Max India:

Business

It has three business –

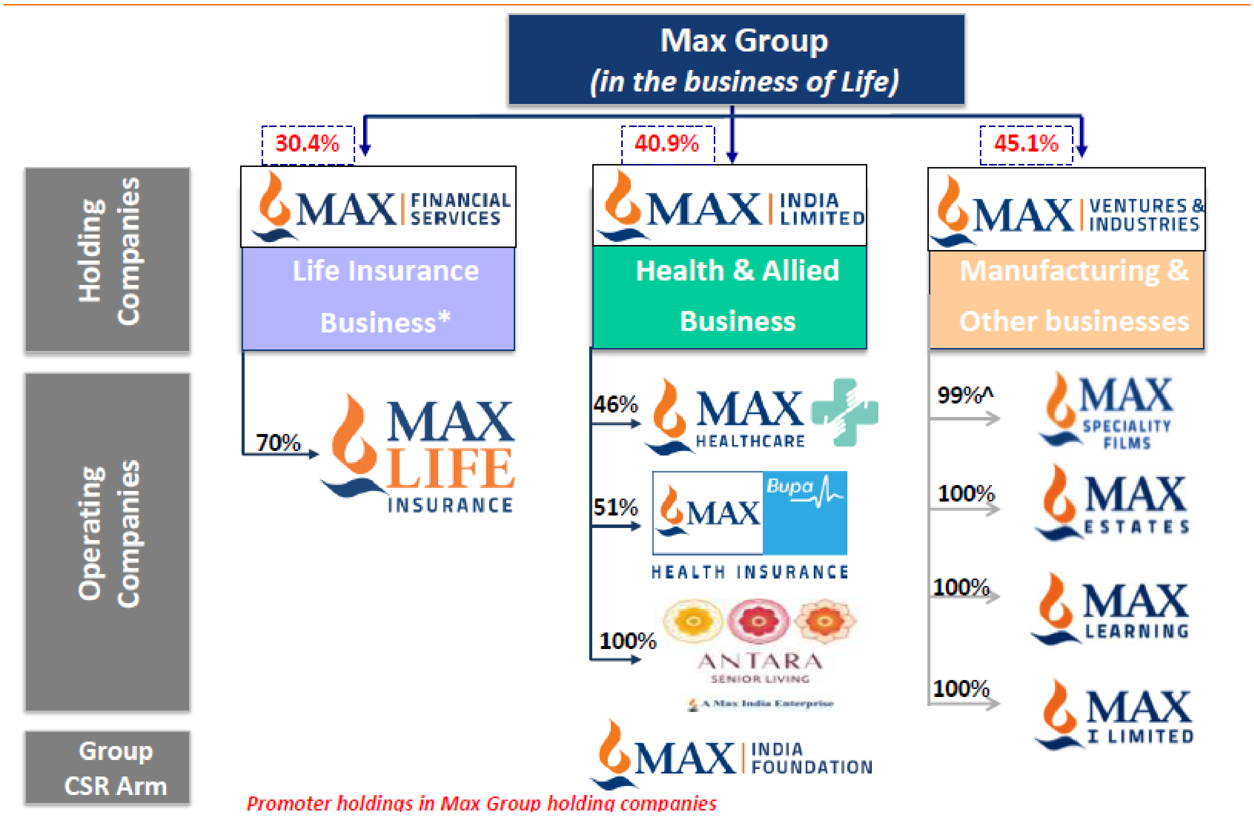
1. Max healthcare

   Max India owns 46% stake in Max health care which is a JV with Life Healthcare from South Africa. It has a total capacity of 2500 beds with 2400 beds which are operational. It is focused on tertiary and quaternary services. This business was launched in 2000

2. Max Bupa
   Launched in 2008, Max Bupa is 51:49 JV with Bupa which is one of the largest health insurance provider in UK. This business is expected to break even in 2019

3. Antara : senior living
   Launched in 2013, Antara is 100% subsidiary of Max India which is in the process of setting up senior living communities in India. The first community is operational in Dehradun

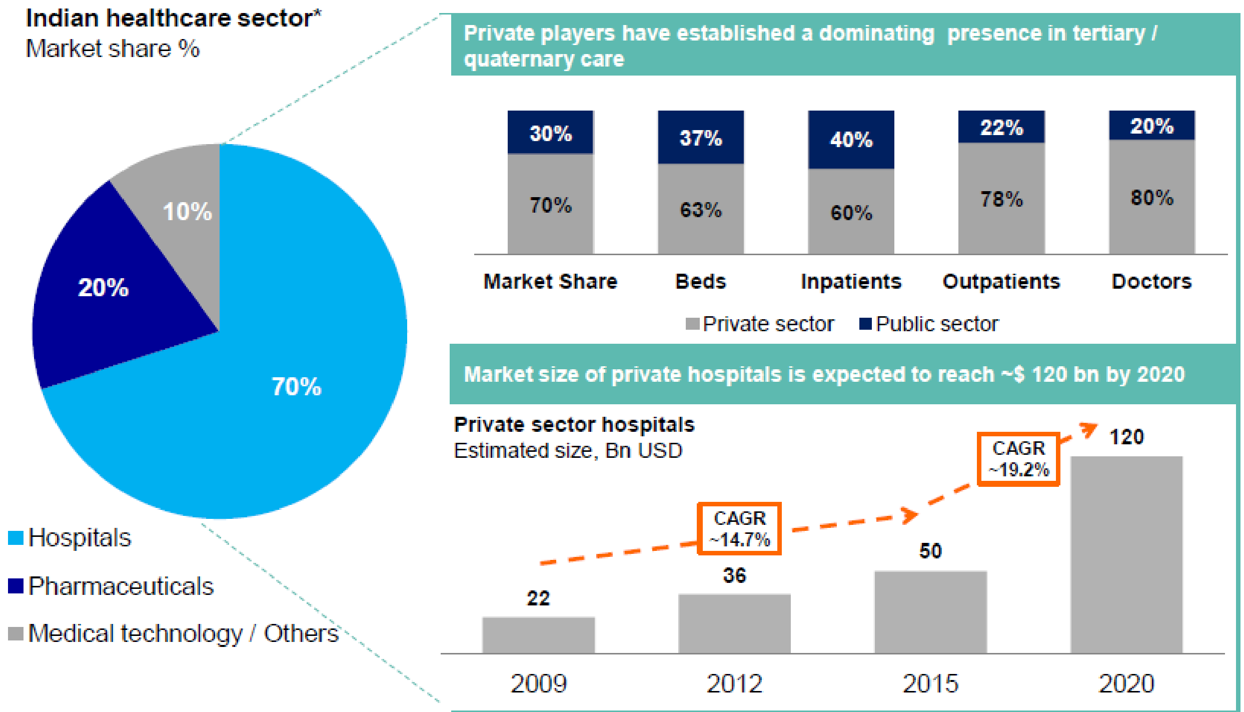
Corporate Structure



Market opportunity

- Indian healthcare market is expected to grow at 15% CAGR to a market size of $400bn by 2025.
- Private sector comprises 70% of the market share of the entire healthcare delivery market
- Hospitals accounting for 70% of the market

Hospitals constitute ~70% of Indian healthcare market with increasingly dominant role of private sector



Deals in healthcare sector

Scale up of well funded incumbents

	CURRENT SCALE	FUNDING (RS. CR.)		CURRENT SCALE	FUNDING (RS. CR.)
Apollo Hospitals	8,600	550, (2013 - KKR)	Narayana Health	6,500	290, (2014 - CDC)
Fortis Hospitals	4,800	820, (2013 - Stan Chart, IFC)	ManipalHospitals	4,900	900, (2015 - TPG Capital)
Medanta	1,300	700, (2015 - Temasek/Punj Lloyd)	CARE Hospitals	2,500 (2012)	560, (2012 - Advent)

Slide sourced from Bain and Company

Understanding hospital business

Hospitals are capex heavy business and take time to establish track record, attract quality doctors and get into deeper (tertiary care) which generate higher. It takes about 5 years to establish a hospital, to generate good EBITDA margin and ROCE. Post 5 years' operating leverage kicks in and hospitals can increase EBITDA faster without any incremental increase in cost.

Indicative numbers	Less than 5 years	Greater than 5 years
EBITDA margins	3-4%	15%
ROCE	0-3%	15-20%
Treatment	Basic	Tertiary

Key Terms in hospital business

- ALOS: Average length of stay. The shorter it is the better it is for the hospitals since hospitals make most of the monies in the first 2-3 days of the stay
- ARPOB : Average revenue per operating bed = (Revenue – other income)/(#Beds*utilization rates)
- ROIC = (Sales/Invested capital) * (Profit/sales)

  Turnover=Sales/Invested capital = ARPOB/Capital cost per operating bed

Operational efficiency (peer comparison)

Particulars	Max India	NH	Apollo	Fortis
No of operating beds	2400	5576	8600	3400
ALOS days	3.24	3.9	4.04	3.56
Occupancy/Utilozation	73%	57%	64%	73%
Capital Cost per operating bed (lakh)	75	27	75	75
ROCE	6.8%	14.2%	10.0%	3.9%
EBITDA margin %	11%	13%	12%	15%-16%
EBITDAR per operating bed (INR lakh)	18.5	9.5	18.8	22.30
ARPOB/p.a (INR Cr)	1.5	0.77	1.16	1.44
Turnover (ARPOB/capital cost per bed)	2.00	2.85	1.55	1.92
Growth	20-21%	18%	15%-16%	9%-10%
D/E	0.99x	0.19x		0.3x
% mature hospital beds	46%	32%		
Additional business	Health insurance			Diagnostic

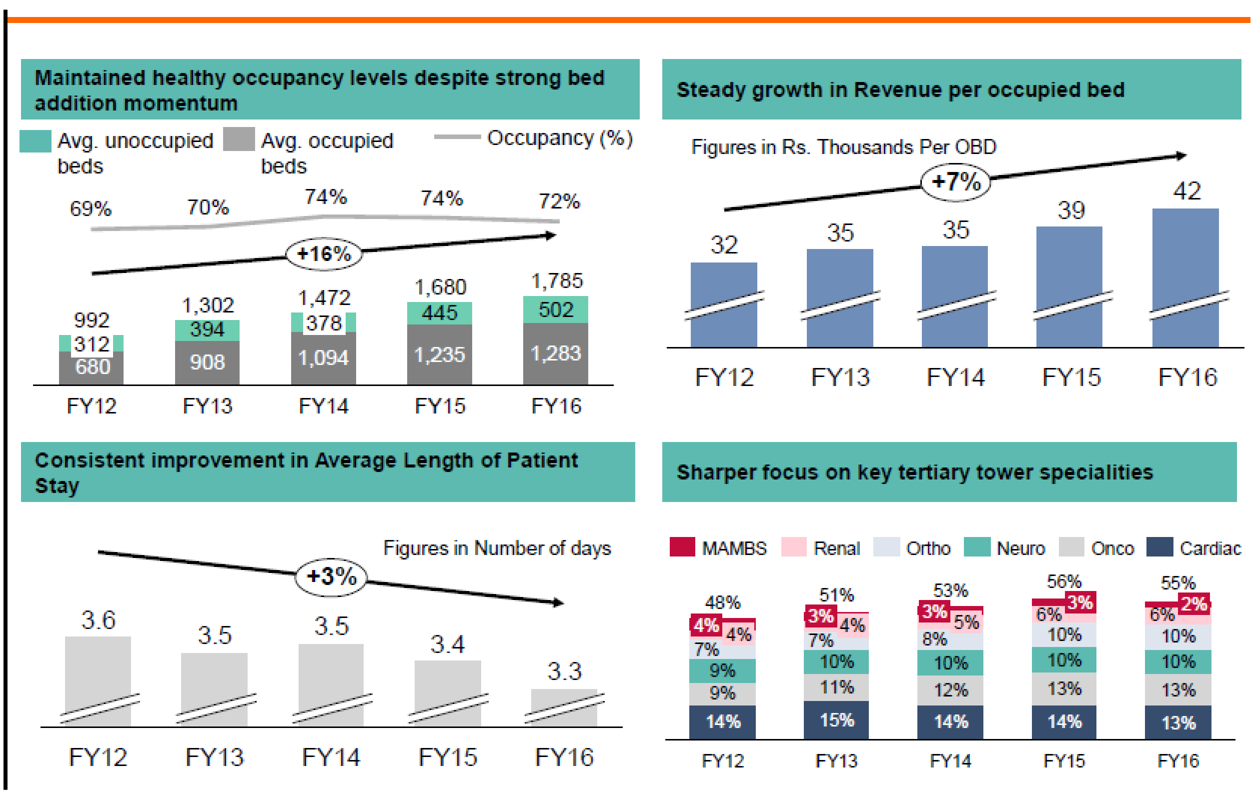
Notes

1) Mature units ROCE for Max in 19.2%
2) EBITDA has potential to improve;

Key insights:

- Max is the fastest growing hospital chain amongst the listed hospital business.
- It has superior operating parameters like higher ARPOB, lower ALOS, highest occupancy, and highest growth.
- Its turnover ratio of ARPOB/capital cost per bed is amongst the highest in the industry. (apart from NH)
- Management has guided on adding 1300 beds in 2-3 years and taking the capacity to 5000 in next 5-6 years.
- Currently it has lower EBITDA, ROCE since 40% of the hospitals are 3 years old. In the next 2 years both margins/ROCE are expected to improve as hospitals cross 5 years of existence. Management is confident of growing the hospital business by more than 20% in the future and also maintain/improve margins driven by heavy focus on cost rationalization.
- /Also given the sector tailwind and skewed ratio of bed per 1000 population and driven by medical tourism growth looks likely. Management has indicated a capex of 1000-1200 Cr in the next few years to add beds both organically and inorganically with optimal use of debt/equity

Track record of operational improvement



Lab business

Management has also indicated of taking out the captive lab for both B2B and B2C opportunities for external customers. This can generate of about 500 Cr of revenue annually after 2-3 years once it gets stabilized. This typically have a margin of 30%+ which will also boost the margin profile. Once they reach scale operating leverage kicks in and break even will happen in FY 19

Basically we are getting into the nursing homes and the smaller hospitals, and trying to run their lab and also going to clinics of the doctors, some of them even work with us, so that is the B2B strategy, where we are actually trying to get the samples into our labs and trying to improve the utilization level, so that is also in a way testing the market.B2C is basically we will go full out, with the strategy firmed up, as Mohit mentioned will be launched in end of Quarter-4.The endeavor is to really launch it in the NCR and go direct to the patients and be able to build a digital platform where we can get the patients to really log on and order for home

Over the next 5-6 years management estimates to generate 600 Cr revenue from the lab/pathology business, of which 300 cr could be external and 300 cr could be internal. Lab business has higher EBITDA margin and has both B2B and B2C potential; 20-25% EBITDA margin possible

Levers of value creation

1) Improvement of profitability of mature hospitals through improvement in speciality, channel mix and cost structure
2) Potential to add 2500+ beds to reach 5000+ beds hospitals
3) Expand pathology business

Case study of improvement of margins

1) <u>Pushpanjali hospitals 350 beds hospital</u>

Financial Turnaround

	Q2FY16	H2FY16	H1FY17	Q3FY17
Revenue* (cr)	12.2	15.5	17.0	18.0
EBITDA* (cr)	0.6	2.6	2.4	2.6
EBITDA (%)*	5%	17%	14%	15%
Occupancy	67%	64%	70%	68%

2) Saket City : 2000 beds hospital

	Dec 15	Q4FY16	H1FY17	Q3FY17
Revenue* (cr)	13.6	13.8	16.2	18.2
EBITDA* (cr)	-0.8	-0.52	1.45	2.09
EBITDA (%)*	-7%	-4%	9%	13%
Occupancy	69%	66%	75%	77%

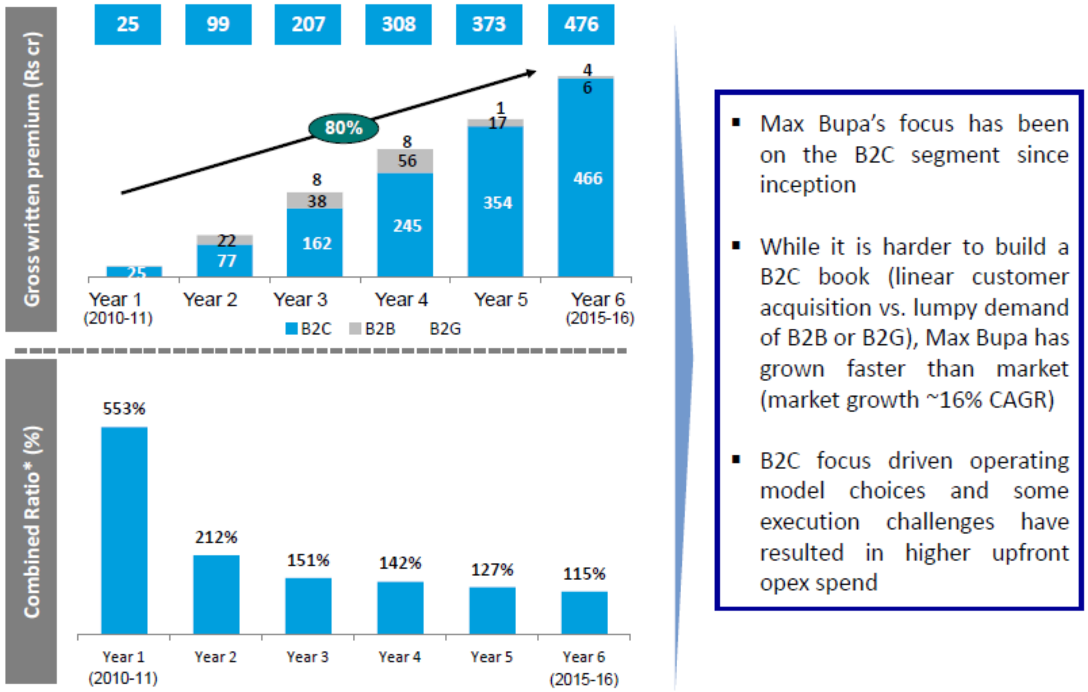
Health insurance business

Gross Premium of ` 476 crore (revenue) with about 13,000 agents and tie-ups with over 3,600 quality Hospitals across over 350 cities in India. <u>It has able to grow the business with improving claim ratios. It has one of the lowest claim ratio in the industry.</u> Current penetration of health insurance is only 0.2% of GDP and sector is expected to grow by 20-25%. Max Bupa is expected to grow faster than that.

<u>Industry trends</u>

1) Heavy investment to add capacity, Banca tie ups
2) Multiple product launches ; cancer care, dengue care
3) New entrants like Kotak, Aditya Birla, Edelweiss
4) Foreign players are increasing stake – Fairfax ICICI, Cigna – Cigna TTK,

Track record of the insurance business



Combined ratio is claim ratio + opex ratio + commission ratio. Max Bupa has the lowest claim ratio of 50% in the entire industry

Valuation

Hospital business		
EBITDA (FY 17)	300	Estimate
EV/EBITDA	25	
EV	7500	
Max India EV	3446	45.95%
Debt	1091	
Max healthcare equity valuation	2355	
Beds	2300	
EV per bed	1.5	
NW	1106	
Mcap	4200	
Intrinsic value	2943	

Health insurance	
GWP FY 16	476
GWP FY 17	533
GWP FY 18	640
EV	1152
Max India share	587.52

Basis EV/EBITDA = Valuation is 2943 Cr
Mcap = INR 4200 Cr

Investment Thesis

a) Healthcare delivery industry is expected to grow at 12 percent over the next 5 years. Being an organized and branded player Max India should grow its top line faster than the industry. This is evident from Max India recent sales growth there is a lot of unmet demand. Generating double digit sales growth shouldn't be a problem.

b) Apollo Hospital price-to-sales ratio for the last 10 years hovered between 1.64 to 3.98. Market capitalization of Max India is around 4200 crores. At a TTM sales of 2000 crores, this translates to a price-to-sales ratio of 2 Max India appears fairly priced on price-to-sales ratio.

c) There is an enormous operating leverage waiting to happen. My estimate is that over 5+ years hospitals will have a EBITDA margin of 14-16% and EBIT margin of 10%. If Max can generate a net profit margin of 3 to 5 percent and turn over its assets by 2 times then we can expect an ROIC of 15 to 18 percent.

d) There is massive unmet demand in the health insurance sector with India being one of the lowest in terms of penetration of health insurance. Currently Max Bupa is 7^{th} and its claim ratios are decreasing. It has tied up with banking channels which is expected to drive sales. The current GWP 0f 500 Cr can easily grow to 700-800 Cr in the next 3-4 years to take the valuation to 1500 Cr alone from the insurance business alone

e) Currently we are not assigning any value to the Antara which is a new concept. This itself can become a major business in times to come. Management might hive off these businesses separately to create value like it did with Max India

f) The promoters are good capital allocators

Promoters

Analjit Singh and family are reliable management with given track record of creating value and distributing it to shareholders. Max India was demerged in 201 into three new entities – Max Financial Services, Max India and Max Ventures and Industries leading to unlocking of additional 3500 Cr of shareholder value

Further the following restructuring will occur in the near term -

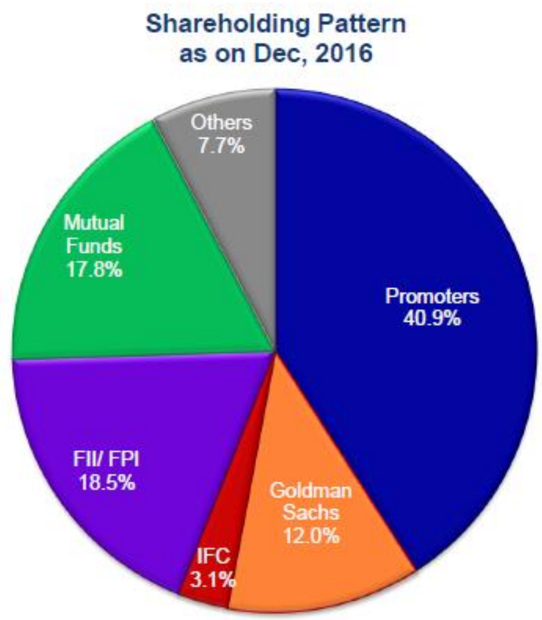
- Merger of Max Life into Max Financial Services
- Demerger of the life insurance undertaking from Max Financial Services into HDFC Life (i.e., the Merged insurance entity)
- Merger of Max Financial Services (holding the residual business) into Max India

Latest update: Increase in promoter holding

- Max India will raise funds from its Sponsor, Max Group's Founder and Chairman Emeritus Mr. Analjit Singh, by issuing warrants amounting to Rs. 300 crore at Rs. 154.76 per share of Max India, priced in accordance with SEBI guidelines.
- The total number of warrants issued will be 1,93,84,854 which translates to approx. 4% stake in the company for the Sponsors. The Sponsors' shareholding in the Company will increase to 45.12% as a result of this transaction

- A significant portion of the proceeds from this transaction will be utilized by Max India to acquire a 3.75% stake in its flagship business Max Healthcare (MHC) from International Finance Corporation (IFC), which owns a 7.5% stake in the latter company.
- IFC's balance 3.75% stake in MHC will be acquired by Max India's joint venture partner in MHC – the Life Healthcare Group, which is South Africa's second largest hospital chain. The total consideration for the stake acquisition will be Rs. 423 crore, translating to Rs. 105 per share of MHC.

Presence of long term capital providers



Risks

1) Government intervention on prices of healthcare – stent pricing
   Will not have much impact since cardiac business is not significant for max. Also all players will go back and negotiate the price with manufacturer
2) Permissions
3) Operational efficiency
4) Expansion