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Fortis Healthcare Ltd.

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A secular growth story…

Fortis Healthcare Ltd. (FHL) is India's leading integrated healthcare delivery service provider. The healthcare verticals of FHL primarily comprise hospitals, diagnostics and day care specialty facilities.

Investment Rationale

Prominent player in domestic healthcare space: FHL is one of India‟s leading healthcare operators with a network of ~4,000 operational beds across 42 healthcare facilities. In FY16, FHL derived ~81% of its turnover from healthcare services segment. Importantly, FHL has positioned itself as a high-quality service provider with a focus on higher-margin/high-growth super-specialty areas including cardiac care (amongst the leaders in India), neuro-sciences, renal care & oncology. Its ARPOB is the best in the industry with Rs1.37cr.

Momentum continues in the Hospital segment: The hospital segment has posted strong revenue CAGR of ~16% over FY12-16, driven largely by ~10% CAGR in ARPOB. Going forward, as the management has guided that it would focus on brownfield expansion with minimal investments in greenfield hospitals, we believe this strategy would bode well for growth & margin improvement. Importantly, the ramp-up of FMRI (Gurgaon) & new hospitals coupled with recovery in occupancy at FEHI (Delhi) remains the growth driver for the hospital business. Hence, we expect hospital business to grow at a CAGR of ~13% over FY16-19E. Moreover, we estimate EBITDA margin of hospital segment to expand by 780bps to 9.3% in FY19E primarily driven by operational efficiency & reduction in BT costs to RHT (Religare Health Trust) post acquiring 51% stake in Fortis Hospotel Limited (FHTL), a subsidiary of RHT.

Diagnostic business shaping up well: Super Religare Laboratories (SRL) is India‟s leading company in the diagnostics space. Across India, SRL Diagnostics had 314 network laboratories with over 7,200 collection points as of March 31, 2016. We expect its diagnostics business to continue to grow steadily and report a 12% revenue CAGR over FY16-19E, fuelled by expanded lab network & higher volumes (number of tests).

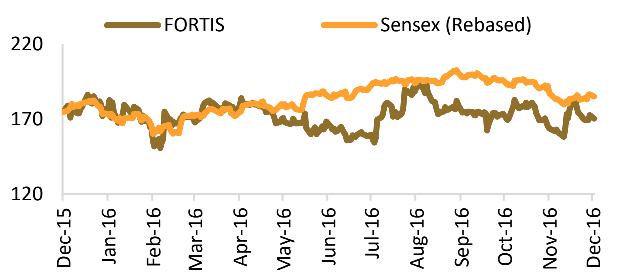
Valuation: FHL is in a sweet spot to tap Indian healthcare‟s growth given its strong brand equity and leading position in the under-penetrated market. We expect revenue to grow at a CAGR of 13% over FY16-FY19E. Further, we estimate EBITDA to post a robust CAGR of 52% over FY16-19E on account of lower net BT costs. We initiate with a Buy rating with a target price of Rs220 based on SoTP valuation.

Market Data	
Rating	BUY
CMP (Rs.)	181
Target (Rs.)	220
Potential Upside	22%
Duration	Long Term
Face Value (Rs.)	10
52 week H/L (Rs.)	199/141
Adj. all time High (Rs.)	199
Decline from 52WH (%)	9.3
Rise from 52WL (%)	28.0
Beta	1.3
Mkt. Cap (Rs.Cr)	8,687

Fiscal Year Ended

Y/E	FY16	FY17E	FY18E	FY19E
Net sales (Rs.Cr)	4,265	4,752	5,389	6,153
Net profit (Rs.Cr)	(25)	73	202	281
EPS (Rs.)	0.1	1.4	3.9	5.4
P/E (x)	-	129.4	46.1	33.2
P/BV (x)	2.3	2.2	1.9	1.8
ROE (%)	0.2	1.8	4.5	5.7

One year Price Chart

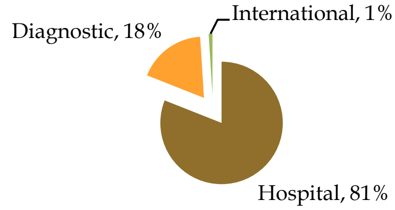


Shareholding Pattern	Sep-16	Jun-16	Chg.
Promoters (%)	70.3	71.3	(1.0)
Public (%)	29.7	28.7	1.0

Company Overview

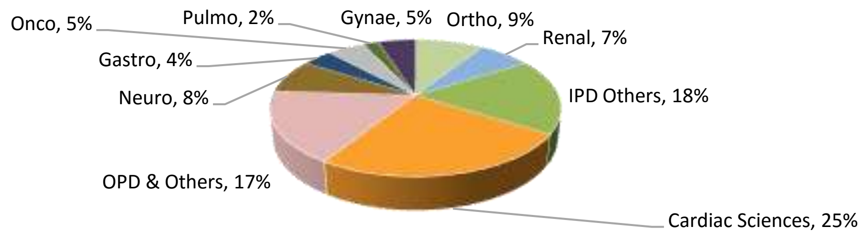
Fortis Healthcare Ltd (FHL) is one of India's leading healthcare operators with a network of ~4,000 operational beds across 42 healthcare facilities. Besides, it owns 314 diagnostic laboratories under the SRL business. FHL holds 56.4% stake in SRL Diagnostics. In the last few years, FHL has divested most of its international assets and is now focusing on the domestic market. While hospital segment contributes 81% to revenues, FHL derives the remaining from diagnostic business.

Business wise revenue mix (FY16)



Source: Company, In-house research

Specialty Revenue Split –India Hospital Business



Source: Company, In-house research

Indian hospitals – a secular growth story

Indian health infrastructure is well below WHO guidelines

India continues to rank low on many of the healthcare infrastructure parameters. According to the statistics of the World Health Organization (WHO), the proportion of Indian government expenditure on healthcare is only 31% as against the global average of 58%. Consequently, the private sector accounts for a majority of the total healthcare expenditure in India.

In terms of availability of medical staff, the number of doctors/nurses available for every 10,000 population was at 6.5/10.0 in India when compared to the global average of 13.9 doctors and 29.0 nurses. Likewise, bed availability in India stood at 9 per 10,000 which was significantly lower than the WHO guideline of 30 beds per 10,000 population. As per industry estimates, in order to meet the WHO standard, India needs investments to the tune of over Rs14trillion.

Abysmal doctor-to-population ratio of India

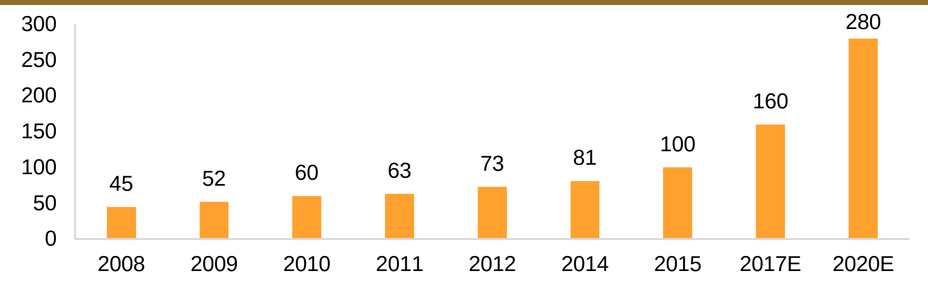
Per 10,000 population	India	China	USA	Singapore	Malaysia	Thailand	Australia
Health Workforce Density							
Physicians	6.5	14.6	24.2	19.2	12.0	3.0	38.5
Nurses & midwives	10.0	15.1	98.2	63.9	32.8	15.2	95.9
Infrastructure							
Hospital Beds	9	39	30	27	18	21	39

Source: Company, In-house research

Under-penetrated market presents a huge opportunity for private healthcare players

A lack of strong public healthcare delivery system and weak penetration of health insurance in the country have led to higher out-of-pocket (OOP) expenditure on healthcare. OOP expenses as a proportion of total healthcare spending continued to remain elevated at about 61% in 2015 as against the global average of 22%. With government having limited resources to cater to the healthcare demands of the population, private players such as Fortis Healthcare are well placed to tap the opportunity in the domestic healthcare sector. We expect the Indian healthcare market to grow at a CAGR of 16% to USD280bn over FY15-20E driven by factors such as rising lifestyle diseases & growing awareness for healthy lifestyle.

Indian healthcare market poised for robust growth

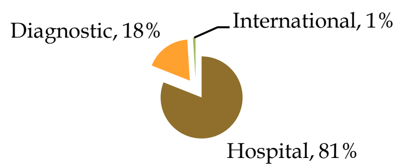


Source: Company, In-house research

FHL is well placed to benefit from growing healthcare spending

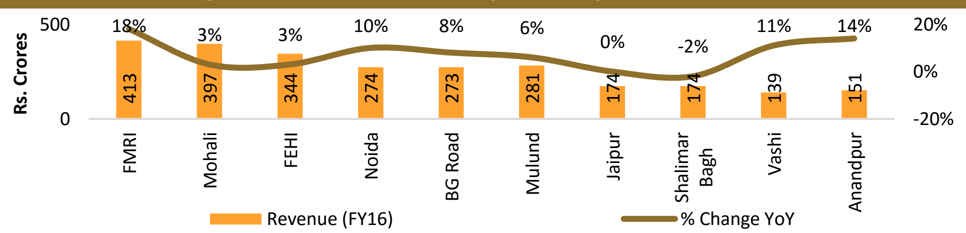
FHL operates one of the largest private hospital networks in India. Fortis commenced its operations in 2001 with Fortis Mohali and currently has ~4,000 operational beds across 42 healthcare facilities. While hospital segment contributes 81% to revenues, FHL derives the remaining from diagnostic business. Notably, ARPOB (Rs1.37cr) is the best in the industry as FHL benefits from its strong anchor hospitals (FMRI, FEHI). FMRI, Gurgaon (launched in May, 2013) in a short span of time has become the highest ARPOB generating facility in the overall network. While the overall blended ARPOB for the network stood at Rs1.37cr, FMRI reported an ARPOB of Rs2.5cr in FY16.

Business wise revenue mix (FY16)



Source: Company, In-house research

Hospital-wise Revenue –Top 10 Hospitals



Source: Company, In-house research

Focus on Super-specialties Leading to Higher ARPOB

In order to enhance the revenue mix, FHL has been focusing on super specialties such as cardiology, oncology, orthopedics, neurology and renal care. Fortis has one of the largest cardiac care programs in India. Importantly, all of these specialties are high-margin high-growth areas in the Indian healthcare space. Consequently, ARPOB has witnessed a CAGR of ~10% over FY12-16.

Classification of Top 6 Hospitals with annual revenue over Rs2bn

Facility	Location	Speciality	Key areas
FMRI	Gurgaon	Multi-super-speciality, quaternary care hospital	Oncology, Neuro, Renal, Cardiac, Robotic Surgery
Fortis Hospital	Mohali	Multi-speciality hospital	Cardiac, Ortho, Neuro, Gastro, Multi spec
FEHI	New Delhi	Multi-speciality hospital	Cardiac
Fortis Hospital	Noida	Multi-speciality hospital	Cardiac, Ortho, Neuro, Multi spec
Fortis Hospital	Mulund	Multi-speciality hospital	Cardiac, Urology, Nephro, Neuro
Fortis Hospital	BG Road	Multi-speciality hospital	Cardiac, Neuro

Source: Company, In-house research

Brownfield expansion to drive the growth ahead

The management is focusing on expanding capacity at the existing facilities rather than opening new hospitals. Importantly, FHL has a proven execution track record at existing facilities and has gained strong traction in healthcare hubs such as NCR. Currently, FHL has ~4,000 operational beds & the same infrastructure has potential to expand to ~8,000 beds (~2x its existing operational capacity) without adding a single hospital. Thus, FHL is targeting to add 400-500 new beds every year. For instance, FHL is adding ~175 beds at BG road hospital in Bengaluru & these new beds would be commissioned in FY18E.

Strong expertise in fast turnaround of new greenfield facilities

Location	Year of launch	EBITDAC breakeven (in months)	ARPOB in FY16 (Rscr)
Jaipur, Rajasthan	2007	16	0.99
Shalimar Bagh, Delhi	2010	10	1.28
FMRI, Gurgaon	2013	5	2.51

Source: Company, In-house research

Hospital segment to sustain the growth momentum

In FY16, the hospital segment contributed 81% to the total revenues. This segment has posted strong revenue CAGR of ~16% over FY12-16, driven largely by ~10% CAGR in ARPOB. Besides, the decline in ALOS from 4.0 to 3.56 days has further fuelled the growth. However, the occupancy rates remained stable at 72%. Going forward, as the management has guided that it would focus on brownfield expansion with minimal investments in greenfield hospitals, we believe this strategy would bode well for growth & margin improvement. Importantly, the ramp-up of FMRI & new hospitals coupled with recovery in occupancy at FEHI remains the growth driver for the hospital business. FHL‟s flagship hospital, FMRI (Gurgaon) which started operations in May 2013 is already generating the highest ARPOB across the network. Likewise, FEHI, in Delhi witnessed a decline in occupancy levels to 67% in FY16 from 82% in FY14, primarily due to the company‟s voluntary exit from the Central Government Health Scheme (CGHS) and other related government businesses. Going forward, we expect occupancy to improve at FEHI. Hence, we expect hospital business to grow at a CAGR of ~13% over FY16-19E.

Fortis vs other major hospitals (FY16)- FHL outperformed peers on operational parameters

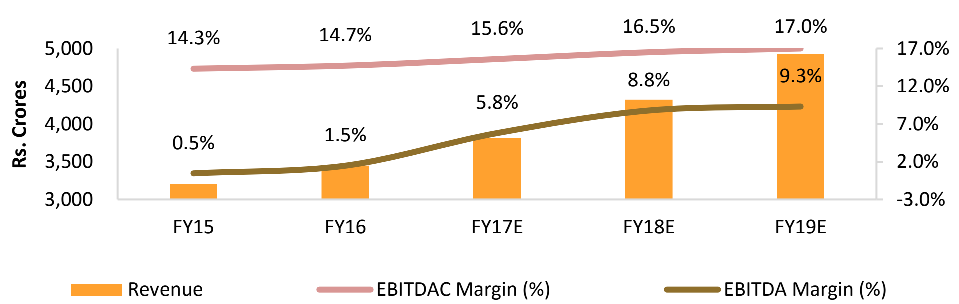
Company	No. of Operational Beds	Occupancy (%)	ALOS (days)	ARPOB(Rscr)
Fortis Healthcare	~4000	72	3.56	1.37
Apollo Hospitals	6724 (owned)	63	4.17	1.02
Narayana Hrudayalaya	5,347	54.2	4.3	0.64

Source: Company, In-house research

EBITDA margin to improve due to lower BT costs

With ramp-up of FMRI & recovery in occupancy at FEHI, we expect EBITDAC (EBITDA before net business trust costs) to grow at a robust CAGR of 17% over FY16-19E. Thus, we forecast EBITDAC margin of hospital business to improve from 14.7% in FY16 to 17.0% in FY19E. Importantly, net BT costs is expected to reduce during the period under review as FHL recently completed the acquisition of 51% economic rights in Fortis Hospotel Limited (FHTL),a subsidiary of RHT at an estimated cost of Rs970cr. FHTL is the owner of FMRI (Gurgaon) & Shalimar Bagh (New Delhi) clinical establishments. Owing to this acquisition, net BT (business trust) cost is expected to decline significantly by Rs2bn. Hence, EBITDA margin is expected to significantly improve from 1.5% in FY16 to 9.3% in FY19E.

Healthcare services segment to grow at a CAGR of 13% over FY16-FY19E

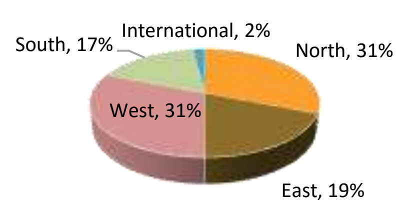


Source: Company, In-house research

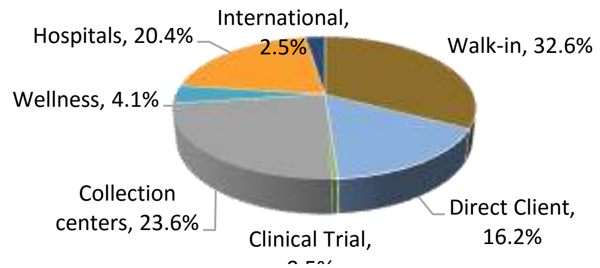
Diagnostic business – 18% of sales

Super Religare Laboratories (SRL) is India‟s leading company in the diagnostics space. Across India, SRL Diagnostics had 314 network laboratories with over 7,200 collection points as of March 31, 2016. In terms of geographical revenue mix, Northern region contributes the maximum 31% to the diagnostic business followed by Western (31%), Eastern (19%) & Southern regions (17%).

Geographical Revenue Mix



Customer Revenue Mix



Source: Company, In-house research

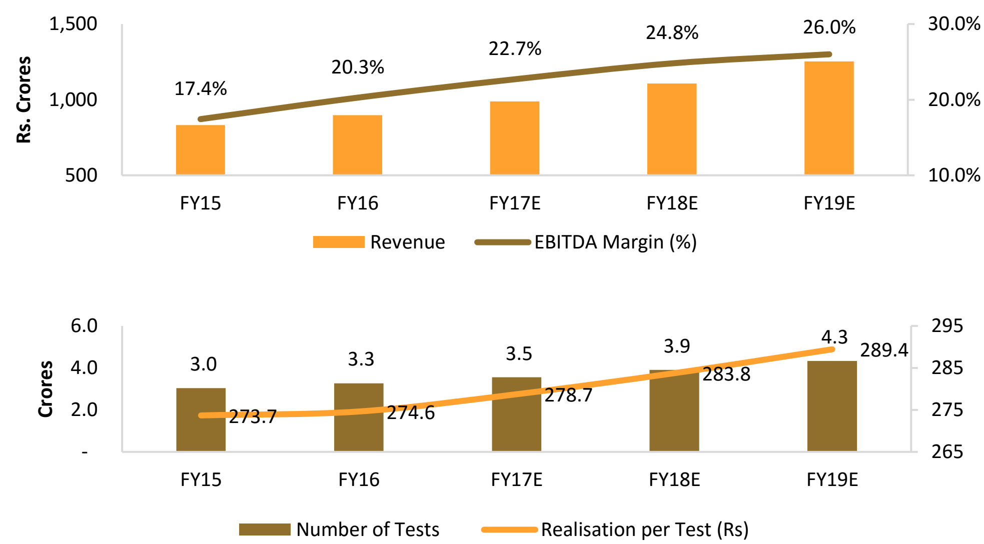
Diagnostic business to grow at a CAGR of 12% over FY16-19E

Expanded lab network and higher volumes (number of tests) has been the key lever for the growth of diagnostic business. The doctors are increasingly giving importance to evidence-based treatment as it enables correct therapy and faster patient recovery. With higher disposable income, rising urbanisation & increasing awareness about health, the demand for better healthcare facilities by households is on a rising trend. Moreover, SRL has been focusing on bundling several tests into branded packages which has significantly helped them in differentiating from competition and pushed up realization. Hence, we expect this segment to grow at a CAGR of ~12% over FY16-19E largely driven by volume CAGR of ~10%.

EBITDA margin on a rising trend

The company has consistently improved margins every year by about 200-300 bps. Although SRL‟s EBITDA margin has improved from 12.4% in FY13 to 20% in FY16 yet it is lower when compared to other industry players (Dr.Lal reported margin of 26% in FY16). The management plans to achieve EBITDA margin of 25- 26% in the coming years. Notably, we expect margin to expand to 26% by FY19E on the back of better operating leverage.

Growing healthcare industry to drive the growth of diagnostic segment



Source: Company, In-house research

Demerger of diagnostic business- an opportunity to unlock value

In August 2016, the board of FHL approved the demerger of its diagnostic business. The composite scheme of arrangement and amalgamation states that SRL will be merged into another majority owned listed subsidiary, Fortis Malar. Fortis Malar is listed on BSE & operates a hospital facility in Chennai. Further, the hospital business of Fortis Malar is being transferred to FHL by way of slump sale at a consideration of Rs43cr. Consequently, the composite scheme will eventually result in two listed entities (a) SRL Ltd (renamed Fortis Malar) housing the entire diagnostic business and (b) Fortis Healthcare which will continue to house hospital assets. Through this restructuring, the management has also achieved its target to create two listed entities, one focused on the hospitals business and the other on diagnostics. We believe a demerger and separate listing of SRL will help unlock value for FHL shareholders. The scheme is pending for regulatory approval and is likely to be completed in next 9-10 months. Hence, we currently do not factor in transaction impact into our estimates.

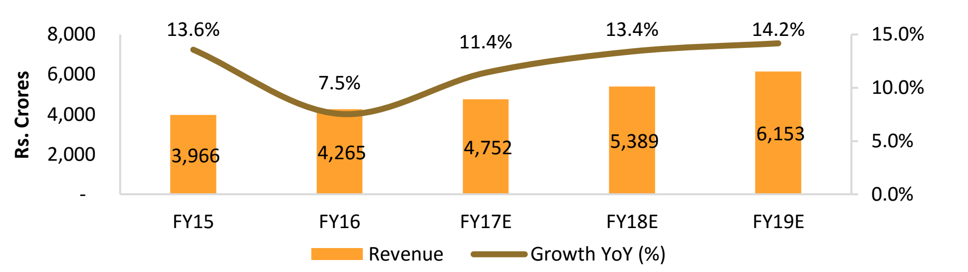
Revenue grew at a CAGR of 13% during FY12-16

During FY12-16, revenues of FHL reported a CAGR of 13% primarily driven by the hospital business. This segment has posted strong revenue CAGR of ~16% over FY12-16, driven largely by ~10% CAGR in ARPOB. Besides, the decline in ALOS from 4.0 to 3.56 days has further fueled the growth. However, the occupancy rates remained stable at 72%. Likewise, the diagnostic business posted a CAGR of 14% over FY12-16. Importantly,FHL sold most of its overseas assets by 2015.

Revenue growth momentum to sustain

We project hospital business (contributed 81% to the consolidated revenues in FY16) to post a CAGR of ~13% during FY16-19E primarily driven by the ramp-up of FMRI (Gurgaon) & new hospitals coupled with recovery in occupancy at FEHI (Delhi). Likewise, we expect diagnostic business to report a CAGR of ~12% over FY16-19E largely driven by volumes. Thus, we forecast consolidated revenues to record a CAGR of 13% during FY16-19E.

Revenue to grow at a CAGR of 13% over FY16-FY19E



Source: Company, In-house research

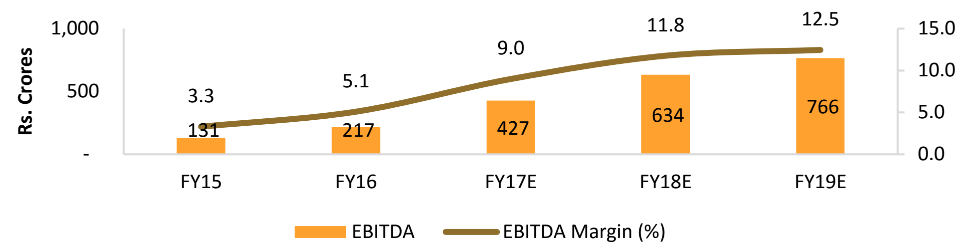
EBITDA margin declined by 780bps over FY12-16

FHL's asset light arrangement with RHT was created in October 2012. Owing to the net BT costs worth Rs133cr, overall EBITDA margin dropped from 12.9% in FY12 (when the BT cost was nil) to 7.3% in FY13. Likewise in FY14, BT costs rose to Rs324cr (~9% of revenues) on the launch of FMRI, Gurgaon. Hence, EBITDA margin plummeted to ~1.5% on the backdrop of higher net BT costs. Currently, FMRI is the largest hospital in FHL network with the highest ARPOB in the network.

EBITDA margin to expand significantly

We estimate overall EBITDA margin to increase from 5.1% in FY16 to 12.5% in FY19E on account of better traction in hospital & diagnostic businesses. With ramp-up of FMRI & recovery in occupancy at FEHI, we expect EBITDAC (EBITDA before net business trust costs) to grow at a robust CAGR of 17.2% over FY16-19E. Thus, we forecast EBITDAC margin of hospital business to improve from 14.7% in FY16 to 17.0% in FY19E. Further, as BT (business trust) costs are expected to decline significantly by ~Rs2bn owing to the acquisition of FHTL (Fortis Hospotel Ltd), EBITDA margin of hospital business is expected to improve from 1.5% to 9.3% during the period under review. Likewise, EBITDA margin of diagnostic business is expected to increase from 20.3% in FY16 to 26% in FY19E on account of better operating leverage.

EBITDA margin to increase by 740 bps over FY16-19E

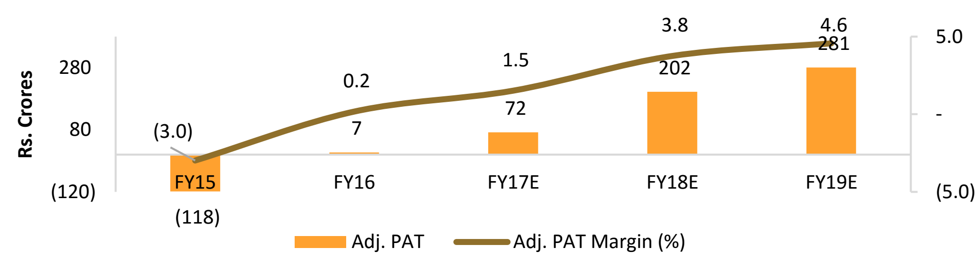


Source: Company, In-house research

Improvement in EBITDA to lead to strong PAT margin

We expect revenue CAGR of 13% in FY16-19E and EBITDA margin to improve to 12.5% leading to an EBITDA CAGR of 52.3% over FY16-19E. Driven by strong EBITDA generation, we expect PAT margin to improve from 0.2% in FY16 to 4.6% in FY19E.

PAT margin to increase by 440bps over FY16-19E



Source: Company, In-house research

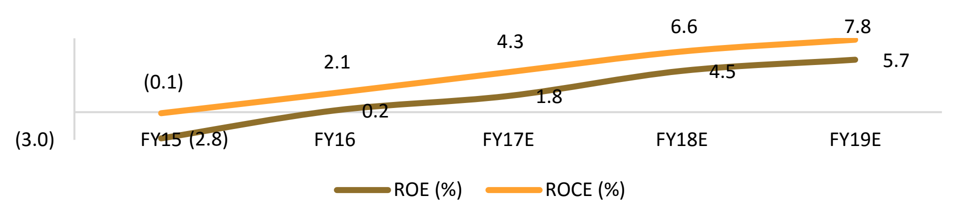
Focus on asset light expansion model to maintain balance sheet health

FHL pursues an asset light business model as it has entered into individual "Hospital and Medical Services Agreement" (HMSA) with Religare Health Trust Group of companies (RHT). Under HMSA, RHT provides and maintains the clinical establishments, while FHL is required to pay a composite service fee namely the base (fixed & increases 3% annually) & variable fee (7.5% of the operating income). Hence, this arrangement with RHT takes care of greenfield expansion & allows FHL to utilise its capital efficiently. Over the past few years, FHL has strengthened its balance sheet significantly by divesting international assets. Thus, FHL's debt/equity ratio has reduced from 1.7x (FY12) as against 0.5x (FY16). Importantly, a significant portion of the debt on books is related to foreign currency convertible bonds (FCCBs) aggregating Rs564cr, which are currently deep in the money (conversion price: Rs99/share). We expect these FCCBs would be converted into equity shares by FY18E (due by Aug, 2018). Therefore, we estimate D/E ratio to decrease to 0.4x by FY18E.

Robust PAT margins to drive RoE

Positive operating leverage in the hospital business coupled with higher margins in the diagnostics business would lead to better margins going ahead. Hence, we believe that FHL would report improvement in its ROE and ROCE on the back of healthy profitability. ROE is expected to improve from 0.2% in FY16 to 5.7% in FY19E. Likewise, ROCE is projected to increase from 2.1% in FY16 to 7.8% in FY19E.

Return Ratios to rise



Source: Company, In-house research

Key Risks:

1. Shortage of healthcare professionals.
2. Delay in commissioning of new beds.
3. Increase in competition from new and existing players could affect ARPOB.

Profit & Loss Account (Consolidated)

Y/E (Rs.Cr)	FY16	FY17E	FY18E	FY19E
Total operating Income	**4,265**	**4,752**	**5,389**	**6,153**
Raw Material cost	957	1,063	1,205	1,364
Employee cost	826	920	1,035	1,182
Other operating expenses	2,265	2,342	2,515	2,841
EBITDA	**217**	**427**	**634**	**766**
Depreciation	229	244	288	315
EBIT	**(13)**	**183**	**346**	**451**
Interest cost	125	234	198	198
Other Income	147	100	105	110
Profit before tax	**10**	**49**	**253**	**363**
Tax	47	13	68	98
Profit after tax	**(37)**	**36**	**185**	**265**
Minority Interests	21	30	32	33
P/L from Associates	66	67	49	49
Adjusted PAT	**7**	**72**	**202**	**281**
E/o income / (Expense)	(32)	1	-	-
Reported PAT	**(25)**	**73**	**202**	**281**

Balance Sheet (Consolidated)

Y/E (Rs.Cr)	FY16	FY17E	FY18E	FY19E
Paid up capital	463	481	517	517
Reserves and Surplus	3,534	3,767	4,289	4,570
Net worth	**3,997**	**4,248**	**4,806**	**5,087**
Minority interest	143	173	205	238
Total Debt	2,166	2,338	1,982	1,982
Other non-current liabilities	104	104	104	104
Total Liabilities	**6,411**	**6,863**	**7,097**	**7,411**
Total fixed assets	2,074	2,479	2,491	2,576
Capital WIP	197	150	100	-
Goodwill	1,706	2,186	2,186	2,186
Investments	1,644	1,194	1,194	1,394
Net Current assets	46	110	382	511
Deferred tax assets (net)	51	51	51	51
Other non-current assets	693	693	693	693
Total Assets	**6,411**	**6,863**	**7,097**	**7,411**

Cash Flow Statement (Consolidated)

Y/E (Rs.Cr)	FY16	FY17E	FY18E	FY19E
Pretax profit	**55**	**115**	**302**	**412**
Depreciation	231	244	288	315
Chg. in Working Capital	16	(37)	(13)	(8)
Others	20	134	93	88
Tax paid	(154)	(13)	(68)	(98)
Cash flow from operating activities	**167**	**444**	**602**	**709**
Capital expenditure	(216)	(603)	(250)	(300)
Chg. in investments	(139)	(30)	-	(200)
Other investing cashflow	576	100	105	110
Cash flow from investing activities	**221**	**(533)**	**(145)**	**(390)**
Equity raised/(repaid)	3	178	356	-
Debt raised/(repaid)	(325)	172	(356)	-
Dividend paid	-	-	-	-
Other financing activities	(121)	(234)	(198)	(198)
Cash flow from financing activities	**(444)**	**116**	**(198)**	**(198)**
Net chg in cash	(55)	27	259	121

Key Ratios (Consolidated)

Y/E	FY16	FY17E	FY18E	FY19E
Growth (%)				
Net Sales	7.3	11.4	13.4	14.2
EBITDA	66.1	96.8	48.5	20.9
Net profit	(106.2)	887.6	180.4	38.8
Margin (%)				
EBITDA	5.1	9.0	11.8	12.5
EBIT	(0.3)	3.8	6.4	7.3
NPM	0.2	1.5	3.8	4.6
Return Ratios (%)				
RoE	0.2	1.8	4.5	5.7
RoCE	2.1	4.3	6.6	7.8
Per share data (Rs.)				
EPS	0.1	1.4	3.9	5.4
DPS	0.0	-	-	-
Valuation(x)				
P/E	-	129.4	46.1	33.2
EV/EBITDA	52.9	27.3	17.5	14.3
EV/Net Sales	2.7	2.5	2.1	1.8
P/B	2.3	2.2	1.9	1.8
Turnover Ratios (x)				
Net Sales/GFA	1.3	1.3	1.3	1.4
Sales/Total Assets	0.6	0.6	0.7	0.7

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

***** To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

***** FORTIS is a mid-cap company.

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