

Company

25 August 2009 | 11 pages

Fortis Healthcare (FOHE.BO)

 Equity

Sell: Significant Deal at Reasonable Valuations

- Scale & profitability** — Our first impression of Fortis' acquisition of 10 hospitals from Wockhardt Hospitals (WHL) is positive. Besides providing scale (operating beds up 73%) & geographical diversification (into Mumbai, Bangalore & Kolkata), valuations appear reasonable at c11x FY09 EBITDA. Fortis expects the deal to be EPS accretive from the first year.
- The deal** — Fortis will buy 10 hospitals (incl. two under construction) from WHL (two in Mumbai, five in Bangalore & three in Kolkata) for an EV of Rs9.1bn (incl. Rs1.9bn for those under construction). The eight operational hospitals have 856 beds (scope to add 512 more), while the two other hospitals (commercialization in 12-15 months) will have an additional 534 beds. Most of the management & clinical team will also move over to Fortis.
- What does Fortis gain?** — a) **Scale:** adds 856 operating beds (up 73%), 49% to sales & 75% to EBITDA (proforma) – it would have taken much longer to achieve this organically; b) **Diversification:** into high potential markets in West (Mumbai), East (Kolkata) & South (B'lore) India; c) **Talent:** strong management & clinical team. With the higher number of cash generating beds, it is now better placed to absorb early losses on newly commissioned hospitals.
- Valuations reasonable** — Excluding Rs1.9bn paid for the projects under construction, the deal valuation works out to c11x FY09 EBITDA & c8.5x FY10E EBITDA (the latter as per Fortis management). We believe this is reasonable, especially as it is lower than the current multiples of the leading listed hospitals (Apollo & Fortis). Fortis expects the deal to be EPS accretive from year one.
- What we do not know** — Does the deal include transfer of ownership of the land on which the hospitals are based? We await further details from management.

Sell/High Risk	3H
Price (24 Aug 09)	Rs118.75
Target price	Rs59.00
Expected share price return	-50.3%
Expected dividend yield	0.0%
Expected total return	-50.3%
Market Cap	Rs37,683M US\$778M

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	nm	5.5	-27.9	0.0
2008A	-376	-1.66	70.5	nm	2.4	-5.0	0.0
2009E	114	0.50	130.2	nm	2.4	1.0	0.0
2010E	361	1.59	217.8	74.6	2.3	3.1	0.0
2011E	813	3.58	125.3	33.1	2.1	6.7	0.0

Source: Powered by dataCentral

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

Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	nm	nm	nm	74.6	33.1
EV/EBITDA adjusted (x)	79.2	nm	46.0	26.2	18.0
P/BV (x)	5.5	2.4	2.4	2.3	2.1
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	-5.63	-1.66	0.50	1.59	3.58
EPS reported	-5.92	-2.45	0.78	1.59	3.58
BVPS	21.55	49.60	50.38	51.97	55.56
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	5,194	5,071	6,244	9,291	11,586
Operating expenses	-5,477	-5,331	-5,815	-8,304	-9,941
EBIT	-283	-260	428	986	1,645
Net interest expense	-660	-555	-495	-630	-720
Non-operating/exceptionals	10	230	304	125	175
Pre-tax profit	-933	-584	237	481	1,100
Tax	-73	-16	-31	-120	-275
Extraord./Min.Int./Pref.div.	-7	45	-28	0	-12
Reported net income	-1,013	-555	178	361	813
Adjusted earnings	-963	-376	114	361	813
Adjusted EBITDA	555	209	912	1,641	2,443
Growth Rates (%)					
Sales	77.6	-2.4	23.1	48.8	24.7
EBIT adjusted	-29.5	8.1	265.0	130.2	66.8
EBITDA adjusted	139.8	-62.4	337.0	80.0	48.9
EPS adjusted	-96.1	70.5	130.2	217.8	125.3
Cash Flow (RsM)					
Operating cash flow	331	121	1,060	848	1,699
Depreciation/amortization	838	468	483	654	798
Net working capital	-91	-101	360	-262	-164
Investing cash flow	-675	-2,008	-1,500	-2,700	-1,700
Capital expenditure	-717	-1,119	-1,500	-2,700	-1,700
Acquisitions/disposals	-10	0	0	0	0
Financing cash flow	441	1,885	746	1,500	0
Borrowings	-422	-2,261	746	1,500	0
Dividends paid	0	0	0	0	0
Change in cash	96	-2	306	-352	-1
Balance Sheet (RsM)					
Total assets	11,449	16,997	18,298	21,231	22,906
Cash & cash equivalent	307	161	453	137	206
Accounts receivable	918	959	1,249	1,765	2,085
Net fixed assets	5,085	9,533	10,550	12,596	13,498
Total liabilities	7,568	5,539	6,648	9,184	9,965
Accounts payable	1,065	1,247	1,610	2,646	3,426
Total Debt	5,922	3,755	4,501	6,001	6,001
Shareholders' funds	3,881	11,458	11,650	12,046	12,942
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	10.7	4.1	14.6	17.7	21.1
ROE adjusted	-27.9	-5.0	1.0	3.1	6.7
ROIC adjusted	-3.6	-2.2	2.5	5.1	7.4
Net debt to equity	144.7	31.4	34.7	48.7	44.8
Total debt to capital	60.4	24.7	27.9	33.2	31.7

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Significant Deal at Reasonable Valuations

Our first impression of Fortis' acquisition of 10 hospitals from Wockhardt Hospitals (WHL) is positive. Besides providing scale (operating beds up 73%) & geographical diversification (into Mumbai, Bangalore & Kolkata), valuations appear reasonable at c11x FY09 EBITDA. Fortis expects the deal to be EPS accretive from the first year.

What has Fortis bought?

Fortis will buy 10 hospitals (incl. two under construction) from WHL (two in Mumbai, five in Bangalore & three in Kolkata) for an EV of Rs9.1bn (incl. Rs1.9bn for those under construction). Most of the management & clinical team will also move over to Fortis.

856 beds currently operational at the eight commercialized hospitals – expansion plans (512 beds) in progress, primarily at Mulund & BG Road hospitals

The hospital at Sarat Bose Road, Kolkata is a secondary care hospital specializing in dental & ophthalmology procedures – primarily an outpatient facility

The Kolkata hospitals are Fortis' first foray into East India

Figure 1. Hospitals covered under the transaction

City	Location	Bed Capacity
Existing		
Mumbai	Mulund	567
Mumbai	Kalyan	60
Bangalore	BG Road	451
Bangalore	Cunningham Road	128
Bangalore	Chord Road	40
Bangalore	Nagarbhavi	55
Kolkata	Rashbehari Avenue	67
Kolkata	Sarat Bose Road	-
Total Existing Bed Capacity (856 operational)		1,368
Under Construction		
Bangalore	Yeshwantpura	120
Kolkata	Anandpur	414
Total Bed Capacity		1,902

Source: Company Reports

What does Fortis gain?

Pan Indian presence

Fortis' presence (prior to this deal) was primarily restricted to North India (primarily the National Capital Region). This deal will change that by giving it access to other high potential markets such as Mumbai (West), Bangalore (South) & Kolkata (East) through a set of well run hospitals. We expect this deal to help Fortis emerge as a well known pan Indian healthcare delivery player.

Figure 2. Bed Capacity – Region wise Distribution*

	North Zone (NCR, Punjab, Rajasthan)		West & Central (Maharashtra, Gujarat, Chhattisgarh)		South Zone (AP, TN, Karnataka, Kerala)		East Zone (West Bengal)		Total	
	Hospitals	Beds	Hospitals	Beds	Hospitals	Beds	Hospitals	Beds	Hospitals	Beds
Fortis Network	13	2,312	3	480	2	350	-	-	18	3,142
Acquired from Wockhardt	-	-	2	627	5	794	3	481	10	1,902
Total	13	2,312	5	1,107	7	1,144	3	481	28	5,044

Source: Company Reports

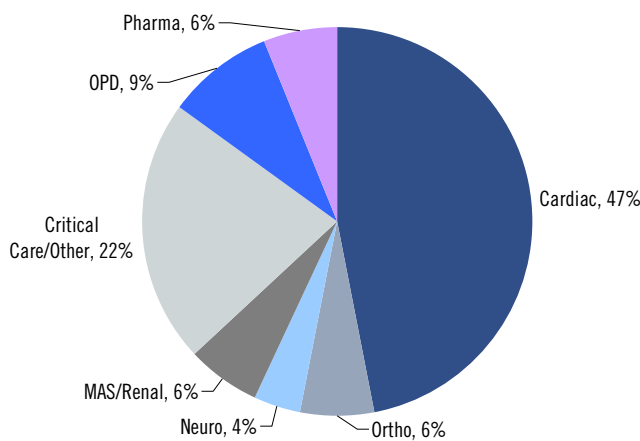
*includes own & managed bed capacity – including planned projects in WHL (operational bed count would be lower)

Scale

On completion of this deal, Fortis will be the leading private healthcare provider in 7 states viz. Delhi, Maharashtra, Karnataka, Punjab, Haryana, Rajasthan and Uttar Pradesh.

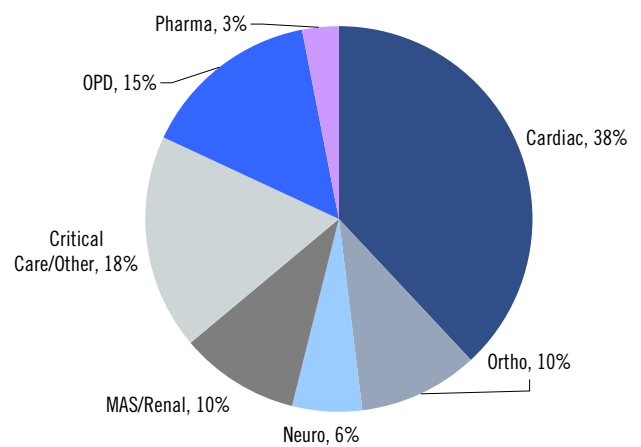
Besides bed capacity (see figure 2), the deal also materially enhances the number of operating beds (up 73%), revenues (up 49%) & EBIDTA (up 54%). Beyond financials, it also gives it a much wider talent pool – in terms of doctors and nurses – and scope to exploit synergies in the areas of purchase & supply management, marketing, training & development and project implementation.

Figure 3. FHL – Therapy wise Revenue Breakup



Source: Company Reports

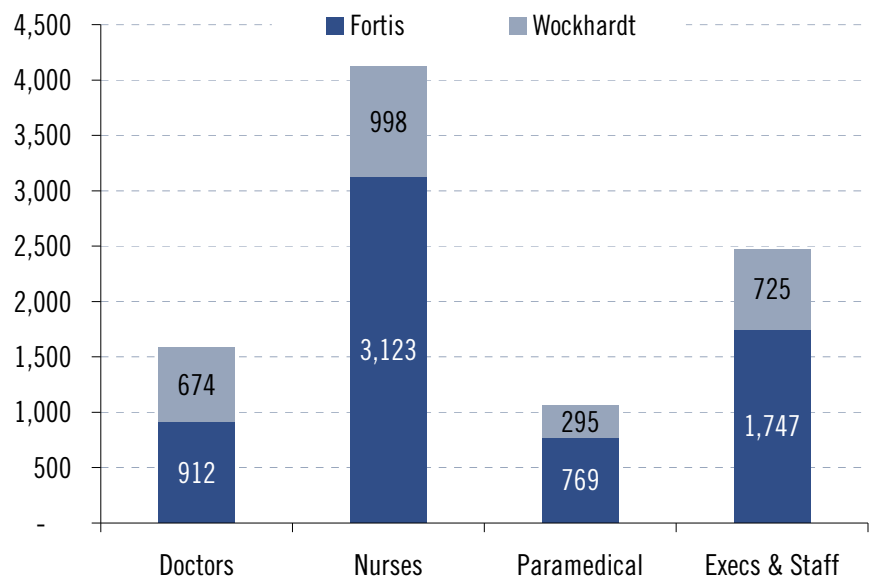
Figure 4. Wockhardt – Therapy wise Revenue Breakup



Source: Company Reports

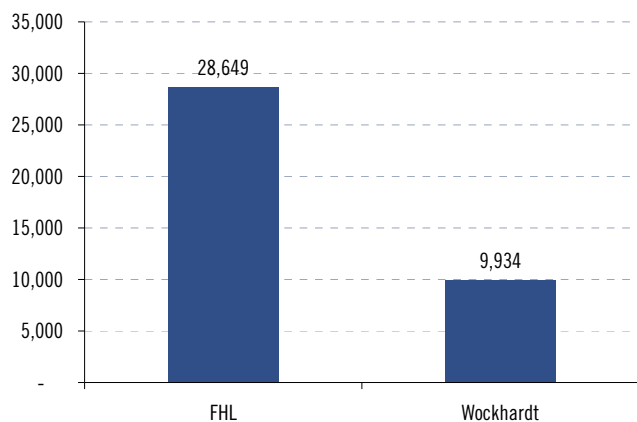
998 doctors and 674 nurses will be added to Fortis' talent pool

Figure 5. FHL – No. of employees – Current & Addition from Wockhardt



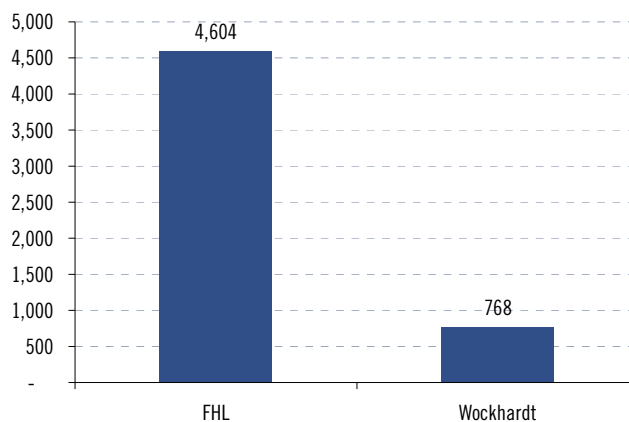
Source: Company Reports

Figure 6. No. of Cardiac Procedures



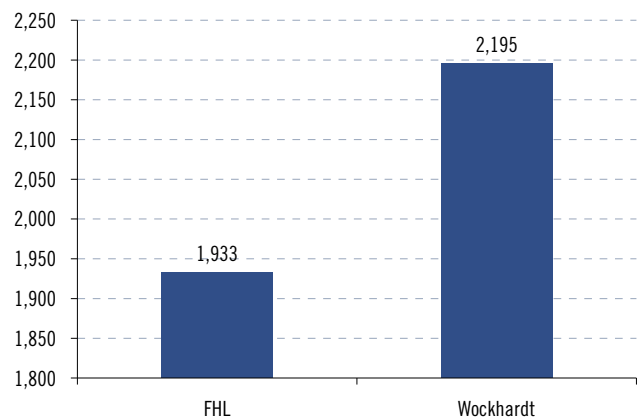
Source: Company Reports

Figure 7. No. of Neuro Procedures



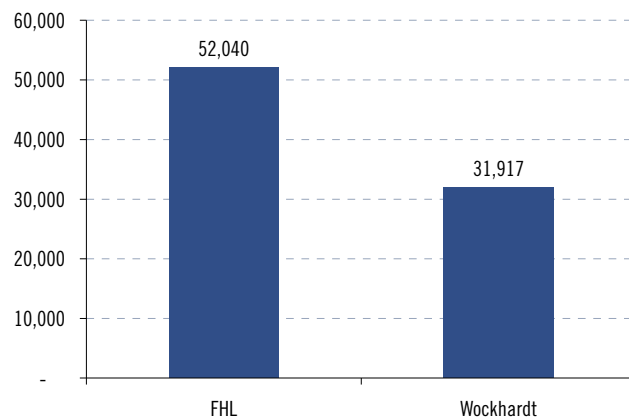
Source: Company Reports

Figure 8. No. of Ortho Procedures



Source: Company Reports

Figure 9. Other Procedures at FHL, Wockhardt



Source: Company Reports

Will be EPS accretive from the first year as per management

FHL's operating margins will be buoyed by higher margins in the acquired hospitals

Valuations appear reasonable at c11x FY09 EBITDA (adjusted for the Rs1.9b paid towards new projects)

*EV/Operational Bed of Rs8.4m – would be lower once the additional 512 beds are commissioned in existing hospitals at much lower incremental cost

Fortis expects the deal to be EPS accretive from the first year.

Figure 10. FY09 Combined Financials – Proforma (Rs m)

	FHL Consolidated	Wockhardt	Total
Operating Income	6,310	3,120	9,430
Materials Consumed	1,900	860	2,760
Personnel Expenses	1,480	410	1,890
Operating Expenses	1,430	970	2,400
S,G&A Expenses	650	240	890
Total Expenses	5,460	2,480	7,940
EBIDTA	850	640	1,490
EBITDA Margins (%)	13.5	20.5	15.8
Other Income	280	10	290
Financial Expenses	440	360	800
Depreciation	480	190	670
Taxes	30	20	50
Exceptional Items	30	10	40
Net Profit	210	90	300

Source: Company Reports

Reasonable Valuations

Figure 11. FHL – Wockhardt Acquisition – Valuation Metrics

Total Consideration	9,090
Towards operational beds	7,190
Operational beds	856
EV/Operational Bed *	8.4
Towards ongoing projects	1,900
Number of beds	534
EV/Bed	3.6
EBIDTA (operational beds)	650
EV/EBIDTA	11.1
Sales (operational beds)	3,120
EV/Sales	2.3

Source: 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 EBIDTA, 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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Ratings and Target Price History

Fundamental Research

Analyst: Prashant Nair, CFA

Covered since July 11 2007

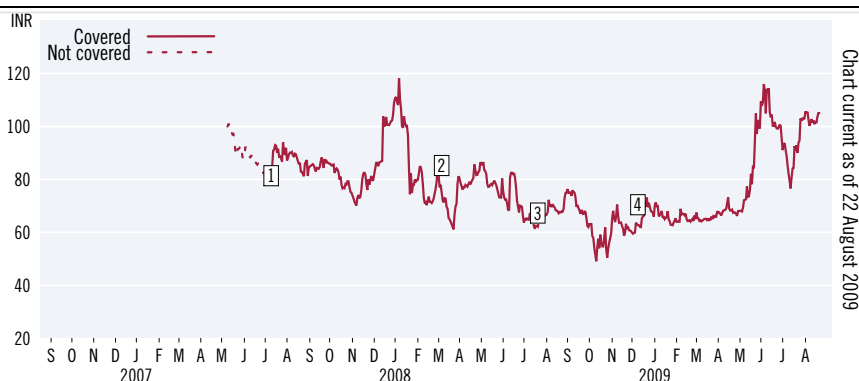


Chart current as of 22 August 2009

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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Data current as of 30 Jun 2009

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