

## Equities

2 November 2011 | 9 pages

# Fortis Healthcare (FOHE.BO)

## FHI Acquisition: Decent Valuation but Adds Risk

- Adding Scale ...& Risk** — We continue to have mixed feelings about FOHE's decision to buy out Fortis Healthcare International (FHI) that focuses on overseas operations. While the deal gives FOHE scale and valuation is reasonable, we are not too convinced on the extent of potential synergies. It also raises the risk on execution while straining the balance sheet and creating a fund raising overhang.
- Some clarity on financials** — 1) FHI to clock revenues & operating EBIDTA of cUS\$500m (+20% YoY) & US\$70-75m (+40% YoY) in FY12; 2) Transaction EV: cUS\$951m (Cash: US\$665m, Net Debt: US\$148m; Min. Interest: US\$138m); 3) Combined entity to have debt of cUS\$1bn & equity of cUS\$600m. Based on the above & our estimates for FOHE, we arrive at proforma revenues & EBIDTA of US\$1bn & US\$140-145m respectively for the combined entity.
- Valuations decent** — Based on FOHE's FY12 estimates for FHI, deal multiples work out to 12-13x EBIDTA & 1.9x Sales: lower than what FOHE currently trades at (16x EBIDTA & 2.3x Sales) but slightly higher than what most global hospital stocks trade at.
- What are the positives?** — Post closure, FOHE will be one of the largest hospital groups in Asia, with a presence in many high growth markets & multiple verticals (see Fig 3). It also expects synergies in Growth (global brand, scale, target insurance), Talent (enhanced pool, cross-border leverage of talent & knowledge sharing, more attractive as an employer), Verticals (primary care, diagnostics, specialty care, cross-border learning) & Cost Efficiencies (IT, supply chain, branding, shared services).
- What are the negatives?** — While the acquisition gives FOHE scale & valuations do not appear demanding, it also increases the risk on the balance sheet (significantly stretched, fund raising required – equity dilution possible) & execution (several moving parts, especially presence in multiple countries where it has not operated in the past). This along with the diversification into primary care & diagnostics could lead to compression of hitherto premium multiples till there is more visibility on execution.

### 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	59.3	2.3	4.8	0.0
2011A	1,066	2.47	12.6	52.7	1.7	4.2	0.0
2012E	2,032	4.70	90.6	27.6	1.6	6.0	0.0
2013E	3,092	7.15	52.1	18.2	1.5	8.5	0.0
2014E	3,880	8.98	25.5	14.5	1.3	9.7	0.0

Source: Powered by dataCentral

### Company Update

<b>Buy</b>	<b>1</b>
Price (02 Nov 11)	Rs129.95
Target price	Rs172.00
Expected share price return	32.4%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>32.4%</b>
Market Cap	Rs52,651M
	US\$1,069M

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



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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
<b>Valuation Ratios</b>					
P/E adjusted (x)	59.3	52.7	27.6	18.2	14.5
EV/EBITDA adjusted (x)	41.7	29.5	16.8	12.3	9.9
P/BV (x)	2.3	1.7	1.6	1.5	1.3
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
<b>Per Share Data (Rs)</b>					
EPS adjusted	2.19	2.47	4.70	7.15	8.98
EPS reported	2.19	2.88	4.70	7.15	8.98
BVPS	57.37	75.95	80.65	87.80	96.78
DPS	0.00	0.00	0.00	0.00	0.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	9,379	14,830	23,490	30,756	38,386
Operating expenses	-8,566	-13,795	-21,139	-27,356	-34,046
<b>EBIT</b>	<b>814</b>	<b>1,035</b>	<b>2,350</b>	<b>3,400</b>	<b>4,339</b>
Net interest expense	-573	-696	-175	-161	-169
Non-operating/exceptionals	493	1,103	293	540	585
<b>Pre-tax profit</b>	<b>734</b>	<b>1,442</b>	<b>2,468</b>	<b>3,779</b>	<b>4,756</b>
Tax	-34	-76	-370	-567	-713
Extraord./Min.Int./Pref.div.	-5	-119	-66	-120	-162
<b>Reported net income</b>	<b>695</b>	<b>1,246</b>	<b>2,032</b>	<b>3,092</b>	<b>3,880</b>
Adjusted earnings	695	1,066	2,032	3,092	3,880
Adjusted EBITDA	1,413	2,080	3,514	4,623	5,715
<b>Growth Rates (%)</b>					
Sales	48.8	58.1	58.4	30.9	24.8
EBIT adjusted	119.2	27.2	127.2	44.7	27.6
EBITDA adjusted	64.6	47.2	69.0	31.6	23.6
EPS adjusted	242.5	12.6	90.6	52.1	25.5
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>1,437</b>	<b>-101</b>	<b>13,654</b>	<b>4,004</b>	<b>5,133</b>
Depreciation/amortization	599	1,045	1,164	1,223	1,375
Net working capital	-2	-336	9,951	-1,090	-1,144
<b>Investing cash flow</b>	<b>-45,023</b>	<b>21,696</b>	<b>-13,598</b>	<b>-4,000</b>	<b>-5,000</b>
Capital expenditure	-10,440	-3,522	-8,500	-4,000	-4,000
Acquisitions/disposals	0	0	0	0	0
<b>Financing cash flow</b>	<b>56,160</b>	<b>-32,399</b>	<b>-1,170</b>	<b>250</b>	<b>250</b>
Borrowings	24,740	-26,446	-1,170	250	250
Dividends paid	0	0	0	0	0
<b>Change in cash</b>	<b>12,574</b>	<b>-10,803</b>	<b>-1,115</b>	<b>254</b>	<b>383</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>76,950</b>	<b>47,566</b>	<b>50,620</b>	<b>55,867</b>	<b>62,030</b>
Cash & cash equivalent	13,114	1,636	456	590	811
Accounts receivable	1,567	1,952	3,523	4,613	5,758
Net fixed assets	16,649	19,100	20,937	23,714	26,339
<b>Total liabilities</b>	<b>58,400</b>	<b>14,433</b>	<b>15,351</b>	<b>17,345</b>	<b>19,426</b>
Accounts payable	2,901	3,196	5,266	6,991	8,803
Total Debt	54,706	10,883	9,713	9,963	10,213
<b>Shareholders' funds</b>	<b>18,550</b>	<b>33,132</b>	<b>35,270</b>	<b>38,523</b>	<b>42,605</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	15.1	14.0	15.0	15.0	14.9
ROE adjusted	4.8	4.2	6.0	8.5	9.7
ROIC adjusted	3.8	2.8	4.9	7.0	8.3
Net debt to equity	224.2	27.9	26.2	24.3	22.1
Total debt to capital	74.7	24.7	21.6	20.5	19.3

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Figure 1. FOHE Post Deal

	Fortis Healthcare India	Fortis Healthcare International	Combined Entity
Hospitals*	66	8 (Vietnam, Sri Lanka and Singapore)	74
Total Beds*	10,600	1,500	12,100
Primary Care	-	580 centers	580 centers
Diagnostic Labs	189	1	190
Day Care Specialty	1	190	191
Geographic Coverage	1 (India)	9 (Australia, New Zealand, Hong Kong, Vietnam, Dubai, Mauritius, Canada, Singapore and Sri Lanka)	10 (India, Australia, New Zealand, Hong Kong, Vietnam, Dubai, Mauritius, Canada, Singapore and Sri Lanka)
Doctor Network	>1,800	>2,200	>4,000
Total Employees	>16,000	>7,000	>23,000

Source: Citi Investment Research and Analysis

\*includes project hospitals and beds as well as managed beds

Figure 2. Verticals & Geographies Mix

	Australia	Canada	Hong Kong	New Zealand	Singapore	Middle East	India	Mauritius	Sri Lanka	Vietnam
Primary Care			X							X
Diagnostics			X			X	X			
Specialty Day Care Centres	X	X	X	X	X		X			
Secondary Care Hospitals							X			X
Tertiary Care Hospitals					X		X	X	X	X

Source: Citi Investment Research and Analysis

Figure 3. Fortis Healthcare International Assets

Company	Dental Corporation (58.1%)	Quality Healthcare (100%)	Hoan My (65%)	SRL Dubai (100%/82.5%**)	Fortis Hospital, Singapore (100%)	Lanka Hospitals (28.6%)
<b>Vertical</b>	Dental Practices	Primary Healthcare	General Hospitals	Diagnostics Labs	Specialty Centre	Sri Lankan hospital
<b>Overview</b>	Australia's largest operator of dental practices  140 practices across 177 sites in Australia, New Zealand and Canada	Largest primary integrated healthcare service provider in Hong Kong  Provides primary healthcare services, Ophthalmic, Psychological, Dental and Physiotherapy  Network of 563 medical; Operates 30 dental & physiotherapy centres	Amongst the largest hospital chain in Vietnam  One of the leading private healthcare providers in Vietnam  Total bed capacity of c.1,100	Premier pathology lab catering outsourcing market in UAE and GCC  Operates on a Hub-Spoke-Spike Model: 1 Reference Lab in UAE & 7 collection agents in GCC	Premium specialty hospital  3 storey specialty hospital with a capacity of 50 bed for colorectal treatment  Expected completion in Q3 2012	Renowned tertiary healthcare delivery provider and currently one of the largest hospitals in Sri Lanka  350-bed hospital  Provides an entry point into one of Asia's fastest growing healthcare delivery markets
<b>Acquired in</b>	January 2011 / May 2011	November 2010	August 2011 (Announced)	February 2011	February 2011	March 2011
<b>Revenue – Mar'11 (US\$m)</b>	230	143	26	2	Greenfield (Under Construction)	30
<b>Operating EBITDA-Mar'11 (US\$m)</b>	38.3	9.3	6.0	-2.1	NA	NA

Source: Company

\*\*SRL Dubai comprises of two entities namely Super Religare Laboratories International (100%) and MENA Healthcare (82.5%)

## 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 66 hospitals and 10,270 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 Rs172. 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 Rs172. 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 16x is also in the range that Fortis has traded over the last several years. At 16x Mar '13E EBITDA, we arrive at a target price of Rs172.

### 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

## Analyst Certification

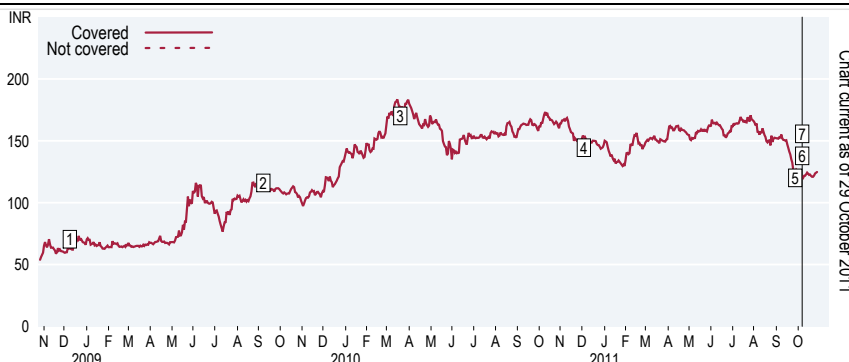
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##### Ratings and Target Price History Fundamental Research

Analyst: Prashant Nair, CFA



	Date	Rating	Target Price	Closing Price
1	9-Dec-08	3H	*59.00	62.95
2	8-Sep-09	*3M	*110.00	110.95
3	19-Mar-10	3M	*145.00	177.55

	Date	Rating	Target Price	Closing Price
4	3-Dec-10	*1L	*190.00	152.90
5	28-Sep-11	1L	*172.00	125.00
6	7-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
7	7-Oct-11	*1	172.00	121.05

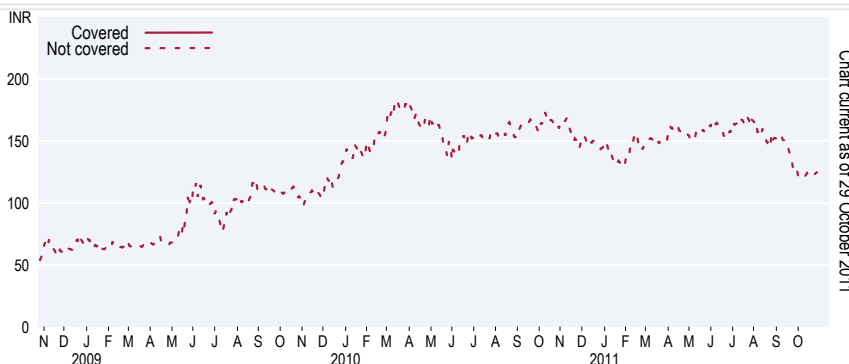
\* Indicates change

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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12 Month Rating

Relative Rating

**Data current as of 9 Oct 2011**

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