Company Flash

31 October 2007 | 6 pages

Fortis Healthcare (FOHE.BO)

Buy: Weak 2Q; Expansion on Track

- **Weak 2Q** — Fortis reported weak 2Q results, with sales up 4% & EBITDA down 42%. EBITDA margins at 6.4% were down 478 bps due to lower occupancies (down to c65%) at Escorts Delhi & losses at the new Jaipur facility (c300bps).
- **Escorts pain continues** —Escorts Delhi faced lower occupancy (65% vs. 70% in 1Q & 87% in FY07), due to the exit of Dr Naresh Trehan & associated negative publicity – thus hurting top line and margins. While this was expected, the extent of decline was higher than we anticipated. Fortis indicated that margins would improve over the next few quarters as costs are brought under control. In the near term, however, this would remain a drag on overall profitability.
- **Expansion update** — 1) Jaipur became operational in 2Q; 2) Malar Hospitals acquisition to be completed by Jan'08; 3) Gurgaon & Shalimar Bagh facilities on track to be commissioned in the next 2 years; 4) Navi Mumbai facility to start in 2H08; 5) one acquisition & one management contract likely in 2H08.
- **Call takeaways** — 1) Fortis' efforts to centralize the supply chain likely to bear fruit from 4QFY08; 2) Flagship facility at Mohali received JCI accreditation; 3) Fortis is evaluating options to move the land & building of some existing facilities to a REIT as part of an asset light strategy.
- **Buy (1M)** — as we believe that Fortis' strong brand equity & super specialty focus make it a good long-term play on the growing healthcare opportunity in India, although execution hiccups/delays on Escorts integration is a key risk.

Buy/Medium Risk	1M
Price (31 Oct 07)	Rs74.95
Target price	Rs100.00
Expected share price return	33.4%
Expected dividend yield	0.0%
Expected total return	**33.4%**
Market Cap	Rs16,989M US$432M

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

Statistical

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	-489	-2.88	na	nm	4.0	-28.6	0.0
2007A	-1,013	-5.92	-105.6	-12.7	3.5	-29.4	0.0
2008E	-494	-2.18	63.2	nm	2.5	-9.5	0.0
2009E	133	0.59	126.9	127.8	2.5	2.0	0.0
2010E	389	1.71	192.4	43.7	2.3	5.5	0.0

Source: Powered by dataCentral

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

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Buy: Weak 2Q; Expansion on track

Fortis reported weak 2Q results, with sales up 4% & EBITDA down 42%. EBITDA margins at 6.4% were down 478 bps due to lower occupancy at Escorts Delhi and losses at the new Jaipur facility. Although the decline in Escorts Delhi was expected, the hit has been higher than our expectations. Other projects continued to progress in-line with expectations and Fortis' plans to follow an asset light strategy could throw up some value unlocking opportunities. We believe that Fortis' strong brand equity & super specialty focus make it a good long-term play on the growing healthcare opportunity in India. However, execution hiccups/delays on Escorts is a key risk

Weak quarter; dragged down by Escorts Delhi

2Q revenues lower due to reduced occupancy rates at Escorts Delhi. Occupancy rates have dropped to c65% from c70% in 1Q and c87% in FY07 at the Escorts Delhi.

EBITDA Margins under pressure as the Jaipur hospital is yet to turn EBITDA positive and lower margins at Escorts Delhi

Figure 1. FHL – Consolidated 2QFY08 Results Snapshot (Rupees in Millions)

Year Ended March	2Q FY07	2Q FY08	%Ch YoY	1QFY08	% Ch QoQ
Net Sales	1,185	1,210	*2.1*	1,268	*(4.5)*
Other Operating Income	29	52	*81.2*	59	*(11.5)*
Net revenues	**1,214**	**1,262**	***4.0***	**1,326**	***(4.8)***
Material Costs	407	360	*(11.5)*	426	*(15.5)*
as a % of revenues	*34.3*	*29.8*	*-458 bps*	*33.6*	*-385 bps*
Staff Costs	320	350	*9.3*	330	*6.1*
as a % of revenues	*27.0*	*28.9*	*190 bps*	*26.1*	*289 bps*
Operating Expenses	240	307	*27.8*	294	*4.5*
as a % of revenues	*20.3*	*25.4*	*509 bps*	*23.2*	*219 bps*
Other expenditure	113	167	*47.4*	135	*23.9*
as a % of revenues	*9.6*	*13.8*	*423 bps*	*10.6*	*316 bps*
Total Expenditure	**1,081**	**1,185**	***9.6***	**1,185**	***(0.1)***
EBITDA	**133**	**78**	***(41.5)***	**141**	***(45.0)***
EBITDA margins (%)	*11.2*	*6.4*	*-478 bps*	*11.1*	*-472 bps*
Other Income	-	25	*nm*	20	
Interest	131	141	*7.5*	170	*(17.1)*
Depreciation	185	227	*22.8*	206	*10.2*
PBT	(184)	(266)	*44.6*	(216)	*23.4*
Tax	20	11	*(46.0)*	24	*(55.3)*
Profit after Tax	**(204)**	**(277)**	***35.8***	**(239)**	***15.6***
Deferred Tax reversal	-	-	*nm*	128	*nm*
Minority interest	(0)	(10)	*nm*	(18)	*(46.4)*
Share in associates	-	0.4	*nm*	0.3	*20.1*
Reported PAT	**(203)**	**(267)**	***(31.4)***	**(349)**	***23.5***

Source: Company Reports and Citi Investment Research

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 Buy/Medium Risk (1M), with a target price of Rs100. Fortis looks well placed to gain from the growing market for healthcare delivery services in India. It is one of the major super-specialty care providers in the country and is expected to benefit from the shift in disease profile from infectious diseases toward lifestyle ailments in India. The company has acquired scale in North India by acquiring the well-known Escorts group of hospitals, and we expect it to pursue further expansion projects - both in North India and beyond. As utilization levels in its existing hospitals pick up and the company is able to exploit the synergies and eliminate inefficiencies in the Escorts hospitals, we expect growth rates and profitability to improve.

Valuation

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. Fortis has only one directly comparable company listed on the Indian market - Apollo Hospitals. While Max India, another listed Indian company, also has a presence in the hospital space, it is not directly comparable, as Max has operations in life insurance, clinical research and other businesses as well. We value Fortis at 15x FY09E EBIDTA, the same multiple we use to value Apollo Hospitals - the leading private-sector hospital company in India.

Risks

We rate Fortis as Medium Risk, as opposed to the default Speculative Risk rating we assign for stocks with a trading history of less than 260 days. We believe a Medium Risk rating is appropriate as Fortis enjoys strong visibility in revenues/earnings and looks well poised to take advantage of the growing market for healthcare delivery in India, which is partly offset by the various litigations against Fortis, especially related to the Escorts group of Hospitals. Key risk factors include: (1) If occupancy rates decline or Fortis is unable to scale up occupancies in its new hospitals, then margins could come under pressure and capital efficiency could suffer; (2) Changing technology could make equipment redundant earlier than budgeted; and (3) Any delay or inability to effectively integrate acquisitions could put undue strain on capital efficiency. Any of these risks could impede the stock from reaching our target price.

Appendix A-1

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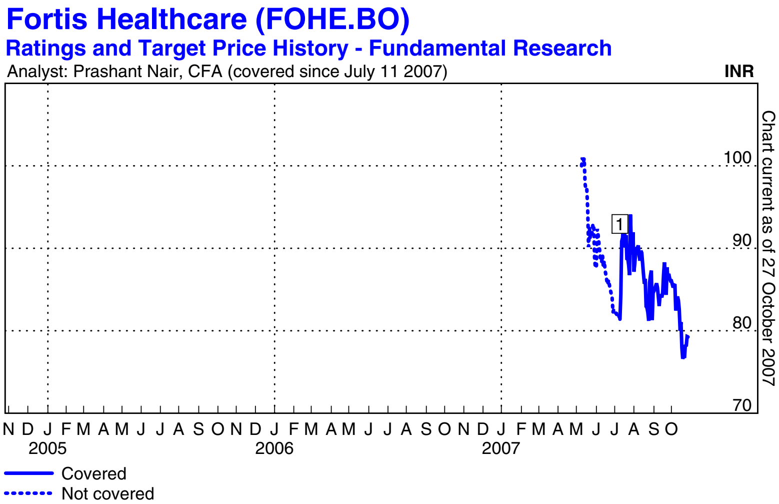

#	Date	Rating	Target Price	Closing Price
1:	10 Jul 07	1M	100.00	81.40

*Indicates change.

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