

08 August 2023

India | Equity research | Q1FY24 result review

Fortis Healthcare

Pharma

Bed addition and seasonality take a toll on margins

Fortis's Q1 hospital EBITDA performance was disappointing (margins at 15.2% vs our estimate of 16.5% and Q4FY23's 16.4%). New bed addition took a toll on margins of Mulund hospital (less than 10% vs 20-25% earlier) while seasonality at a few facilities led to a drop in overall occupancy to 64% vs 65% in Q1FY23 and 67% in Q4FY23. Q1 also saw a one-off charge of INR 65mn (40bps impact). Diagnostics arm Agilus reported a strong 230bps YoY improvement in margins to 21.9%. Company has divested the Arcot road facility in Jul'23, which will likely reduce revenue growth by 1% though margins could improve by 70-80bps from Q2. We remain confident on prospects of hospital biz while IPO of Agilus will also likely unlock value. We raise FY24E/FY25E earnings by 2%/6%. Retain **BUY** with a higher TP of INR 390.

Dismal margins in hospital biz weigh on performance

Revenues rose 11.4% YoY (+0.9% QoQ) to INR 16.6bn, lower than our estimate of INR 17bn, due to lower occupancies in the hospital segment. Gross margins fell 60bps YoY (-80bps QoQ) to 76%. EBITDA margins fell 40bps YoY (-10bps QoQ) to 16.4% (I-Sec: 17.1%) with decline in hospital margins (-100bps YoY, -110bps QoQ). Adjusted PAT stood at INR 1.1bn (I-Sec: INR 1.5bn), down 9.5% YoY and 9.3% QoQ

Lower occupancy, inferior payor mix impacts hospitals

Hospital revenues was flat QoQ (+13.6% YoY) at INR 13.5bn (I-Sec: INR14bn). Occupancy declined to 64% vs 67% / 65% QoQ / YoY, partially impacted by the seasonal rains. ARPOBs rose 4.5% QoQ (+12.1% YoY) to INR 60,076 vs INR 57,476 (in Q4FY23), aided by price hikes and favourable mix. ALOS stood at 3.58 days (3.82 / 3.58 QoQ / YoY). Revenues from international patients grew 29.2% YoY (+1.8% QoQ) to INR 1.15bn. EBITDA margins of the hospital segment contracted 100bps YoY (-110bps QoQ) to 15.2% due to lower occupancy and higher revenue share of scheme-based patients (11% vs 9% in last year). Fortis is on track to add 1,400-1,500 beds through brownfield expansion over the next 3-5 years.

Agilus margins trajectory improving, IPO on cards

Diagnostics revenue rose 2.7% YoY (+4% QoQ) to INR 3bn. Number of tests was flat YoY (+1.8% QoQ) at 9.95mn. Number of patients declined 3.7% YoY (+2.2% QoQ) at 4.1mn. Realisation per test was up 3% YoY (flat QoQ) at INR 344. Margins expanded 230bps YoY (490bps QoQ) to 21.9%. Board has given approval to initiate an IPO process of Agilus by way of offer for sale (OFS).

Financial summary

Y/E March (INR mn)	FY22A	FY23A	FY24E	FY25E
Net Revenue	57,177	62,976	74,886	84,808
EBITDA	10,691	11,013	13,867	16,116
EBITDA Margin (%)	18.7	17.5	18.5	19.0
Net Profit	3,032	5,315	7,744	9,558
EPS (Rs)	4.0	7.0	10.3	12.7
EPS % Chg YoY	(380.2)	75.3	45.7	23.4
P/E (x)	80.7	46.0	31.6	25.6
EV/EBITDA (x)	23.3	22.3	17.3	14.3
RoCE (%)	4.0	5.8	7.4	8.3
RoE (%)	4.9	7.9	10.1	11.3

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Market Data

Market Cap (INR)	245bn
Market Cap (USD)	2,955mn
Bloomberg Code	FORH IN
Reuters Code	FOHE.BO
52-week Range (INR)	353 /245
Free Float (%)	69.0
ADTV-3M (mn) (USD)	6.3

Price Performance (%)	3m	6m	12m
Absolute	22.0	16.9	22.9
Relative to Sensex	8.8	10.4	14.4

ESG Disclosure	2021	2022	Change
ESG score	37.1	37.9	0.9
Environment	2.4	2.4	-
Social	23.7	26.3	2.6
Governance	84.9	84.9	-

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

Earnings Revisions (%)	FY24E	FY25E
Revenue	1.6	4.5
EBITDA	2.1	6.3
EPS	3.7	9.1

Previous Reports

28-05-2023: [Q4FY23 results review](#)

15-05-2023: [Re-initiating coverage](#)

Valuations and risks

We expect EBITDA CAGR of 21% over FY23-FY25E driven by revenue CAGR of 17.6%. EBITDA margins are expected to rise to levels of 18-19% over the next few years backed by improvement in ARPOB, surge in occupancy, divestment of loss-making hospitals and healthy growth in non-covid biz of Agilus Diagnostics.

We raise our revenue estimates by ~2-5% and EBITDA estimates by ~2-6% over FY23-FY25E to factor-in healthy performance of Agilus and improvement in ARPOB of the hospital biz. The stock currently trades at EV/EBITDA of 17.3x FY24E and 14.3x FY25E. We remain optimistic on the outlook considering strong growth in hospitals with increasing occupancy (targeting 70% levels) and ARPOB, imminent recovery of non-covid volumes, and cost-control initiatives employed by the current management. Maintain **BUY** with a revised target price of INR 390/share based on FY25E SoTP-based valuation (earlier: INR 360/share based on FY25E SoTP valuation)

Exhibit 1: Sum of the parts (SoTP) valuation

	FY25E EBITDA	(x)	Values (INR mn)
Hospitals	13,058	18	2,39,610
Agilus (56.9% stake)	3,059	25	43,856
EV			2,83,466
Less: Net debt			(11,167)
Implied Mkt Cap			2,94,633
Value per share			390

Source: Company data, I-Sec research

Q1FY24 concall highlights

Hospitals

- Top 6 specialities account for 60% of hospital sales. Change in specialty mix impacted margins of hospitals.
- International patients grew 29% and accounted for 8.5% of sales in Q1 vs 7.5% in Q1FY23.
- Oncology grew faster in Q1; Fortis has slightly lower margins in this specialty.
- Arcot (Chennai) hospital was divested in Jul'23, proceeds of which was INR 1.52bn. The hospital had sales of INR 510mn and incurred a loss of INR 360mn.
- Fortis acquired a facility in Manesar for INR 2.25bn. The hospital complements well its existing FMRI and Gurgaon facilities. It will initially commission 125 beds and ramp-up thereof should be fast. The facility will be fully commissioned in 2 years post commercialisation and will take 18 months to breakeven.
- Q1 has historically been relatively softer. Q1 financials were impacted by occupancy and payer mix skewed towards government biz.
- Company has reiterated its bed addition target for next 2-3 years. Overall, it will add 1,400 beds in 2-3 years at Mulund FMRI, Shalimar Bagh, Noida, etc. Target is to take operational bed count at each of these hospitals to 450-500 beds.
- New bed addition at Mulund took a toll on margins and occupancy of this hospital.

- Kalyan hospital profitability and margins were impacted in Q1 due to monsoon.
- Anandapur (Kolkata) facility got all clearances for operationalising 80 beds.
- Q1 did not witness any slowdown in operations on account of pent up demand earlier. Specialty mix now is similar to pre-covid levels. Profitability drop at some facilities was mainly on account of unseasonal rains.
- Occupancy number in Q2FY24 till date have surged to healthy levels. Management is confident of achieving occupancy levels of over 70% in FY24.
- Operational beds include: 4,100 owned beds and 400 on O&M basis.
- None of the Gurgaon hospitals of Fortis have been impacted by unrest in the nearby areas.

Diagnostics

- In May'23, the company changed name of its diagnostic arm to Agilus Diagnostics Limited.
- In Aug'23 the Board granted approval to Agilus to initiate an IPO process by way of an offer for sale (OFS) of its equity shares.
- The IPO would not need any clearance from Indian courts.

Q1 financials

- Employee costs were higher in Q1 due to annual increment of 7-8%. Addition of medical staff also led to increase in cost. Company is working on reducing employee costs, benefit of which will be seen in quarters ahead.
- Fortis incurred a one off charge of INR 35mn pertaining to clearances for the Anandapur facility and INR 30mn in other one-offs.
- Inferior payor mix (11% of hospital revenues were from scheme-based patients vs 9% in Q1FY23 & Q4FY24) also impacted margins.
- Consumables cost rose QoQ due to higher share of surgical revenue (61% vs 57% in Q4FY23).

FY24 guidance

- Hospital biz is expected to grow 11-12% in FY24.
- EBITDA margin guidance of 20% by FY24-FY25 has been maintained.
- Occupancy will move to over 70% in the short term.
- Hospital biz ARPOB will improve by 4-5% every year.
- Revenue contribution from international patients will touch 10-11% in the near term.

Exhibit 2: Quarterly review

INR mn	Q1FY24	Q1FY23	YoY % Chg	Q4FY23	QoQ % Chg	FY23	FY22	YoY % Chg
Net Sales	16,574	14,879	11.4	16,427	0.9	62,976	57,176	10.1
Gross profit	12,589	11,387	10.6	12,603	(0.1)	48,429	43,604	11.1
Gross margins (%)	76.0	76.5	-60bps	76.7	-80bps	76.9	76.3	60bps
EBITDA	2,725	2,511	8.5	2,709	0.6	11,013	10,690	3.0
EBITDA margins (%)	16.4	16.9	-40bps	16.5	-10bps	17.5	18.7	-120bps
Other income	75	307	(75.5)	155	(51.5)	836	515	62.3
PBITD	2,800	2,818	(0.7)	2,864	(2.2)	11,849	11,205	5.8
Depreciation	792	743	6.7	818	(3.1)	3,157	3,008	5.0
Interest	315	312	0.9	317	(0.7)	1,291	1,469	(12.1)
Extra ordinary income/ (exp.)	15	-		105		736	3,150	
PBT	1,707	1,763	(3.2)	1,834	(6.9)	8,137	9,878	(17.6)
Tax	468	420	11.3	451	3.7	1,807	1,978	(8.7)
Minority Interest	122	121	1.1	58	112.0	443	2,348	(81.2)
Reported PAT	1,118	1,223	(8.6)	1,326	(15.7)	5,887	5,551	6.1
Adjusted PAT	1,107	1,223	(9.5)	1,220	(9.3)	5,315	3,032	75.3

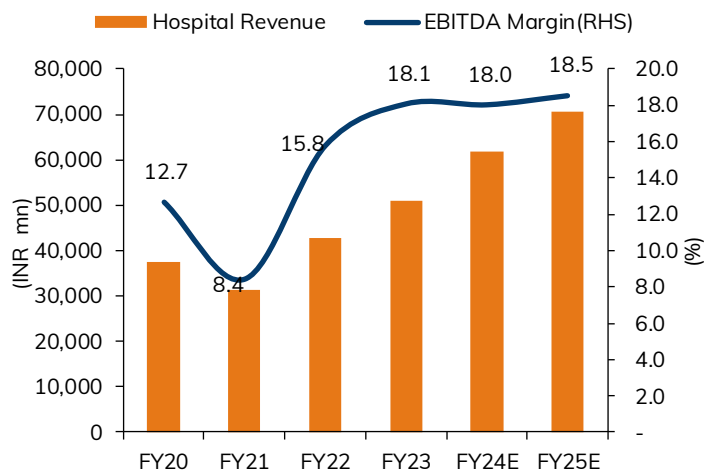
Source: Company data, I-Sec research

Exhibit 3: Business mix

INR mn	Q1FY24	Q1FY23	YoY % Chg	Q4FY23	QoQ % Chg
Hospitals	13,540	11,924	13.6	13,510	0.2
EBITDA margins(%)	15.2	16.2	-100bps	16.4	-110bps
SRL	3,034	2,955	2.7	2,917	4.0
EBITDA margins(%)	21.9	19.6	230bps	17.0	490bps
Total	16,574	14,879	11.4	16,427	0.9

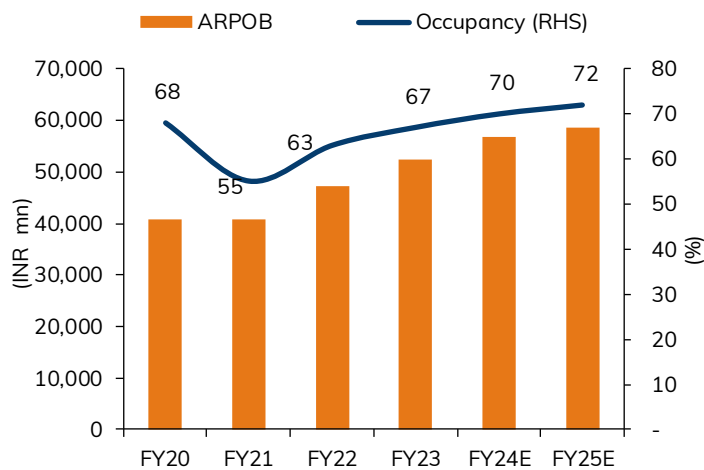
Source: Company data, I-Sec research

Exhibit 4: Hospital revenues to deliver healthy growth with improved occupancies and capacity



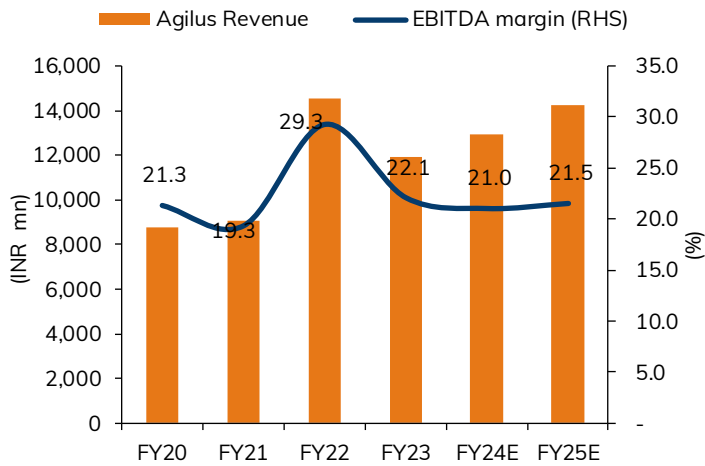
Source: Company data, I-Sec research

Exhibit 5: Steady improvement in ARPOBs and occupancies over the years



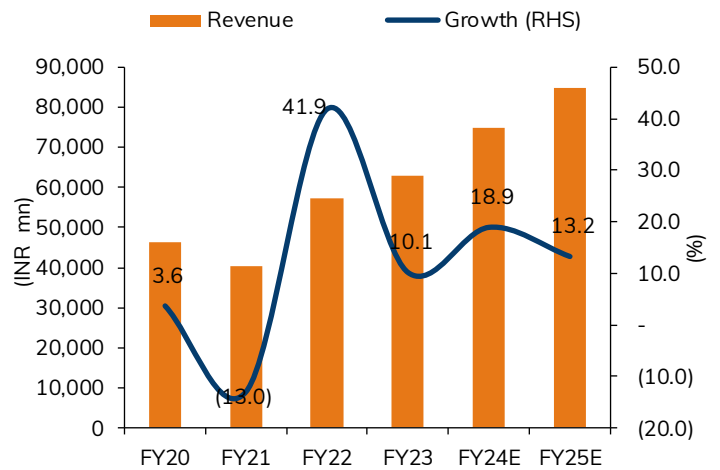
Source: Company data, I-Sec research

Exhibit 6: Non-covid business recovery likely to boost Agilus revenue growth



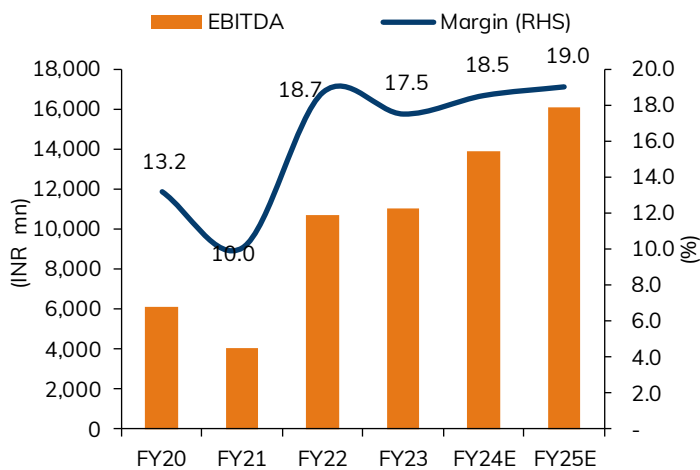
Source: Company data, I-Sec research

Exhibit 7: Expect revenue CAGR of 16% over FY23-FY25E



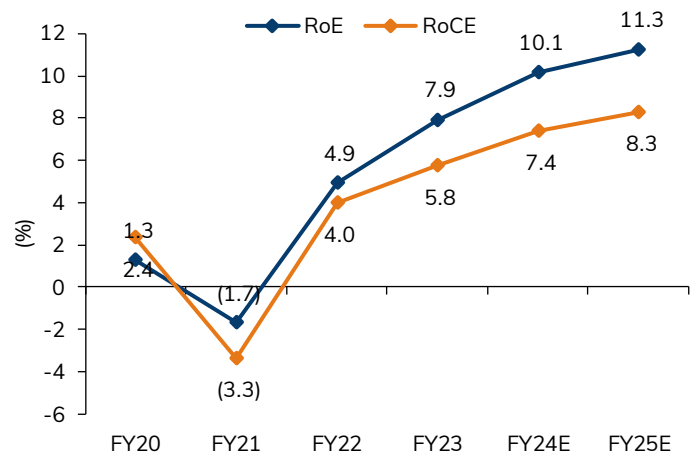
Source: Company data, I-Sec research

Exhibit 8: EBITDA margin likely to improve to ~19%



Source: Company data, I-Sec research

Exhibit 9: Return ratios expected to improve from current levels



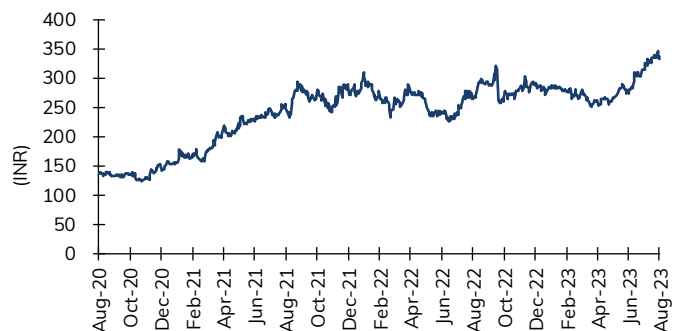
Source: Company data, I-Sec research

Exhibit 10: Shareholding pattern

%	Dec'22	Mar'23	Jun'23
Promoters	31.2	31.2	31.2
Institutional investors	51.4	51.9	52.2
MFs and others	17.5	17.4	18.5
FIs/Banks	1.2	1.2	1.2
Insurance	1.6	2.1	2.4
FIIIs	31.1	31.2	30.1
Others	17.4	16.9	16.6

Source: Bloomberg

Exhibit 11: Price chart



Source: Bloomberg

Financial summary

Exhibit 12: Profit & Loss

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Net Sales	57,177	62,976	74,886	84,808
Operating Expenses	46,487	51,963	61,019	68,692
EBITDA	10,691	11,013	13,867	16,116
EBITDA Margin (%)	18.7	17.5	18.5	19.0
Depreciation & Amortization	3,008	3,157	3,330	3,554
EBIT	7,682	7,856	10,537	12,562
Interest expenditure	1,469	1,291	881	606
Other Non-operating Income	3,150	736	-	-
Recurring PBT	9,879	8,137	10,523	12,855
Profit / (Loss) from Associates	-	-	-	-
Less: Taxes	1,978	1,807	2,337	2,855
PAT	7,900	6,330	8,186	10,000
Less: Minority Interest	(2,348)	(443)	(443)	(443)
Extraordinary (Net)	-	-	-	-
Net Income (Reported)	7,900	6,330	8,186	10,000
Net Income (Adjusted)	3,032	5,315	7,744	9,558

Source Company data, I-Sec research

Exhibit 13: Balance sheet

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Total Current Assets	11,333	14,064	20,111	28,591
of which cash & cash eqv.	4,127	3,627	8,185	15,425
Total Current Liabilities & Provisions	10,473	12,550	14,237	15,663
Net Current Assets	860	1,513	5,873	12,928
Investments	1,036	2,103	759	759
Net Fixed Assets	38,323	37,918	40,588	41,034
ROU Assets	11,179	10,577	10,577	10,577
Capital Work-in-Progress	1,935	2,278	2,278	2,278
Total Intangible Assets	44,654	45,768	45,768	45,768
Other assets	6,693	8,175	8,175	8,175
Deferred Tax assets	3,691	3,443	3,443	3,443
Total Assets	1,08,375	1,11,786	1,17,472	1,24,972
Liabilities				
Borrowings	9,657	7,032	4,532	2,032
Deferred Tax Liability	3,812	4,107	4,107	4,107
provisions	1,147	1,302	1,302	1,302
other Liabilities	20,784	16,115	16,115	16,115
Equity Share Capital	7,550	7,550	7,550	7,550
Reserves & Surplus	54,233	64,873	72,617	82,174
Total Net Worth	61,782	72,423	80,166	89,724
Minority Interest	8,300	8,581	9,024	9,466
Total Liabilities	1,08,375	1,11,786	1,17,472	1,24,972

Source Company data, I-Sec research

Exhibit 14: Cashflow statement

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Operating Cashflow	8,654	8,222	12,595	14,346
Working Capital Changes	154	(211)	(61)	(31)
Capital Commitments	(4,403)	(4,513)	(6,000)	(4,000)
Free Cashflow	4,251	3,709	6,595	10,346
Other investing cashflow	(741)	776	1,344	-
Cashflow from Investing Activities	(5,144)	(3,737)	(4,656)	(4,000)
Issue of Share Capital	-	-	-	-
Interest Cost	-	-	-	-
Inc (Dec) in Borrowings	(3,703)	(3,256)	(2,500)	(2,500)
Dividend paid	-	(1,598)	-	-
Others	154	(132)	(881)	(606)
Cash flow from Financing Activities	(3,549)	(4,985)	(3,381)	(3,106)
Chg. in Cash & Bank balance	(39)	(500)	4,558	7,240
Closing cash & balance	4,127	3,627	8,185	15,425

Source Company data, I-Sec research

Exhibit 15: Key ratios

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
Per Share Data (INR)				
Reported EPS	10.5	8.4	10.8	13.2
Adjusted EPS (Diluted)	4.0	7.0	10.3	12.7
Cash EPS	8.0	11.2	14.7	17.4
Dividend per share (DPS)	-	2.1	-	-
Book Value per share (BV)	81.8	95.9	106.2	118.8
Dividend Payout (%)	-	25.2	-	-
Growth (%)				
Net Sales	41.9	10.1	18.9	13.2
EBITDA	164.3	3.0	25.9	16.2
EPS (INR)	(380.2)	75.3	45.7	23.4
Valuation Ratios (x)				
P/E	80.7	46.0	31.6	25.6
P/CEPS	40.5	28.9	22.1	18.6
P/BV	4.0	3.4	3.1	2.7
EV / EBITDA	23.3	22.3	17.3	14.3
P / Sales	4.3	3.9	3.3	2.9
Operating Ratios				
Gross Profit Margins (%)	76.3	76.9	77.1	77.2
EBITDA Margins (%)	18.7	17.5	18.5	19.0
Effective Tax Rate (%)	20.0	22.2	22.2	22.2
Net Profit Margins (%)	5.3	8.4	10.3	11.3
Net Debt / Equity (x)	0.1	0.0	0.0	(0.1)
Net Debt / EBITDA (x)	0.4	0.1	(0.3)	(0.9)
Profitability Ratios				
RoCE (%)	4.0	5.8	7.4	8.3
RoE (%)	4.9	7.9	10.1	11.3
RoIC (%)	3.9	5.7	7.4	8.8
Fixed Asset Turnover (x)	1.5	1.7	1.9	2.1
Inventory Turnover Days	9	7	8	8
Receivables Days	38	35	37	36
Payables Days	49	43	45	43

Source Company data, I-Sec research

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