

4 July 2011

Healthcare Services

Q1FY12 Results Preview

A healthy performance expected

We remain positive on the healthcare services sector given the demand-supply mismatch, good brand-building exercises by companies and robust long-term growth potential. We retain our Buy rating on Apollo Hospitals and Hold on Fortis Healthcare. Both companies are well-positioned to register strong growth due to increasing demand for quality healthcare services and have sound business models.

- **Sales growth to continue:** We expect Apollo Hospitals to report 22.3% YoY sales growth in Q1FY12 to Rs6,401mn. Fortis Healthcare is expected to notch a higher growth of 28.9% YoY to Rs4,356mn.
- **Concerns over margins:** We expect Apollo Hospitals' EBITDA margin to marginally inch up to 15.6% from 15.2% in Q4FY11. We expect margin to contract 130bps YoY because of inflationary pressures. We expect Fortis Healthcare to report EBITDA margin of 14.1%, up 130bp QoQ, but flat YoY. Fortis incurred one-time expenses in Q3FY11 and Q4FY11 related to the opening of the Shalimar Bagh Hospital in Delhi and Kolkata Hospital. The margin improvement would primarily be driven by cost efficiencies and improving operating leverage.
- **Profitability to grow:** We expect Apollo Hospitals' PAT to grow by a healthy 16.7% YoY to Rs458mn and Fortis to report a PAT of Rs131mn against a loss of Rs143mn in Q1FY11.
- **Key points:** For Apollo Hospitals, the key thing to watch out for would be the performance of its pharmacy division. The division reported a positive EBIT margin of 0.3% in Q2FY11, negative margin of 0.5% in Q3FY11 and positive margin of 0.3% again in Q4FY11. We believe the division would achieve PAT breakeven by the end of FY12 and this division's performance would be a key factor in improving overall margins. For Fortis Healthcare, the status of its 900-bed greenfield hospital in Gurgaon (phase 1: 450 beds) would be important. The facility was slated to open in early Q2FY12. Any delay would impact our estimates.
- **Valuations:** We have a Buy rating on Apollo Hospitals and value it at 14x FY13E EV/EBITDA to arrive at a price target of Rs646. We have a Hold rating on Fortis Healthcare and value it at 15x FY13E EV/EBITDA to arrive at a price target of Rs167.

Price Performance (%)

	1M	3M	1Y
Apollo Hospitals	2.9	7.7	32.3
Fortis Healthcare	(0.1)	10.3	7.9
NIFTY	2.4	(8.1)	7.9

Source: Bloomberg, Centrum Research Estimates
*as on 04 July 2011

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Summary Estimates

Y/E Mar (Rsmn)	Net Sales (Rsmn)				EBITDA (Rsmn)				EBITDA Margin (%)		Adj. PAT (Rsmn)			
	Q1FY12E	YoY (%)	QoQ (%)	FY12E	Q1FY12E	YoY (%)	QoQ (%)	FY12E	Q1FY12E	Q1FY11	Q1FY12E	YoY (%)	QoQ (%)	FY12E
Apollo Hospitals	6,401	22.3	3.0	28,447	998	13.0	5.4	4,523	15.6	16.1	458	16.7	(2.7)	2,163
Fortis Healthcare	4,356	28.9	4.8	19,890	613	29.0	16.4	3,101	14.1	14.1	131	NA	(59.4)	1,159

Source: Centrum Research Estimates

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Apollo Hospitals Enterprise (Buy; Target Price: Rs646)

- We expect Apollo Hospitals to register 22.3% YoY and 3% QoQ sales growth to Rs6,401mn. We expect revenues from the hospital segment to grow 2% QoQ to Rs 4,480mn and pharmacy segment to grow 2.2% QoQ to Rs 1,862mn. We expect the company to have 1,234 operational pharmacies by Q1FY12. We believe the contribution of pharmacy segment to overall revenues would increase to 29.1% from 26.5% in Q1FY11.
- We expect EBITDA to improve 5.4% QoQ and 13.0% YoY to Rs998mn. EBITDA margin is expected to increase 40bps QoQ to 15.6%.
- We expect PAT to decline 2.7% QoQ, but grow 16.7% YoY, to Rs458mn. PAT margin is expected to marginally fall by 30bps QoQ to 7.2%.
- The key thing to watch out for is the performance of the pharmacy vertical. This segment achieved EBIT breakeven (0.3% EBIT margin) for the first time in Q2FY11 but slipped back into red in Q3FY11 reporting EBIT margin of negative 0.5%. It again reported positive EBIT margin of 0.3% in Q4FY11. We believe the division would be able to achieve a PAT breakeven by the end of FY12. If the division can convincingly better its performance, then it will definitely be a key positive and lead to overall improvement in overall margins.
- The company has finalized plans for raising money through a QIP for the next round of greenfield expansions. The management commentary on this would be something to watch out for, especially given some media reports of the company already finalizing the pricing and buyers.
- The stock currently trades at 10.8x FY13E EV/EBITDA and Rs12.4mn FY13E EV/Adjusted Bed.
- We have a Buy rating on the stock with a target price of Rs646, valuing the stock at 14x FY13E EV/EBITDA. The implied EV/Adjusted Bed is Rs15.6mn.

Fortis Healthcare (Hold; Target Price: Rs167)

- We expect Q1FY12 consolidated net sales to grow 28.9% YoY and 4.8% QoQ to Rs4,356mn. We have not incorporated the financials of Super Religare Laboratories (SRL) in our estimates and wait for SRL to file the DRHP with Sebi for the latest numbers.
- We expect EBITDA to rise 29% YoY and 16.4% QoQ to Rs613mn. In Q3FY11 and Q4FY11, the company incurred one-time expenses related to the commissioning of the 350-bed Shalimar Bagh Hospital in Delhi and 414-bed hospital in Kolkata. Hence, the EBITDA growth on a QoQ basis looks substantial.
- EBITDA margin is expected to expand 140bp QoQ, but remain flat YoY, at 14.1%.
- We expect the company to report a PAT of Rs131mn vs a loss of Rs143mn in Q1FY11. In Q4FY11, the company reported a PAT of Rs322mn as huge other income boosted profitability.
- The key things to watch out for are the performance of 350-bed Shalimar Bagh Hospital in Delhi and 414-bed Kolkata Hospital. Both these hospitals were commissioned towards the end of Q2FY11. The operational performance of these facilities would shed light on the management's ability to successfully run new greenfield facilities (till date, Fortis has mainly grown inorganically). Also, the progress on the Gurgaon greenfield hospital and other new projects would be important. The Gurgaon facility is slated to open in early Q2FY12 and any delay would affect our estimates.
- We have a Hold rating with a target price of Rs167, valuing the stock at 15x FY13E EV/EBITDA thus giving potential upside of 1.7%. The implied EV/Bed translates into Rs16mn. The stock currently trades 14.8x FY13E EV/EBITDA and Rs 12.3mn FY13E EV/Adjusted Bed.

Valuation snapshot

	Rating	CMP (Rs)	Upside/ Downside (%)	P/E (x)		P/BV (x)		EV/EBITDA (x)		EV/Adj. Bed (Rsmn)	
				FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Apollo Hospitals	Buy	497.2	29.9	26.6	20.5	3.1	2.5	13.3	10.8	14.0	12.4
Fortis Healthcare	Hold	164.6	1.7	58.1	30.9	1.9	1.8	20.4	14.8	15.0	12.3

Source: Company, Centrum Research Estimates

Appendix A

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