Company In-Depth

10 September 2007 | 8 pages

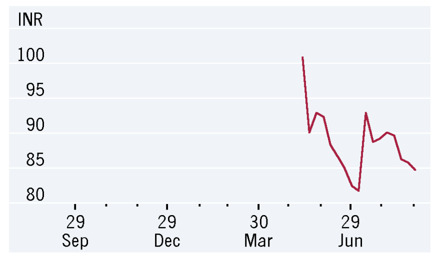
Fortis Healthcare (FOHE.BO)

Buy: Malar Acquisition — Heading South

- **Maintain Buy (1M)** — Fortis' (FHL) acquisition of the Chennai-based Malar Hospitals, although small, is significant as it marks the company's entry into South India. We believe that FHL's strong brand equity and super specialty focus make it a good play on the growing healthcare opportunity in India, and we expect more initiatives from the company to build a pan-India presence.
- **The deal** — FHL will acquire a majority stake (c59%) in Malar Hospitals through a combination of conversion of loan into equity (18%), buyout of existing promoter stake (21%) and an open offer (20%). This works out to an equity value of Rs420m and EV of Rs560m for the 180-bed multi-specialty hospital.
- **Small, but accretive** — Malar Hospitals is a 180-bed multi-specialty hospital, operating at an occupancy of 75%, with estimated sales & EBIDTA of Rs160m & Rs40-45m respectively. This values the deal at an attractive 13x Sept'07E EBIDTA, which we believe makes it accretive from the first year.
- **Going South** — The Malar acquisition is part of Fortis' efforts to diversify beyond North India and represents its maiden foray into South India. Fortis will be able to leverage MHL's 500+ employee base (including 50+ doctors) to tap this market, while using its own expertise to improve the delivery of care and grow average collections. With the existing management continuing in place, we expect seamless integration of operations.

Buy/Medium Risk	1M
Price (10 Sep 07)	Rs84.15
Target price	Rs100.00
Expected share price return	18.8%
Expected dividend yield	0.0%
Expected total return	18.8%
Market Cap	Rs19,074M
	US$471M

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



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

Statistical Abstract

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	4.5	-28.6	0.0
2007A	-1,013	-5.92	-105.6	-14.2	3.9	-29.4	0.0
2008E	-494	-2.18	63.2	nm	2.8	-9.5	0.0
2009E	133	0.59	126.9	143.5	2.8	2.0	0.0
2010E	389	1.71	192.4	49.1	2.6	5.5	0.0

Source: Powered by dataCentral

Prashant Nair, CFA[1]
+91-22-6631-9855
prashant.nair@citi.com

Chirag Dagli[1]
+91-22-6631-9874
chirag.dagli@citi.com

Akshay Rai[1]
akshay.rai@citi.com

[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	nm	-14.2	nm	143.5	49.1
EV/EBITDA adjusted (x)	98.0	52.4	24.8	13.1	10.5
P/BV (x)	4.5	3.9	2.8	2.8	2.6
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	-2.88	-5.92	-2.18	0.59	1.71
EPS reported	-2.88	-5.92	-2.18	0.59	1.71
BVPS	18.84	21.55	29.61	30.20	31.92
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	2,926	5,124	6,255	8,641	10,858
Operating expenses	-3,144	-5,477	-6,209	-7,930	-9,813
EBIT	**-218**	**-353**	**46**	**711**	**1,045**
Net interest expense	-363	-660	-477	-431	-534
Non-operating/exceptionals	44	81	31	73	133
Pre-tax profit	**-538**	**-933**	**-399**	**353**	**644**
Tax	9	-73	-80	-190	-219
Extraord./Min.Int./Pref.div.	39	-7	-15	-30	-36
Reported net income	**-489**	**-1,013**	**-494**	**133**	**389**
Adjusted earnings	-489	-1,013	-494	133	389
Adjusted EBITDA	232	485	962	1,703	2,116
Growth Rates (%)					
Sales	296.8	75.1	22.1	38.1	25.7
EBIT adjusted	-37.4	-61.9	113.1	nm	46.9
EBITDA adjusted	422.4	109.3	98.5	77.1	24.2
EPS adjusted	-470.1	-105.6	63.2	126.9	192.4
Cash Flow (RsM)					
Operating cash flow	**-132**	**-298**	**1,488**	**1,549**	**1,869**
Depreciation/amortization	450	838	916	992	1,071
Net working capital	-121	-96	993	248	204
Investing cash flow	**-7,167**	**-899**	**-2,281**	**-1,500**	**-1,700**
Capital expenditure	-679	-899	-2,280	-1,500	-1,700
Acquisitions/disposals	-6,276	-1	0	0	0
Financing cash flow	**7,450**	**1,337**	**1,450**	**966**	**1,220**
Borrowings	3,987	-116	-2,070	966	1,220
Dividends paid	0	0	0	0	0
Change in cash	**151**	**139**	**658**	**1,015**	**1,389**
Balance Sheet (RsM)					
Total assets	**10,596**	**11,438**	**12,732**	**14,588**	**16,909**
Cash & cash equivalent	167	307	964	1,980	3,369
Accounts receivable	678	882	563	778	977
Net fixed assets	4,541	5,085	6,904	7,867	8,951
Total liabilities	**7,203**	**7,557**	**5,810**	**7,503**	**9,400**
Accounts payable	790	1,053	1,828	2,546	3,212
Total Debt	5,985	5,922	3,852	4,818	6,038
Shareholders' funds	**3,393**	**3,881**	**6,922**	**7,085**	**7,510**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	7.9	9.5	15.4	19.7	19.5
ROE adjusted	-28.6	-29.4	-9.5	2.0	5.5
ROIC adjusted	-3.9	-4.3	-0.3	5.2	8.1
Net debt to equity	171.4	144.7	41.7	40.1	35.5
Total debt to capital	63.8	60.4	35.8	40.5	44.6

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Malar Acquisition – Heading South

Fortis' (FHL) acquisition of the Chennai-based Malar Hospitals, although small, is significant as it marks the company's entry into South India. We believe that FHL's strong brand equity and super specialty focus make it a good play on the growing healthcare opportunity in India and expect more initiatives from the company to build a pan-India presence.

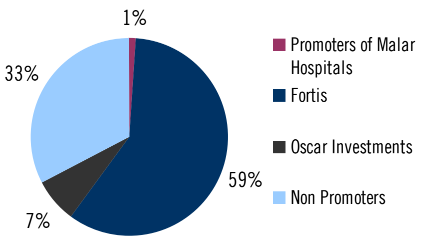
Going South

Fortis' (FHL) acquisition of the Chennai-based Malar Hospitals, although small, is significant as it marks the company's entry into South India. FHL's 100% subsidiary, International Hospitals Limited (IHL), will acquire a majority stake (c59%) in Malar Hospitals through a combination of conversion of loan into equity (18%), buyout of existing promoter stake (21%) and an open offer (20%).

IHL and another group company (Oscar Investments Limited) had lent Rs140m to Malar Hospitals - IHL's share being Rs100m. As per the deal, this loan would be converted into equity at a price of Rs30/share. Besides, IHL would also buy around 3.9m shares from the existing promoters at the same price and make an open offer for 20% of the expanded equity of Malar Hospitals.

Malar Hospitals is a 180-bed multispecialty hospital that provides cardiac care, renal transplants, neurosurgery among others and trauma care centres. The acquisition provides Fortis with a strong foothold in the South India region as it tries to develop a pan-India presence. It currently has an occupancy of around 75% and is expected to clock revenues, EBIDTA and net profit of Rs160m, Rs40-45m and Rs6m respectively for the year ended September '07.

Figure 2. Shareholding pattern of Malar Hospitals post open offer



Source: Citigroup Investment Research

Figure 1. FHL's shareholding of Malar Hospitals post the open offer

	No. of Shares (m)	CIR Comments
Initial		
Promoter's Stake	4.1	
Non-Promoters' Stake	9.8	
Total	13.9	
Post-Conversion of Rs. 140 m loan from FHL and Oscar Investments Ltd.		
Promoter's Stake	4.1	
Non-Promoters	9.8	
Conversion of loan from FHL	3.3	*18% of expanded equity on conversion*
Conversion of loan from Oscar	1.3	*7% of expanded equity on conversion*
Total	18.6	*Total equity shares of Malar hospitals after conversion of 140 million loan from FHL & Oscar*
Fortis' Holding in Malar Hospitals		
Bought from promoters	3.9	*21% of expanded equity to be bought over by FHL*
Fresh issue from conversion of loan	3.3	*18% of expanded equity on conversion*
Bought through open offer	3.7	*Open offer by FHL for 20% of expanded equity*
Total	11.0	*59% of expanded equity to be owned by FHL*
Eventual holding of FHL in Malar post open offer	*59%*	

Source: Citigroup Investment Research

This works out to an equity value of Rs420m for Malar Hospitals. Besides, the company has debt of around Rs140m, working out to an enterprise value of Rs560m. This values the deal at an attractive 13xSept'07E EBIDTA. We believe the deal will be accretive from the first year.

FHL's strong brand equity and super specialty focus make it a good play on the growing healthcare opportunity in India, and we expect more initiatives from the company to build a pan-India presence. Fortis currently trades at an attractive 13x FY09E EBIDTA, we maintain a Buy with Medium Risk rating.

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 thesis

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

Analyst Certification

We, Prashant Nair, CFA and Chirag Dagli, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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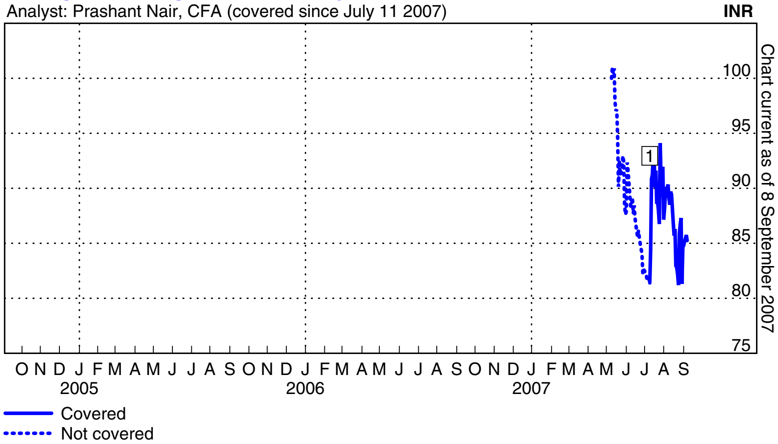
Fortis Healthcare (FOHE.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Prashant Nair, CFA (covered since July 11 2007)



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

*Indicates change.

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India -- Asia Pacific (144)	64%	11%	25%
% of companies in each rating category that are investment banking clients	89%	94%	83%

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