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IPO Note | Pharmaceutical
March 15, 2016

Healthcare Global Enterprises

Long term bet

Healthcare Global Enterprises Ltd(HCG) is one of the largest cancer care network in India in terms of the total number of private cancer treatment centers licensed by the AERB as of May 31, 2015. The HCG network was ranked second in India and first in the South India region and Bengaluru in the oncology segment in the Times Health All India Critical Care Hospital Ranking Survey 2016 while the Milann network was ranked first in India, the South India region and Bengaluru in the fertility segment in the same survey.

Dominant player in the Cancer Care industry: Despite high demand for comprehensive cancer care centres, India has only 200-250 comprehensive cancer centres, which represent just 1 per 6mn people V/s 1 per 0.2mn people in the US. Also, ~40% of these centres are located in the 8 metropolitan cities and fewer than 15% of these centres are government operated, which limits access to advanced and multimodal treatment options available to cancer patients. As a consequence, the majority of cancer care is expected to be provided by the private/for-profit sector in India. The HCG network is the largest provider of cancer care in India in terms of total number of private cancer treatment centres. As of December 31, 2015, HCG operated 18 HCG cancer centres, including 14 comprehensive cancer centres, 3 freestanding diagnostic centres and 1 day-care chemotherapy centre in India. Cancer centres contribute a major part of the overall revenues of the company.

Outlook and Valuation: HCG's sales have grown at a CAGR of 24.7% over FY2011-2015 and EBITDA grew by 19% during same period. However, HCG has exhibited a loss in FY2013-2014 primarily due to higher interest cost and depreciation. Currently the capacity utilisation of the hospitals at around 50% is lower and has some room for improvement. In terms of valuations, the company is valued at 3.3x-3.5x FY2016E (lower- upper ends of the price band) on P/BV basis. Its comparable peer Apollo Hospitals trades at 5.4x FY2016E P/BV. **Given the company has strong growth potential and would continue to enjoy pricing power in the long run, only long term investors should subscribe to the issues.**

Key Financials

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015
Net Sales	**267**	**338**	**451**	**519**
% chg	*24.1*	*26.9*	*33.4*	*15.1*
Net (loss)/Profit	**(3)**	**(11)**	**(36)**	**6**
% chg	-	-	-	-
EPS (₹)	-	-	-	**0.7**
EBITDA Margin (%)	15.5	13.7	8.5	14.7
P/E (x)	-	-	-	**294.5**
RoE (%)	(1.6)	(4.3)	(13.0)	2.3
RoCE (%)	4.3	2.9	0.4	6.6
P/BV (x)	8.8	6.5	7.0	6.6
EV/Sales (x)	7.5	6.2	4.6	3.9
EV/EBITDA (x)	48.3	45.2	53.9	26.5

Source: Company, Angel Research; Note :Valuations at upper price band and Equity post IPO

SUBSCRIBE

Issue Open: March 16, 2016
Issue Close: March 18, 2016

Issue Details
Face Value: ₹10
Present Eq. Paid up Capital: ₹7.35cr
Offer Sale:2.98cr Shares
Post Eq. Paid up Capital: ₹8.51cr
Issue (amount): ₹611-650cr
Price Band: ₹205-218
Post-issue implied mkt. cap ₹1745cr*- 1855cr**

*Note:*at Lower price band and **Upper price band*

Book Building	
QIBs	75%
Non-Institutional	15%
Retail	10%

Post Issue Shareholding Pattern(%)	
Promoters Group	25.1
MF/Banks/Indian FIs/FIIs/Public & Others	74.9

Sarabjit Kour Nangra
+91 22 3935 7800 Ext: 6806
sarabjit@angelbroking.com

Company background

HCG is a specialty healthcare provider in India focused on cancer and fertility. Under the HCG brand, the company operates the largest cancer care network in India. The HCG network consists of 14 comprehensive cancer centres, including its Centre of Excellence in Bengaluru, 3 freestanding diagnostic centres and 1 day-care chemotherapy centre, across India. HCG also provides fertility treatment under the "Milann" brand and provides clinical reference laboratory services in India with a specialisation in oncology, including molecular diagnostic services and genomic testing under the "Triesta" brand.

The HCG network operates through a "hub and spoke" model where the HCG Centre of Excellence in Bengaluru serves as a hub to the other cancer centres. Out of the 14 cancer centres under HCG's network, only four are owned and controlled by HCG while others are on joint venture or profit sharing basis.

Issue details

Through the IPO, HCG proposes to offer 2.98cr equity shares for sale by Promoter and Investors and fresh issues. While the company has put up around 1.82cr offer for sale shares, the fresh issues are upto 1.16cr shares. Out of offer for sale, Promoter group is offering 0.018cr shares, while other selling shareholders are offering 1.8cr shares. The company shall not receive any proceeds from the offer for sale. The net proceeds will be utilised for the following objects-

- Purchase of medical equipments (~₹42.2cr),
- Investment in information technology software, services and hardware (~₹30.2cr),
- Pre-payment of debt (~₹147.1cr), and
- General corporate purposes.

Exhibit 1: Shareholding pattern

Particulars	Pre-Issue		Post-Issue	
	No. of shares	(%)	No. of shares	(%)
Promoter group	21,161,084	28.8	19,482,401	22.9
Others	52,388,379	71.3	65,593,585	77.1
Total	73,475,986	100.0	85,075,986	100.0

Source: Company, Angel Research

Industry

Healthcare spending represented an estimated 4% of India's GDP in 2012. At a market value of US$81.3bn, India was the sixth largest healthcare market globally in 2014. The Indian healthcare industry comprises five segments: (i) hospitals, (ii) pharmaceuticals, (iii) medical insurance, (iv) medical equipment and supplies, and (v) diagnostics. The hospital segment comprised about 71% of the total healthcare revenue in India in 2012.

Healthcare delivery in India has two components - public and private. The public, ie the government healthcare system, focuses on addressing primary healthcare needs across India and particularly so in the rural areas. The government also manages secondary and tertiary care hospitals across India. The private sector comprises primarily secondary and tertiary care hospitals predominantly located in metropolitan, tier I and tier II cities. The private sector accounts for almost 72% of India's total healthcare expenditure.

The Indian healthcare industry is expected to grow at a CAGR of 17% between 2008 and 2020; and by 2020, the Indian healthcare industry is expected to have a market value of US$280bn.

The key drivers for the industry are –

- Socio-economic changes such as growing health awareness, increasing per-capita income, increasing penetration of health insurance, increasing instances of lifestyle diseases and an aging population.
- Technological advancements such as continuing development of mobile technology which will enhance the delivery of healthcare through telemedicine; affordability of healthcare in India, which will attract more patients. For example, treatment for major surgeries in India costs approximately 20% less than the cost in a developed country.
- Government policies in India that support the growth in the healthcare industry such as tax reliefs on hospitals in tier II and tier III cities, which will attract healthcare investment in these areas.

Amongst the segments HCG is present, Cancer and Fertility offer good potential for the company. According to a survey, prevalence of cancer in India is estimated to be in 3.9mn people (in 2015), with 1.1mn reported new cancer cases during the year. The real incidence of cancer in India could be significantly higher than the reported figure. Data from large randomised screening trials undertaken in India suggest that the real incidence of cancer could be 1.5 to 2 times higher than the reported incidence, or an estimated 1.6 to 2.2mn new cancer cases during 2015. Even at this level, it is lower than in the United States and China, which is around 1.7mn and 3.4mn respectively.

On the fertility front, estimated 220mn women in India are of reproductive age (between 20 and 44 years of age) and about 27.5mn couples in this group are estimated to be suffering from infertility. The number of infertile couples in India is expected to increase from 27.5mn in 2015 to between 29mn and 32mn by 2020. The total fertility rate (defined as the average number of children that would be born to a woman if she experiences the current fertility pattern throughout her reproductive span (15 to 49 years)) in India has witnessed a rapid decline over the last few decades, from 3.9 in 1990 to 2.3 in 2013.

Only 1% of 27.5mn couples suffering from infertility presented for fertility assessment and only 65,000 couples availed IVF (In-vitro fertilization) treatment.

The prevalence of infertility in India has been rising owing to (i) demographic changes with an increase in the number of women of reproductive age; (ii) lifestyle changes; (iii) prevalence of several known clinical factors; and (iv) ethnicity.

Key investment rational

Significant potential for the Cancer Care industry

Despite high demand for comprehensive cancer care centres, India has only 200-250 comprehensive cancer centres, which represent just 1 per 6mn people compared to 1 per 0.2mn people in the US. Also, ~40% of these centres are located in the 8 metropolitan cities and fewer than 15% of these centres are government operated, which limits access to advanced and multimodal treatment options available to cancer patients. As a consequence, the majority of cancer care is expected to be provided by the private/for-profit sector in India. India needs at least 450 to 550 comprehensive cancer centres by 2020, with a high proportion of such centres in non-metropolitan cities and towns.

In addition, there is a significant shortage of oncologists in India. India has only 1 oncologist per 1,600 cancer patients in India, against 1 per 100 cancer patients in the US as of 2014. Due to the limited access to cancer care in India and inability of significant sections of the population to pay for quality care, only around 15-20% of cancer patients are currently able to undergo radiation treatment in India, compared to a potential clinical need of 40-50% of cancer patients.

Dominant player in Cancer Care

The HCG network is the largest provider of cancer care in India in terms of total number of private cancer treatment centres. As of December 31, 2015, HCG operated 18 HCG cancer centres, including 14 comprehensive cancer centres, 3 freestanding diagnostic centres and 1 day-care chemotherapy centre in India. Cancer centres contribute a major part of the overall revenues of the company.

During the six months ended September 30, 2015 and FY2015, HCG registered 18,079 and 37,458 new cancer patients across its network and delivered radiation therapy to 6,163 and 12,647 patients, respectively. As of 1HFY2016 and FY2015, HCG network had 912 and 875 available operational beds respectively, which included intensive care unit (ICU) beds and day-care beds but excluded self-care beds. For 1HFY2016 and FY2015, HCG network recorded an average length of stay (ALOS) of 2.90 days and 3.00 days, an average occupancy rate (AOR) of 51.6% and 53.5% and an average revenue per occupied bed (ARPOB) of ₹26,685 per day and ₹24,467 per day, respectively.

Overall, HCG's avg. revenue per bed per day has increased at a CAGR of 13.8% over FY2013-2015. Patients treated with radiation therapy and chemotherapy administration has increased at a CAGR of 11.2% and 10.0%, respectively during FY2013-2015.

Entry into Fertility treatment industry

Fertility treatment is an emerging segment in the Indian healthcare industry which is currently relatively underdeveloped and fragmented. Of the estimated

27.5mn infertile couples in India, fewer than 0.3mn currently seek fertility treatment, owing to lack of awareness and access to fertility treatment, as well as high cost of treatment. Nonetheless, the number of In Vitro Fertilisation (IVF) cycles performed in India has increased from 7,000 in 2001 to 100,000 in 2015. Through acquisition of a 50.10% equity interest in BACC Healthcare, HCG now operates 4 Milann fertility centres in Bengaluru. The fragmentation of the market presents HCG with an opportunity to leverage the expertise of building the HCG brand into a nationally recognised speciality healthcare brand and to build and establish the Milann brand across India. Milann fertility centres provide comprehensive reproductive medicine services, including assisted reproduction, gynaecological endoscopy and fertility preservation. During FY2015, the Milann fertility centres registered 8,027 new patients and performed 1,111 IVF procedures.

Valuation

HCG's sales have grown at a CAGR of 24.7% over FY2011-2015 and EBITDA grew by 19% during same period. However, HCG has exhibited a loss in FY2013-2014 primarily due to higher interest cost and depreciation. There has been a dip in yoy sales growth in FY2015 due to reduction in Onco drugs on account of implementation of NLEM pricing. However, HCG guided towards margins remaining stable despite the fall in prices. Thus, while the company has been growing at higher growth rates, its profitability has been elusive, as the company has been in an expansion mode and the same has been financed through debt. Also, currently the capacity utilisation of the hospitals at around 50% is lower and has some room for improvement. Thus an improvement in margins along with improvement in capacity utilisation are key to achieve a high ROE and for the business to sustain.

In terms of valuations, the company is valued at 3.3x-3.5x FY2016E (lower- upper ends of the price band) on P/BV basis. Its comparable peer Apollo Hospitals trades at 5.4x FY2016E P/BV. On EV/sales, the company is trading at 3.0x-3.2x FY2016E V/s 3.3x FY2016E for Apollo Hospitals. On EV/EBDITA basis, the company is trading at 19.0-20.1xFY2016E V/s 18.8xFY2016E for Apollo Hospitals.

The company has strong growth potential and would continue to enjoy pricing power in the long run. Our estimates puts, that company will take around 3-4 years to get profitable like Apollo Hospitals and **hence only long term investors should subscribe to the issues.**

Risks for the company

- HCG's operations and proposed expansions are funded to a large extent by debt and any increase in interest expense may have an adverse effect on operations and financial condition.
- As of 1HFY2016, 33% revenues (₹93cr) were billed to the third party payers. In the past, there have been delays and non-payment by third-party payers (The third-party payers include; (i) central, state and local government bodies; (ii) private and public insurers, including third-party administrators acting on behalf of insurers; and (iii) corporate entities that pay for medical expenses of their employees and in certain cases, their dependents). As of November 30, 2015, HCG had outstanding gross receivables amounting to ₹90cr from third-party payers. Provisions for disallowances reduce the revenue from operations and provisions for doubtful trade receivables increases expenses and thus reduce the profitability.

- Capital intensive business, which makes it a more cash guzzling business, with higher paybacks.
- High concentration of geography and disease segment, which could impact the operations. More than 30% of the revenue is derived from single centre at Bengaluru, while Cancer accounts for almost >50% of sales of the company.
- Hospital segment is dependent upon high skilled workforce; hence any shortfall can restrict the growth plans.

Consolidated Profit & Loss Statement

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015
Gross sales	**267**	**338**	**451**	**519**
Less: Excise duty	-	-	-	-
Net sales	267	338	451	519
Other operating income	3.6	2.4	4.0	4.8
Total operating income	**270**	**341**	**455**	**524**
% chg	*24.1*	*26.1*	*33.6*	*15.1*
Total expenditure	225	292	413	443
Net raw materials	81	104	133	146
Personnel	42	54	77	82
Other	102	135	203	216
EBITDA	**41**	**46**	**38**	**76**
% chg		*12.1*	*(17.3)*	*99.7*
(% of Net Sales)	*15.5*	*13.7*	*8.5*	*14.7*
Depreciation& amortisation	24	30	36	36
Interest & other charges	24	29	32	32
Other income	-	-	-	-
(% of PBT)	-	-	-	-
Share in profit of Associates	-	-	-	-
Recurring PBT	**(3)**	**(10)**	**(30)**	**13**
% chg	-	-	-	-
Extraordinary expense/(Inc.)	-	-	-	-
PBT (reported)	**(3)**	**(10)**	**(30)**	**13**
Tax	0	1	5	(2)
(% of PBT)	*32.0*	*30.6*	*32.7*	*32.0*
PAT (reported)	**(3)**	**(11)**	**(32)**	**14**
Add: Share of earnings of asso.	-	-	-	-
Less: Minority interest (MI)	0	(0)	4	8
Prior period items	-	-	-	-
PAT after MI (reported)	**(3)**	**(11)**	**(36)**	**6**
ADJ. PAT	**(3)**	**(11)**	**(36)**	**6**
% chg	*53.5*	*211.8*	*235.8*	-
(% of Net Sales)	*(1.3)*	*(3.1)*	*(7.9)*	*1.2*
Basic EPS (₹)	**(0.4)**	**(1.2)**	**(4.2)**	**0.7**
Fully Diluted EPS (₹)	**(0.4)**	**(1.2)**	**(4.2)**	**0.7**
% chg	*53.5*	*211.8*	*235.8*	-

*Note: *EPS calculation is based on Post IPO outstanding shares*

Consolidated Balance Sheet

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015
SOURCES OF FUNDS				
Equity share capital	59.3	66.9	68.2	70.0
Preference Capital	-	-	-	-
Reserves & surplus	152	217	196	210
Shareholders funds	**211**	**283**	**264**	**280**
Minority Interest	8.2	12.6	18.3	25.3
Total loans	187	277	270	310
Deferred tax liability	(0)	1	1	(5)
Total liabilities	**406**	**574**	**553**	**609**
APPLICATION OF FUNDS				
Net block	**382**	**448**	**462**	**510**
Goodwill	10	61	60	61
Investments	0.2	61	2.3	0.1
Current assets	109	134	159	192
Cash	**17**	**11**	**26**	**27**
Loans & advances	6	7	8	9
Other	**86**	**116**	**126**	**156**
Current liabilities	98	134	136	161
Net current assets	**11**	**(0)**	**23**	**31**
Other Current Assets	3.0	5.0	5.0	8.0
Total assets	**406**	**574**	**553**	**609**

Consolidated Cash Flow Statement

Y/E March	FY2012	FY2013	FY2014	FY2015	FY2016E
Profit before tax	(3)	(10)	(30)	13	(3)
Depreciation	24	30	36	36	24
(Inc)/Dec in Working Capital	(0)	(41)	19	52	(0)
Less: Other income	-	-	-	-	-
Direct taxes paid	0	1	5	(2)	0
Cash Flow from Operations	**20**	**(23)**	**20**	**103**	**20**
(Inc.)/Dec.in Fixed Assets	(46)	(89)	(51)	(81)	(46)
(Inc.)/Dec. in Investments	-	-	-	-	-
Other income	-	-	-	-	-
Cash Flow from Investing	**(46)**	**(89)**	**(51)**	**(81)**	**(46)**
Issue of Equity	43	80	15	10	43
Inc./(Dec.) in loans	14	90	(8)	40	14
Dividend Paid (Incl. Tax)	-	-	-	-	-
Others	(31)	(64)	38	(70)	(31)
Cash Flow from Financing	**26**	**106**	**45**	**(20)**	**26**
Inc./(Dec.) in Cash	0	(6)	15	2	0
Opening Cash balances	**16**	**17**	**11**	**26**	**16**
Closing Cash balances	**17**	**11**	**26**	**27**	**17**

Research Team Tel: 022 - 39357800 E-mail: research@angelbroking.com Website: www.angelbroking.com

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