

Fortis Healthcare

BSE SENSEX
31,298

S&P CNX
9,654

CMP: INR198

TP: INR240(+21%)

Buy



Stock Info

Bloomberg	FORH IN
Equity Shares (m)	463.1
52-Week Range (INR)	231 / 143
1, 6, 12 Rel. Per (%)	-5/-12/4
M.Cap. (INR b)	91.7
M.Cap. (USD b)	1.4
Avg Val, INRm	442
Free float (%)	47.7

Financials Snapshot (INR b)

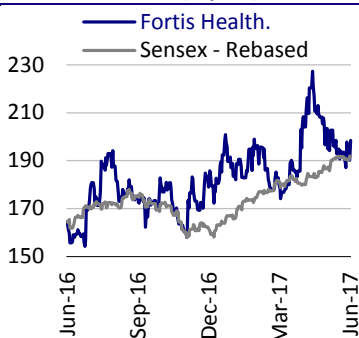
Y/E Mar	FY17	FY18E	FY19E
Net Sales	45.7	52.0	59.1
EBITDA	3.5	5.8	7.8
PAT	4.8	1.0	2.8
EPS (INR)	10.3	2.1	6.1
Gr. (%)	481.4	-79.6	187.9
BV/Sh (INR)	96.8	110.9	117.0
RoE (%)	11.3	2.0	5.3
RoCE (%)	3.5	3.0	4.8
P/E (x)	19.1	93.8	32.6
P/BV (x)	2.0	1.8	1.7

Shareholding pattern (%)

As On	Mar-17	Dec-16	Mar-16
Promoter	52.3	67.6	71.3
DII	0.4	1.1	5.3
FII	34.5	20.7	12.8
Others	12.8	10.6	10.6

FII Includes depository receipts

Stock Performance (1-year)



Possibility of three-step value unlocking

- According to media reports, IHH Healthcare Bhd, Asia's largest private hospital operator, may announce acquisition of a controlling stake in Fortis Healthcare Ltd (FORH) and SRL Diagnostics. In this note, we have evaluated the possibility of a three-step value unlocking in FORH: 1) IHH/private equity buying a controlling stake in FORH, 2) fresh equity infusion, which will be used to buyback RHT and 3) acquisition of a controlling stake in SRL to help provide exit to the existing private equity players. We have tried and analyzed the impact of all the three events.
- **Step-1: IHH/private equity buys controlling stake in FORH:** According to media reports, IHH may buy a controlling stake in the company from the promoters, valuing FORH at INR140b. This would mean a fair value of INR270/ share (>35% upside from current levels).
- **Step-2: Fresh equity infusion in FORH to execute RHT buyback; TP will increase by ~20%:** RHT is listed in Singapore with a market cap of ~INR35b in INR terms. Given that FORH will pay business trust (BT) cost of >INR4b to RHT in FY19E, at current market cap, RHT trades at 10.75x FY19E EV/EBITDA, significantly below hospital asset valuation of 20-22x forward EV/EBITDA. We believe that the acquisition of RHT will increase EV of FORH by ~INR60b. FORH owns ~30% stake in RHT, and thus, it will have to buy back the remaining stake (worth INR25b), for which it may look to raise fresh equity. Even after assuming dilution through fresh equity (share count increasing from 523m to 642m), our TP for FORH will increase from ~INR240 currently to INR290.
- **Step-3: Acquisition of controlling stake in SRL can defer demerger:** According to media reports, IHH may look to buy controlling stake in SRL. This will help provide partial/complete exit to the existing private equity. According to FORH, the demerger process will complete by July-17 end/ Aug-17 beginning. We believe that the SRL business demerger, coupled with stake acquisition in FHTL and asset sweating in existing hospitals, will help unlock significant value for FORH's shareholders.
- **Hospital business EBITDAC to grow 3x over FY17-19E:** Given that a large part of BT cost is fixed (except Chennai, no major greenfield addition expected in the near term), we expect normalized growth in BT cost to be in mid-single-digits (much lower than EBITDAC CAGR of ~20%). The impact of one-time reduction of INR1b in BT cost on annualized basis due to the FHTL transaction will also come in FY18. Lower base, coupled with strong growth in EBITDAC and relatively flattish BT cost, would result in a multifold increase in hospital EBITDA for FORH from INR0.5b in FY16 to INR5.4b in FY19E.
- **Top pick in healthcare delivery space:** Although RHT buyback could act as a significant catalyst (will increase the TP by INR50), regardless of this event, we argue for a multiple re-rating in the stock on the back of a multifold increase in hospital business EBITDA, SRL demerger, asset light expansion strategy and FHTL transaction. We have rolled forward our valuation multiple to FY19E from 1HFY19E. We have valued the hospital business based on 20x FY19E EV/EBITDA and the diagnostics business based on 25x FY19E EV/EBITDA. FORH remains our top pick in the healthcare delivery space with a TP of INR240.

Kumar Saurabh (Kumar.Saurabh@MotilalOswal.com); +91 22 6129 1519

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Valuations attractive – RHT buyback can create significant value

We believe FHTL acquisition, coupled with demerger of SRL business, will help unlock significant value for FORH shareholders. Operating profit growth of the hospital business is at an inflection point. Asset sweating, coupled with high operating leverage, will play a key role in driving a multifold increase in EBITDA. We expect hospital business EBITDA to grow more than 10x over next three years on the back of its strong operational performance, acquisition of FHTL and flattish BT cost. Also, ex-SRL and RHT stake, the hospital business is trading at a significant discount to peers.

We value the hospital business based on 20x FY19E EV/ EBITDA (in line with peers) and the diagnostic business based on 25x FY19E EV/ EBITDA (in-line with Dr. Lal). We maintain our **Buy** rating and an SOTP-based TP of INR240, implying an upside of ~21%.

Exhibit 1: SOTP based target price of INR240 provides ~21% to CMP

SOTP (INR m)	FY19E	INR/ Share	Comments
SRL (56% stake Diagnostic business)	37,696	25 x	72 EV/EBITDA x
Domestic hospital	103,775	20 x	198 EV/EBITDA x
Fortis stake in business trust (~30%)	10,650	CMP	20 CMP
Target EV (INR m)	152,121		
Net debt/cash	-13,000		
Monetization of non-core assets	5,000		Land Parcels in Delhi, Mohali & minority interest in Sri Lanka Hospital
Minority interest in FHTL	-20,000		
Implied Equity Value	124,121		
Diluted Shares Outstanding	523		
Target Price (INR/share)	240		

Source: MOSL, Company

Key catalysts driving stock performance over medium term are:

- Buyback of RHT using proceeds from fresh equity issuance
- Faster ramp-up of new hospitals, including FMRI, Bangalore, Ludhiana and Chennai.
- 100% acquisition of FHTL will lead to a significant reduction in interest cost and minority interest.
- SRL business, in our view, trades at a significant discount to peers. Demerger of the business should help unlock value for shareholders.

Hospitals + Diagnostics = Double dose of growth

Two-pronged growth strategy in hospital business – no major greenfield expansion required

We believe asset sweating and introduction of high-end medical programs will be the key growth drivers for FORH's hospital business in the medium term. Despite restrained capex, the company should be able to drive growth by improving occupancy at existing hospitals and bolt-on additions.

FORH has installed capacity of ~4,200 beds, of which ~3,600 (FORH/RHT-owned) are operationalized. Total potential bed capacity stands at ~10,000. We expect FORH to add ~800-900 beds over next three years, which is easily achievable without any M&A or major greenfield expansion in the near term (no greenfield in the pipeline, except Chennai and Ludhiana).

Hospital business EBITDA to grow 10x over FY16-19E

We expect robust EBITDAC (EBITDA before business trust cost) CAGR of 19% over FY16-19E (implying addition of INR3.6b to EBITDAC). We estimate that almost one-fourth of this addition to EBITDAC would be driven by the ramp-up of Fortis Memorial Research Institute (FMRI; occupancy increasing from 61% to ~70% with EBITDAC margins greater than 20% from ~16% over next three years). Apart from this, shift in business mix away from government schemes as well as recovery in occupancy (from 67% in FY16 to ~74% in FY19E) at Fortis Escorts Heart Institute (FEHI) will contribute ~15% of EBITDAC growth over next three years.

Given that a large part of business trust (BT) cost is fixed (except Chennai, no major greenfield addition expected in the near term), we expect normalized growth in BT cost to be in mid-single-digits (much lower than EBITDAC CAGR of ~20%). We expect one-time reduction of INR1b in BT cost on annualized basis from FY18E (>40% reduction in BT cost) due to the FHTL transaction.

Lower base, coupled with strong growth in EBITDAC and relatively flattish BT cost, would result in a multifold increase in hospital EBITDA for FORH from INR0.5b in FY16 to INR5.4b in FY19E.

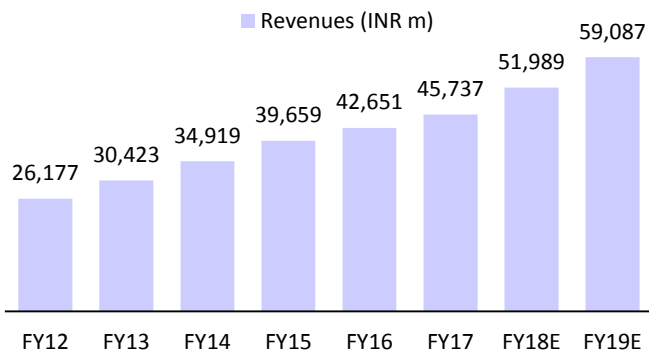
SRL demerger – value unlocking opportunity

SRL is the largest diagnostics chain in India with four reference labs and a pan-India network of 310 clinical labs, 1,074 collection centers and 7,200 collection points. SRL is one of the early movers to establish its presence across India (SRL and Dr. Lal generate 35% and 72%, respectively, of revenues from their respective strongest zones). FORH's EBITDA margins in the diagnostics business have almost doubled in last four years to >20% (as of FY16) due to its better capacity utilization, change in business mix and improvement in realizations

We expect EBITDA margins for the diagnostics business to improve by another 300bp by FY19E on the back of deeper penetration in existing markets, rationalization of low-margin centers, growth in samples tested and higher share from the O&M model.

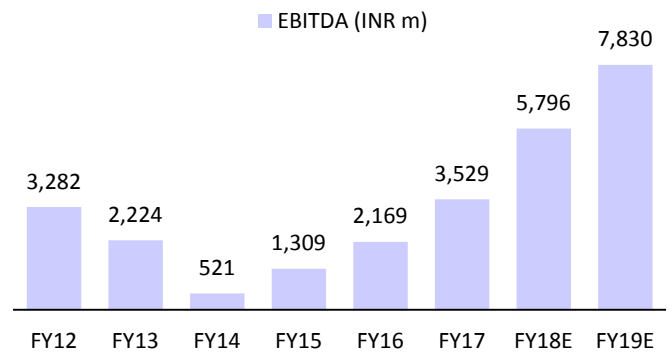
Story in charts

Exhibit 2: FORH revenue to exhibit 14% CAGR over FY17-19E



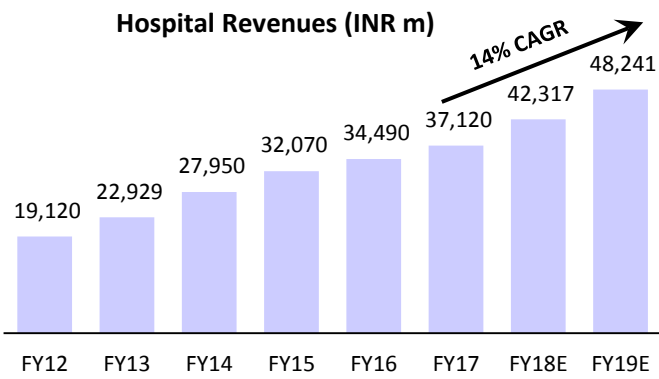
Source: MOSL, Company

Exhibit 3: FORH EBITDA to exhibit 49% CAGR over FY17-19E



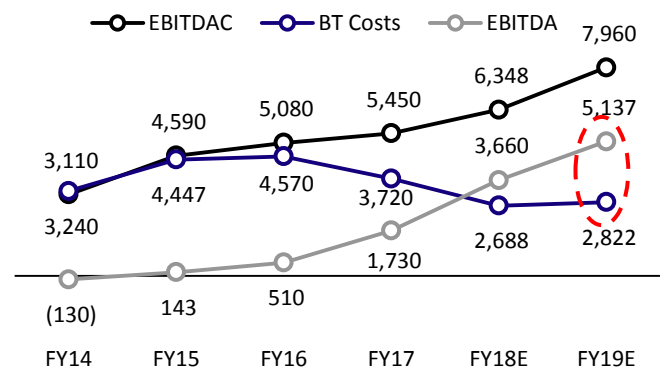
Source: MOSL, Company

Exhibit 4: Hospital revenues to exhibit 14% CAGR over FY17-19E



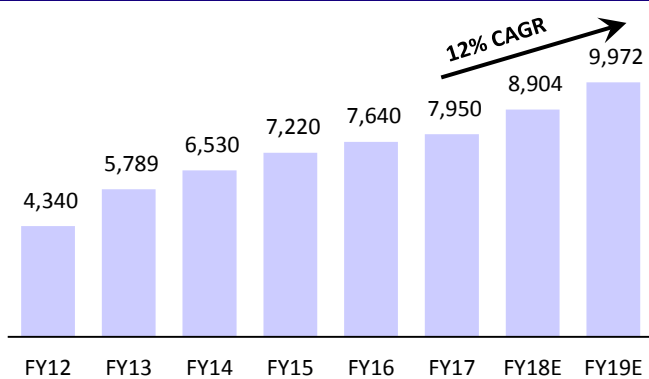
Source: MOSL, Company

Exhibit 5: Hospital EBITDA margins to improve due to robust EBITDAC growth and lower BT costs



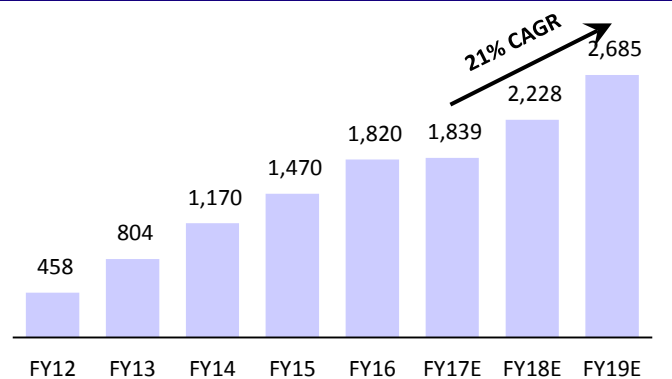
Source: MOSL, Company

Exhibit 6: Diagnostic revenues to exhibit 12% CAGR over FY16-19E



Source: MOSL, Company

Exhibit 7: Diagnostic EBITDA to witness 21% CAGR over FY17-19E



Source: MOSL, Company

Financials and Valuations

Income Statement		(INR Million)				
Y/E March	FY14	FY15	FY16	FY17	FY18E	FY19E
Total Income from Operations	34,919	39,659	42,651	45,737	51,989	59,087
Change (%)	14.8	13.6	7.5	7.2	13.7	13.7
Raw Materials	8,807	9,345	9,572	9,976	11,178	12,408
Employees Cost	6,952	7,646	8,260	9,089	9,098	10,340
Other Expenses	18,639	21,358	22,650	23,144	25,917	28,508
Total Expenditure	34,398	38,349	40,482	42,208	46,193	51,257
% of Sales	98.5	96.7	94.9	92.3	88.9	86.7
EBITDA	521	1,309	2,169	3,529	5,796	7,830
Margin (%)	1.5	3.3	5.1	7.7	11.1	13.3
Depreciation	1,828	2,346	2,295	2,222	3,000	3,200
EBIT	-1,307	-1,036	-125	1,307	2,796	4,630
Int. and Finance Charges	2,502	1,518	1,249	2,294	2,000	1,000
Other Income	1,674	887	926	1,660	300	300
PBT bef. EO Exp.	-2,135	-1,667	-448	673	1,096	3,930
EO Items	-51	68	212	-16	0	0
PBT after EO Exp.	-2,186	-1,599	-236	656	1,096	3,930
Total Tax	107	45	466	724	362	1,297
Tax Rate (%)	-4.9	-2.8	-197.4	110.3	33.0	33.0
Minority Interest/ associate income	-105	-458	-443	-4,861	-243	-182
Reported PAT - Continuing Opr.	-2,188	-1,186	-259	4,793	978	2,815
Adjusted PAT - Continuing Opr.	-2,134	-1,256	-890	4,791	978	2,815
Change (%)	-17.0	-41.1	-29.1	-638.2	-79.6	187.9
Margin (%)	-6.1	-3.2	-2.1	10.5	1.9	4.8

Balance Sheet		(INR Million)				
Y/E March	FY14	FY15	FY16	FY17	FY18E	FY19E
Equity Share Capital	4,628	4,628	4,631	4,631	5,231	5,231
Eq. Share Warrants & App. Money	0	0	0	0	0	0
Preference Capital/ FCCB	6,700	0	0	0	0	0
Total Reserves	38,196	35,848	35,342	40,184	46,152	48,937
Net Worth	49,524	40,476	39,973	44,815	51,383	54,168
Minority Interest	1,393	1,529	1,431	1,431	1,431	1,431
Total Loans	18,803	17,843	14,960	26,460	16,460	16,460
Deferred Tax Liabilities	350	-71	-506	-506	-506	-506
Capital Employed	70,070	59,777	55,858	72,200	68,768	71,553
Gross Block	27,751	29,230	26,997	29,855	27,676	30,641
Less: Accum. Deprn.	10,056	11,726	12,569	14,791	17,791	20,991
Net Fixed Assets	17,695	17,504	14,428	15,064	9,885	9,650
Goodwill on Consolidation	23,773	24,673	23,328	23,328	23,328	23,328
Capital WIP	1,471	2,282	2,010	1,652	1,830	1,866
Total Investments	10,314	10,561	10,784	22,284	22,284	22,284
Curr. Assets, Loans&Adv.	25,255	20,826	21,264	25,114	27,935	33,051
Inventory	620	640	619	646	706	784
Account Receivables	4,407	4,094	4,438	5,639	7,122	8,094
Cash and cash equivalents	10,446	5,970	7,369	9,353	9,334	11,929
Loans and Advances	9,782	10,122	8,838	9,478	10,773	12,244
Curr. Liability & Prov.	8,438	16,069	15,957	15,227	16,480	18,610
Account Payables	5,061	5,649	6,071	4,626	4,429	4,915
Other Current Liabilities	2,477	9,316	8,872	9,514	10,815	12,291
Provisions	899	1,103	1,013	1,087	1,235	1,404
Net Current Assets	16,817	4,757	5,307	9,888	11,455	14,441
Appl. of Funds	70,070	59,777	55,857	72,216	68,784	71,569

Financials and Valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18E	FY19E
Basic (INR)						
EPS	-4.6	-2.7	-1.9	10.3	2.1	6.1
Cash EPS	-0.7	2.4	3.0	15.1	8.6	13.0
BV/Share	106.9	87.4	86.3	96.8	110.9	117.0
DPS	0.0	0.0	0.0	-0.1	0.0	0.1
Payout (%)	-0.2	-0.9	-2.4	-1.0	1.1	1.1
Valuation (x)						
P/E		-73.0	-103.0	19.1	93.8	32.6
Cash P/E		84.2	65.3	13.1	23.1	15.2
P/BV		2.3	2.3	2.0	1.8	1.7
EV/Sales		2.6	2.3	2.4	1.9	1.6
EV/EBITDA		79.1	45.8	30.8	17.0	12.3
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	-1.3	1.3	4.3	-4.9	12.6	6.8
Return Ratios (%)						
RoE	-4.6	-2.8	-2.2	11.3	2.0	5.3
RoCE	0.4	-0.2	1.1	3.5	3.0	4.8
RoIC	-2.0	-2.6	-0.2	2.6	5.0	8.8
Working Capital Ratios						
Fixed Asset Turnover (x)	1.3	1.4	1.6	1.5	1.9	1.9
Asset Turnover (x)	0.5	0.7	0.8	0.6	0.8	0.8
Inventory (Days)	6	6	5	5	5	5
Debtor (Days)	46	38	38	45	50	50
Creditor (Days)	53	52	52	37	31	30
Leverage Ratio (x)						
Current Ratio	3.0	1.3	1.3	1.6	1.7	1.8
Interest Cover Ratio	-0.5	-0.7	-0.1	0.6	1.4	4.6
Net Debt/Equity	0.2	0.3	0.2	0.4	0.1	0.1

Cash Flow Statement

(INR Million)

Y/E March	FY14	FY15	FY16	FY17	FY18E	FY19E
OP/(Loss) before Tax	1,491	-1,374	552	673	1,096	3,930
Depreciation	2,479	2,628	2,305	2,222	3,000	3,200
Interest & Finance Charges	1,839	1,048	587	634	1,700	700
Direct Taxes Paid	-1,049	-1,193	-1,544	-724	-362	-1,297
(Inc)/Dec in WC	-203	-280	126	-2,597	-1,586	-390
CF from Operations	4,556	829	2,026	208	3,848	6,143
Others	235	-587	-352	0	0	0
CF from Operating incl EO	4,791	242	1,674	208	3,848	6,143
(Inc)/Dec in FA	-5,413	383	325	-2,500	2,000	-3,000
Free Cash Flow	-622	625	1,999	-2,292	5,848	3,143
(Pur)/Sale of Investments	-5,858	4,097	-1,393	-11,500	0	0
Others	42,162	-6,162	5,229	1,660	300	300
CF from Investments	30,891	-1,682	4,162	-12,340	2,300	-2,700
Issue of Shares	10,196	1	32	0	5,600	0
Inc/(Dec) in Debt	-37,737	-1,539	-3,255	11,500	-10,000	0
Interest Paid	-3,777	-1,400	-1,248	-2,294	-2,000	-1,000
Dividend Paid	0	0	0	50	-10	-30
Others	-854	-98	34	4,861	243	182
CF from Fin. Activity	-32,172	-3,035	-4,438	14,116	-6,167	-848
Inc/Dec of Cash	3,510	-4,475	1,399	1,984	-19	2,596
Opening Balance	6,936	10,446	5,970	7,369	9,353	9,334
Closing Balance	10,446	5,970	7,369	9,353	9,334	11,929

NOTES

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SEBI pursuant to a complaint from client Shri C.R. Mohanraj alleging unauthorized trading, issued a letter dated 29th April 2014 to MOSL notifying appointment of an Adjudicating Officer as per SEBI regulations to hold inquiry and adjudge violation of SEBI Regulations; MOSL replied to the Show Cause Notice whereby SEBI granted us an opportunity of Inspection of Documents. Since all the documents requested by us were not covered we have requested to SEBI vide our letter dated June 23, 2015 to provide pending list of documents for inspection.

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Varun Kumar

Varun.kumar@motilalosal.com

Contact : (+65) 68189232

Office Address: 21 (Suite 31), 16 Collyer Quay, Singapore 04931



Motilal Oswal Securities Ltd

Motilal Oswal Tower, Level 9, Sayani Road, Prabhadevi, Mumbai 400 025

Phone: +91 22 3982 5500 E-mail: reports@motilalosal.com