

Fortis Healthcare

BSE SENSEX 32,325
 S&P CNX 10,066

CMP: INR166 TP: INR220(+33%) Buy

Motilal Oswal values your support in the Asiamoney Brokers Poll 2017 for India Research, Sales and Trading team. We request your ballot.



Bloomberg	FORH IN
Equity Shares (m)	463.1
M.Cap.(INRb)/(USDb)	76.9 / 1.2
52-Week Range (INR)	231 / 143
1, 6, 12 Rel. Per (%)	3/-24/-28
Avg Val, INRm/Vol m	698
Free float (%)	57.0

Financials & Valuations (INR b)

Y/E Mar	2017	2018E	2019E
Net Sales	45.7	51.2	58.2
EBITDA	3.5	5.6	7.6
PAT	4.8	1.0	2.6
EPS (INR)	10.3	2.2	5.6
Gr. (%)	-638.2	-78.9	155.6
BV/Sh (INR)	96.8	111.0	116.5
RoE (%)	11.3	2.1	4.9
RoCE (%)	3.5	3.4	4.9
P/E (x)	16.0	76.0	29.7
P/BV (x)	1.7	1.5	1.4

Estimate change ↔

TP change ↔

Rating change ↔

Sequential improvement visible; recovery pace slower than expected

- Sales increased 3.2% YoY to INR11.6b, missing our estimate of INR12.2b, due to the impact of demonetization and stent price control. EBITDA rose 38% YoY to INR861m (est. of INR941b), with the margin at 7.4% (v/s est. of 7.7% and 5.6% in 1QFY17). Adj. PAT increased 41.1% YoY to INR228m.
- **Demonetization and stent price control impacted numbers:** Hospital revenue rose 3% YoY/QoQ to INR9.4b. EBIDTAC stood at INR1.3b, with the margin at 13.5% (+150bp QoQ, -170bp YoY). Occupancy levels stood at ~71% v/s 70% in 4QFY17 and 74% in 1QFY17. Diagnostic EBITDA margin contracted 400bp YoY (-130bp QoQ) to 18.4%, led by pricing pressure, high marketing expense and change in business mix. Stent price control continued to impact Hospital growth. FORH expects sequential improvement in 2Q, with strong double-digit growth in 2H, as the impact of stent pricing and demonetization will be in the base.
- **Earnings call takeaways:** 1) Annual capex in Hospital expected to be INR2-2.5b. 2) Ludhiana and Chennai-based greenfield hospitals to start in FY18. 3) SRL EBITDA margin to improve by at least 100bp annually in the medium term. 3) Hospital margin to bounce back to 15% in 2H. 4) BT cost to stay in the current range for the rest of FY18. 5) FEHI margin expected to improve from current levels of ~10% on pick-up in newly added therapies, including nephrology and ortho. 6) Double-digit growth in SRL in 1Q was primarily driven by volume growth.
- **Top pick in healthcare delivery space:** The stock has remained volatile in recent past due to news flow related to possibility of promoter change and equity infusion in FORH. These events can help prepone value unlocking in the stock, but, regardless of this event, we argue for multiple re-rating led by multifold increase in Hospital EBITDA, SRL demerger, asset light expansion strategy and FHTL transaction. We value Hospital and Diagnostic based on 20x FY19E EV/EBITDA. We lower TP multiple for Diagnostic to 20x from 25x, expecting relatively slow margin expansion in the medium term. FORH is our top pick in healthcare delivery space with TP of INR220 (v/s INR240 earlier). We cut EBITDA by 3%/4% for FY18/19E as we build in the impact of stent price control and pricing pressure in Diagnostic.

Consolidated - Quarterly Earning Model

Y/E March	FY17E				FY18E				FY17	(INR Million)		
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		FY18E	FY19E	Var
Net Sales	11,212	11,957	11,334	11,234	11,566	13,512	13,034	13,124	45,737	51,236	12,221	-5
YoY Change (%)	8.4	10.9	8.9	3.2	3.2	13.0	15.0	16.8	7.8	12.0	9.0	
Total Expenditure	10,585	10,968	10,211	10,444	10,705	12,012	11,587	11,335	42,208	45,639	11,280	
EBITDA	626	990	1,123	790	861	1,500	1,447	1,788	3,529	5,596	941	-8
Margins (%)	5.6	8.3	9.9	7.0	7.4	11.1	11.1	13.6	7.7	10.9	7.7	
Depreciation	476	517	599	630	590	750	780	230	2,222	2,350	675	
Interest	420	461	748	666	644	500	500	756	2,294	2,400	550	
Other Income	330	380	589	361	576	75	75	-426	1,660	300	75	
PBT before EO expense	61	393	365	-146	203	325	242	376	673	1,146	-209	
Extra-Ord expense	0	-9	-4,194	8	6	0	0	0	16	0	0	
PBT	61	402	4,559	-153	197	325	242	376	657	1,146	-209	
Tax	29	242	190	263	123	107	80	69	724	378	-69	
Rate (%)	47.3	60.2	4.2	-171.7	62.1	33.0	33.0	18.3	110.3	33.0	33.0	
Minority Interest & Profit/Loss of Asso. Cos.	-130	-154	-165	-41	-151	-61	-61	30	-4,861	-243	-61	
Reported PAT	162	314	4,533	-375	226	278	223	278	4,793	1,011	-79	-385
Adj PAT	162	310	514	-354	228	278	223	278	4,791	1,011	-79	
YoY Change (%)	-82.6	-62.6	-193.1	-61.0	41.1	-10.2	-56.7	-178.5	460.3	-78.9	-	
Margins (%)	1.4	2.6	4.5	-3.2	2.0	2.1	1.7	2.1	10.5	2.0	-0.6	

E: MOSL Estimates

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilalosal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Exhibit 1: Key operating metrics

	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Revenue Mix (%)									
Hospitals	80.6	81.2	81.6	80.7	81.2	81.3	80.9	81.3	81.2
Diagnostics	17.3	17.7	17.3	17.6	17.1	17.8	16.6	18.1	18.3
International	2.1	1.1	1.1	1.7	1.7	0.9	3.6	0.7	0.5
Revenue Growth (%)									
Hospitals	6.0	9.9	7.3	5.6	9.1	11.0	7.9	4.0	3.2
Diagnostics	1.1	5.5	0.6	3.8	7.3	11.5	4.4	5.7	10.4
International	(62.5)	(78.3)	(79.2)	(61.4)	(9.9)	(6.9)	267.5	(59.4)	(70.7)
Cost of sales (%)									
Raw material	23.1	21.7	22.4	22.5	22.7	21.9	20.8	21.9	22.5
Staff cost	19.5	19.3	19.2	20.3	20.0	18.7	20.0	20.8	20.5
Other expenses	52.7	52.9	57.0	59.9	51.8	51.1	49.2	50.3	49.6
Tax Rate	10.9	0.5	(17.9)	(13.0)	47.3	60.2	4.2	(171.7)	62.1
Margins (%)									
Gross Margins	76.9	78.3	77.6	77.5	77.3	78.1	79.2	78.1	77.5
EBITDAC Margins	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9
EBITDA Margins	4.7	6.1	1.3	(2.7)	5.6	8.3	9.9	7.0	7.4
EBIT Margins	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0

Source: Company, MOSL

Highlights from con call

- There was certain impact of demonetization in 1Q, which, along with stent price control, led to miss in revenues.
- FORH saw the highest and best-in-industry average revenue per operating bed (ARPOB) at INR15m.
- Growth in Diagnostic business was led by increase in volumes, offsetting price decline of 3% due to higher number of low-value tests.
- Management expects growth trajectory in 2Q to be better and sees double-digit growth in 2HFY18.
- In the Hospital business, the company has started a number of new clinical programs and plans to introduce few more, which will boost the segment's growth over the next 1-2 years. EBITDA margin for the hospital business is expected to improve by ~100bp in FY18 and can increase to 20% in next 2-3 years from current 14-15%.
- During the quarter, the company added 12 new labs.

Story in charts- Hospital

Exhibit 2: Hospital revenues grew 3%YoY

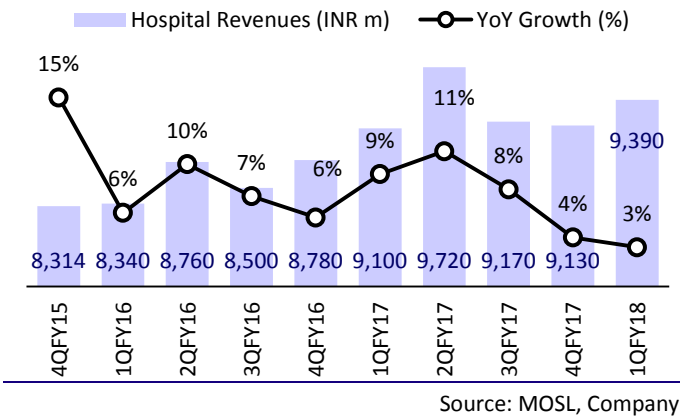


Exhibit 3: Hospital EBITDAC margins increased 150bp QoQ

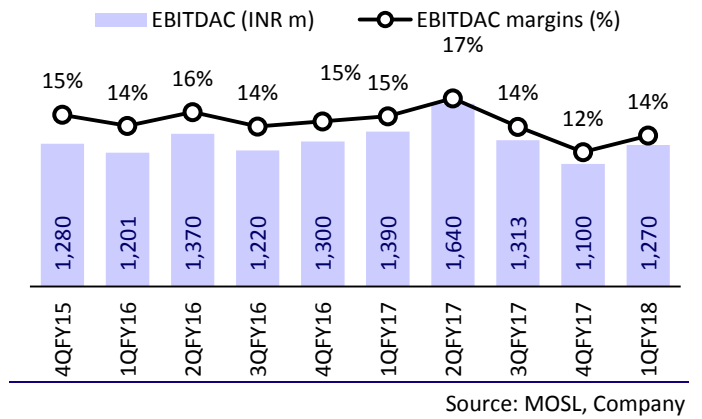


Exhibit 4: Hospital EBITDA margins contracted 400bp YoY

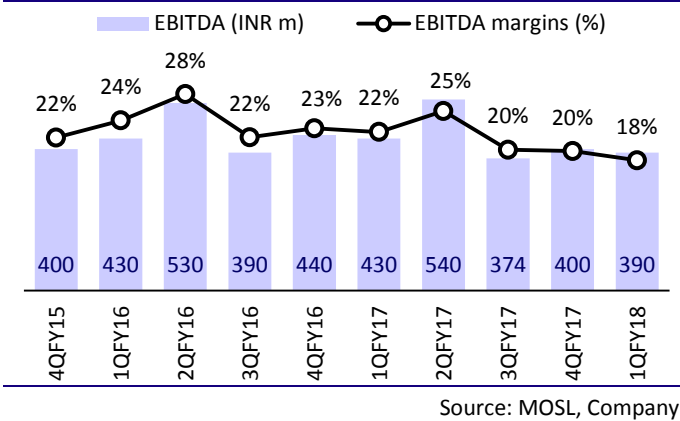


Exhibit 5: Decreased FEHI occupancy

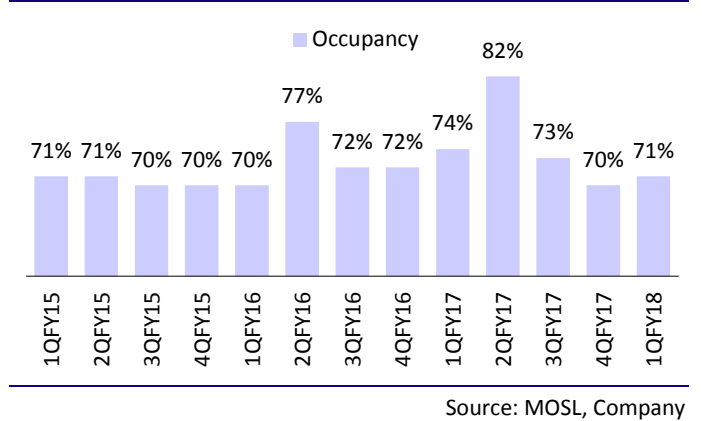


Exhibit 6: ARPOB witnessed YoY improvement

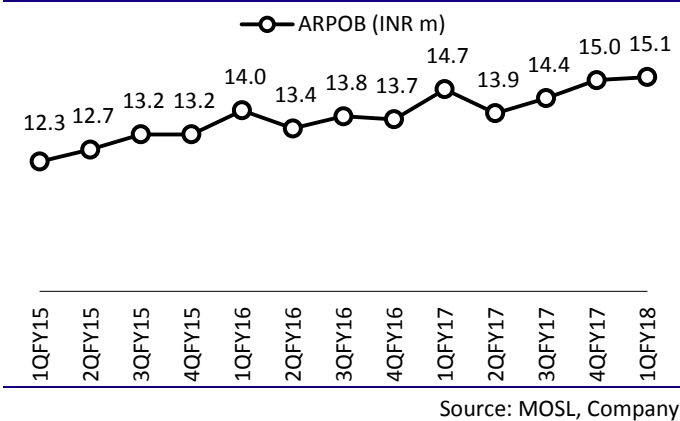
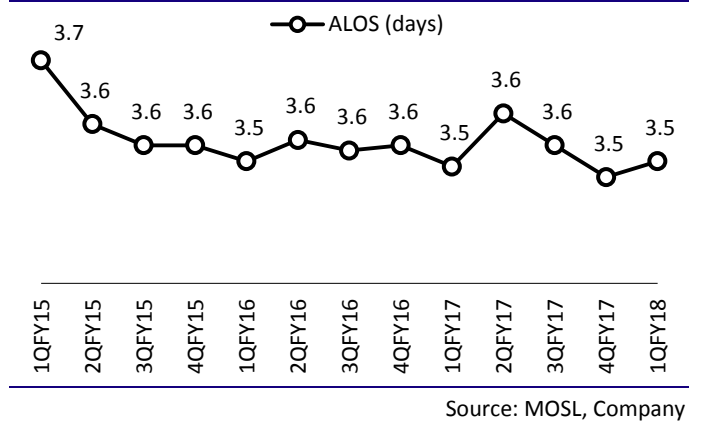
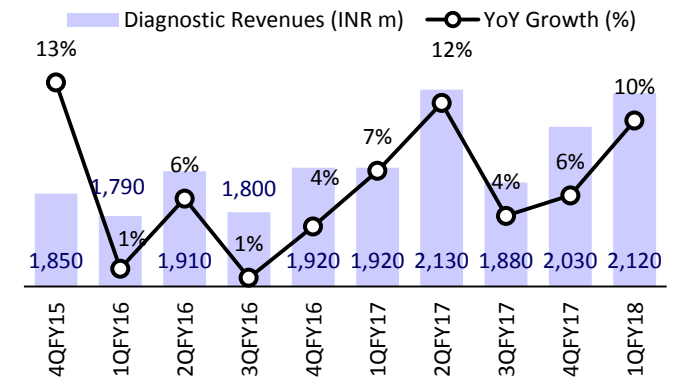


Exhibit 7: ALOS saw marginal improvement in 1QFY18



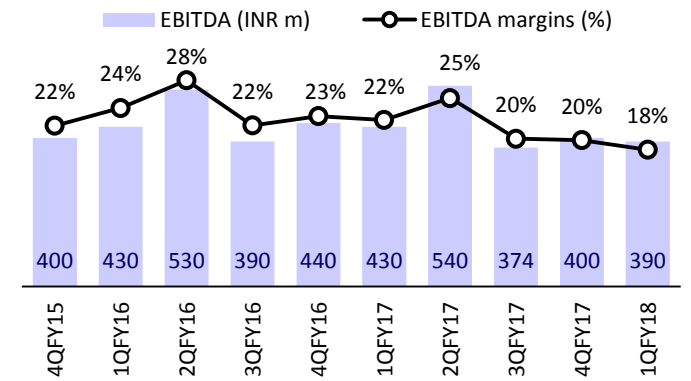
Story in charts- Diagnostics

Exhibit 8: Diagnostic revenues grew 10%YoY



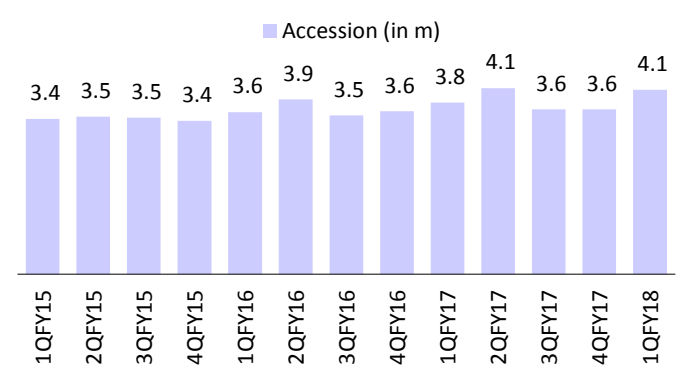
Source: MOSL, Company

Exhibit 9: Diagnostic EBITDA margins declined to 18%



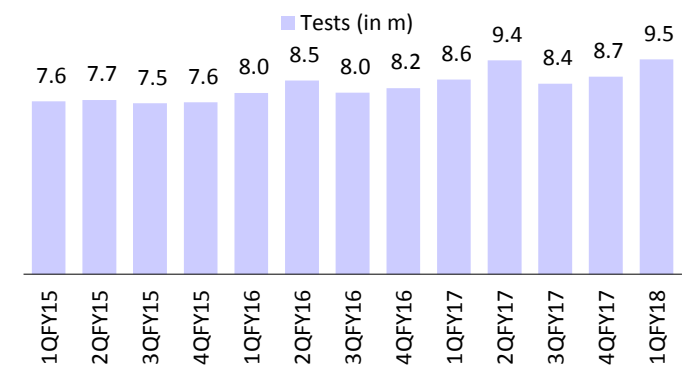
Source: MOSL, Company

Exhibit 10: Sample volumes



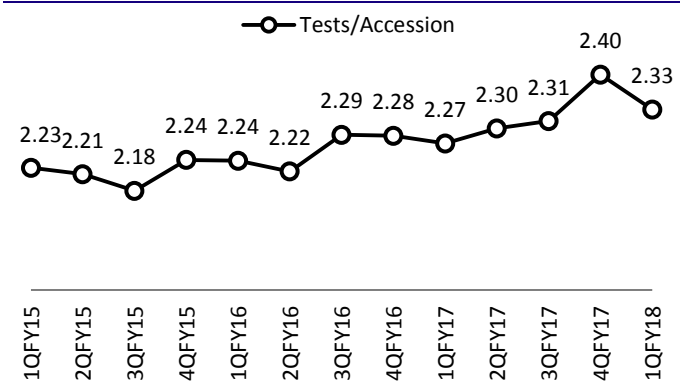
Source: MOSL, Company

Exhibit 11: No of tests conducted increased 10%YoY



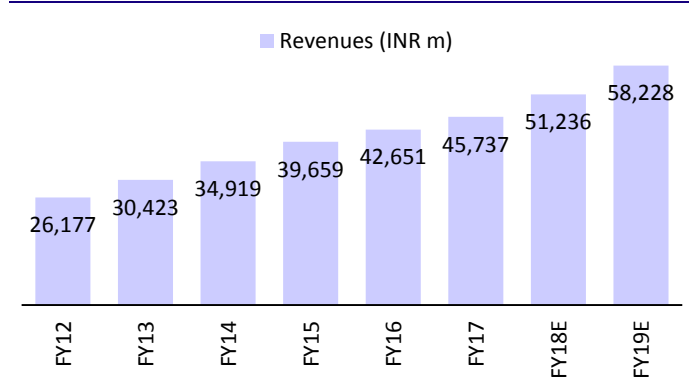
Source: MOSL, Company

Exhibit 12: No of Tests/sample increased 3%YoY



Source: MOSL, Company

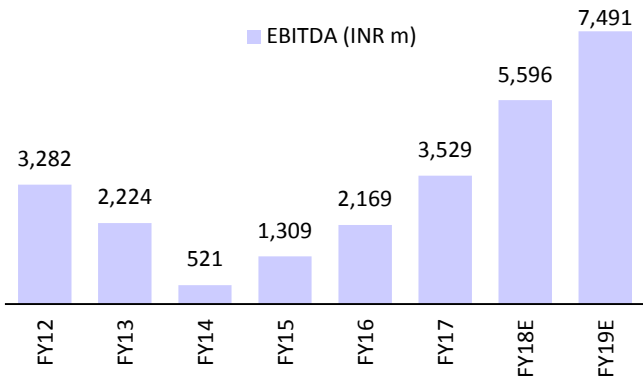
Exhibit 13: FORH revenues to exhibit 13%CAGR over FY17-19E



Source: MOSL, Company

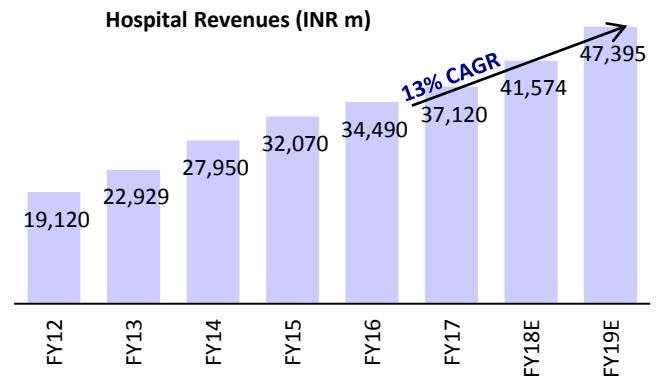
Story in charts

Exhibit 14: FORH EBITDA to exhibit 46% CAGR over FY17-19E



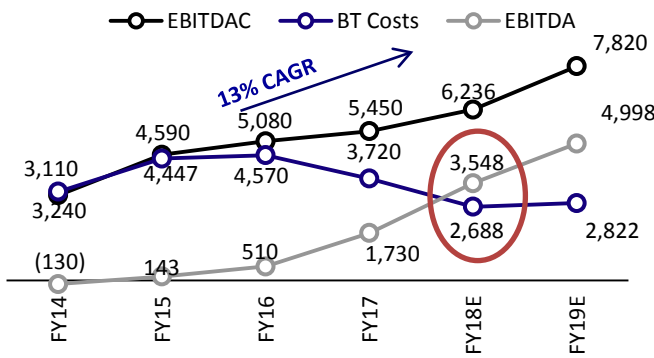
Source: MOSL, Company

Exhibit 15: Hospital revenues to exhibit 13% CAGR over FY17-19E



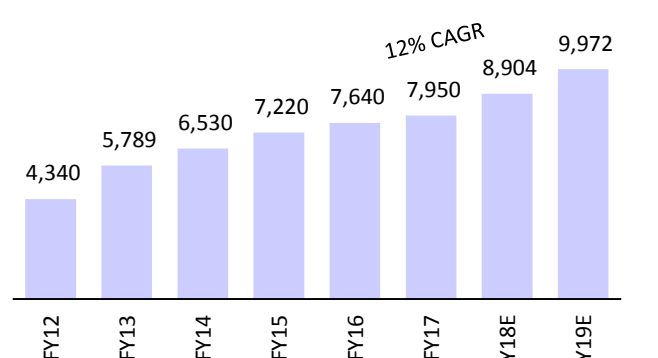
Source: MOSL, Company

Exhibit 16: Hospital EBITDA margins to improve due to robust EBITDAC growth and lower BT costs



Source: MOSL, Company

Exhibit 17: Diagnostic revenues to exhibit 12% CAGR over FY17-19E



Source: MOSL, Company

Valuation and view

We expect hospital business EBITDA to grow more than ~3x 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 (~15x FY19E EV/ EBITDA; >25% discount to peers).

We argue for a multiple re-rating in the stock on the back of multifold increase in hospital business EBITDA, SRL demerger, asset light expansion strategy and FHTL transaction. We have valued the hospital and diagnostic business based on 20x FY19E EV/EBITDA. We have brought down TP multiple for diagnostic business to 20x from 25x earlier as we expect relatively slower margin expansion in the medium term. FORH remains our top pick in the healthcare delivery space with TP of INR220 (v/s INR240 earlier). We have cut our EBITDA by 3%/4% for FY18/19E as we build impact of stent price control and pricing pressure in diagnostic business.

Exhibit 18: SOTP based target price of INR220 provides ~33% upside to CMP

SOTP (INR m)	FY19E	INR/ Share	Methodology	
SRL (56% stake Diagnostic business)	27,923	20 x	53	EV/EBITDA x
Domestic hospital	102,869	20 x	197	EV/EBITDA x
Fortis stake in business trust (~30%)	10,650	CMP	20	CMP
Target EV (INR m)			141,442	
Net debt/cash			-13,000	
Monetization of non-core assets		5,000		Land Parcels in Delhi, Mohali & minority interest in Sri Lankan hospital
Minority interest in FHTL		-20,000		
Implied Equity Value			113,442	
Diluted Shares Outstanding			523	
Target Price (INR/share)			220	

Source: MOSL, Company

Key catalysts driving stock performance over medium term are:

- 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.

Financials and valuations

Consolidated - Income Statement						(INR Million)		
Y/E March	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E
Total Income from Operations	26,177	30,423	34,919	39,659	42,651	45,737	51,236	58,228
Change (%)	75.0	16.2	14.8	13.6	7.5	7.2	12.0	13.6
Raw Materials	6,386	7,769	8,807	9,345	9,572	9,976	11,016	12,228
Employees Cost	5,510	6,277	6,952	7,646	8,260	9,089	8,966	10,190
Other Expenses	10,998	14,154	18,639	21,358	22,650	23,144	25,658	28,319
Total Expenditure	22,894	28,199	34,398	38,349	40,482	42,208	45,639	50,737
% of Sales	87.5	92.7	98.5	96.7	94.9	92.3	89.1	87.1
EBITDA	3,282	2,224	521	1,309	2,169	3,529	5,596	7,491
Margin (%)	12.5	7.3	1.5	3.3	5.1	7.7	10.9	12.9
Depreciation	1,745	2,288	1,828	2,346	2,295	2,222	2,350	2,800
EBIT	1,537	-63	-1,307	-1,036	-125	1,307	3,246	4,691
Int. and Finance Charges	2,512	4,613	2,502	1,518	1,249	2,294	2,400	1,500
Other Income	1,156	1,478	1,674	887	926	1,660	300	300
PBT bef. EO Exp.	181	-3,198	-2,135	-1,667	-448	673	1,146	3,491
EO Items	750	9,992	-51	68	212	-16	0	0
PBT after EO Exp.	931	6,793	-2,186	-1,599	-236	656	1,146	3,491
Total Tax	366	1,748	107	45	466	724	378	1,152
Tax Rate (%)	39.3	25.7	-4.9	-2.8	-197.4	110.3	33.0	33.0
Minority Interest/ associate income	-69	195	-105	-458	-443	-4,861	-243	-182
Reported PAT - Continuing Opr.	634	4,850	-2,188	-1,186	-259	4,793	1,011	2,521
Adjusted PAT - Continuing Opr.	179	-2,571	-2,134	-1,256	-890	4,791	1,011	2,521
Change (%)	-109.6	-1,536.8	-17.0	-41.1	-29.1	-638.2	-78.9	149.3
Margin (%)	0.7	-8.4	-6.1	-3.2	-2.1	10.5	2.0	4.3

Consolidated - Balance Sheet						(INR Million)		
Y/E March	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E
Equity Share Capital	4,052	4,052	4,628	4,628	4,631	4,631	5,231	5,231
Preference Capital/ FCCB	43	6,743	6,700	0	0	0	0	0
Total Reserves	28,468	33,013	38,196	35,848	35,342	40,184	46,184	48,742
Net Worth	32,563	43,809	49,524	40,476	39,973	44,815	51,416	53,973
Minority Interest	8,308	10,212	1,393	1,529	1,431	1,431	1,431	1,431
Total Loans	68,630	64,712	18,803	17,843	14,960	26,460	16,460	16,460
Deferred Tax Liabilities	-416	261	350	-71	-506	-506	-506	-506
Capital Employed	109,085	118,994	70,070	59,777	55,858	72,200	68,800	71,358
Gross Block	36,598	28,405	27,751	29,230	26,997	29,855	27,676	30,641
Less: Accum. Deprn.	9,619	10,232	10,056	11,726	12,569	14,791	17,141	19,941
Net Fixed Assets	26,980	18,172	17,695	17,504	14,428	15,064	10,535	10,700
Goodwill on Consolidation	64,823	74,569	23,773	24,673	23,328	23,328	23,328	23,328
Capital WIP	5,658	2,438	1,471	2,282	2,010	1,652	1,830	1,866
Total Investments	2,348	10,055	10,314	10,561	10,784	22,284	22,284	22,284
Curr. Assets, Loans&Adv.	23,968	29,903	25,255	20,826	21,264	25,114	27,090	31,548
Inventory	799	925	620	640	619	646	698	774
Account Receivables	5,461	6,628	4,407	4,094	4,438	5,639	7,019	7,976
Cash and cash equivalents	4,210	6,936	10,446	5,970	7,369	9,353	8,757	10,731
Loans and Advances	13,498	15,415	9,782	10,122	8,838	9,478	10,617	12,066
Curr. Liability & Prov.	14,691	16,144	8,438	16,069	15,957	15,227	16,252	18,352
Account Payables	8,102	9,267	5,061	5,649	6,071	4,626	4,376	4,856
Other Current Liabilities	5,676	5,318	2,477	9,316	8,872	9,514	10,658	12,113
Provisions	912	1,559	899	1,103	1,013	1,087	1,217	1,383
Net Current Assets	9,277	13,759	16,817	4,757	5,307	9,888	10,838	13,195
Appl. of Funds	109,085	118,994	70,070	59,777	55,857	72,216	68,816	71,374

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E
Basic (INR)								
EPS	0.4	-5.6	-4.6	-2.7	-1.9	10.3	2.2	5.6
Cash EPS	4.2	-0.6	-0.7	2.4	3.0	15.1	7.3	11.6
BV/Share	70.3	94.6	106.9	87.4	86.3	96.8	111.0	116.5
DPS	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.1
Payout (%)	0.0	0.0	-0.2	-0.9	-2.4	-1.0	1.1	1.1
Valuation (x)								
P/E				-61.2	-86.4	16.0	76.0	29.7
Cash P/E				70.6	54.7	11.0	22.9	14.3
P/BV				1.9	1.9	1.7	1.5	1.4
EV/Sales				2.2	2.0	2.1	1.7	1.4
EV/EBITDA				67.8	38.9	26.6	15.1	10.9
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0
FCF per share	-5.2	26.9	-1.3	1.3	4.3	-4.9	12.2	6.5
Return Ratios (%)								
RoE	0.5	-6.7	-4.6	-2.8	-2.2	11.3	2.1	4.9
RoCE	2.3	1.0	0.4	-0.2	1.1	3.5	3.4	4.9
RoIC	1.4	0.0	-2.0	-2.6	-0.2	2.6	5.8	8.9
Working Capital Ratios								
Fixed Asset Turnover (x)	0.7	1.1	1.3	1.4	1.6	1.5	1.9	1.9
Asset Turnover (x)	0.2	0.3	0.5	0.7	0.8	0.6	0.7	0.8
Inventory (Days)	11	11	6	6	5	5	5	5
Debtor (Days)	76	80	46	38	38	45	50	50
Creditor (Days)	113	111	53	52	52	37	31	30
Leverage Ratio (x)								
Net Debt/Equity	1.6	1.9	3.0	1.3	1.3	1.6	1.7	1.7

Consolidated - Cash Flow Statement

(INR Million)

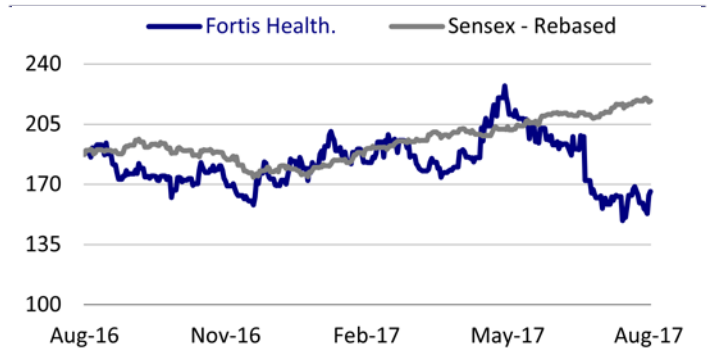
Y/E March	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E
OP/(Loss) before Tax	1,131	7,313	1,491	-1,374	552	673	1,146	3,586
Depreciation	1,822	2,922	2,479	2,628	2,305	2,222	2,350	2,800
Interest & Finance Charges	1,708	4,483	1,839	1,048	587	634	2,100	1,200
Direct Taxes Paid	-1,073	-2,496	-1,049	-1,193	-1,544	-724	-378	-1,183
(Inc)/Dec in WC	-544	2,240	-203	-280	126	-2,597	-1,546	-383
CF from Operations	3,044	14,461	4,556	829	2,026	208	3,672	6,020
Others	-67	1,975	235	-587	-352	0	0	0
CF from Operating incl EO	2,977	16,436	4,791	242	1,674	208	3,672	6,020
(Inc)/Dec in FA	-5,397	-3,978	-5,413	383	325	-2,500	2,000	-3,000
Free Cash Flow	-2,420	12,458	-622	625	1,999	-2,292	5,672	3,020
(Pur)/Sale of Investments	583	-6,971	-5,858	4,097	-1,393	-11,500	0	0
Others	-3,124	-2,020	42,162	-6,162	5,229	1,660	300	300
CF from Investments	-7,937	-12,969	30,891	-1,682	4,162	-12,340	2,300	-2,700
Issue of Shares	3,005	3,002	10,196	1	32	0	5,600	0
Inc/(Dec) in Debt	6,418	-3,916	-37,737	-1,539	-3,255	11,500	-10,000	0
Interest Paid	-2,031	-5,553	-3,777	-1,400	-1,248	-2,294	-2,400	-1,500
Dividend Paid	0	0	0	0	0	50	-11	-27
Others	-479	5,725	-854	-98	34	4,861	243	182
CF from Fin. Activity	6,912	-741	-32,172	-3,035	-4,438	14,116	-6,567	-1,345
Inc/Dec of Cash	1,952	2,726	3,510	-4,475	1,399	1,984	-596	1,974
Opening Balance	2,257	4,210	6,936	10,446	5,970	7,369	9,353	8,757
Closing Balance	4,210	6,936	10,446	5,970	7,369	9,353	8,757	10,731

Corporate profile

Company description

Incorporated in 1991, the Hyderabad-based Granules India (GRAN) is a vertically integrated manufacturer of pharmaceutical products. It is among the largest manufacturers of Paracetamol and Ibuprofen in the world. It derives 63% of its business from Europe and the US. GRAN also has a formulations plant, with a capacity to produce 18b tablets per annum. It has its own Abbreviated New Drug Applications (ANDAs) and dossiers. GRAN services more than 300 customers across 60 nations (exports are ~87% of revenues).

Exhibit 1: Sensex rebased



Source: MOSL/Bloomberg

Exhibit 2: Shareholding pattern (%)

	Jun-17	Mar-17	Jun-16
Promoter	43.0	52.3	71.3
DII	6.0	0.4	5.3
FII	32.7	34.5	13.6
Others	18.4	12.8	9.8

Note: FII Includes depository receipts Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
INTERNATIONAL FINANCE CORPORATION	3.9
EAST BRIDGE CAPITAL MASTER FUND LIMITED	3.7
MORGAN STANLEY MAURITIUS COMPANY LIMITED	3.4
WF ASIAN SMALLER COMPANIES FUND LIMITED	2.0
NORDEA 1 SICAV - ASIAN FOCUS EQUITY FUND	1.9

Source: Capitaline

Exhibit 4: Top management

Name	Designation
Shivinder Mohan Singh	Vice Chairman
Malvinder Mohan Singh	Executive Chairman

Source: Capitaline

Exhibit 5: Directors

Name	Name
Harpal Singh	P S Joshi
Sunil Godhwani	Pradeep Ratilal Raniga
Brian W Tempest	Shradha Suri Marwah
Joji Sekhon Gill	

Independent

Exhibit 6: Auditors

Name	Type
Deloitte Haskins & Sells LLP	Statutory
Jitender, Navneet & Co	Cost Auditor
Rajiv Puri	Internal
Sanjay Grover	Secretarial Audit

Source: Capitaline

Exhibit 7: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY18	2.2	2.1	4.8
FY19	5.6	6.1	-8.2

Source: Bloomberg

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