

HEALTHCARE

Ind AS 116: Impact analysis on Healthcare companies

India Equity Research | Healthcare

Ind AS 116 will likely impact profitability, liabilities and valuations of hospital companies. The new accounting standard eliminates the classification between operating and finance lease, thereby recognising all leases on the lessee's balance sheet. This entails implications for hospital, diagnostic and pharmacy companies as they typically recognise operating lease on land and buildings, to create asset-light balance sheets. HCG, which has 20 of 26 hospitals on lease, will see the maximum impact-capital employed will increase by ~30% and EBITDA will jump ~50%. Apollo Hospitals' capital employed will rise ~30% and EBITDA will jump ~40%. While this will have a bearing on valuation metrics, especially of hospitals, there will be no impact on cash flows and little impact on RoCEs. In this report, we evaluate IndAS 116's impact on financials of companies.

Hospital companies – Bubbling Balance sheets and declining PAT

Apollo's INR3,200mn rent (~4% of revenue) is likely to result in 40% jump in EBITDA and ~30% increase in capital employed, thereby dragging down its EV/EBITDA multiple from 26x to 20x. PBT will fall ~30%. **HCG:** The company, with the highest rent as a percentage of revenue among hospitals i.e., ~6%, will see 50% increase in EBITDA and ~30% rise in capital employed. This will lower its EV/EBITDA multiple from 18x to 14x. PBT will also be eroded ~45%. **Aster DM:** Relying on the asset-light model, its EBITDA is likely to rise ~50%, PBT will fall ~40% and capital employed is likely to rise ~30%. **Max India:** With insignificant rent amount, EBITDA will rise only 15%, PBT will decline ~20% and capital employed will increase 10%. **Fortis:** PBT is least likely to be impacted with this accounting treatment on account of shorter lease tenure. However, EBITDA and capital employed will increase ~15% and ~5%, respectively. **Narayana Hrudayala:** It will have the lease impact as majority of its hospitals are either owned or under O&M. Only 10% of its rentals pertaining to equipment will come under Ind AS 116's purview. **Refer Table 1 on page 2.**

Diagnostic companies – No major impact

Thyrocare, with insignificant amount of operating lease, will not see any major impact on financial statements. However, **Dr Lal's** INR500mn rent (~5% of revenue) is likely to result in rise in EBITDA by 18% and capital employed will jump ~25%. PBT will not be significantly impacted on account of shorter lease tenure. **Refer Table 2 on page 2.**

Reset in the valuation methodology

As balance sheet expands and depreciation & interest replace rent, we estimate enterprise value as well as EBITDA to rise. Overall, the sector's EV/EBITDA is likely to dip from 19x to 16x, primarily due to Apollo (26x to 20x) and Aster DM (15x to 11x).

Refer detailed note on [Ind AS 116 "Dimming the light on asset lite models?"](#) for sector-wide analysis.

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Table 1: Impact on Ind AS 116 implementation on hospital companies

Company	Rent	Rent (%) revenues)	EBIDTA	PBT	Capital Employed	Facility details	Average Remaining Lease term (Yrs)	Impact on			
								EBIDTA (%)	PBT (%)	Capital Employed (Amount)	Capital Employed (%)
Apollo Hospitals	3,190	4%	7,932	1,712	66,870	Leased : 21 Owned : 44 S.A. : 5 Pharmacy - 100% leased	5 (Pharmacy) 25 (Hospitals)	40%	-31%	18,838	28%
HCG	550	7%	1,188	286	10,635	Leased : 20 Owned : 4 S.A. : 2	10	46%	-45%	3,380	32%
Aster Dm	3,197	5%	6,128	1,758	57,603	Leased : 13 Owned : 6 S.A. : 2	5 (Pharmacy) 20 (Hospitals)	52%	-37%	10,887	32%
Max India	336	1%	2,220	(450)	22,467	Leased : 3 Owned : 9 S.A. : 4	15	15%	-18%	2,556	11%
Fortis	914	2%	5,387	(9,649)	66,441	Leased : 7 Owned : 20 S.A. : 20	5	17%	-2%	3,465	5%
Narayana Hrudayalaya	69	0%	2,123	850	17,700	Owned : 15 S.A. : 8 Leased Equipments (10% of rent)	5	3%	-1%	262	1%

Table 2: Impact on Ind AS 116 implementation on diagnostic companies

Company	Rent	Rent (%) revenues)	EBIDTA	PBT	Capital Employed	Average Remaining Lease term (Yrs)	Impact on			
							EBIDTA (%)	PBT (%)	Capital Employed (Amount)	Capital Employed (%)
Dr Lal	488	5%	2,640	2,613	7,860	5	18%	-2%	1,854	24%
Thyrocare	52	1%	1,447	1,472	4,535	5	4%	-3%	197	4%

Note: Selection of different transition methodology and lease tenure will have different impact on its profitability and Balance Sheet

Source: Edelweiss research

Key assumptions considered for the above model:

- Lease rentals are discounted at 10% for computation of lease obligations and right-of-use (ROU) assets;
- ROU asset is depreciated on straight-line-method basis over the lease term;
- We have considered prospective transition methodology to arrive at the impact.

Table 3: Valuation table: Healthcare

INR mn	CMP	Target	Reco	Mcap (USD bn)	Sales (INR mn)			EBITDA (INR mn)			EPS (INR)			CAGR (%) (FY18-21E)	P/E (x)		EV/ EBITDA (x)	
	INR	Price			FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E		FY20E	FY21E	FY20E	FY21E
Apollo Hospitals	1,271	1,700	BUY	2.7	92,919	1,05,146	1,14,968	10,151	12,643	13,938	21.8	38.8	46.4	76.5	32.7	27.4	16.1	14.6
Fortis Healthcar	141	170	BUY	1.1	52,270	61,722	54,864	7,259	8,984	8,705	1.2	4.1	6.1	(196.9)	34.8	23.1	10.7	10.9
Max India (MHC)	70	110	BUY	0.3	26,426	29,899	34,639	1,210	1,547	1,758	(0.8)	(0.8)	(1.1)	4.9	NA	NA	12.2	12.0
HCG	204	265	BUY	0.3	9,521	11,018	12,740	1,350	1,607	1,852	0.0	(0.2)	(0.1)	(149.2)	NA	NA	15.0	13.5
Hospitals																	13.5	12.8
Dr. Lal Pathlabs	1,065	1,240	BUY	1.4	12,276	14,259	16,289	3,253	3,707	4,431	26.2	31.7	39.6	24.6	33.6	26.9	22.8	19.1
Thyrocare	516	500	HOLD	0.4	4,216	4,851	5,568	1,624	1,844	2,072	17.8	19.8	21.8	7.4	26.0	23.6	14.4	12.8
Diagnostics																	20.0	17.1

Source: Edelweiss research

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Coverage group(s) of stocks by primary analyst(s): Healthcare

Apollo Hospitals Enterprise, Dr. Lal Pathlabs Ltd, Fortis Healthcare Ltd., HealthCare Global Enterprises Limited, Max India Limited, Thyrocare Technologies Ltd

Recent Research

Date	Company	Title	Price (INR)	Recos
29-Mar-19	Healthcare	Growth muted on prolonged winter; <i>Result Preview</i>		
15-Feb-19	Fortis Healthcare	Operations stable during seasonally weak quarter; <i>Result Update</i>	135	Buy
12-Feb-19	Thyrocare Technologies	Disruptor gets disrupted; <i>Result Update</i>	496	Hold

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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