

07 August 2024

India | Equity Research | Q1FY25 results review

## Fortis Healthcare

Healthcare

### Grim outlook on margins

Fortis Healthcare's (Fortis) Q1FY25 result was below our expectations. Hospital revenue (up 14%) was boosted by better ARPOB (+4% QoQ to INR 65,924) and occupancy (+100bps QoQ to 67%). However, hospital margin dropped 280bps QoQ to 18.5%, dragged by FEHI, Vashi, Jaipur and Ludhiana (new) hospitals. Management aims for 20%+ margin in hospitals in FY25. Diagnostic margin contracted 390bps YoY to 17.9% due to higher rebranding cost and provisions. Fortis is likely to buyback 31% stake in Agilus from PE investors in next couple of months and fund it via debt (debt to EBITDA max at 1.5x). It is also adding 400 brownfield beds in FY25 which may increase leverage. We trim EBITDA estimates by ~2% for FY25-26E. Downgrade to **HOLD** with revised TP of INR 490 (earlier INR 500), valuing hospitals/diagnostics at 21x/23x FY26E EV/EBITDA, respectively.

### Momentum driven by hospitals; margins below expectations

Revenue rose 12.2% YoY (+4.1% QoQ) to INR 18.6bn (I-Sec: INR 18.2bn) driven by hospital business. Gross margin contracted 30bps YoY (-120bps QoQ) to 75.6%. EBITDA grew 25.7% YoY (-10.1% QoQ) to INR 3.4bn (I-Sec: INR 3.8bn) while margin expanded 200bps YoY (-290bps QoQ) to 18.4% (I-Sec: 20.7%) driven by hospitals (accounted for 84% of consolidated EBITDA). Adjusted PAT rose 49.8% YoY (-6.0% QoQ) to INR 1.7bn (I-Sec: INR 1.8bn).

### Multiple drags on hospital margin

Hospital revenue grew 14.4% YoY (+4.0% QoQ) at INR 15.5bn driven by better traction in its Mulund, Anandpur, BG Road and Shalimar Bagh hospitals. Occupancy stood to 67% vs 66%/64% QoQ/ YoY. ARPOB rose 3.9% QoQ (+10% YoY) to INR 65,924. ALOS stood at 4.16 days vs 4.41/4.19 QoQ/YoY. Revenue from international patients grew 11.0% YoY to INR 1.27bn. Hospital EBITDA margin stood at 18.5%, up 330bps YoY and -380bps QoQ, dragged by FEHI, Vashi, Jaipur and new facility in Ludhiana. It is on track to add 2,200 beds in existing clusters in 4 years by incurring capex of INR 12-13bn.

### Rebranding dents B2C growth of Agilus

Diagnostics revenue rose 2.0% YoY (+4.6% QoQ) to INR 3.1bn. Number of tests was flat YoY to 9.92mn. Patient count declined by 3.1% YoY at 4.0mn. Average revenue per test was down 0.9% YoY at INR 341. Walk-in patients (40% of B2C) volume has been hit the most post rebranding. Margin contracted 390bps YoY (+170bps QoQ) to 17.9%. Parent entity Fortis will raise capital (equity or debt) to honour put option liability in Agilus by Oct'24.

### Financial Summary

Y/E March (INR mn)	FY23A	FY24A	FY25E	FY26E
Net Revenue	62,976	68,929	78,235	88,827
EBITDA	11,013	12,676	14,875	17,721
EBITDA Margin (%)	17.5	18.4	19.0	19.9
Net Profit	5,315	5,868	7,128	9,131
EPS (INR)	7.0	7.8	9.4	12.1
EPS % Chg YoY	75.3	10.4	21.5	28.1
P/E (x)	63.7	62.6	52.6	41.1
EV/EBITDA (x)	34.1	29.6	24.6	20.1
RoCE (%)	5.8	6.4	7.7	8.9
RoE (%)	7.9	7.9	8.9	10.3

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#### Market Data

Market Cap (INR)	375bn
Market Cap (USD)	4,471mn
Bloomberg Code	FORH IN
Reuters Code	FOHE.BO
52-week Range (INR)	532 /308
Free Float (%)	69.0
ADTV-3M (mn) (USD)	10.5

Price Performance (%)	3m	6m	12m
Absolute	7.7	8.8	46.8
Relative to Sensex	1.3	(0.1)	27.2

#### Previous Reports

25-05-2024: [Q4FY24 results review](#)

## Valuation and risks

Through divestments and cost optimisation effort, Fortis has been able to scale up its hospital margin from 15% in FY24 to ~18% Q1FY25. Persistent issues at some hospitals like Vashi, Jaipur and FEHI have dragged the margin below the much anticipated 20% mark. Pickup at newly-added Ludhiana hospital is below management's expectations. Q2 has historical been a strong quarter for hospitals and the company is also commissioning 100 beds at new Manesar hospital in Q2FY25 which may exert pressure on margins in near term. In diagnostics, the focus is towards adding more spokes to the network which will help the company in growing in line with the market in FY26 and improve margins.

The PE investor in Agilus is likely to exercise the put option for taking an exit from the company, and hence, Fortis will have a liability to acquire 31% stake in Agilus by Oct'24. Besides, it is adding 2,200 beds in next 4 years for an outlay of INR 12-13bn, and hence, may have to raise debt in near term. Management aims to keep debt to EBITDA below 1.5x (implying INR 10bn of debt to be raised) for funding additional 31% stake in Agilus.

We expect 18.2% EBITDA CAGR over FY24-26E driven by revenue CAGR of 13.5%. EBITDA margin is likely to rise to 19-20% over the next couple of years backed by improvement in ARPOB, surge in occupancy, divestment of loss-making hospitals and healthy growth in Agilus diagnostics.

The stock currently trades at EV/EBITDA of 24.6x FY25E and 20.1x FY26E. We lower our rating to **HOLD** (earlier Add) with a revised target price of INR 490/share (earlier INR 500) based on FY26E SoTP-based valuation, valuing the hospital/diagnostic business at 21x/23x FY26E EV/EBITDA (unchanged), respectively.

**Key upside risks:** Faster growth in newer hospitals, Turnaround in diagnostics business.

**Key downside risks:** Regulatory hurdles, higher than expected competition.

### Exhibit 1: Sum of the parts (SoTP) valuation

	FY26E EBITDA	(x)	Values (INR mn)
Hospitals	15,720	21	3,24,718
Agilus (56.9% stake)	2,398	23	31,133
EV			<b>3,55,851</b>
Less: Net debt			(13,727)
Implied Mkt Cap			<b>3,69,578</b>
<b>Value per share</b>			<b>490</b>

Source: Company data, I-Sec research

## Q1FY25 concall highlights

### Hospitals

- Hospitals accounted for 84% of consolidated EBITDA in Q1FY25.
- Top 8 hospitals are operating at EBITDA margin of over 20% and accounted for 69% of hospital revenue.
- Key specialties like oncology, gastroenterology, neurosciences, renal sciences, orthopedics and cardiac sciences grew 15.7% YoY in Q1FY25 and accounted for 63% of hospital sales.
- International patients accounted for 8% of revenue and grew 11% YoY to INR 1.3bn.
- Mulund, Anandpur, BG Road, Shalimar Bagh, Amritsar, Mohali, FMRI, and Noida grew 24%, 23%, 23%, 22%, 20%, 19%, 15%, and 15% respectively.

- It plans to add 700 beds in FY25 at Faridabad, Anandpur, Shalimar Bagh and Noida and in Q2FY25 it will also commission 350 bed Manesar facility.
- Revenue from digital channel grew 52% YoY and 17% QoQ. It accounted for 30% of revenue.
- It added 30 beds in Mohali in FY24; occupancy has risen in last couple of months.
- FMRI hospital is operating at 75% occupancy (added clinical talent for oncology and cardiac).
- FMRI expansion will be in two phases. Its civil structure has been completed for brownfield expansion and aims to add 220 beds by H1FY26. Further, it will also add 21 beds in the existing building by Nov'24.
- Operational cost of Manesar hospital is currently capitalised and will be expensed out once operational in Q2FY25. The hospital has capacity of 350 beds. In phase 1 it will initially operationalise 100 beds and further 250 beds will be added in 18 months once occupancy surges to over 60-65%.
- FMRI hospital has highest ARPOB since it's the flagship hospital of the group. Manesar hospital ARPOB will be 20-25% lower than FMRI.
- FEHI hospital margin was less than 10% in Q1FY25; dip in margin was due to annual salary hike of staff.
- Jaipur hospital revenue declined in Q1 and EBITDA turned negative.
- Revenue and margin of Vashi hospital were impacted by competition and the management is working to improve occupancy at this hospital.
- New Ludhiana hospital has not performed as per expectation in the initial 6 months of operations.
- Q1 margin was negatively impacted by one-off cost (50-60bps) pertaining to conversion of debt, GST liability and higher provisions for doubtful debts.

### Diagnosics

- Agilus added 185 customer touchpoints in Q1FY25.
- Agilus conducted 9.92mn tests lower than 9.95mn tests in Q1FY24. The decline in tests was primarily because of lower covid volumes.
- One-off costs pertaining to rebranding (INR 90mn) and provisioning related to government business (INR 25mn) impacted Agilus' EBITDA margin.
- Preventive test revenue grew 13% YoY in Q1FY25 and contributed 12% of revenue (10% in Q1FY24).
- Genomics portfolio grew 12% YoY.
- Private equity (PE) investor is likely to exercise the put option in Aug'24. The company has appointed an independent evaluator to assess the market value of Agilus.
- Fortis is comfortably placed to raise capital to fund this put option liability.
- Post the transaction, Fortis's stake in Agilus will go up to 88% as against ~57% currently. The company will take 2 months to initiate the buyback post notification from the PE. However, the buyback may require a couple of regulatory approvals.
- Rebranding has impacted the walk-in B2C (40% of B2C) business the most.

- In Q1FY25, it took a write off of INR 25mn for receivables from Mohalla clinic.
- In FY25, it will incur INR 500mn on rebranding expenses of Agilus.

#### Q1 financials

- Q1 is a relatively modest quarter despite which occupancy rose to 67% vs 64% in Q1FY24.
- Net debt stood at INR 3.1bn at end of Q1FY25.

#### Guidance

- Management is targeting over 20%+ margin for FY25 in hospital segment.
- FY25 will be a year of consolidation for Agilus and management is confident of growing its business in line with market in FY26.
- Debt to EBITDA will be 1.5x after exercising the put option.
- Capex plan for expansion of hospital business will not be delayed due to capital raise to fund the put option liability in Agilus.
- Litigation with Daiichi is in final stages; however, management does not expect any decrease in legal cost as the verdict by the High Court may be challenged by Daiichi.
- International patient revenue may not be adversely impacted by recent development in Bangladesh, due to lower patient flow at Fortis from this country.

### Exhibit 2: Quarterly review

Particulars (INR mn)	Q1FY25	Q1FY24	YoY % Chg	Q4FY24	QoQ % Chg	FY24	FY23	YoY % Chg
<b>Net Sales</b>	<b>18,589</b>	<b>16,574</b>	<b>12.2</b>	<b>17,859</b>	<b>4.1</b>	<b>68,929</b>	<b>62,976</b>	<b>9.5</b>
Gross profit	14,060	12,589	11.7	13,722	2.5	52,742	48,429	8.9
<b>Gross margins (%)</b>	<b>75.6</b>	<b>76.0</b>	<b>-30bps</b>	<b>76.8</b>	<b>-120bps</b>	<b>76.5</b>	<b>76.9</b>	<b>-40bps</b>
EBITDA	3,425	2,725	25.7	3,810	(10.1)	12,676	11,013	15.1
<b>EBITDA margins (%)</b>	<b>18.4</b>	<b>16.4</b>	<b>200bps</b>	<b>21.3</b>	<b>-290bps</b>	<b>18.4</b>	<b>17.5</b>	<b>90bps</b>
Other income	136	75	80.9	141	(3.7)	478	836	(42.8)
<b>PBIDT</b>	<b>3,561</b>	<b>2,800</b>	<b>27.2</b>	<b>3,952</b>	<b>(9.9)</b>	<b>13,154</b>	<b>11,849</b>	<b>11.0</b>
Depreciation	910	792	14.8	922	(1.3)	3,425	3,157	8.5
Interest	353	315	12.0	347	1.7	1,310	1,291	1.4
Extra ordinary income/ (exp.)	2	15		31		160	736	
<b>PBT</b>	<b>2,301</b>	<b>1,707</b>	<b>34.7</b>	<b>2,714</b>	<b>(15.2)</b>	<b>8,580</b>	<b>8,137</b>	<b>5.4</b>
Tax	561	468	19.9	682	(17.8)	2,128	1,807	17.7
Minority Interest	80	122	(34.2)	244	(67.1)	463	443	4.7
<b>Reported PAT</b>	<b>1,660</b>	<b>1,118</b>	<b>48.5</b>	<b>1,787</b>	<b>(7.1)</b>	<b>5,989</b>	<b>5,887</b>	<b>1.7</b>
<b>Adjusted PAT</b>	<b>1,658</b>	<b>1,107</b>	<b>49.8</b>	<b>1,764</b>	<b>(6.0)</b>	<b>5,868</b>	<b>5,315</b>	<b>10.4</b>

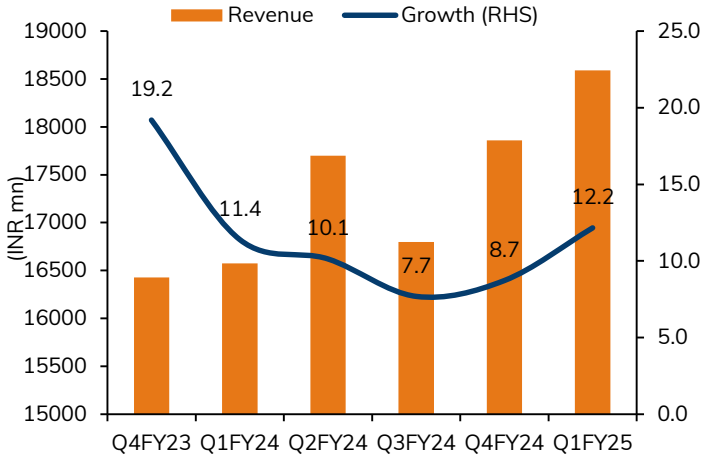
Source: Company data, I-Sec research

### Exhibit 3: Business mix

INR mn	Q1FY25	Q1FY24	YoY % Chg	Q4FY24	QoQ % Chg	FY24	FY23	YoY % Chg
Hospitals	15,493	13,540	14.4	14,898	4.0	56,859	51,076	11.3
EBITDA margins(%)	18.5	15.2	330bps	22.4	-380bps	18.6	17.1	150bps
Agilus	3,096	3,034	2.0	2,961	4.6	12,070	11,899	1.4
EBITDA margins(%)	17.9	21.9	-390bps	16.2	170bps	17.4	21.1	-370bps
<b>Total</b>	<b>18,589</b>	<b>16,574</b>	<b>12.2</b>	<b>17,859</b>	<b>4.1</b>	<b>68,929</b>	<b>62,976</b>	<b>9.5</b>

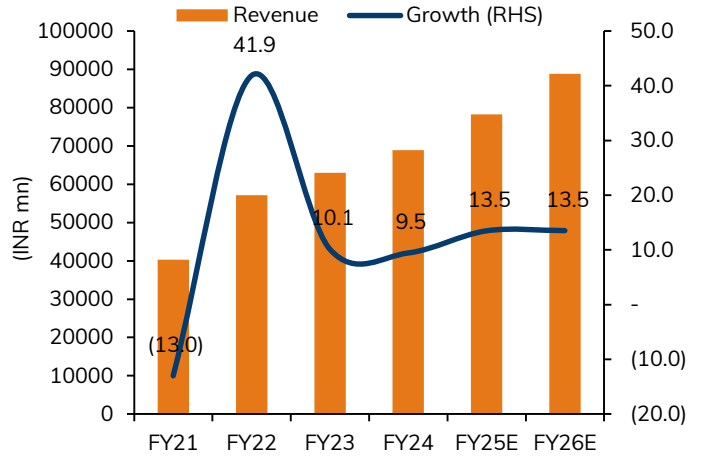
Source: Company data, I-Sec research

**Exhibit 4: Traction across key hospitals is driving growth**



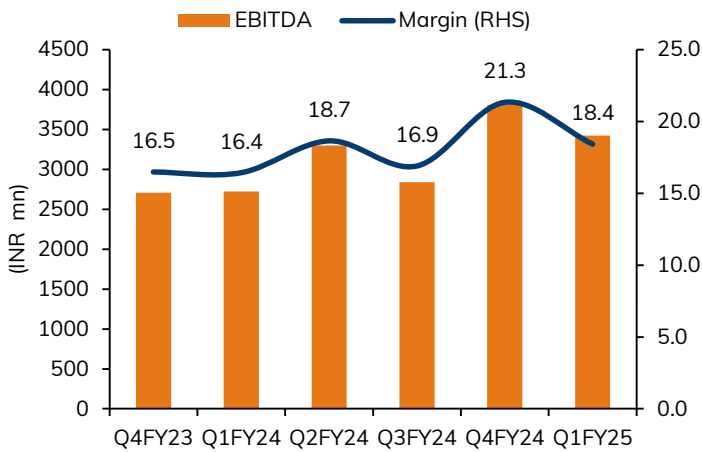
Source: I-Sec research, Company data

**Exhibit 5: Hospitals to deliver healthy growth with improved occupancies and bed capacity**



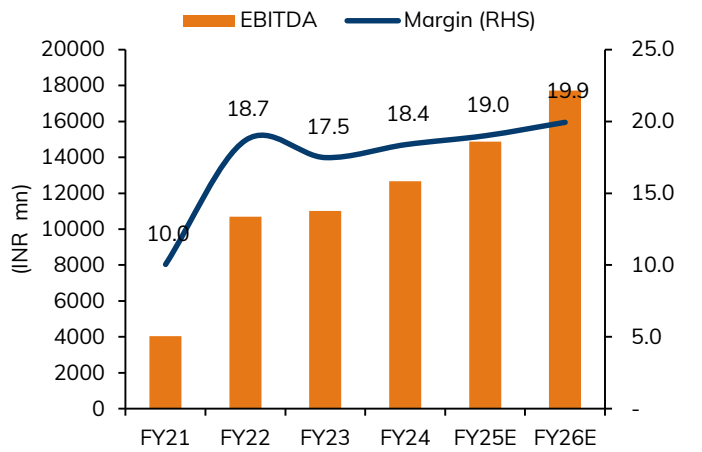
Source: I-Sec research, Company data

**Exhibit 6: Hospital business is driving overall improvement in margins**



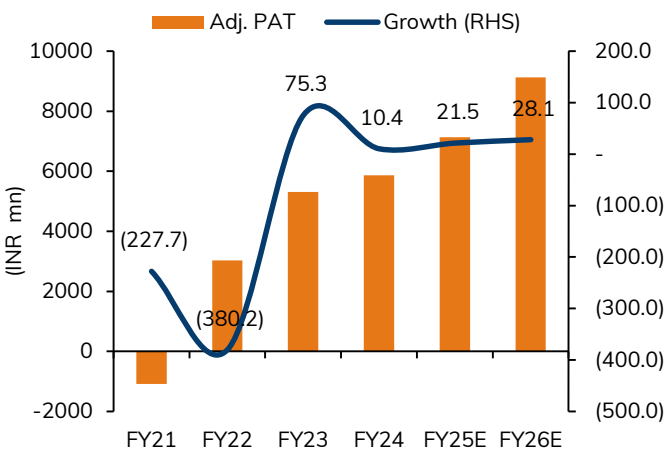
Source: I-Sec research, Company data

**Exhibit 7: Expect 156bps improvement in margins over FY24-26E**



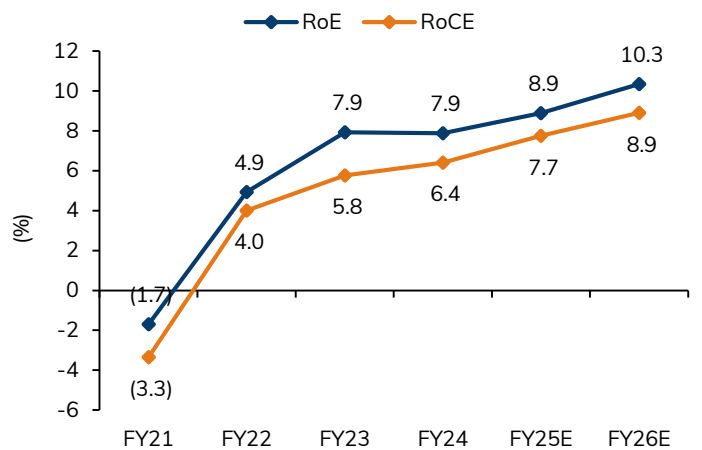
Source: I-Sec research, Company data

**Exhibit 8: Sustained improvement in profitability**



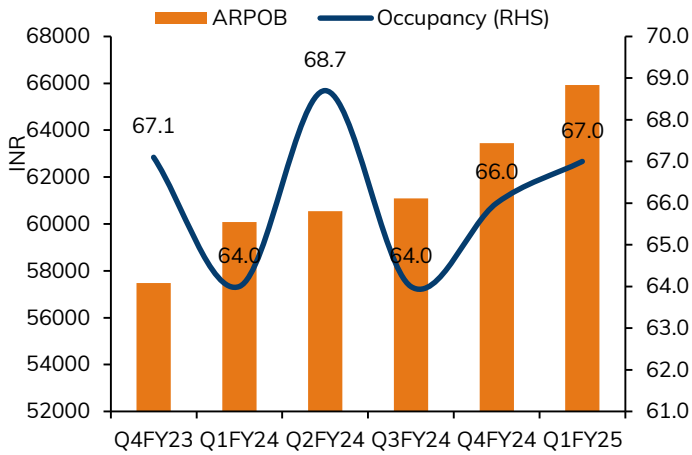
Source: I-Sec research, Company data

**Exhibit 9: Return ratios may improve from current 6-8% levels**



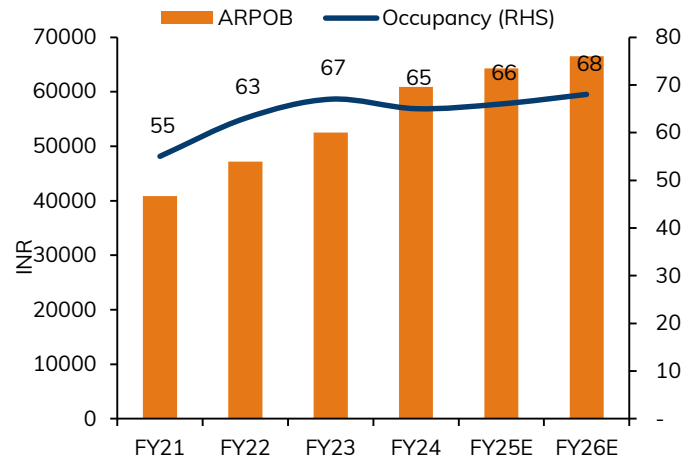
Source: I-Sec research, Company data

**Exhibit 10: ARPOB rose ~10% YoY**



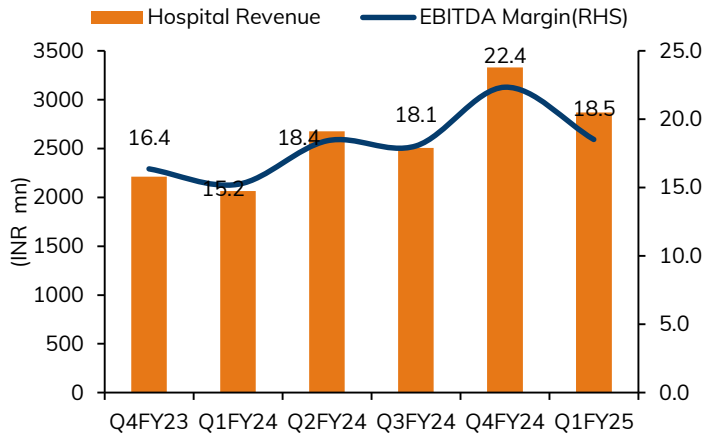
Source: I-Sec research, Company data

**Exhibit 11: ARPOB to increase ~4% every year**



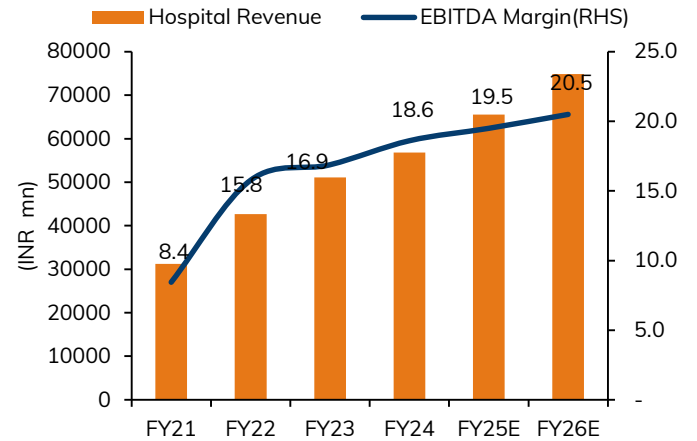
Source: I-Sec research, Company data

**Exhibit 12: Better ARPOB and case mix are driving growth and margins**



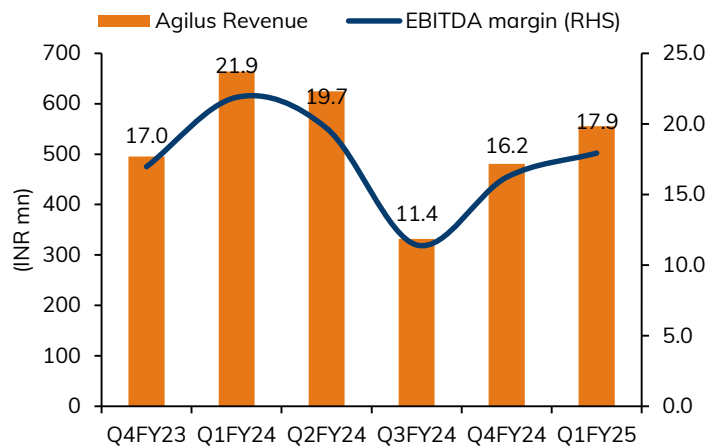
Source: I-Sec research, Company data

**Exhibit 13: Hospital business is at an inflection**



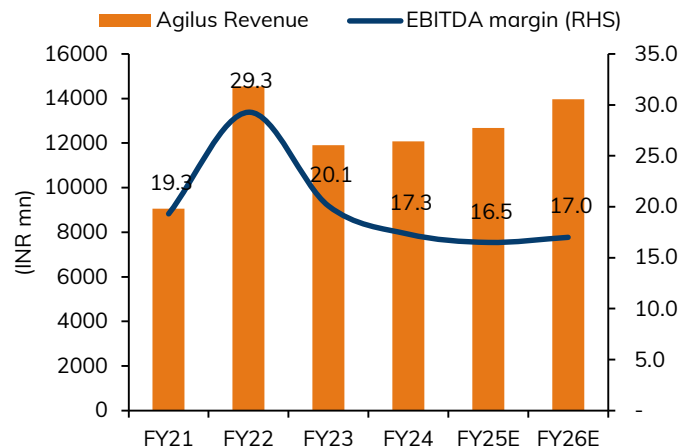
Source: I-Sec research, Company data

**Exhibit 14: Rebranding cost has dented margins**



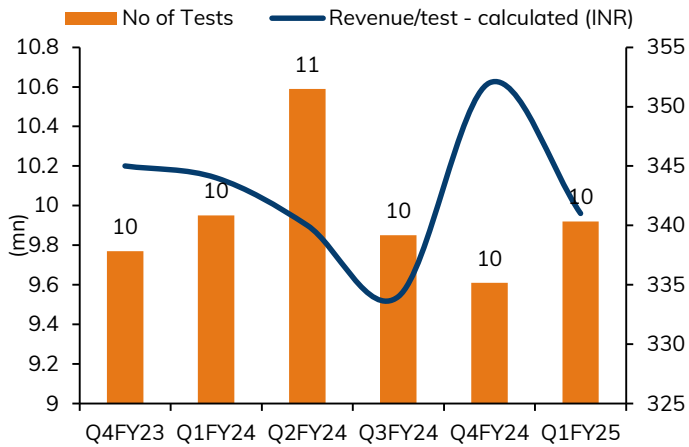
Source: I-Sec research, Company data

**Exhibit 15: Adding of spokes to the network will drive growth**



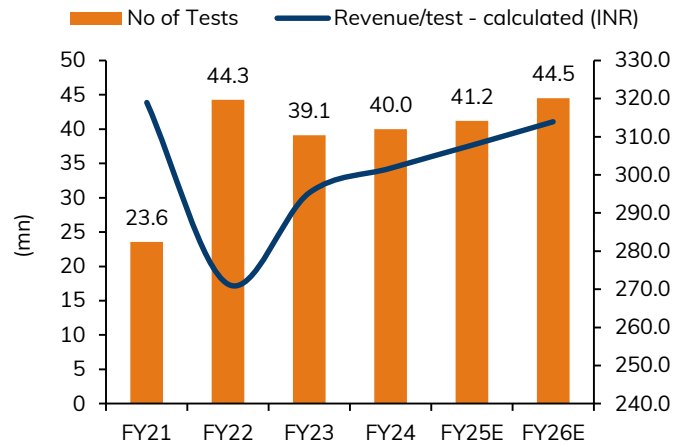
Source: I-Sec research, Company data

**Exhibit 16: Number of tests was flat YoY**



Source: I-Sec research, Company data

**Exhibit 17: Efforts to improve test volumes underway**



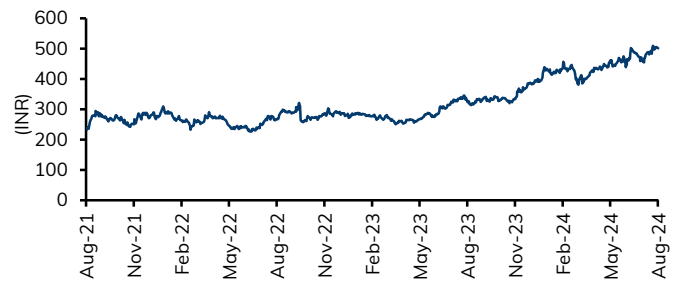
Source: I-Sec research, Company data

**Exhibit 18: Shareholding pattern**

%	Dec'23	Mar'24	Jun'24
Promoters	31.2	31.2	31.2
Institutional investors	53.1	54.4	55.6
MFs and others	25.0	26.5	27.5
FIs/Banks	1.2	1.2	1.3
Insurance	3.1	3.3	3.4
FII	23.8	23.4	23.4
Others	15.7	14.4	13.2

Source: Bloomberg

**Exhibit 19: Price chart**



Source: Bloomberg

## Financial Summary

### Exhibit 20: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Net Sales	62,976	68,929	78,235	88,827
<b>Operating Expenses</b>	<b>51,963</b>	<b>56,253</b>	<b>63,360</b>	<b>71,106</b>
EBITDA	11,013	12,676	14,875	17,721
<b>EBITDA Margin (%)</b>	<b>17.5</b>	<b>18.4</b>	<b>19.0</b>	<b>19.9</b>
Depreciation & Amortization	3,157	3,425	3,945	4,145
EBIT	7,856	9,251	10,930	13,575
Interest expenditure	1,291	1,310	1,454	1,454
Other Non-operating Income	736	160	-	-
Recurring PBT	8,137	8,580	10,126	12,821
<b>Profit / (Loss) from Associates</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Less: Taxes</b>	<b>1,807</b>	<b>2,128</b>	<b>2,511</b>	<b>3,179</b>
PAT	6,330	6,452	7,615	9,642
Less: Minority Interest	(443)	(463)	(487)	(511)
Extraordinary (Net)	-	-	-	-
Net Income (Reported)	5,887	5,989	7,128	9,131
<b>Net Income (Adjusted)</b>	<b>5,315</b>	<b>5,868</b>	<b>7,128</b>	<b>9,131</b>

Source Company data, I-Sec research

### Exhibit 21: Balance sheet

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Total Current Assets	14,064	14,206	24,630	35,872
of which cash & cash eqv.	3,627	5,984	15,299	25,277
Total Current Liabilities & Provisions	12,550	30,010	31,336	32,791
<b>Net Current Assets</b>	<b>1,513</b>	<b>(15,804)</b>	<b>(6,706)</b>	<b>3,081</b>
Investments	2,103	2,297	759	759
Net Fixed Assets	37,918	40,968	41,023	40,877
ROU Assets	10,577	11,708	11,708	11,708
Capital Work-in-Progress	2,278	5,420	5,420	5,420
Total Intangible Assets	45,768	46,061	46,061	46,061
Other assets	8,175	9,039	9,039	9,039
Deferred Tax Assets	3,443	3,174	3,174	3,174
<b>Total Assets</b>	<b>1,11,786</b>	<b>1,02,878</b>	<b>1,10,493</b>	<b>1,20,135</b>
<b>Liabilities</b>				
<b>Borrowings</b>	<b>7,032</b>	<b>8,583</b>	<b>8,583</b>	<b>8,583</b>
<b>Deferred Tax Liability</b>	<b>4,107</b>	<b>4,293</b>	<b>4,293</b>	<b>4,293</b>
provisions	1,302	1,466	1,466	1,466
other Liabilities	16,115	8	8	8
Equity Share Capital	7,550	7,550	7,550	7,550
Reserves & Surplus	64,873	69,079	76,208	85,338
<b>Total Net Worth</b>	<b>72,423</b>	<b>76,629</b>	<b>83,757</b>	<b>92,888</b>
Minority Interest	8,581	8,932	9,419	9,930
<b>Total Liabilities</b>	<b>1,11,786</b>	<b>1,02,878</b>	<b>1,10,493</b>	<b>1,20,135</b>

Source Company data, I-Sec research

### Exhibit 22: Cashflow statement

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
<b>Operating Cashflow</b>	<b>8,222</b>	<b>11,001</b>	<b>13,231</b>	<b>15,432</b>
Working Capital Changes	(211)	(221)	(9)	(66)
Capital Commitments	3	15	17	19
<b>Free Cashflow</b>	<b>8,225</b>	<b>11,016</b>	<b>13,249</b>	<b>15,452</b>
<b>Other investing cashflow</b>	<b>776</b>	<b>(2,227)</b>	<b>1,537</b>	<b>-</b>
Cashflow from Investing Activities	6	30	35	38
Issue of Share Capital	-	-	-	-
Interest Cost	-	-	-	-
Inc (Dec) in Borrowings	(3,256)	1,296	-	-
Dividend paid	(1,598)	(860)	-	-
Others	(132)	(1,300)	(1,454)	(1,454)
Cash flow from Financing Activities	(4,985)	(865)	(1,454)	(1,454)
<b>Chg. in Cash &amp; Bank balance</b>	<b>3,243</b>	<b>10,166</b>	<b>11,812</b>	<b>14,017</b>
Closing cash & balance	7,370	13,794	17,796	29,315

Source Company data, I-Sec research

### Exhibit 23: Key ratios

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
<b>Per Share Data (INR)</b>				
Reported EPS	7.8	7.9	9.4	12.1
Adjusted EPS (Diluted)	7.0	7.8	9.4	12.1
Cash EPS	11.2	12.3	14.7	17.6
Dividend per share (DPS)	2.1	1.1	-	-
Book Value per share (BV)	95.9	101.5	110.9	123.0
Dividend Payout (%)	27.1	14.4	-	-
<b>Growth (%)</b>				
Net Sales	10.1	9.5	13.5	13.5
EBITDA	3.0	15.1	17.3	19.1
EPS (INR)	75.3	10.4	21.5	28.1
<b>Valuation Ratios (x)</b>				
P/E	63.7	62.6	52.6	41.1
P/CEPS	44.3	40.4	33.9	28.3
P/BV	5.2	4.9	4.5	4.0
EV / EBITDA	34.1	29.6	24.6	20.1
P / Sales	6.0	5.4	4.8	4.2
Dividend Yield (%)	0.0	0.0	-	-
<b>Operating Ratios</b>				
Gross Profit Margins (%)	76.9	76.5	76.5	76.6
EBITDA Margins (%)	17.5	18.4	19.0	19.9
Effective Tax Rate (%)	22.2	24.8	24.8	24.8
Net Profit Margins (%)	8.4	8.5	9.1	10.3
NWC / Total Assets (%)	-	-	-	-
Net Debt / Equity (x)	0.0	0.0	(0.1)	(0.2)
Net Debt / EBITDA (x)	0.1	0.0	(0.5)	(1.0)
<b>Profitability Ratios</b>				
RoCE (%)	5.8	6.4	7.7	8.9
RoE (%)	7.9	7.9	8.9	10.3
RoC (%)	5.7	6.3	8.0	10.1
Fixed Asset Turnover (x)	1.7	1.7	1.9	2.2
Inventory Turnover Days	7	6	6	6
Receivables Days	35	35	35	35
Payables Days	43	40	41	41

Source Company data, I-Sec research



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