

## Company

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# Fortis Healthcare (FOHE.BO)

Equity

## Alert: No Major Surprise in FY10, All Eyes on Parkway

- **FY10 Results No Major Surprise; All Eyes on Parkway** — We believe Fortis' response to Khazanah's open offer for Parkway will have a greater bearing on Fortis' valuations than results, which were disappointing at the EBITDA level. We await management commentary during the earnings call on Monday. (4:30pm, Dial in: +91 22 3036 0400 / +91 22 3056 0400)
- **4Q: Revenues Strong, Margins Disappoint** — Recurring PAT at Rs272m was ahead of expectations, though largely on the back of lower than expected tax rate. Revenue growth (+91% YoY), on the back of Wockhardt acquisition, was impressive, but the margin decline (-73 bps YoY & 106 bps QoQ) was a surprise, especially as Wockhardt boasted of significantly higher margins than Fortis' own hospitals. Interest costs ballooned (+245% YoY) due to loans used to finance the Wockhardt acquisition, but were cancelled out by the income earned on the cash from the rights issue. This along with the lower tax rate led to a 470% PAT growth.
- **FY10: A Transitional Year** — FY10 remains a transitional year as the full impact of the Wockhardt acquisition and the recent stake acquisition in Parkway will be reflected only in FY11 financials. Recurring PAT was at Rs695m (+376% YoY) driven by strong growth in Fortis' own hospitals and the acquisition of Wockhardt hospitals in end CY09 as well as the low base. EBITDA margins expanded 140bps YoY due as newer hospitals turned profitable. Numbers were skewed by 4Q results which accounted for more than a third of FY10 topline and bottomline.

Fortis Healthcare (FOHE.BO; Rs147.45; 3M)

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

**Akshay Rai**  
 akshay.rai@citi.com

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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## Fortis Healthcare

### Company description

Fortis Healthcare was incorporated in 1996, set up and owned by the erstwhile founders of India's largest pharmaceutical company, Ranbaxy Laboratories. It is a professionally managed company with a broad management team, headed by Mr. Shivinder Singh (founder shareholder and Managing Director). The company went public in May 2007. It is one of the largest hospital chains in India with a network of 38 hospitals and c5,000 beds under management in the country. The company has made two large acquisitions in the last few months - ten hospitals from Wockhardt Hospitals (WHL) and 23.9% stake in Parkway Holdings which has made it the largest hospital group from India.

### Investment strategy

We rate Fortis as Sell/Medium Risk (3M) with a target price of Rs145. 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 globally and upside looks limited. While we 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. Our Sell rating is purely a valuation call and we would look to get more constructive on any share price weakness.

### Valuation

Our target price for Fortis is Rs145. 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. Fortis has only one directly comparable company listed on the Indian market - Apollo Hospitals. We value Fortis at a slight premium to Apollo, at 16x EBITDA (vs 15x for Apollo) as we believe Fortis' greater scale & geographical diversification post the WHL hospitals acquisition merit a higher multiple. Our current EV/EBIDTA multiple of 16x is also in the range that Fortis has traded over the last several years. At 16x June '11E EBITDA we arrive at a target price of Rs145.

### Risks

Our risk rating for Fortis is Medium Risk as suggested by our quants-based rating system, which tracks 260-day historical share price volatility. Key upside risks that could prevent the stock from achieving our rating and target price include: (1) Faster than expected ramp up in occupancy rates, especially in Escorts, could lead to the company beating our earnings estimates; (2) Better than expected performance of the WHL acquisition, 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 price.

# Appendix A-1

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#### Fundamental Research

Analyst: Prashant Nair, CFA

Covered since July 11 2007

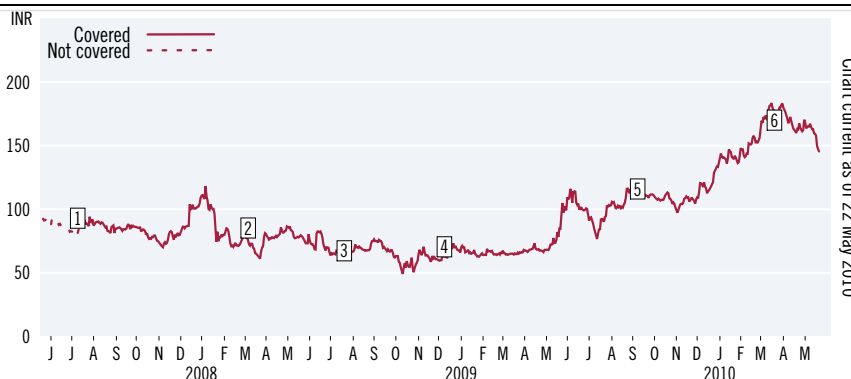


Chart current as of 22 May 2010

	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

	Date	Rating	Target Price	Closing Price
5	8-Sep-09	*3M	*110.00	110.95
6	19-Mar-10	3M	*145.00	177.55

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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