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Viewpoint | Company Update

Healthcare Global Enterprises Ltd

Bed capacity expansion and improved profitability to drive growth ahead

Healthcare & Diagnostics	Sharekhan code: HCG
Reco/View: **Positive** ↔	CMP: **Rs. 297**
	Upside potential: **18%** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

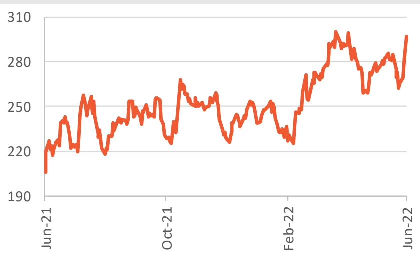
Company details

Market cap:	Rs. 4,134 cr
52-week high/low:	Rs. 313 / 202
NSE volume: (No of shares)	1.7 lakh
BSE code:	539787
NSE code:	HCG
Free float: (No of shares)	4.0 cr

Shareholding (%)

Promoters	71.4
FII	7.0
DII	5.9
Others	15.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.7	9.5	30.1	44.0
Relative to Sensex	10.6	17.6	37.8	44.0

Sharekhan Research, Bloomberg

Summary

- Healthcare Global Enterprises Limited (HCG) is planning to expand its bed capacity by 8-10% from existing operational capacity of 1,702 beds (total bed capacity of 1,944) through the organic and inorganic route over the next two to three years.
- The company has cash kitty of close to Rs. 200 crore, which will take care of acquisition of new hospital and bed capacity addition in the existing facility.
- The company indicated of maintaining strong growth momentum achieved in the past few quarters; we expect revenue and EBITDA to grow by 16% and 28%, respectively (with EBITDA margins standing at 17.5%) in Q1FY2023.
- Strong growth prospects, prudent capital allocation plan, and lean balance sheet make HCG one of the better picks in the hospital space. We retain our Positive stance with a potential upside of 18% from current levels.

Healthcare Global Enterprises Limited (HCG) is planning to enhance its bed capacity by 8-10% through organic and inorganic initiatives from existing operational bed capacity of 1,702 beds (total bed capacity of 1,944). The company has acquired Radiant Hospitals Services (Radiant Hospitals) with radiation therapy centre and its assets at Sambalpur, Odisha, for cash consideration of Rs. 16 crore. The company will be adding around 125 beds including a Greenfield 25 bed capacity in Bangalore and 100 beds in one of its facilities in Ahmedabad. The company has close to Rs. 200 crore of cash on its books, which can be utilised for its organic and inorganic initiatives. Further, the company has hired consultants, Ernst & Young and Alvarez & Marsal India, to provide consultancy services to improve profitability in the coming years. The company expects growth momentum sustained in the past few quarters to stay in the quarters ahead with continued improvement in profitability.

- **Event – Acquisition of radiation centre in Odisha:** HCG entered into business transfer agreement with Radiant Hospitals for the acquisition of its radiation therapy centre along with assets at Sambalpur, Odisha, for cash consideration of Rs. 16 crore. The centre was developed in June 2020. The acquisition is part of the company's initiative to focus on integrated end-to-end oncology scale-up. It will help HCG to gain more market share in Odisha market, where it has a strong position in the cities like Cuttack. The transaction is likely to be completed by July 2022.
- **Expanding the current bed capacity:** The company currently has operational bed capacity of 1,702 beds (overall bed capacity of 1,944 beds). It will be setting up a ~25 bed cancer care centre in Whitefield, Bangalore. HCG Medi-Surge Hospitals Private Limited, a subsidiary of the company, is expanding its existing facility from 100 beds to ~200 beds by setting up a new facility in Ahmedabad as the facility is operating at optimal capacity utilisation. Additional bed capacity is expected to come under operations from FY2024. Addition of 125-bed capacity will be done through internal accruals. HCG has cash kitty of close to Rs. 200 crore on its books.
- **Growth momentum to sustain in Q1FY2023:** HCG registered strong double-digit revenue growth and consistent improvement in EBITDA margin for six consecutive quarters. The company has indicated of maintaining its growth momentum in the coming quarters. We expect revenue to grow by 15-16% y-o-y to Rs. 370 crore-375 crore in Q1FY2023 with occupancy ratio at ~60% and 4-5% increase in ARPOB. With consistent improvement in the profitability of new facilities, we expect EBITDA margin to improve by 165 bps to 17.5%. EBITDA is expected to grow by 28% y-o-y to Rs. 65.4 crore.

Our Call

View – Retain Positive stance with a potential upside of 18%: HCG revenue and EBITDA grew by 13% and 24% over FY2019-FY2022. With additional bed capacity, market share gains in key markets and better capacity utilisation for existing facilities would help the company's revenue to grow in double digits over the next two-three years. Further, the company has built a digital platform for patient acquisition through improved communication, which will help it add new patients consistently. Consistent double-digit earnings growth along with margin expansion and lean balance sheet with prudent capital allocation plan make it a good pick in the hospital space. The stock is currently trading at 14.6x/11.8x its FY2023E/FY2024E EV/EBITDA. We maintain our Positive stance with a potential upside of 18% over the next 12 months.

Key Risks

Any pandemic-led disruption, slow scale-up in new centres, and increased competition for top players would act as key risk to our earnings estimates in the medium term.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	1,013	1,398	1,594	1,785
EBITDA Margin (%)	12.5	17.0	18.0	19.2
Adjusted PAT	-127	-12	45	102
Adjusted EPS (Rs.)	-9.2	-0.9	3.3	7.3
P/E (x)	-	-	91.2	40.5
P/B (x)	5.3	4.7	4.5	4.1
EV/EBITDA (x)	33.4	18.6	14.6	11.8
RoNW (%)	-	-	5.1	10.5
RoCE (%)	-	5.0	7.6	11.1

Source: Company; Sharekhan estimates

Acquisition of oncology facility in Odisha

HCG entered business transfer agreement with Radiant Hospitals for the acquisition of its radiation therapy centre along with assets at Sambalpur, Odisha, for cash consideration of Rs. 16 crore. The hospital was developed in June 2020. The acquisition is part of the company's initiative to focus on integrated end-to-end oncology scale-up. It will help HCG to gain more market share in the Odisha market, where it has a strong position in a city like Cuttack. The transaction is likely to be complete by July 2022.

Expanding the existing bed capacity

The company is in the process of setting up a ~25 bed cancer care centre in Whitefield, Bangalore. The company is in advanced discussion with the landlord for entering into a definitive agreement for the premises on which the hospital would be set up. The company envisages a period of two years for the commencement of operations of the cancer centre. HCG Medi-Surge Hospitals Private Limited, a subsidiary of the company, is expanding the existing facility from 100 beds to ~200 beds by setting up a new facility in Ahmedabad. The new facility is expected to commence operations in FY2024. The company has already outlined a capex plan of Rs. 50 crore-75 crore to expand its bed capacity under the existing facilities and in technology and digital initiatives in the coming years.

To acquire a majority stake in NCHRI

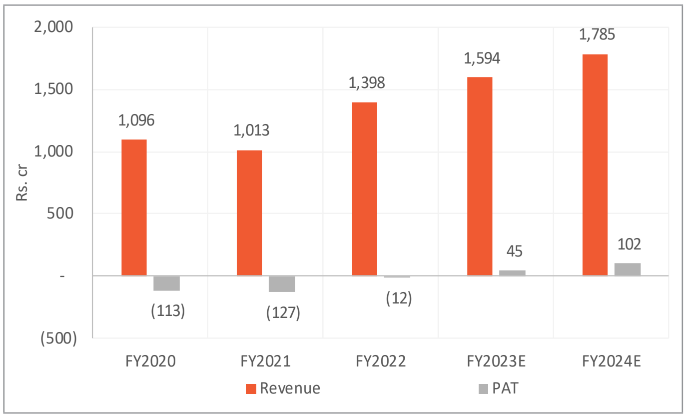
The company is considering acquiring 51% of the share capital of Nagpur Cancer Hospital and Research Institute Private Limited (NCHRI). NCHRI is a partner in HCG NCHRI Oncology LLP, a subsidiary of the company. The acquisition shall be subject to NCHRI obtaining requisite approval from NIT, and the company obtaining necessary approvals from the Board of Directors and execution of definitive agreements. The acquisition of majority stake in NCHRI will help to wipe out the rent cost for the facility in the Nagpur as land (currently held by NCRI) will come under the books of HCG.

Hired consultants to improve operating efficiency and margin-accretive growth

HCG has engaged Ernst & Young for launching an operational transformation programme for improving operating efficiency, patient care and experience, and capability enhancement. Further, the company has engaged Alvarez & Marsal India Pvt. Ltd. to provide consulting and advisory services for leveraging key strategic digital interventions for margin-accretive growth in the coming years.

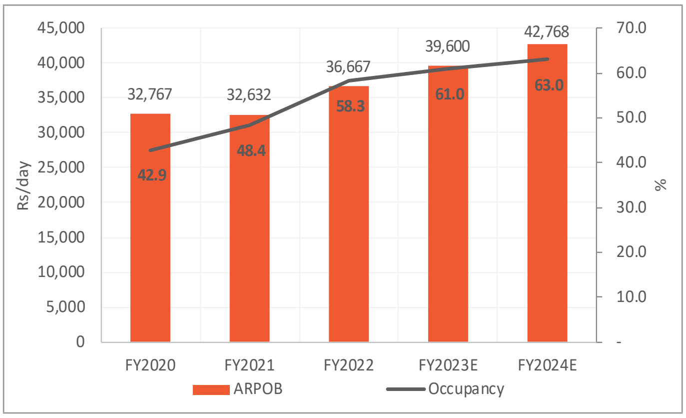
Financials in charts

Stable increase in revenues; Turn profitable by FY2023



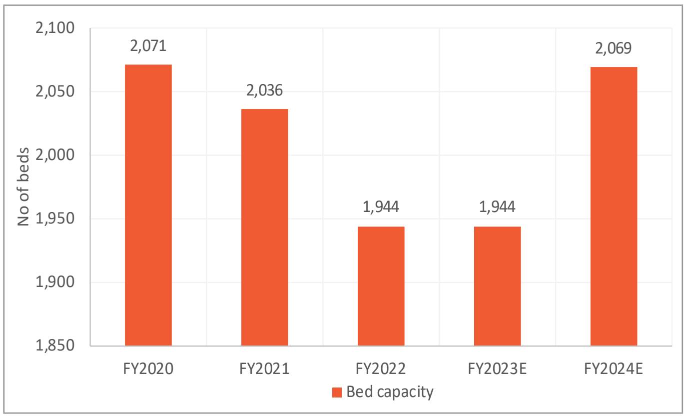
Source: Company, Sharekhan Research

Occupancy and ARPOB expected to improve



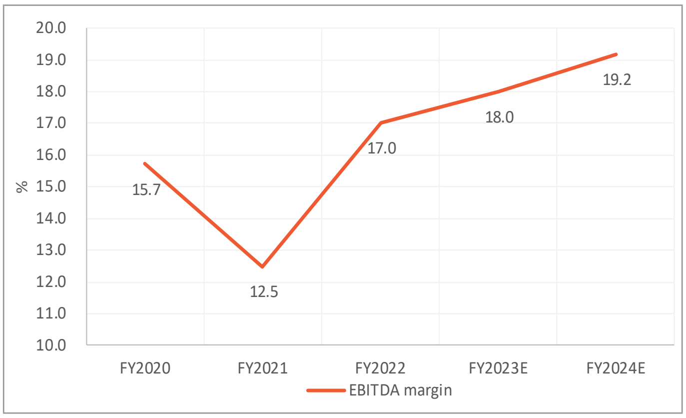
Source: Company, Sharekhan Research

Bed capacity to increase going ahead



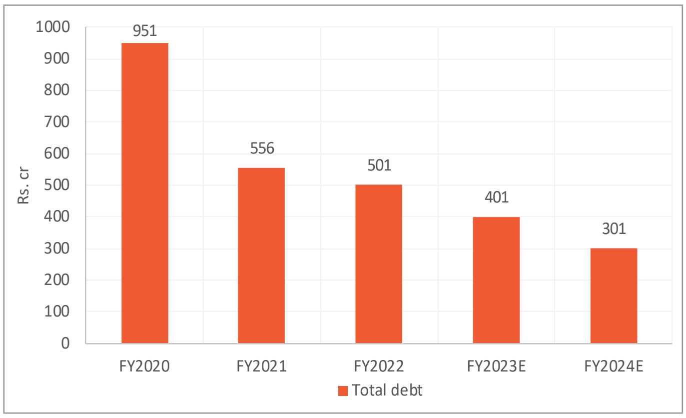
Source: Company, Sharekhan Research

Expansion in operating EBIDTA margin



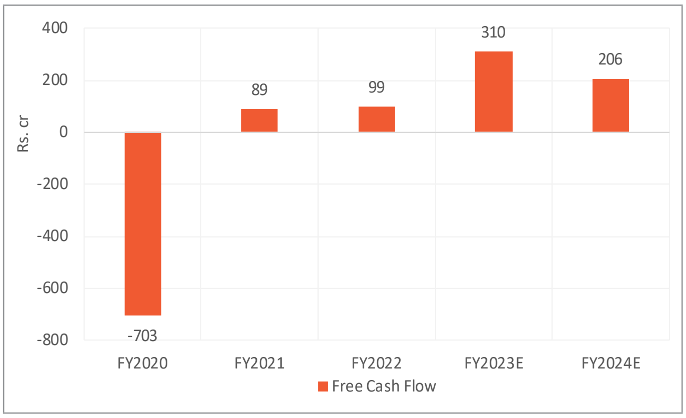
Source: Company, Sharekhan Research

Reduction in debt



Source: Company, Sharekhan Research

Increased free cash flow



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Oncology services to grow faster among others

Cancer is an increasing cause of morbidity and mortality in most countries. In India, the incidence of cancer is increasing and is becoming one of the major causes of death. Healthcare survey report suggests that growth in oncology mortality is a cause for concern and needs focused intervention. Cases are expected to grow at a rate of 12% over the next five years (tobacco-related cancer is expected to contribute ~27% to total cases). Rising population, higher consumption of tobacco/alcohol, increasing air pollution, and unhealthy diet are termed as some of the reasons for growing cancer cases globally (including India). Early detection reduces the risk of mortality rate. Oncology services are expected to grow faster in the coming years (also driven by growing awareness among the strata of population).

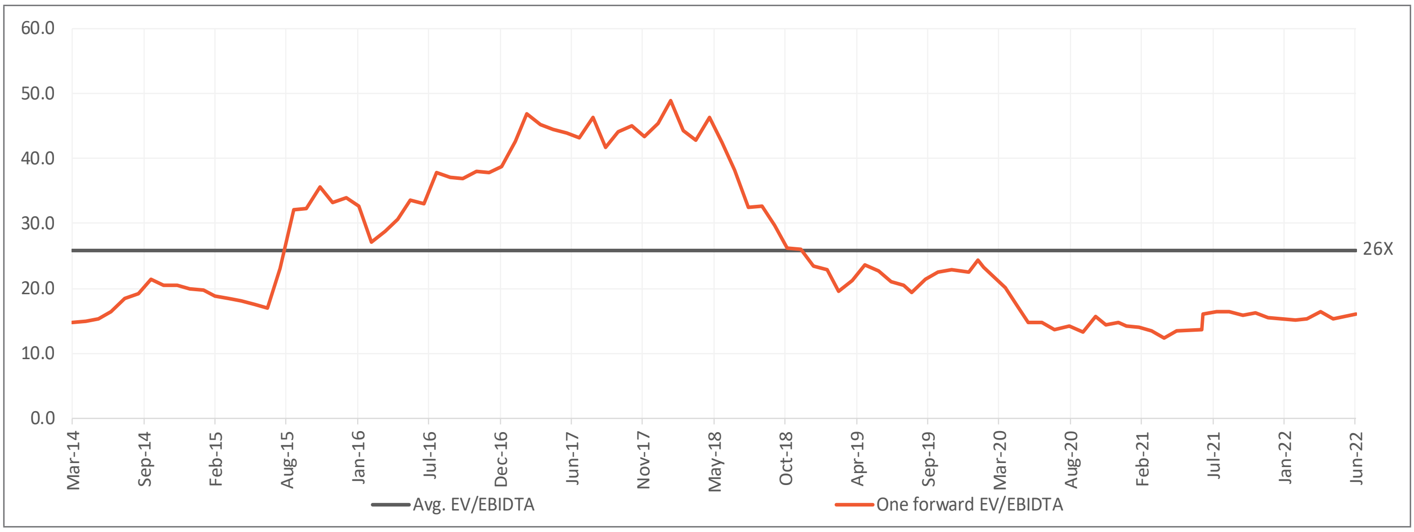
■ Company Outlook – Expected margin expansion and lower interest cost to drive PAT ahead

HCG's revenue to post a CAGR of 13% to Rs. 1,784.7 crore in FY2024, led by healthy improvement in key business fundamentals (including occupancy ARPOB). Scale-up in operations of new centres (will help them to fast breakeven) and increased contribution of Milann fertility services (~28% EBITDA margin) will help consolidated EBITDA margin to improve to 19% from 17% in FY2022. The company's PAT is expected to stand at Rs. 102 crore in FY2024 compared to loss of Rs. 12 crore in FY2022.

■ Valuation – Retain Positive stance with a potential upside of 18%

HCG revenue and EBITDA grew by 13% and 24% over FY2019-FY2022. With additional bed capacity, market share gains in key markets and better capacity utilisation for existing facilities would help the company's revenue to grow in double digits over the next two-three years. Further, the company has built a digital platform for patient acquisition through improved communication, which will help it add new patients consistently. Consistent double-digit earnings growth along with margin expansion and lean balance sheet with prudent capital allocation plan make it a good pick in the hospital space. The stock is currently trading at 14.6x/11.8x its FY2023E/FY2024E EV/EBITDA. We maintain our Positive stance with a potential upside of 18% over the next 12 months.

One-year forward EV/EBITDA chart



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Apollo Hospitals	41.0	49.9	37.8	26.5	23.0	19.0	20.6	17.5	19.9
Fortis Healthcare	23.1	37.6	29.3	18.4	17.1	14.8	9.0	7.2	8.5
Healthcare Global	-	91.2	40.5	18.6	14.6	11.8	-	5.1	10.5

Source: Company, Sharekhan estimates

About company

HCG, headquartered in Bengaluru, is the largest provider of cancer care in India under 'HCG' brand and a leading provider of fertility treatments under the 'Milann' brand. The company's network comprises 22 comprehensive cancer centres across India (21 centres) and Africa (1 centre in Kenya), seven fertility centres in Bengaluru and North India, and four multispecialty hospitals in Ahmedabad and Bhavnagar. HCG's comprehensive cancer centres provide expertise and advanced technologies for the effective diagnosis and treatment of cancer under one roof, while fertility centres provide integrated reproductive medicine services to its patients.

Investment theme

HCG is the largest hospital chain in India with specialisation in oncology treatment with 25 centres across India. Comprehensive centres with presence in non-metros, hub-and-spoke model, and promoters with strong expertise provide it a competitive edge over large multispecialty hospitals in India. Management is aiming at stark improvement in profitability, focusing on key levers such as reduction in ALOS (patient days stay in hospitals), providing specialised services, and scaling up the performance of new centres in the coming years. No major capex plan and focus on building up an asset-light model would help FCF to improve significantly over the next three years.

Key Risks

- Any delay in setting up new centres would impact our earnings estimates.
- Increased competition from top players would act as a key risk to our earnings estimates and profitability.

Additional Data

Key management personnel

Basavalinga Ajaikumar Sadashivaiah	Executive Chairman
Raj Gore	CEO
Srinivasa Raghavan	CFO
Sunu Manuel	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	International Finance Corp	3.14
2	Tata Asset Management Pvt Ltd	1.56
3	Wellington Management Group LLP	1.48
4	Gopi Chand Mammillapillai	1.25
5	Ahmadullah Zafar	1.09
6	Sundaram Asset Management Co Ltd	0.37
7	Nippon Life India Asset Management Co.	0.37
8	ICICI Prudential AMC	0.21
9	Investment Trust of India	0.08
10	Dimensional Fund Advisors	0.08

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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