Initiating Coverage

Fortis Healthcare Ltd.

07-June-2021

Fortis Healthcare Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Healthcare Facilities	Rs. 226.95	Buy at LTP and add more on dips to Rs 199-200 band	Rs. 249	Rs. 271	2 quarters

HDFC Scrip Code	FORHEAEQNR
BSE Code	532843
NSE Code	FORTIS
Bloomberg	FORH IN
CMP June 04, 2021	226.95
Equity Capital (Rs cr)	754.9
Face Value (Rs)	10.0
Equity Share O/S (cr)	75.5
Market Cap (Rs cr)	17133.8
Book Value (Rs)	81.1
Avg. 52 Wk Volumes	3233242
52 Week High	242.1
52 Week Low	116.1

Share holding Pattern % (Mar 2021)	
Promoters	31.2
Institutions	48.0
Non Institutions	20.8
Total	100.0

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Our Take:

Fortis Healthcare Limited (FHL) – an IHH Healthcare Berhad company – is a leading integrated healthcare services provider with 36 healthcare facilities (including projects under development), 3900 operational beds (including O&M model) and 428 network diagnostic centres. FHL is India's second largest healthcare chain having a North Indian skew with ~60% beds. FHL has a long and established track record having favourable hospital maturity mix profile with large network of healthcare facilities. It has presence across various healthcare verticals, including secondary, tertiary and diagnostics. Fortis Healthcare is well positioned to capitalise on the positive outlook for healthcare services - better affordability, widening medical insurance coverage, growing healthcare awareness and government boost. With its corporate governance issues behind it, the association of FHL with IHH has provided an opportunity to gain from international experience and world class standards in patient care. Fortis Healthcare, under the new management undertook a comprehensive strategic review and prioritized key areas that would drive revenues and operational performance. The ongoing litigation at the Hon'ble Supreme Court has delayed the ability of the company to carry out the planned expansion activities which could further strengthen its operational performance and financial position.

Valuations & Recommendation:

Hospital business is well positioned and has demonstrated healthy operational efficiency with industry leading ARPOB, ALOS, capacity utilization. Addition of 1,300 beds in a phased manner over the next four-five years will help in strengthening its network. In case of diagnostics business, greater focus on B2C penetration through digital transformation coupled with expansion of collection centers is likely to support healthy growth trajectory for SRL. Diagnostic business is asset light, highly scalable business with high RoCE. Faster shift of unorganized business to organized players, potential consolidation, likely increase in preventive & health check-ups would benefit the large organized players like SRL. Moreover, management's focus on cost optimization and productivity improvement add to these positives. We expect margin improvement across segments, given increased focused on B2C volume in the diagnostics business and improving product mix in the hospital segment along with cost rationalization initiatives.

Fortis healthcare is a good bet on the structural long term growth story of Indian healthcare & diagnostics industry, considering its established presence across healthcare verticals, quality testing capabilities and structural changes under the new management. With reignited capex plans, cost control initiatives, focus on B2C and higher-end care, we believe there is a scope for re-rating of this stock. Fortis is administering all the approved three vaccines currently with a monthly capacity of administering 6 lac doses (which can be easily doubled). It is charging administration fees in the range of Rs 150-300 with >60% margin. We have not considered the revenues/margins from the vaccine inoculation drive in our estimates. However, any negative outcome from its ongoing legal cases with respect to diversion of funds by erstwhile promoters and IHH open offer would impact its business operations. **We believe the base case fair value of the stock is Rs 249 (39.5x FY23E EPS, 16.8x FY23E EV/EBITDA) and the bull case fair value of the stock is Rs 271 (43x FY23E EPS, 18.3 FY23E EV/EBITDA) over the next two quarters. Investors can buy the stock at LTP and add on dips to 199-200 band (31.5x FY23E EPS, 13.2x FY23E EV/EBITDA). At the LTP of Rs 226.95, the stock is trading at 35.9x FY23E EPS, 15.2x FY23E EV/EBITDA.**

Financial Summary (Consolidated):

Particulars (Rs cr)	Q4FY21	Q4FY20	YoY-%	Q3FY21	QoQ-%	FY19	FY20	FY21	FY22E	FY23E
Total Operating Income	1252.4	1112.9	12.5	1177.0	6.4	4,469.4	4,632.3	4,030.1	5,514.0	6,222.6
EBITDA	197.3	125.8	56.8	190.5	3.6	225.2	609.5	404.4	931.9	1,070.3
Depreciation	71.5	80.1	-10.7	73.1	-2.2	232.9	291.7	290.6	304.1	313.4
Other Income	6.3	18.4	-65.6	10.2	-37.7	92.4	52.6	46.6	60.7	68.4
Interest Cost	40.6	57.0	-28.7	42.1	-3.5	336.8	205.1	165.9	160.6	148.7
Tax	48.0	50.4	-4.8	49.3	-2.5	113.6	147.9	99.5	132.0	169.2
PAT	62.2	-41.2	-250.8	53.9	15.5	-365.7	17.5	-104.9	395.9	507.5
Adjusted PAT	43.2	-44.5	-197.0	29.9	44.4	-298.9	57.9	-109.8	362.5	476.7
EPS (Rs)	0.6	-0.6	-197.0	0.4	44.4	-4.9	0.8	-1.5	4.8	6.3
RoE-%						-5.6	0.9	-1.7	5.8	7.1
P/E (x)						-46.2	294.7	-156.1	47.3	35.9
EV/EBITDA						80.7	30.2	44.8	19.0	16.1

(Source: Company, HDFC sec)

Q4FY21 Result Review:

Fortis Healthcare reported strong sequential improvement in revenue of Rs 1252.4cr in Q4FY21 (up 12.5%/6.4% YoY/QoQ) aided by strong recovery in the hospital business and healthy performance in the diagnostics segment. Hospital Business posted a revenue of Rs 982.1cr (up 7.5%/8.3% YoY/QoQ), while diagnostic business recorded revenues of Rs 305.7cr (+31.8%/flat, YoY/QoQ). Increasing non-covid occupancy and continued cost optimisation helped it to post decent EBITDA margins of 15.8% (vs 11.3% in Q4FY20). EBITDA stood at Rs 197.3cr with EBITDA margins for hospital business standing tall at 14.2% (as against 12.5% in Q4FY20) while for diagnostics it was 22% (as against 14.5% in Q4FY20). Management has taken steps to reduce personnel and SG&A costs and the benefits are visible.

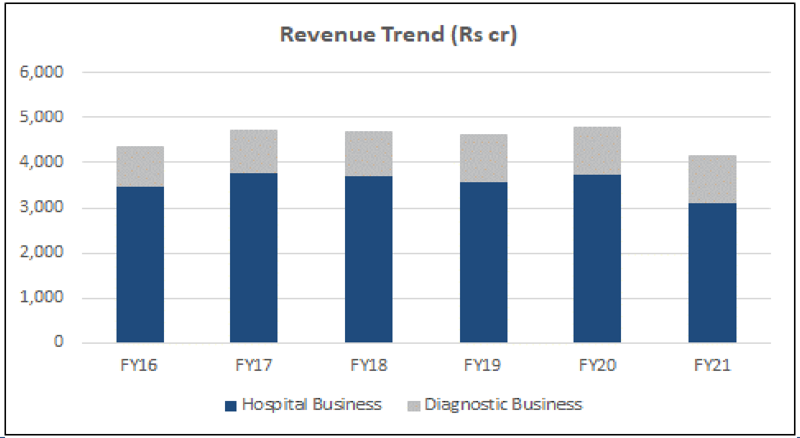
Improving non-covid occupancy (57% as against 46% in Q3FY21; Q2FY21:38%) with recovery in elective surgery volumes paved way for the hospital business to register healthy growth in revenues and profitability in the quarter. Average revenue per occupied bed (ARPOB) improved and stood at Rs 1.70cr vs Rs 1.58cr in the previous quarter, as the patient mix was skewed towards speciality surgical procedures. Average length of stay (ALOS) was at 3.38 days (as against 3.29 days in Q4FY20). Growth at SRL (diagnostic business) was driven by covid and higher non-covid realisations aided by a favourable test mix and higher home collections. Average Revenue Per Test (ARPT) increased by 17% YoY to Rs 400. The B2B-B2C business mix is increasingly tending towards the B2C side for the diagnostic business, which is a relatively higher margin segment. The B2C segment contributed 45% to the total revenues as against a contribution of 42% in Q4FY20. In April 2021, balance 50% stake in DDRC SRL Diagnostic Private ltd (DDRC-SRL) was completed; this will help consolidate SRL's position in Kerala market and strengthen its position in South India.

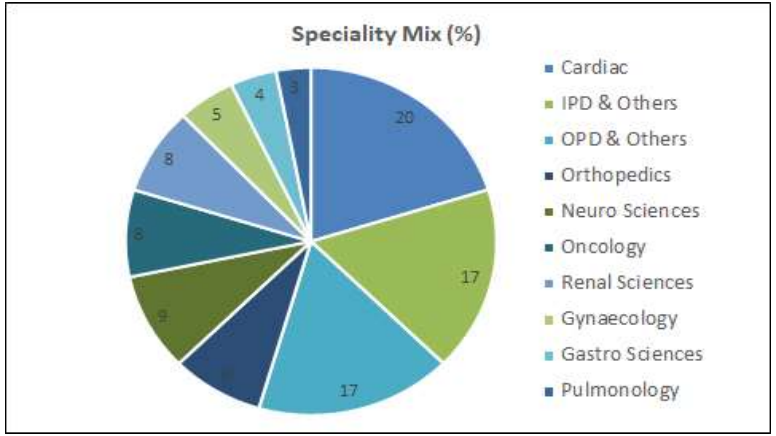
Addition of 1,300 beds in a phased manner over the next four-five years will help in strengthening its network. In case of diagnostics business, greater focus on B2C penetration through digital transformation with expansion of collection centres is likely to chart a healthy growth trajectory for SRL. Encouraging signs of pick-up in elective procedures/ non-covid related business indicate faster recovery in business. Furthermore, focus on cost optimisation and productivity improvement adds to these positives. The management expects by July 2021, the Supreme Court resolution with respect to its ongoing cases should come through.

Triggers:

Strong market position in Hospital & Diagnostic Business:

Fortis is India's leading integrated healthcare service provider having pan India presence of 36 healthcare facilities, ~3,900 operational beds, 428 diagnostics centres. Hospital's revenue share stands consistent at ~80% over the last three years while the remaining is contributed by its subsidiary SRL diagnostics. Wide distribution of specialty treatment at hospital ensures proper diversification of revenue stream of hospitals. The company also has diversified presence across multiple healthcare verticals, such as secondary care, tertiary care, quaternary care, and diagnostics. Further, almost all of the hospitals in Fortis Group's network are mature facilities and are favourably located in Metros and Tier-I cities. The strong market position should be sustained over the medium term, given the wide geographical footprint and diverse specialty mix. SRL has established a strong brand in both retail and B2B diagnostics, managing 428 labs (including joint ventures) with over 1,600+ collection centres and over 5400+ sample pick-up points in India. SRL customer base is wide across country diversifying business from any kind of regional risk. SRL's revenue mix between the B2C and B2B is at 44:56 in FY21.





(Source: Company, HDFC sec)

Established track record of the new promoter:

IHH Healthcare Berhad (IHH) acquired ~31% stake in Fortis Group, has been classified as the promoter of Fortis Group, has nominated five of the nine board members of FHL and has parked Rs. 3349cr in an escrow account for acquiring additional up to ~26% stake in Fortis Group through open offer, subject to the directions from Supreme Court of India. IHH Healthcare Berhad is a leading premium healthcare provider operating in the home markets of Malaysia, Singapore, Turkey and India. The group also has a growing presence in Greater China and an expanding network across Asia and Central and Eastern Europe. It employs over 65,000 people and operates over 15,000+ licensed beds across 80 hospitals in 10 countries worldwide. The group's portfolio comprises of premium-brand healthcare assets, collectively representing a unique multi-market investment position in the healthcare sector. 'Mount Elizabeth', 'Gleneagles', 'Pantai', 'Parkway', 'Acibadem' brands are among its most prestigious brands in Asia and Central and Eastern Europe.

The association with IHH has provided an opportunity to gain from international experience and world class standards in patient care. The two companies are closely working together towards implementing best global practices, improved standards of patient care and advanced technology across the medical organization, procurement and other processes. IHH owns and operates one of the largest hospital networks globally with an established track record of acquiring and successful running large healthcare facilities across multiple countries; strong promoter with diversified international presence has enabled Fortis Group to report faster turnaround of operations as well as availing synergies with key equipment suppliers, vendors and lenders. Fresh equity infusion of around Rs 4,000cr by IHH in November 2018 helped to reduce high-cost debt and buy RHT assets, which helped in substantial saving of clinical establishment costs.

Company's Transformational Journey - Under new Promotor and Board:

The strategic partnership of IHH Healthcare Berhad, one of the largest healthcare groups, has spurred a major transformational journey for the company. It has overseen the successful 'RHT Health Trust' buyback and has helped put in place a new management with vast industry experience. The newly reconstituted board has developed a bold strategy to curate leading practices in patient centricity, clinical excellence and quality healthcare delivery. A robust and restructured audit program has been implemented to enhance the organization's governance mechanism.

Fortis Healthcare under the new management undertook a comprehensive strategic review and prioritized key areas that would drive revenues and operational performance. These include evaluating the current portfolio of facilities and planned bed expansion, initiating cost optimization measures across the network, investing in technology and medical equipment and further strengthening its clinical excellence program. To optimize costs, third party contracts have been renegotiated, new doctor patient engagement models were tested and adopted, and higher output was sought from the diagnostic arm of the business. With the view of sustaining profitability, the company rationalized its investments in network hospitals and made an exit from a few, such as the Bikaner, Udaipur and Aashlok, New Delhi facilities. On the clinical side, it will consolidate its existing position in specialties such as Cardiac Sciences and Orthopedics, while focusing on high growth specialties such as Oncology, Neurosciences, Gastro Sciences and Renal to improve margins. The company re-ignited its capital expenditure program which was at a standstill due to liquidity constraints in the previous years. The company over the next four-five years plans to expand its capacity to more than 5,000 beds by commissioning 1,300 new beds in existing facilities to leverage economies of scale – with majority of addition likely to happen in its facilities in Noida (NCR), BG Road (Bengaluru), Shalimar Bagh (NCR), FMRI (NCR) and Mohali (Punjab).

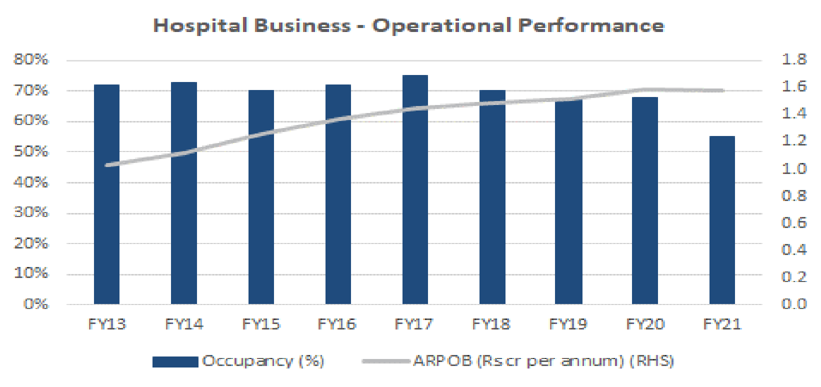
Fortis Board in August 2020 has given in-principal approval to rebrand the hospital business as ‘Parkway’ and seeking SRL Diagnostics business a neutral name. ‘Parkway’ is a well renowned and internationally acclaimed brand in the field of healthcare, belonging to IHH Healthcare Berhad, the ultimate parent of Northern TK Venture Pte Ltd. The move is part of the Fortis management's effort to distance itself from its erstwhile promoter - Singh brothers.

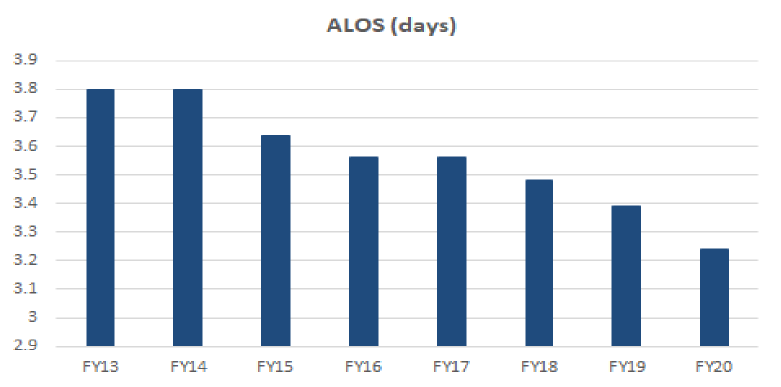
Change in Leadership - Improve operational performance:
Dr. Ashutosh Raghuvanshi, who joined as Managing Director and CEO in March 2019 brings in 28 years of experience as a clinician and hospital administrator. Dr Raghuvanshi, a Paediatric Cardiac Surgeon by training, has led the streamlining of all business operations, improving patient care and service, bringing forward clinical excellence, reorienting the operating model and delayering the existing structures to ensure simplification and transparency in processes and procedures. Prior to joining Fortis, Dr. Raghuvanshi was associated with the Narayana Hrudayalaya group for over 18 years. He was the Group Chief Executive Officer since November 2010, Managing Director since November 2011 and also served as its Executive Vice Chairman. He was responsible for creating structures and processes to build a successful healthcare organization. With a proven track record as a successful clinician and an able administrator, Dr. Raghuvanshi ensured that Fortis made a turnaround in business performance in FY20.

Under Dr Raghuvanshi’s leadership and with the support of new promoter, FY20 was a turnaround year for the company. After reporting sluggish revenue and operating performance in FY18 & FY19, due to corporate governance issues; the company reported decent revenue growth and improvement in EBITDA margins, largely driven by management focus on controlling cost and implementing operational efficiency. The fund infusion by IHH has recapitalized Fortis’ weak Balance Sheet leading to improvement in credit rating and lower borrowing costs. Further, collaboration of IHH and Fortis is driving synergies in medical operations, procurement and IT and helping in its transformational initiatives including a comprehensive portfolio review and a robust clinical excellence programme.

Hospital business - Well positioned to deliver better returns:
Fortis’ Hospital business is well positioned and has demonstrated healthy operational efficiency with industry leading ARPOB, ALOS, capacity utilisation. The business is coming out of its legacy corporate governance related issues and turned EBIT positive on the back of new management’s initiatives towards enhancing operational performance. The management focus is on increasing the profitability of the business has led to consolidation of its geographical presence by investing in, transforming and scaling up high potential units and evaluating the divestments of low potential units. In FY20, the company made exits in certain non-core facilities in Bikaner, Udaipur,

Aashlok and Mauritius hospital. The company is focussed to enhance its presence in - NCR, Mumbai, Bengaluru, and Kolkata. Rationalisation of its network & investments will continue in the ensuing years, which will support sustainability of profits and margins. The company focus is on specialties like oncology, cardiac, orthopedic, GI and organ transplantation, etc - to improve margins. The results of all these efforts have started to reflect in its performance - Hospital business EBITDA margins improved in Q3FY21 & Q4FY21 to 15.3% and 14.2% respectively.

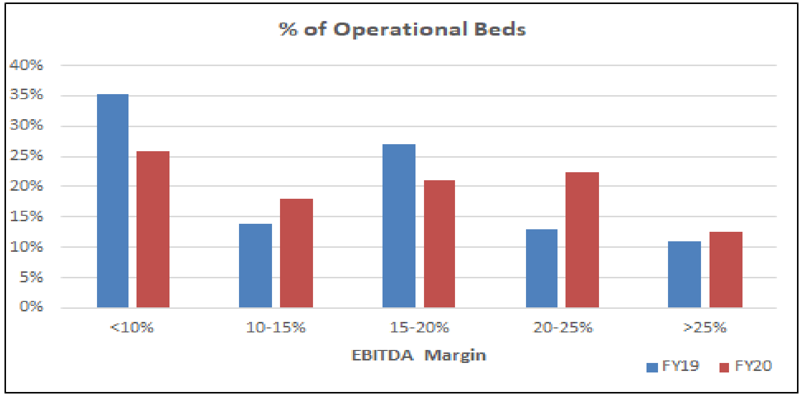


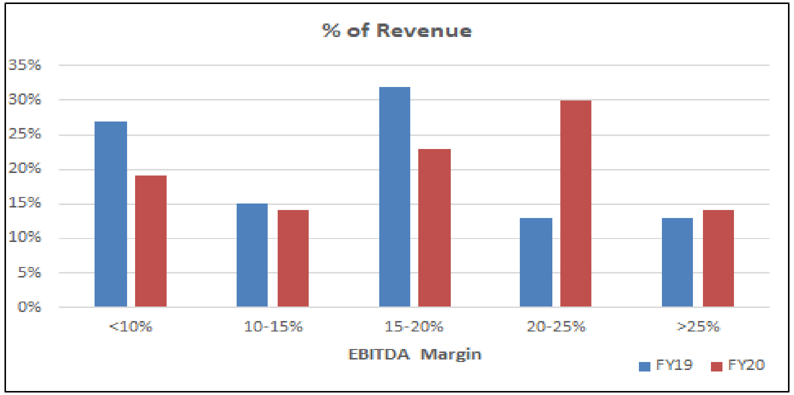


(Source: Company, HDFC sec)

The company has concrete plan for adding about 1,300 beds to its network over next four-five years, apart from expanding the medical programs and further building the clinical talent. With current expansion underway, overall bed capacity will go to 5,200 beds by FY25, translating to ~33% increase in capacity. This capacity expansion will include additional beds in existing facilities to leverage economies of scale - majority of bed additions are planned in Noida, BG Road, Shalimar Bagh, FMRI, Mohali and Arcot Road. Brownfield expansion in geographies where it already has good presence, will not be a drag on the margins to a greater extent. Also, the gestation period of these additional capacities in FY21 & FY22 would be less (6-18 months). To tap into India's growing medical tourism, the company has partnered with companies like OYO, MakeMyTrip and Pure Health and has increased its digital presence which will create new synergies to help make travel and stay for its international patients (~10.6% hospital business revenue in FY20) more comfortable. Higher international business is a positive due to better margin realisations.

The company is working on improving its payer mix to bring in more cash and TPA business. The maturity mix profile of the hospitals is also improving; ~34% of operational beds generate over 20% EBITDA margin and contribute ~44% revenue of the hospital business (FY20 data). New beds which are in pipeline over the next year are likely to operate in <10% EBITDA margin for couple of years of operation. But ~26% of operational beds as of FY20, which belong to <10% EBITDA margin will gradually mature and move to scale; 10-15% or 15-20% margin levels. Q4FY21 which was near normal quarter also witnessed impressive trend, with higher share of hospitals (~61% of revenue) falling in >20% EBITDA level.

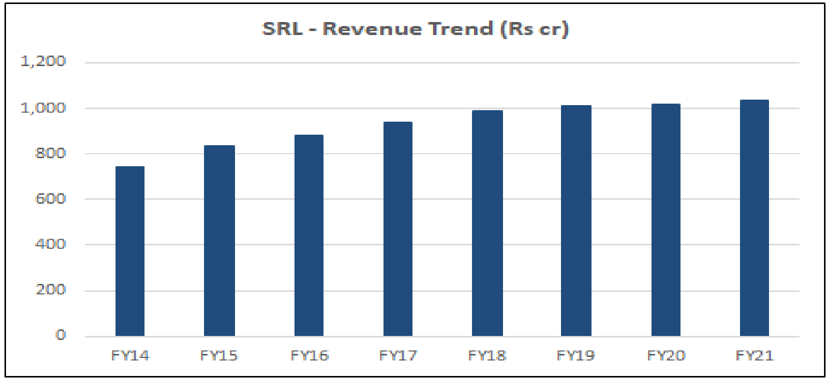


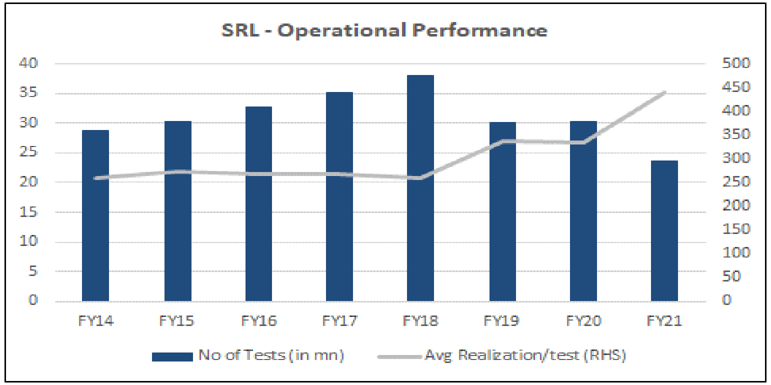


(Source: Company, HDFC sec)

Diagnostic Business growth supported by improving operational efficiency and strong industry tailwinds:

SRL has 4 reference labs in Delhi, Mumbai, Bangalore and Calcutta, offering a comprehensive range of investigations in pathology and imaging for over 3,700 diagnostic tests. Diagnostic business is expected to return to growth trajectory post covid induced slowdown in FY21. The management has announced their intention to increase B2C in its business mix, and is planning to expand its presence in Tier 2-3 cities. The recent acquisition of 50% stake in DDRC-SRL joint venture which has leadership position in Kerala and higher B2C share, was in that direction. The company during this covid times has been proactive and has scaled up its home collection capacity; improving traffic in mobile app will further enhance its B2C share. In FY21, home collection revenues grew 2.0x, contributing 6% to overall revenues.





(Source: Company, HDFC sec)

SRL has identified key levers, which would help in achieving higher EBITDA margin in diagnostic business – improve B2C share, offering integrated products, strengthening doctor connection and at the same time focus on cost optimisation. Results of these efforts are reflected in its recent performance. Both channel optimization and product portfolio, played out well, resulting in margins expanding to over 22% levels in H2FY21 compared to mid-teens levels in second half of last year. The B2B-B2C business mix is also increasingly tending towards B2C side, which is relatively higher margin. The B2C: B2B revenue mix improved to 44:56 in FY21 vs 42:58 in FY20. The company is enhancing its operational efficiencies, implementing some new-age technologies and tests. SRL integrated AI and data analytics to help improve testing. Calibrated network expansion in both B2B & B2C segment coupled with tailoring product portfolio towards value accretive specialised test is likely to improve topline growth, better than industry growth. Faster shift of unorganized business to organized players, potential consolidation, likely increase in preventive check-ups and sizeable scale would benefit the large organized players having strong balance sheet.

Digital Healthcare Initiatives:

The company has actively begun digitizing its clinical outreach with the objective of easing the patient journey from the first touch point to translation into actual footfall/visits to the hospitals. The MyFortis App allows the consumers to book their appointments, get doctor details and schedule health check-ups. With adoption of the 'MarTech' stack it is improving the lifetime value of patients through constant engagement at various life-stages by offering relevant healthcare solutions and information that helps them stay healthy.

Teleconsultations and video consultations have been introduced at most of their hospitals. The company is progressing towards one integrated platform across all hospitals vis-à-vis the present diverse legacy systems, aimed at creating a singular view of a patient irrespective of which Fortis Hospital the patient visits. Also, SRL integrated AI and data analytics to help improve testing. SRL completed the development of an AI algorithm in partnership with Microsoft for advanced test and scanning.

Strong Operational performance with healthy Balance Sheet:

IHH's equity infusion of around Rs 4,000cr in November 2018 helped to reduce high-cost debt and buy RHT assets. This led to significant improvement in cash accrual and strengthening of the financial risk profile; improving the credit rating and lowering the borrowing cost. Fortis completed the RHT Health Trust transaction in January 2019. With this deal, Fortis acquired the entire portfolio of the India assets held by RHT Health Trust, comprising 12 clinical establishments, 2 operating hospitals, 1 clinical establishment under construction as well as 4 greenfield clinical establishments. The transaction is value accretive for Fortis Healthcare as it would save significant clinical establishment fees (~Rs 270cr) and has resulted in significant improvement in the company's operating profitability. Net debt/equity was low at 0.13x as of FY21-end. Healthy operational performance, helped in acquisition of remaining 50% stake in DDRC. Transaction valued at Rs 350cr was mainly funded by internal cash accruals. The company is being prudent and proceeding with its capex plans judiciously. We expect revenue growth at CAGR of 24% over FY21-23 and higher profitability, on the back of improving maturity mix and product mix of hospital business, higher volume from diagnostic business, B2C focus and various cost control measures.

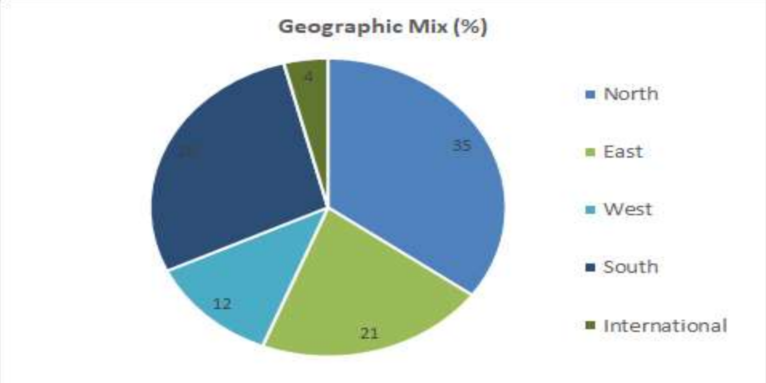
SRL (Diagnostic Business):

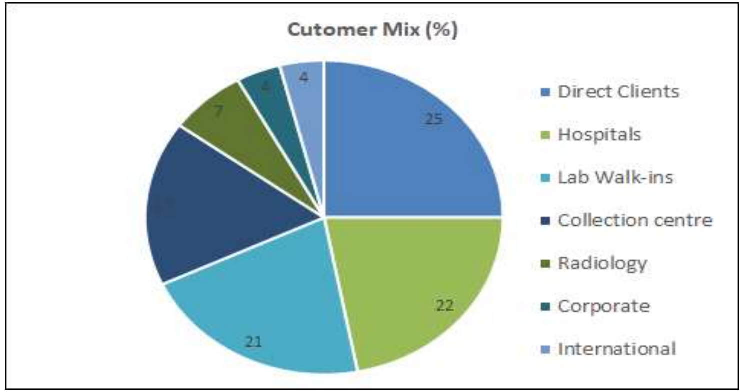
SRL Ltd, a subsidiary of Fortis Healthcare, leading diagnostic laboratory network in India with 4 reference labs and 428 networking labs. SRL has over 3700 tests in its repertoire which is the largest menu of tests in India. SRL's wide range of tests provides quality diagnostic, prognostic and monitoring services to other path labs, hospitals and patients. SRL's laboratory network extends to 98 Company Owned and Operated Collection Centers, 1144 other Collection Centers in India, 79 Collection Centers outside India and over 8288 Collection Points as of March-end 2020. Expanding its retail footprint SRL added ~500 new collection centres and 2100 direct clients (pick-up points) in FY21. Furthermore, enhancing the company's operational efficiencies, SRL implemented some new-age technologies and tests viz. NIPS (Non-Invasive Prenatal Screening), CMA (Chromosomal Microarray), eFTS (Enhanced First Trimester Screening), High- Resolution HLA, ABPA, Biofire based tests, which gained recognition from clinicians. SRL has the most Accredited Lab Network in India comprising of 48 NABL and CAP accredited labs.

Fortis Healthcare Ltd.

SRL customer base is wide across country diversifying business from any kind of regional risk. SRL's revenue mix between the B2C and B2B is at 44:56. The B2C segment primarily comprises the Lab Walk-ins, Collection Centres, Franchisee labs and Partner Doctors while the B2B segment comprises revenues from Hospital Lab management, SRL's labs in Fortis facilities, Doctors and other corporate and institutional clients. SRL beefed up its home collection operations offering its services in 90 cities. In Q4FY21, home collection visits increased 2.5x compared to last year. Also 70% of these home visits were for non-covid related tests.

Among the major chains, SRL diagnostic, have witnessed subdued growth compared to its peers in the last couple of years. Slower pace of expansion, both in the retail network (collection centre) and institutional network (direct clients) along with increasing competitive environment impeded on its channel engagement and product portfolio strategy. With the management's renewed focus on diagnostic business, various initiatives are undertaken aimed at fortifying its key pillars of a focused channel strategy along with a balanced and better integrated product portfolio. Focus would be on improving the market depth and patient accessibility, maximising the deep portfolio of tests, collaborating across lines of business to increase client value and to drive consumer trials and doctor recommendations, all resulting in driving long-term profitable growth.





(Data: FY20, Source: Company, HDFC sec)

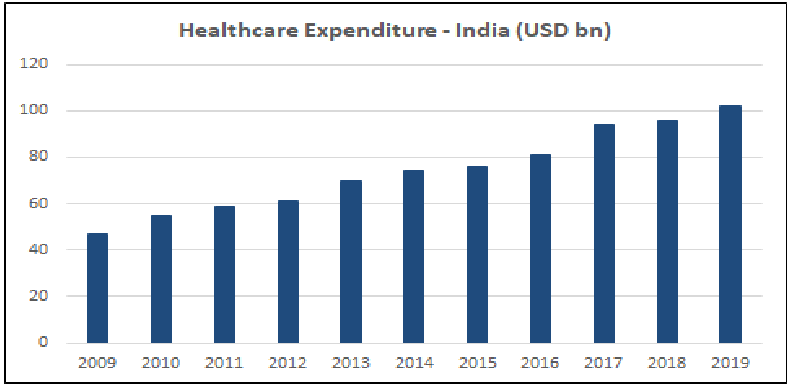
On the B2C side, specific plans on channel strategy going forward include expanding the collection centre network with a performance-linked channel incentive plan along with retail activities to drive consumer awareness and provide superior customer experience and increased accessibility. The B2B segment is expected to see further direct clients (pick-up points) being added and plans to increase the hospital lab management agreements and business from wellness and co-marketing initiatives. SRL also plans to undertake actions in order to further build on doctor connects and relationships along with patient engagement with the objective of enhancing brand equity amongst important stakeholders and driving repeat business. In parallel, an integrated product portfolio approach to capture value from specialised diseases, lifestyle diseases and preventive checks across the spectrum of B2B and B2C segments would also be aggressively pursued. As all these efforts are being rolled out, and we have seen some green-shoots in FY21. We believe with the management renewed focus; the company will revert back to stable growth from FY22 onwards.

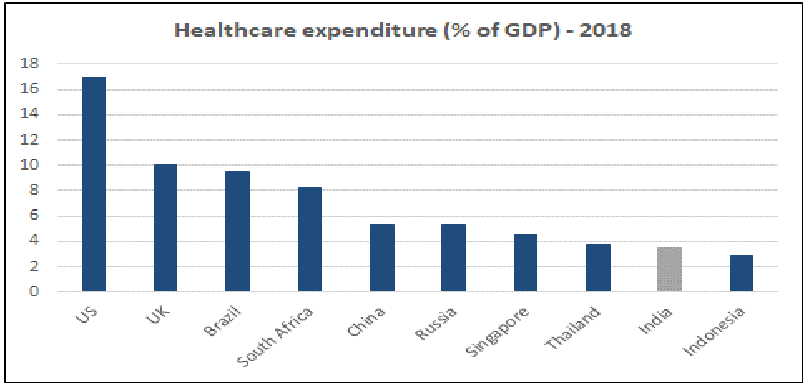
SRL’s Board has approved the acquisition of the remaining 50% stake in the existing joint venture company, DDRC SRL Diagnostics Pvt Ltd (DDRC) by SRL Ltd. The all-cash deal for 50% stake is valued at Rs 350 crore (including ownership of the DDRC brand) is funded through internal accruals and some debt portion. DDRC is the largest organized chain of Diagnostic centres in Kerala with 202 labs and 5 collection centres. This consolidation would help to enhance SRL’s presence in South India and complement its strategy of increasing the share of its retail (B2C) business, which has a higher margin. DDRC had normalised revenue of Rs 165cr with a reported normalised EBITDA of Rs 31cr (margin ~18%) in FY20. Proforma revenue number for FY21 along with DDRC is at Rs 1336cr with EBITDA of Rs 328cr (24.5% margin). The transaction should benefit consolidated revenue and operating profits going forward. This acquisition consolidates SRL's leadership position as the second largest diagnostic player by revenue, and the largest path lab chain with highest number of labs in the country.

Industry Insights & Triggers:

Hospitals:

Hospitals in India has long runway to growth with lower number of doctors/bed relative to total population, healthcare spends as percentage of GDP to the global averages. The hospital industry in India stood at $62 billion in 2017 and is expected to increase at a 16-17% CAGR to reach a size of $133 billion by 2023. This indicates that there is tremendous scope for enhancing healthcare services penetration in India and ample opportunity for the development of the healthcare industry as a whole. The demand outlook for healthcare services is positive in the long-run, due to growing awareness of healthcare issues, under-served nature of the sector, better affordability through increasing per capita income, and widening medical insurance coverage. India offers affordable healthcare treatment to many developing countries encouraging inbound medical tourism. Treatment for major surgeries in India costs approximately 1/5th of developed countries. A rare combination of world-class hospitals, equipped with best-in-class technology, skilled medical professionals, low treatment costs, and process improvements like e-medical visa, have made India a preferred destination for medical tourism.



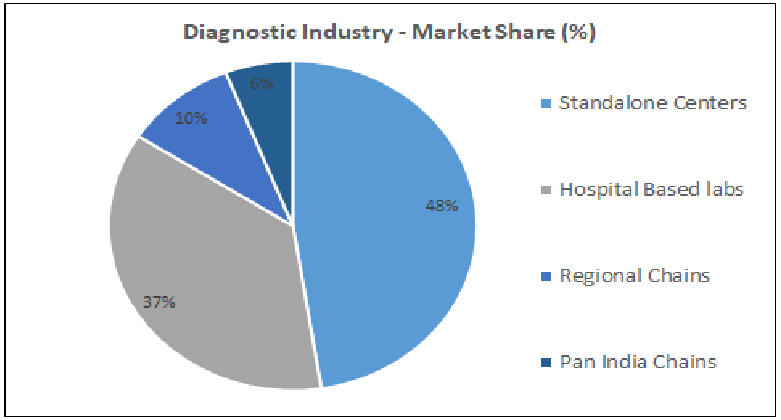


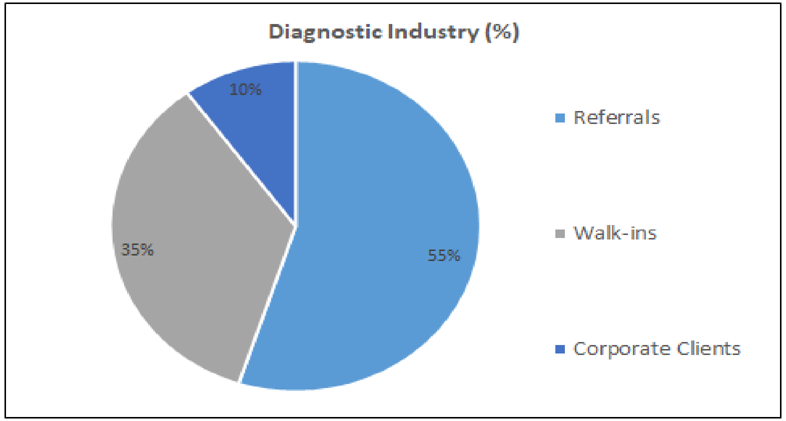
(Source: World Bank, HDFC sec)

India's huge demand-supply gap, rising health insurance penetration, high out-of-pocket spends, increase in medical tourism provide compelling growth prospects for the industry. The adoption of asset-light models of expansion, enhanced focus on retail formats – pharmacy, diagnostics and digital initiatives – are expanding avenues of growth while keeping the balance sheet light. Private players remain the key growth contributors, given that the government spending remains low at ~1.5% of GDP.

Diagnostics:

The diagnostic industry has emerged as an attractive play in India's growing healthcare sector and is one of the fastest growing services in the country. The domestic diagnostic industry is estimated at USD 9.5bn and is expected to grow at a compounded annual growth rate (CAGR) of ~11% over the next 5 years. The growth will be largely driven by increase in healthcare spending by aging population, rising income levels, rising awareness for preventive testing, advanced healthcare diagnostic tests offerings and central government healthcare measures. The sector is currently dominated by high volume/low-cost testing activity by majority of players where there is little or no investment in building awareness of clinical utility. The market share categorized currently as unorganized (47%), hospital-based lab (37%) and remaining ~16% is with the organized players. Doctor referrals constitute a large part of this business. This includes commission payments to doctors in lieu of referring the diagnostic lab. Further, currently the illness segment diagnosis is more prevalent rather than wellness in India. Diagnostic business growth is mostly driven by volume as price increase is not commensurate to inflation.





(Source: Industry Reports, Annual Reports, HDFC sec)

The fragmented & under-penetrated market offers tremendous opportunity for diagnostic companies to deliver higher value services on the back of asset light model and strong cash flow generation. To capture the increasingly important shift towards the consumer, industry leaders have started to implement initiatives such as partnering with retailers, offering home testing and driving greater engagement with patients through its digital presence while maintaining basic testing as a revenue safety net. We expect the trend of organized players (having national presence/regional chains) and gaining market share will continue as the topline will be primarily volume-driven (quantum of common tests like Blood sugar, Lipid profile, Malaria/Dengue, Covid-19) and better product mix. We believe that organized players are likely to grow 15-17% CAGR ahead of the industry. Faster shift of unorganized business to organized players, potential consolidation, likely increase in preventive check-ups and sizeable scale would benefit the large organized players having strong balance sheet. Among the major chain, SRL diagnostic, have grown slower than the industry and peers in the last couple of years. We believe with the management's renewed focus the company will revert back to stable growth from FY22 onwards.

Concerns:

High competition: The healthcare sector is competitive, as increasing healthcare providers (newer and existing hospitals, low-cost nursing homes, etc) try to establish themselves among patients. Increasing subsidies from the government and improvement in services from the government hospitals may cause attrition in patients and disrupt business sustainability. With the advancing technology and newer medical interventions, several hospitals are evolving with their services as well.

Operational Risk: As significant capex incurred for new hospitals, or laboratory, delay in ramp-up will impact EBITDA and affect cashflow generation. Any delay in commissioning or expansion (reaching breakeven) of new facilities may impact overall growth, thus impacting overall financials. Hospital business, being a highly capital intensive business, can deliver high EBITDA margin/RoCE only through high utilization level. Lower occupancy level in hospitals could impact its profitability.

Ongoing Litigations and Investigations by SEBI & SFIO: Fortis Group, due to its erstwhile promoters is facing multiple investigations and litigations; any adverse ruling may impact the company's operations and its credit profile.

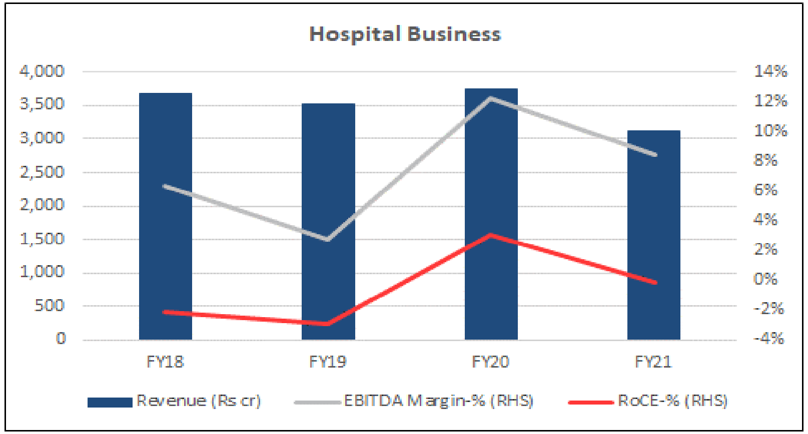
Discontinuation of leases: The company's operations are carried on leased hospital buildings and stand-alone pharmacies. In the event of these leased properties are not renewed or are not renewed on favourable terms to the company, its business operations would be disrupted.

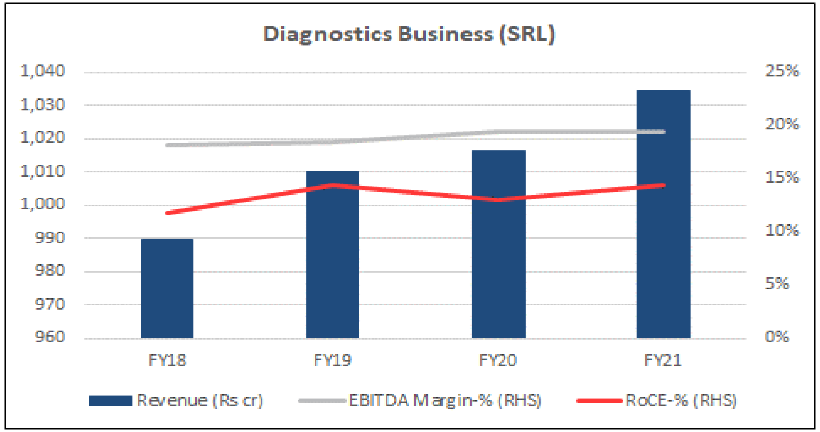
Price Regulation: Government regulating prices for critical medical treatment (including that of medical devices) which private hospital charges from patient remains a risk to revenues and margins.

Company Profile:

Fortis Healthcare Limited (FHL) – an IHH Healthcare Berhad Company – is a leading integrated healthcare services provider in India. It is one of the largest healthcare organizations in the country with 36 healthcare facilities (including projects under development) and 3900 operational beds (including O&M model) as of March 31, 2021. Fortis offers a full spectrum of integrated healthcare services ranging from clinics to quaternary care facilities and a wide range of ancillary services to patients in Cardiac Care, Orthopedics, Neurosciences, Oncology, Renal Care, Metabolic diseases care and mother and childcare. Healthcare verticals of the company primarily comprise day care specialty, diagnostics and tertiary and quaternary care. Fortis is present in India, United Arab Emirates (UAE), Nepal & Sri Lanka. The company has entered women and child health and well-being segments through its brand, 'La Femme' and has four facilities under this brand. SRL Ltd, a subsidiary of Fortis Healthcare, is among the leading diagnostic laboratory chains with 4 reference labs and 428 networking labs with 8,288 collection points.

The earstwhile promoters, Malvinder Singh and Shivinder Singh, who were involved in diversion of funds and misrepresentation of financials statements, were forced to reduce their stake to less than 1% (Feb 2018) after the Supreme Court allowed lenders to invoke the pledge against shares of FHL held as security. Thereafter, the search for a new promoter began and bids were invited from investors. IHH was the winning bidder and became the new promoter, investing around Rs 4,000cr in the company against fresh issuance for around 31.1% stake. IHH also plans to bring open offer for acquiring up to 26% stake in FHL, subject to the subscription by the minority shareholders to the open offer. Pursuant to order dated December 14, 2018 passed by the Court, the open offer has been put on hold. In order to reinforce complete dissociation with erstwhile promoters, the board has proposed to rename the Fortis brand as 'Parkway', which is a strong international brand belonging to IHH while a neutral name will be considered for SRL. Fortis Healthcare draws strength from its partnership with global major and parent company, IHH, to build upon its culture of world-class patient care and superlative clinical excellence.





(Source: Company, HDFC sec)

Open Offer, Extension of Put option to SRL minority shareholders & ongoing legal proceedings:

Open Offer by IHH:

Post the preferential allotment to IHH Healthcare Berhad of 31.1% equity stake, IHH was under an obligation to make open offer to the public shareholders of Fortis healthcare to acquire upto 26% shareholding at Rs 170 per share and 26% of share capital of Fortis Malar at Rs 58.

On an appeal by Daiichi Sankyo, (party defrauded by earlier promoters) alleging that change in control of the hospital chain was orchestrated by ex-promoters -Singh brothers - to avoid paying the arbitration award in connection with the Ranbaxy case (in which the Singh brothers and Daiichi were parties); the Hon'ble Supreme Court passed an order dated December 14, 2018 - directing "status quo with regard to sale of the controlling stake in Fortis Healthcare to Malaysian IHH Healthcare Berhad be maintained". The mandatory open offer by IHH Healthcare Berhard to the shareholders continues to await the outcomes of proceedings in the Supreme Court.

Post infusion of funds by IHH into Fortis, Fortis bought back all the Indian assets of RHT Health Trust by paying Rs 4,666cr; the Hon'ble Supreme Court in November 15, 2019 issued suo-moto contempt notice to Fortis in regard to alleged violation of the order dated December 14, 2018 in connection to the IHH Healthcare Berhad (IHH) equity infusion and purchase of RHT Health Trust (RHT) assets. In response, the company has filed response to the suo-moto contempt notice praying that the proceedings be dropped. Northern TK Ventures Pte ltd, SEBI and a retail shareholder have also pleaded the jurisdiction of Hon'ble Supreme Court of India for allowing the mandatory open offer to proceed. The matter is sub-judice and hearings are yet to take place. The company is making all efforts to ensure a speedy resolution to the matter. SEBI has also prayed to the Supreme Court for allowing the mandatory open offer.

Extension of Put option in case of SRL's minority shareholders:

Minority shareholders of SRL, having around 31.5% stake, hold a put option and the liability towards this option, of around Rs 1,405cr. The company has been in active discussions for providing an extension for this. In lieu of the revised exit rights and timelines, the option holders have agreed to keep the put option in abeyance for three years, till February 5, 2024. In Q4FY21, an amendment agreement in lieu of the new proposed exit rights was entered. Accordingly, financial liability for cash put option has been classified as non-current liability as at March 31, 2021.

Ongoing Litigations:

- The Securities and Exchange Board of India (SEBI) and the Serious Fraud Investigation Office (SFIO) are investigating into alleged financial irregularities at the company. Furthermore, on November 20, 2020, SEBI issued a show-cause notice to FHL and its wholly owned subsidiary, Fortis Hospitals Ltd for alleged involvement in diversion of funds by the erstwhile promoters and misrepresentation of the financials, thereby not safeguarding investor interests. The hearings are currently ongoing. The outcome of these matters including any punitive action may have a bearing on the credit risk profile.

- A Civil Suit claiming Rs 25,344 lacs was filed by a third party against various entities including the company and certain entities within the group relating to “Fortis, SRL and La-Femme” brands. Based on legal advice of external legal counsel, the management believes that the claims are without legal basis and not tenable. The matter is currently sub-judice.

Peer Comparison:

	Mcap (Rs cr)	Sales				EBITDA Margin (%)				PAT			
		FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
Fortis Healthcare	17,134	4,632	4,030	5,514	6,223	13.2	10.0	16.9	17.2	57.9	-110	362	477
Apollo Hospitals	48,601	11,247	10,577	13,258	15,412	14.1	10.3	14.3	15.3	257	82	694	993
Narayana Hrudayalaya	10,112	3,128	2,582	3,546	4,055	13.5	7.1	16.4	17.9	111	-14	234	313

	RoE (%)				RoCE (%)				P/E			
	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
Fortis Healthcare	0.9	-1.7	5.8	7.1	4.4	2.0	9.0	10.3	294.7	negative	47.3	35.9
Apollo Hospitals	7.7	2.1	13.6	16.4	10.4	7.0	12.5	16.4	183.7	572.9	70.0	48.9
Narayana Hrudayalaya	11.0	-0.7	19.9	22.6	10.9	3.6	15.6	16.7	91.6	negative	43.4	32.3

(Source: Company, HDFC sec)

Fortis Healthcare Ltd.

Financials (Consolidated)

Income Statement

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
Net Revenues	**4469.4**	**4632.3**	**4030.1**	**5514.0**	**6222.6**
Growth (%)	-2.0	3.6	-13.0	36.8	12.8
Operating Expenses	4244.1	4022.8	3625.7	4582.2	5152.3
EBITDA	**225.2**	**609.5**	**404.4**	**931.9**	**1070.3**
Growth (%)	-17.5	170.6	-33.6	130.4	14.9
EBITDA Margin (%)	**5.0**	**13.2**	**10.0**	**16.9**	**17.2**
Depreciation	232.9	291.7	290.6	304.1	313.4
EBIT	**-7.7**	**317.8**	**113.8**	**627.8**	**756.9**
Other Income	92.4	52.6	46.6	60.7	68.4
Interest expenses	336.8	205.1	165.9	160.6	148.7
PBT	**-252.1**	**165.4**	**-5.5**	**527.8**	**676.6**
Tax	113.6	147.9	99.5	132.0	169.2
RPAT	**-365.7**	**17.5**	**-104.9**	**395.9**	**507.5**
APAT	**-298.9**	**57.9**	**-109.8**	**362.5**	**476.7**
Growth (%)	-70.4	-119.4	-289.4	-430.2	31.5
EPS	-4.9	0.8	-1.5	4.8	6.3

Balance Sheet

As at March	FY19	FY20	FY21	FY22E	FY23E
SOURCE OF FUNDS					
Share Capital	755.0	755.0	755.0	755.0	755.0
Reserves	5845.9	5906.1	5364.9	5727.3	6204.0
Shareholders' Funds	**6600.8**	**6661.1**	**6119.8**	**6482.3**	**6959.0**
Minority's Interest	511.7	544.5	598.0	664.5	735.7
Long Term Debt	674.6	1166.6	1199.3	1119.3	1039.3
Net Deferred Taxes	15.5	-81.3	-81.5	-101.5	-121.5
Long Term Prov & Others	92.4	85.1	1715.8	1811.9	1866.3
Total Source of Funds	**7895.0**	**8376.0**	**9551.4**	**9976.5**	**10478.8**
APPLICATION OF FUNDS					
Net Block & Goodwill	8505.7	8817.3	8800.9	8781.8	8793.4
CWIP	420.9	188.8	163.1	163.1	163.1
Other Non-Current Assets	892.9	1008.4	783.7	947.0	1001.2
Total Non Current Assets	**9819.4**	**10014.5**	**9747.7**	**9891.9**	**9957.7**
Current Investments	79.3	0.0	0.0	50.0	100.0
Inventories	56.5	78.2	76.8	90.6	102.3
Trade Receivables	542.4	458.8	389.9	498.5	545.5
Cash & Equivalents	855.9	266.0	416.6	746.0	1170.6
Other Current Assets	132.5	137.6	153.6	199.4	226.7
Total Current Assets	**1666.6**	**940.5**	**1036.8**	**1584.6**	**2145.1**
Short-Term Borrowings	1232.4	390.4	207.8	227.8	247.8
Trade Payables	753.5	597.6	548.2	679.8	733.1
Other Current Liab & Prov	1605.1	1591.0	477.0	592.4	643.2
Total Current Liabilities	**3591.0**	**2578.9**	**1233.0**	**1500.1**	**1624.1**
Net Current Assets	-1924.4	-1638.5	-196.2	84.6	521.0
Total Application of Funds	**7895.0**	**8376.0**	**9551.4**	**9976.5**	**10478.8**

Fortis Healthcare Ltd.

Cash Flow Statement

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
Reported PBT	-110.1	239.4	43.3	527.8	676.6
Non-operating & EO items	-69.1	-48.5	-7.0	-69.1	-0.8
Interest Expenses	263.0	174.8	123.9	160.6	148.7
Depreciation	232.9	291.7	290.6	304.1	313.4
Working Capital Change	-247.4	-146.4	-12.7	93.6	39.5
Tax Paid	-247.8	-339.5	47.5	-132.0	-169.2
OPERATING CASH FLOW (a)	**-178.5**	**171.5**	**485.5**	**885.1**	**1,008.3**
Capex	-82.6	-136.6	-211.5	-285.0	-325.0
Free Cash Flow	-261.1	34.9	274.0	600.1	683.3
Investments	339.1	79.7	0.0	-50.0	-50.0
Non-operating income	-3,535.9	120.4	81.0	0.0	0.0
INVESTING CASH FLOW (b)	**-3,279.3**	**63.5**	**-130.6**	**-335.0**	**-375.0**
Debt Issuance / (Repaid)	648.1	-656.8	25.7	-60.0	-60.0
Interest Expenses	-401.3	-204.9	-168.6	-160.6	-148.7
FCFE	-14.3	-826.7	131.0	379.4	474.6
Share Capital Issuance	4,009.8	0.0	0.0	0.0	0.0
Dividend	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0
FINANCING CASH FLOW (c)	**4,256.6**	**-861.6**	**-142.9**	**-220.6**	**-208.7**
NET CASH FLOW (a+b+c)	**798.8**	**-626.6**	**212.0**	**329.4**	**424.6**

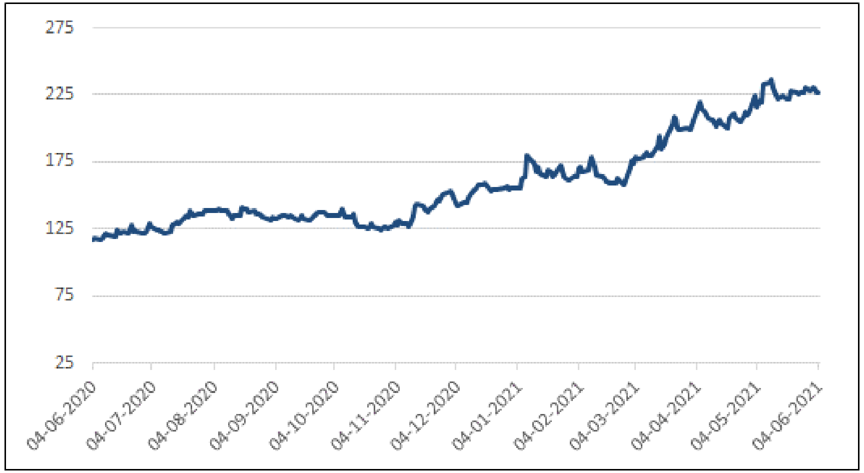
Key Ratios

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
EBITDA Margin	5.0	13.2	10.0	16.9	17.2
EBIT Margin	1.9	8.0	4.0	12.5	13.3
APAT Margin	-6.7	1.3	-2.7	6.6	7.7
RoE	-5.6	0.9	-1.7	5.8	7.1
RoCE	1.2	4.4	2.0	9.0	10.3
Solvency Ratio					
Debt/EBITDA (x)	8.5	2.6	3.5	1.4	1.2
D/E	0.3	0.2	0.2	0.2	0.2
PER SHARE DATA					
EPS	-4.9	0.8	-1.5	4.8	6.3
CEPS	-0.9	4.6	2.4	8.8	10.5
Dividend	0.0	0.0	0.0	0.0	0.0
BVPS	87.4	88.2	81.1	85.9	92.2
Turnover Ratios (days)					
Debtor days	41.3	39.4	38.4	29.4	30.6
Inventory days	5.0	5.3	7.0	5.5	5.7
Creditors days	62.7	53.2	51.9	40.6	41.4
VALUATION					
P/E	-46.2	294.7	-156.1	47.3	35.9
P/BV	2.6	2.6	2.8	2.6	2.5
EV/EBITDA	80.7	30.2	44.8	19.0	16.1
EV/Revenues	4.1	4.0	4.5	3.2	2.8
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
Dividend Payout	0.0	0.0	0.0	0.0	0.0

(Source: Company, HDFC sec)

Fortis Healthcare Ltd.

One Year Price Chart



(Source: Company, HDFC sec)

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