
Total Expenditure	1,252	1,573	25.7	1,469	7.1	
<b>EBITDA</b>	<b>187</b>	<b>281</b>	<b>50.5</b>	<b>259</b>	<b>8.6</b>	
<b>EBITDA margins</b>	<b>13.0</b>	<b>15.1</b>	<b>218 bps</b>	<b>15.0</b>	<b>17 bps</b>	
Other Income	45	31	(31.6)	46	(33.2)	Higher tax YoY due to higher taxes paid at profitable hospitals especially Escorts Delhi
Interest	109	104	(4.8)	93	11.5	
Depreciation	117	114	(2.6)	128	(11.5)	
PBT	6	94	1,522.4	83	13.1	
Tax	5	18	nm	16	11.0	
Profit after Tax	1	76	nm	67	13.6	
Minority interest	(4)	6	(245.0)	9	(37.6)	
Share in profit of associates	5	5	nm	(9.8)	(154.1)	
<b>Net Profit</b>	<b>9</b>	<b>75</b>	<b>703.2</b>	<b>48</b>	<b>57.9</b>	

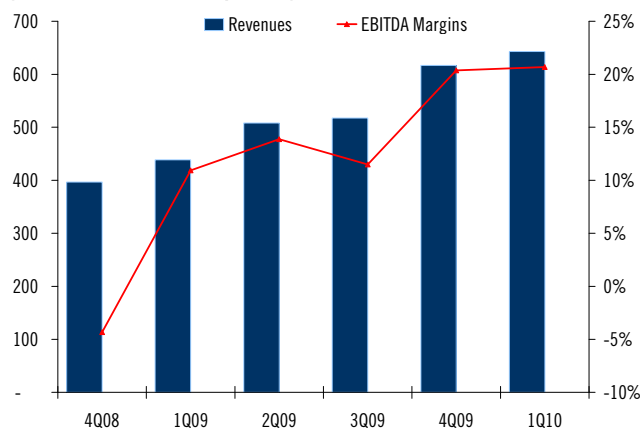
Source: Company Reports and Citi Investment Research and Analysis

Figure 2. Fortis – Key Hospitals Revenues & EBIDTA margins (Rs m, %)

Year Ended March	1Q FY09	1Q FY10	%Ch YoY	4Q FY09	% Ch QoQ
FHL - Mohali	362	414	14.3	415	(0.3)
FHL - Noida	240	275	14.6	228	20.5
Escorts - Delhi	417	643	54.2	617	4.2
Escorts - Faridabad	137	181	32.1	158	14.7
Escorts - Amritsar	88	118	33.8	114	3.3
Escorts - Jaipur	83	141	69.3	131	7.7

Source: Company Reports and CIRA Estimates

Figure 3. Escorts Delhi – Operating Metrics (Rs m, %)

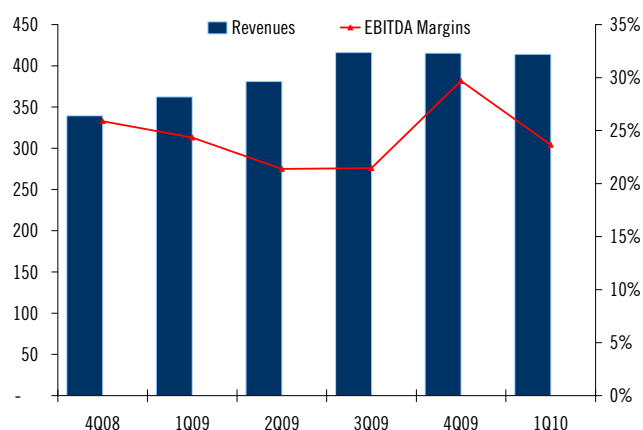


#### CIRA Comments

- Revenues up 54% YoY
- EBITDA margins at 21% up 917bps YoY
- Average revenue/ operating bed of Rs11m
- cRs550m revenues from international patients
- ALOS: 5day; Occupancy: 80%

Source: Company Reports and Citi Investment Research and Analysis

Figure 4. FHL Mohali/Amritsar – Operating Metrics (Rs m, %)

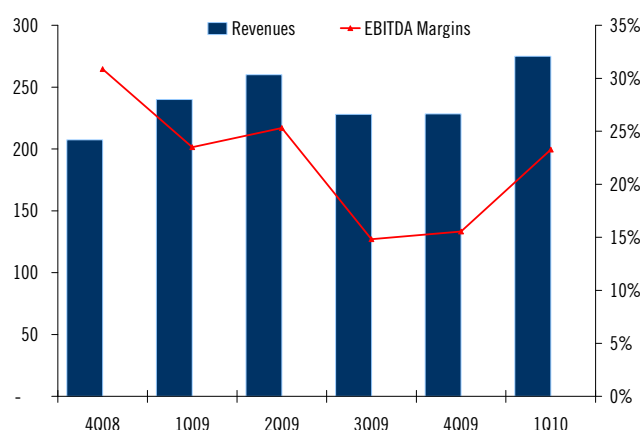


**CIRA Comments**

- Revenue up 14% YoY with EBITDA margins of 24%
- Growth driven by 33% increase in orthopedic procedures
- Occupancy levels of 69% in 1QFY10
- Received license to perform renal transplants

Source: Company Reports and Citi Investment Research and Analysis

Figure 5. Fortis Noida – Operating Metrics (Rs m, %)

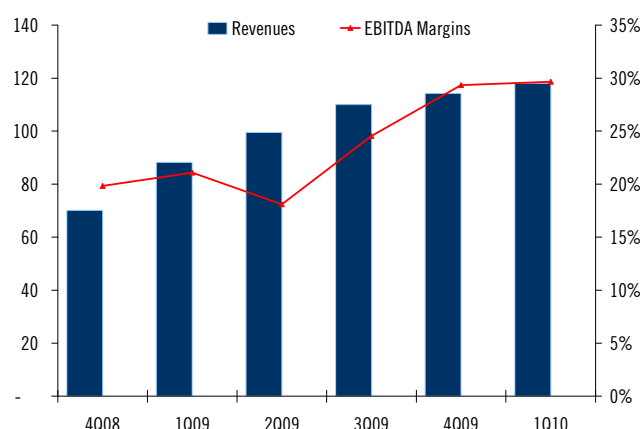


**CIRA Comments**

- Revenues up 15% YoY with EBITDA margins of 23%
- Average occupancy of 64% in 1QFY10
- Launched stroke clinic & added equipments to the Neuro program

Source: Company Reports and Citi Investment Research and Analysis

Figure 6. Escorts Amritsar – Operating Metrics (Rs m, %)

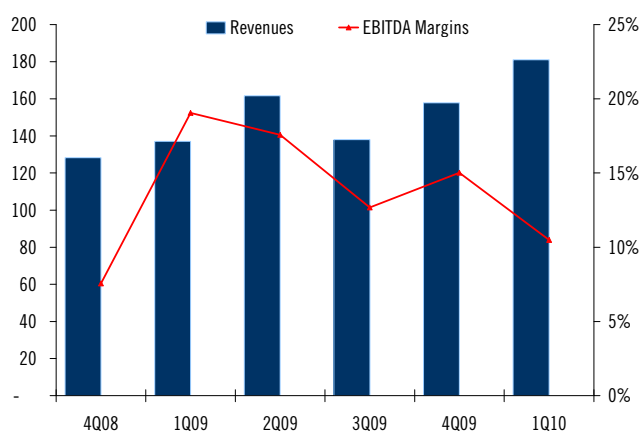


**CIRA Comments**

- Revenues up 33% YoY with EBITDA margins of 30%
- Growth driven by higher number of orthopaedic, neurosciences and cardiac procedures
- Average occupancy of 74% in 1QFY10
- Launched oncology program and commenced operation at the oncology OPD

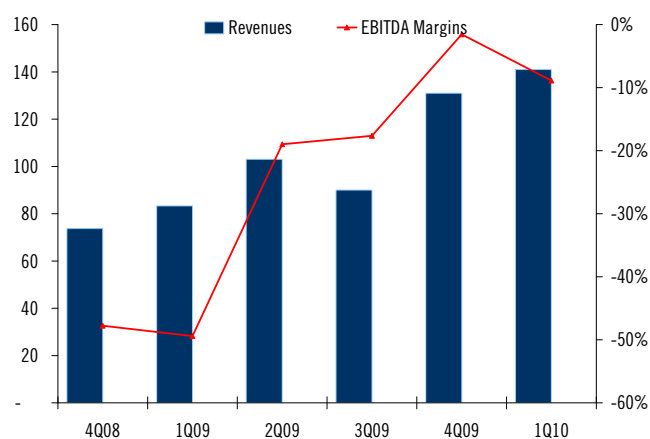
Source: Company Reports and Citi Investment Research and Analysis

Figure 7. Escorts Faridabad – Operating Metrics (Rs m, %)



Source: Company Reports and Citi Investment Research and Analysis

Figure 8. Escorts Jaipur – Operating Metrics (Rs m, %)



Source: Company Reports and Citi Investment Research and Analysis

## Fortis Healthcare

### Company description

Fortis was set up and is owned by the founders of India's largest pharmaceutical company, Ranbaxy Laboratories. Fortis went public in May 07. It is a professionally managed company with a fairly broad management team, headed by Mr. Shivinder Singh (founder shareholder and Managing Director).

### Investment strategy

We rate Fortis as Sell/High Risk with a target price of Rs59/share. While Fortis looks well placed to gain from the growing market for healthcare delivery services in India over the longer term, at current levels it is one of the most expensive hospital stocks in the world and upside is limited, in our view. While we do appreciate the need to value Indian hospitals at a premium to global peers owing to higher growth rates, we believe any re-rating from current levels will be difficult.

### Valuation

We have a price target for Fortis of Rs59/share. We prefer to use EV/EBIDTA versus EBIDTA CAGR as the primary method to value Fortis. We believe that hospital companies in India would have a predictable and steady revenue stream, given high unmet demand and low but growing penetration of organized healthcare. However, given that these companies are still in an investment phase, we believe EBIDTA provides a much better reflection of the operating profitability of the business at this point. Fortis has only one directly comparable company listed on the Indian market - Apollo Hospitals. While Fortis is expected to grow at a faster pace owing to its low base, execution risk is also higher in our view owing to the sheer scale of the expansion planned. As such, we believe it is fair to value both hospitals at similar multiples and in a

similar manner. We therefore value Fortis at 10x FY10E EBITDA, which is the same fair-value multiple that we use for Apollo, being set at the lower end of the latter's EV/EBITDA trading band of 6-20x over the past 2-3 years.

### **Risks**

Our risk rating for Fortis is High Risk, factoring in the recent volatility in markets and therefore overriding the Medium Risk suggested by our quant-based rating system, which tracks 260-day historical share price volatility. Key upside risks to our rating and target price include: (1) If occupancy rates in Escorts increase much faster than expected, the company could beat our earnings estimates; (2) Any significant acquisition, if accretive, could change the outlook for the stock; (3) Any progress on Fortis' plan to unlock value in its land holding could also trigger an upward move in the stock.

# Appendix A-1

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Analyst: Prashant Nair, CFA

Covered since July 11 2007

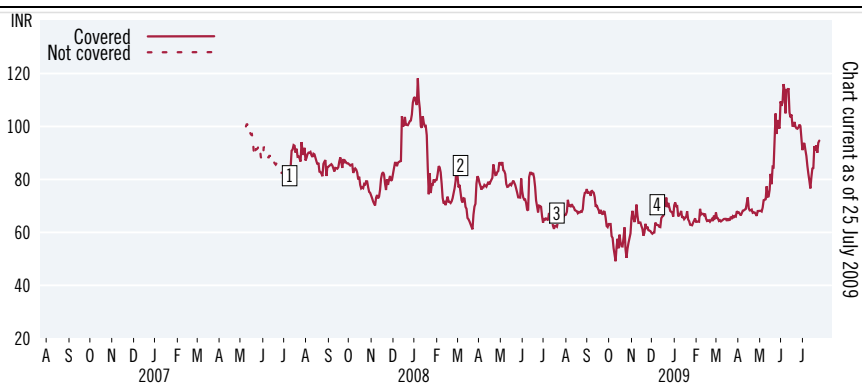


Chart current as of 25 July 2009

	Date	Rating	Target Price	Closing Price
1	10-Jul-07	*1M	*100.00	81.40
2	6-Mar-08	*3M	*75.00	77.95

	Date	Rating	Target Price	Closing Price
3	21-Jul-08	*3H	*60.00	62.15
4	9-Dec-08	3H	*59.00	62.95

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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