

Equities

13 February 2012 | 9 pages

Fortis Healthcare (FOHE.BO)

Growth Momentum Sustained

- **Awaiting a clearer picture** — Fortis continues to do well in India, with good growth & improving operating metrics in hospitals - though margins in the diagnostics biz disappointed. The stock has taken a beating after its decision to buy Fortis International and valuations appear undemanding. However, any material re-rating is unlikely till investors get more details on financial & operating parameters of the acquired overseas assets.
- **Growth momentum sustained** — Revenue growth (+63% YoY, +30% ex-SRL) remained robust on higher operational beds (c900beds YoY) & ARPOBs (+15% YoY, +5% QoQ). The growth is encouraging as it has come despite the larger hospitals (Escorts Delhi, Mohali, Noida) witnessing single-digit growth – primarily due to postponement of some procedures due to the festive season.
- **Start-up expenses pull down margins** — EBITDA margin declined (-74bps YoY, -52 bps QoQ) due to start-up expenses: a) commissioning of two new SRL Labs (c400bps QoQ margin decline) & b) commissioning of 225 new hospital beds. However, Hospitals biz margin improved (+80bps YoY, +100bps after adj for impact of new beds) on better mix & increasing avg EBITDA margin of mature hospitals. Higher interest income (on loans & advances) buoyed PAT despite higher interest and depreciation.
- **Hospitals operating metric trends mixed** — Increasing revenue contribution (81% vs. 78% in 2Q'12) & rising ARPOBs of hospitals with over 3 years maturity led to higher ARPOBs. Occupancy was lower & ALOS was higher on addition of c700 beds in 9mFY12 – similar trends QoQ due to seasonality. Product mix also improved as key therapies (including cardiac, ortho, neuro, renal – over 50% of sales now) contributed more to revenues.
- **Other conference call takeaways** — 1) Fortis International to be consolidated from 4Q'12 onwards; 2) Gross debt: Rs22bn, Cash: Rs0.5bn; 3) To add 600beds in next 6 months; 4) Targeting 1:1 net D/E ratio; 5) Revenues from international patients: Rs330m; 6) Operational beds: 4,100.

Statistical Abstract

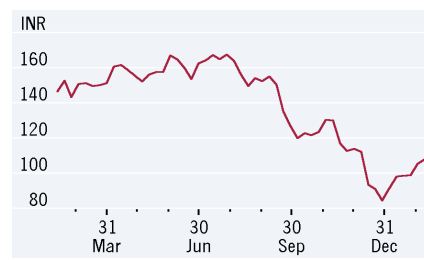
Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2010A	695	2.19	242.5	48.8	1.9	4.8	0.0
2011A	1,066	2.47	12.6	43.3	1.4	4.2	0.0
2012E	235	0.54	-78.0	196.5	1.4	0.7	0.0
2013E	2,243	5.19	854.6	20.6	1.3	6.5	0.0
2014E	2,335	5.40	4.1	19.8	1.2	6.4	0.0

Source: Powered by dataCentral

Company Update

Buy	1
Price (10 Feb 12)	Rs106.80
Target price	Rs150.00
Expected share price return	40.4%
Expected dividend yield	0.0%
Expected total return	40.4%
Market Cap	Rs43,273M
	US\$877M

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



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FOHE.BO: Fiscal year end 31-Mar						Price: Rs106.80; TP: Rs150.00; Market Cap: Rs43,273m; Recomm: Buy					
Profit & Loss (Rsm)	2010	2011	2012E	2013E	2014E	Valuation ratios	2010	2011	2012E	2013E	2014E
Sales revenue	9,379	14,830	23,490	56,606	66,846	PE (x)	48.8	43.3	nm	20.6	19.8
Cost of sales	-5,341	-8,395	-12,997	-29,127	-34,370	PB (x)	1.9	1.4	1.4	1.3	1.2
Gross profit	4,038	6,435	10,493	27,479	32,476	EV/EBITDA (x)	35.1	25.0	18.1	10.3	10.6
Gross Margin (%)	43.1	43.4	44.7	48.5	48.6	FCF yield (%)	-26.6	-7.8	-29.7	-69.6	-7.7
EBITDA	1,413	2,080	3,255	7,935	9,419	Dividend yield (%)	0	0	0	0	0
EBITDA Margin (%)	15.1	14.0	13.9	14.0	14.1	Payout ratio (%)	0	0	0	0	0
Depreciation	-599	-1,045	-1,970	-3,114	-3,425	ROE (%)	4.8	4.9	0.7	6.5	6.4
Amortisation	0	0	0	0	0	Cashflow (Rsm)	2010	2011	2012E	2013E	2014E
EBIT	814	1,035	1,285	4,821	5,994	EBITDA	1,413	2,080	3,255	7,935	9,419
EBIT Margin (%)	8.7	7.0	5.5	8.5	9.0	Working capital	-2	-336	-385	-1,425	-2,765
Net interest	-573	-696	-1,081	-2,156	-3,220	Other	26	-1,844	-1,062	-2,147	-3,195
Associates	0	0	0	0	0	Operating cashflow	1,437	-101	1,809	4,363	3,459
Non-op/Except	493	1,103	43	9	9	Capex	-10,440	-3,522	-15,500	-36,500	-7,000
Pre-tax profit	734	1,442	247	2,674	2,783	Net acq/disposals	0	0	0	0	0
Tax	-34	-76	-37	-401	-418	Other	-34,583	25,218	802	0	0
Extraord./Min.Int./Pref.div.	-5	-119	25	-30	-31	Investing cashflow	-45,023	21,696	-14,698	-36,500	-7,000
Reported net profit	695	1,246	235	2,243	2,335	Dividends paid	0	0	0	0	0
Net Margin (%)	7.4	8.4	1.0	4.0	3.5	Financing cashflow	56,160	-32,399	11,307	32,573	3,825
Core NPAT	695	1,066	235	2,243	2,335	Net change in cash	12,574	-10,803	-1,583	436	284
Per share data	2010	2011	2012E	2013E	2014E	Free cashflow to s/holders	-9,003	-3,623	-13,691	-32,137	-3,541
Reported EPS (Rs)	2.19	2.88	0.54	5.19	5.40						
Core EPS (Rs)	2.19	2.47	0.54	5.19	5.40						
DPS (Rs)	0	0	0	0	0						
CFPS (Rs)	4.53	-0.23	4.18	10.09	8.00						
FCFPS (Rs)	-28.37	-8.38	-31.67	-74.35	-8.19						
BVPS (Rs)	57.37	75.95	76.79	81.98	87.38						
Wtd avg ord shares (m)	317	432	432	432	432						
Wtd avg diluted shares (m)	317	432	432	432	432						
Growth rates	2010	2011	2012E	2013E	2014E						
Sales revenue (%)	48.8	58.1	58.4	141.0	18.1						
EBIT (%)	119.2	27.2	24.2	275.1	24.3						
Core NPAT (%)	379.5	53.4	-78.0	854.6	4.1						
Core EPS (%)	242.5	12.6	-78.0	854.6	4.1						
Balance Sheet (Rsm)	2010	2011	2012E	2013E	2014E						
Cash & cash equiv.	13,114	1,636	79	485	739						
Accounts receivables	1,567	1,952	4,228	10,189	12,032						
Inventory	238	263	705	1,698	2,005						
Net fixed & other tangibles	16,649	19,100	22,630	38,516	42,091						
Goodwill & intangibles	8,626	8,867	18,867	36,367	36,367						
Financial & other assets	36,756	15,747	13,993	15,085	17,487						
Total assets	76,950	47,566	60,501	102,340	110,721						
Accounts payable	2,901	3,196	4,561	11,497	13,628						
Short-term debt	24,253	254	4,100	12,000	16,000						
Long-term debt	30,454	10,629	17,959	36,459	36,459						
Provisions & other liab	792	354	372	390	410						
Total liabilities	58,400	14,433	26,992	60,346	66,496						
Shareholders' equity	18,205	32,829	33,195	35,438	37,773						
Minority interests	345	304	314	6,682	6,753						
Total equity	18,550	33,132	33,509	42,120	44,526						
Net debt	41,593	9,247	21,980	47,974	51,720						
Net debt to equity (%)	224.2	27.9	65.6	113.9	116.2						

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3QFY12 Financial Snapshot

Figure 1. Fortis HC – 3QFY12 Earnings Summary (Rs m, %)

Fortis	3Q FY11	3Q FY12	%Ch YoY	2Q FY12	% Ch QoQ	CIRA Comments
Net Sales	3,714	6,047	62.8	6,101	(0.9)	Conclusion: PAT higher despite lower EBITDA – helped by other income
Material Costs	976	1,547	58.6	1,584	(2.3)	
as a % of revenues	26.3	25.6	-68 bps	26.0	-37 bps	
Staff Costs	656	1,105	68.3	1,144	(3.5)	Revenue growth driven by robust performance across hospitals & consolidation of SRL revenues
as a % of revenues	17.7	18.3	60 bps	18.8	-49 bps	
Other Expenditure	1,544	2,562	66.0	2,501	2.5	
as a % of revenues	41.6	42.4	82 bps	41.0	138 bps	Even without SRL – growth remained robust
EBITDA	539	832	54.5	871	(4.5)	EBITDA margin declined YoY on addition of new capacity, (start up losses) & consolidation of lower margin SRL
EBITDA margins (%)	14.5	13.8	-74 bps	14.3	-52 bps	
Other Income	369	528	43.1	99	432.6	
Interest	211	595	182.2	504	18.2	After adj for losses at new hospitals, EBITDA margin higher both YoY & QoQ
Depreciation	269	424	57.7	385	10.0	
PBT	428	341	(20.3)	81	318.5	
Tax	71	84	17.1	130	(35.9)	Higher interest & depreciation on higher debt & commissioning of new facilities respectively
Profit after Tax	357	258	(27.8)	(49)	(626.6)	
Minority interest	10	(34)	(435.0)	(16)	113.4	
Share in profit of associates	(2)	3	nm	2	8.7	Higher other income (Rs400m of interest income) helped recurring PAT – interest income accrued due to advance to a third party for a transaction (which didn't happen)
Recurring PAT	345	294	(14.9)	(31)	(1,049.8)	
EO Items –Loss/(Gain)	-	-	nm	95.0	(100.0)	
Reported PAT	345	294	(14.9)	(126)	(333.1)	

Source: Company, Citi Investment Research and Analysis

Figure 2. Fortis Healthcare – Performance of Key Hospitals (Rs m, %)

Year Ended March	3Q FY11	3Q FY12	%Ch YoY	2Q FY12	% Ch QoQ
Escorts - Delhi	780	831	6.5	816	1.8
Mohali	559	595	6.4	637	(6.6)
Noida	447	464	3.8	463	0.2
BG Road	355	424	19.4	417	1.7
Vasant Kunj	304	348	14.5	377	(7.7)
Escorts - Jaipur	206	282	36.9	287	(1.7)
Mulund	350	432	23.4	445	(2.9)

Source: Company, Citi Investment Research and Analysis

Figure 3. Maturity-wise Performance – 3QFY12

Maturity	Hospitals	Operating Beds	Revenue Contribution	EBITDA contribution	Avg EBITDA Margin	Average Occupancy	Average ARPOB (Rs m)
5 years and above	5	14%	24%	29%	24%	76%	11.7
3-5 years	10	56%	57%	67%	23%	67%	8.2
1-3 years	10	23%	18%	5%	5%	64%	6.9
upto 1 year	4	7%	1%	-1%	-15%	32%	1.9

Source: Citi Investment Research and Analysis

Fortis Healthcare

Company description

Fortis Healthcare was incorporated in 1996, set up and owned by the erstwhile founders of Ranbaxy. It is one of India's fastest growing hospital chains, with a network of 51 hospitals and 6,700 bed capacity under management in the country. Post commissioning of the first hospital in 2001, it has acquired several hospitals across India and is now one of the largest hospital groups from India. It recently forayed into diagnostics by acquiring Super Religare Labs (SRL) and announced the acquisition of the founders' privately held firm, Fortis Healthcare International, to lead its expansion into the international markets.

Investment strategy

We rate Fortis Buy (1) with a TP of Rs150. Fortis looks well placed to gain from the growing market for healthcare delivery services in India over the longer term. We expect growth to remain strong on the back of its aggressive expansion plan and faster turnaround of newer hospitals. On the other hand, we are cautious on its overseas strategy and its possible impact on balance sheet & return ratios - likely to weigh on valuations. However, with the recent dip, we believe these are priced in.

Valuation

Our target price for Fortis is Rs150. We prefer to use EV/EBIDTA versus EBIDTA CAGR as the primary method to value the company. 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. We therefore use EV/EBIDTA vs. EBIDTA CAGR as our primary methodology to value Fortis Healthcare. We believe Indian hospitals should trade at a premium to their global counterparts given the much higher growth opportunity in the Indian market. We benchmark our target sector multiple with comparable peers in the Asia Pac region. Our current EV/EBIDTA multiple of 15x is also in the range that Fortis has traded over the last several years. At 15x Mar '13E EBITDA, we arrive at a target price of Rs150.

Risks

The key risks to our target price include: 1) Execution is a key risk - delays in setting up hospital projects - especially given its foray into less understood international markets; 2) Rising cost of capital - given the capital intensive nature of the business; 3) Higher cost of real estate and / or inability to get property at the desired locations could impact operations.

Appendix A-1

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Fortis Healthcare (FOHE.BO)

Ratings and Target Price History Fundamental Research

Analyst: Prashant Nair, CFA



	Date	Rating	Target Price	Closing Price
1	8-Sep-09	*3M	*110.00	110.95
2	19-Mar-10	3M	*145.00	177.55
3	3-Dec-10	*1L	*190.00	152.90

* Indicates change

	Date	Rating	Target Price	Closing Price
4	28-Sep-11	1L	*172.00	125.00
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*1	172.00	121.05

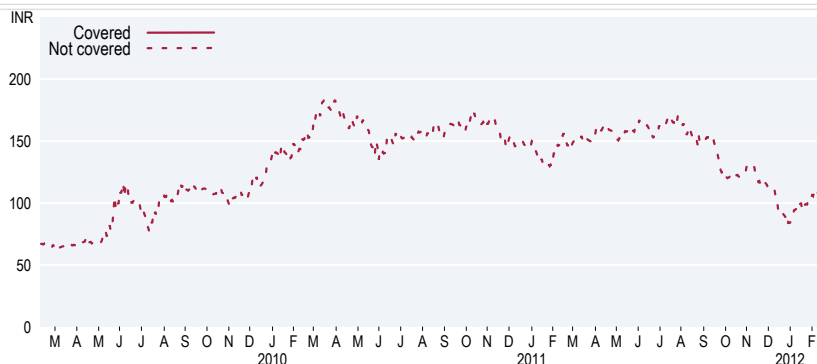
	Date	Rating	Target Price	Closing Price
7	28-Nov-11	1	*150.00	116.20

Rating/target price changes above reflect Eastern Standard Time

Fortis Healthcare (FOHE.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Prashant Nair, CFA



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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