

B11012

Long term financing, EVA and MVA

Apollo Hospitals Enterprise Ltd

Major Sources of Funds (all figures in Rs Crores)

Apollo Hospitals Enterprise Ltd

Sources of funds	2006-07	2007-08	2008-09	2009-10	2010-11
Internal sources	88.25	97.56	114.51	155.03	192.64
Retained profits	58.22	61.03	71.36	101.56	127.37
Depreciation	30.03	36.53	43.15	53.47	65.27
External sources	99.79	586.37	203.56	273.92	146.91
Fresh capital	34.75	416.46	68.59	77.09	103.04
Long term borrowings	65.04	169.91	134.97	196.83	43.87
• Bank/Fin. Inst. borrowings	85.87	181.44	144.68	68.82	-112.98
• Debentures & bonds	-17.99	-7.59	-6.86	-7.71	100
• Foreign borrowings	-2.84	-3.94	-2.85	137.52	56.85

Fortis Healthcare

Sources of funds	2006-07	2007-08	2008-09	2009-10	2010-11
Internal sources	-39.75	11.65	-0.63	39.64	152.04
Retained profits	-48.88	1.98	-6.92	29.6	142.86
Depreciation	9.13	9.67	6.29	10.04	9.18
External sources	97.62	207.99	24.81	1705.03	505.64
Fresh capital	149.59	438.77	-77.83	752.19	1295.03
Long term borrowings	-51.97	-230.78	102.64	958.24	-789.39
• Bank/Fin. Inst. borrowings	-77.12	-315.87	56.91	-75.81	-29.03
• Debentures & bonds	0	0	0	260	-260
• Borrowings from corporate bodies	9.19	69.32	57.58	804.52	-946.23
• Foreign borrowings	20.45	-9.1	-6.44	-4.91	445.87
• Other borrowings	-4.49	24.87	-5.41	-25.56	0

Note:

1. Internal Sources = Retained profits + Depreciation
2. External Sources = Fresh Capital + Long-term borrowings

Conclusions:

1. The funding due to internal sources has picked up due to higher profits generated by Apollo. This can be attributed to **Apollo diversifying into insurance and pharmacy business** also. These

businesses have improved the overall profits of Apollo by good amounts. Additionally, new specialty and super-specialty hospitals have started operating, bringing in good revenues.

2. But, for Fortis there is no trend in internal source financing as the company is in a growth phase through organic as well as inorganic route. So, the interest payments made were huge which left nearly no part of earnings which could be ploughed back into business. It can be said that **“Fortis is working for bankers”**
3. Apollo is funded heavily by external sources. This can be attributed to infrastructure augmentation by the company. It has gone on an expansion spree and is investing in new technologies like Robotics to improve the efficiency of its hospitals, so that more patients can be served with the same bed capacity.
4. Fortis has also raised capital through equity as well as debt. But, financing through debt overshadows equity. This can be attributed to lack of good management at the top level. It has bought assets in that past and sold them. The style of functioning of the top management is not very clean.
5. For Apollo, the total share-holding of promoter group is 33.24 % which the promoters would not like to dilute further. So, they have taken the debenture and borrowing route lately to fund their expansion plans.

EVA and MVA computations (All figures in Rs crores)

EVA= NOPAT – Capital charge

NOPAT = Net operating profit after tax= EBIT- Tax

Capital invested = Net block – cash – loans and advances +net current assets

Apollo Hospitals

Year	EBIT	Tax	NOPAT	WACC	Capital invested	Capital charges	EVA
2006-07	152.054	35.56	116.494	8.56 %	381.72	32.67	83.824
2007-08	164.995	43.352	121.643	8.56 %	519.657	44.48	77.163
2008-09	198.573	54.169	144.404	8.56 %	819.73	70.17	74.234
2009-10	259.913	70.201	189.712	8.56 %	1014.48	86.83	102.882
2010-11	328.056	87.606	240.45	8.56 %	1283.3	109.85	130.6

Fortis Healthcare

Year	EBIT	Tax	NOPAT	WACC	Capital invested	Capital charges	EVA
2006-07	(10.6)	3.24	(1.384)	13 %	144.248	18.75	(20.14)
2007-08	6.79	5.25	0.154	13 %	126.142	16.398	(16.24)
2008-09	1.046	5.08	(4.034)	13 %	125.586	16.33	(20.36)
2009-10	11.548	0	11.548	13 %	128.421	16.69	(5.15)
2010-11	12.955	0	12.955	13 %	141.054	18.33	(5.38)

To calculate market value, the closing price on 31st March of that year has been taken for BSE

MVA = Market value of equity – Book value of equity

Apollo Hospitals

Year	Book Value of Equity	Market Value of equity	MVA
2006-07	788.261	1812.72	1024.46
2007-08	1333.158	2479.44	1146.282
2008-09	1495.421	2458.8	963.379
2009-10	1677.619	4509.69	2832.07
2010-11	1923.82	5876.3	3952.48

Fortis Healthcare

Year	Book Value of Equity	Market Value of equity	MVA
2006-07	NA	NA	NA
2007-08	723.31	1840.8	1117.49
2008-09	787.88	1561.27	773.39
2009-10	1577.9	5838.32	4260.42
2010-11	3014.75	6181.83	3167.08

Historical performance of the companies

1. Apollo:

- Apollo has charted a graph of stable growth, and has met the expectations of the street.
- The management is strong and cohesive, there are no succession issues and the transition to the next generation has been smooth.
- We have seen that Apollo keeps a healthy and stable mix of equity and debt, thus using financial leverage.
- Apollo has been consistently giving fair dividends to its shareholders and thus thinking about their welfare.
- If we track price of Apollo's stock for the past five years, then we see an increase from Rs 170 then to Rs 580 now, which is a good performance.

2. Fortis:

- It's a typical company where the promoters are not following a concrete strategy and are changing tactics every year.
- The only thing in favour of the company right now is that it's group had Ranbaxy under its umbrella.
- Right now, succession issues et al are plaguing the company.

- The company has not been able to remove red from its books, and it seems that it will be unable to do so in the near future due to heavy debt.

Which is better: EVA or MVA?

EVA is used to gauge the operating efficiency of a company, whereas MVA tells about the perception of the company among the investors.

For the healthcare industry, we observe that EVA is positive for Apollo at all times, whereas it is negative for Fortis at all times. It clearly, tells us that Apollo's operations are better streamlines as compared to Fortis and Apollo is utilizing its capacity optimally.

In our case, MVA is positive for both the companies, but it is driven by sentiment. Moreover, for a company which has low trading volumes on the bourses, it is easy to manipulate the share price and thus increase (or decrease) the MVA.

EVA v/s Price, P/E, P/BV

Year	2008-09	2008-09	2009-10	2009-10	2010-11	2010-11
Company	Apollo	Fortis	Apollo	Fortis	Apollo	Fortis
Price of share (CLOSING PRICE ON 31 MARCH)	204.1	204.1	364.95	364.95	471.2	364.95
P/BV(price/book value)	0.0139	0.0154	0.022	0.0176	0.0261	0.01085
P/E(Price/EPS)	23.760	221.84	32.73	139.293	31.752	112.98

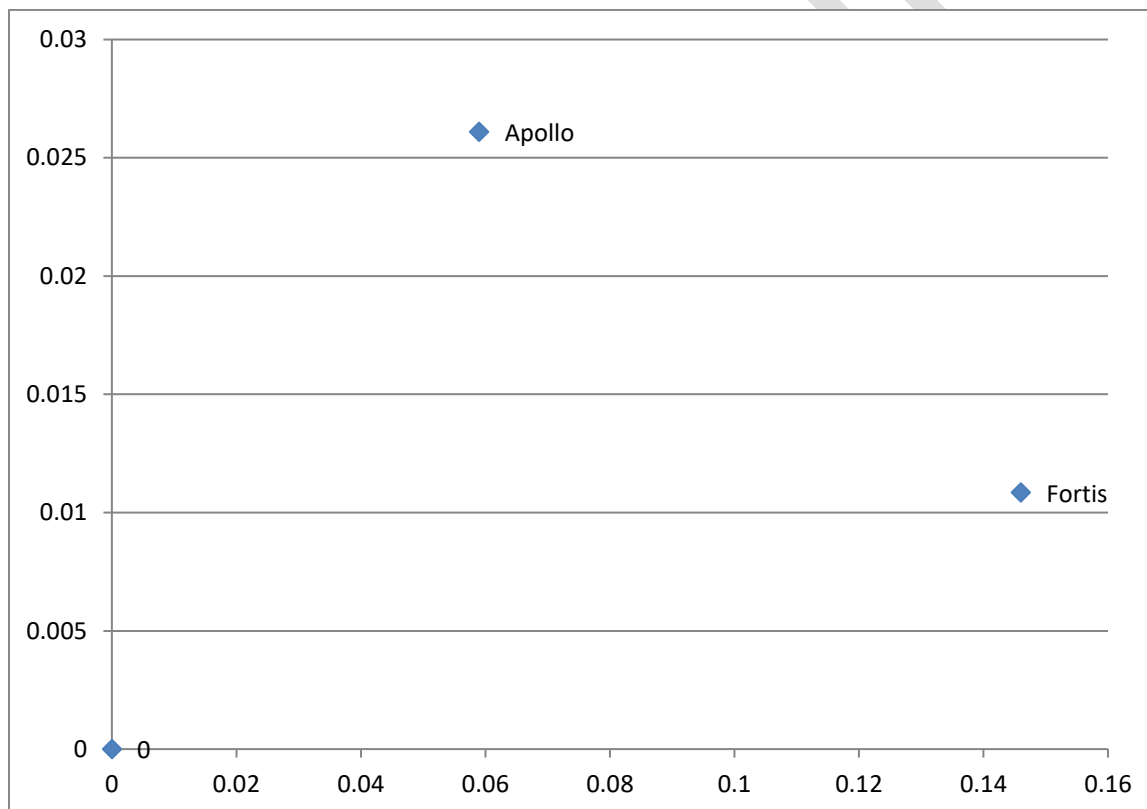
In the case of Apollo, P/E will give nearly same results about the health of the company as given by EVA. But, for Fortis P/ BV is a better measure as it is used for companies whose balance sheet are stressed. Also, with companies in a sector like Hospitals which needs high investment and long gestation periods, finding the health of a company in the short term using EVA may prove to be fatal.

Comparison between RoOA/WACC and P/ BV

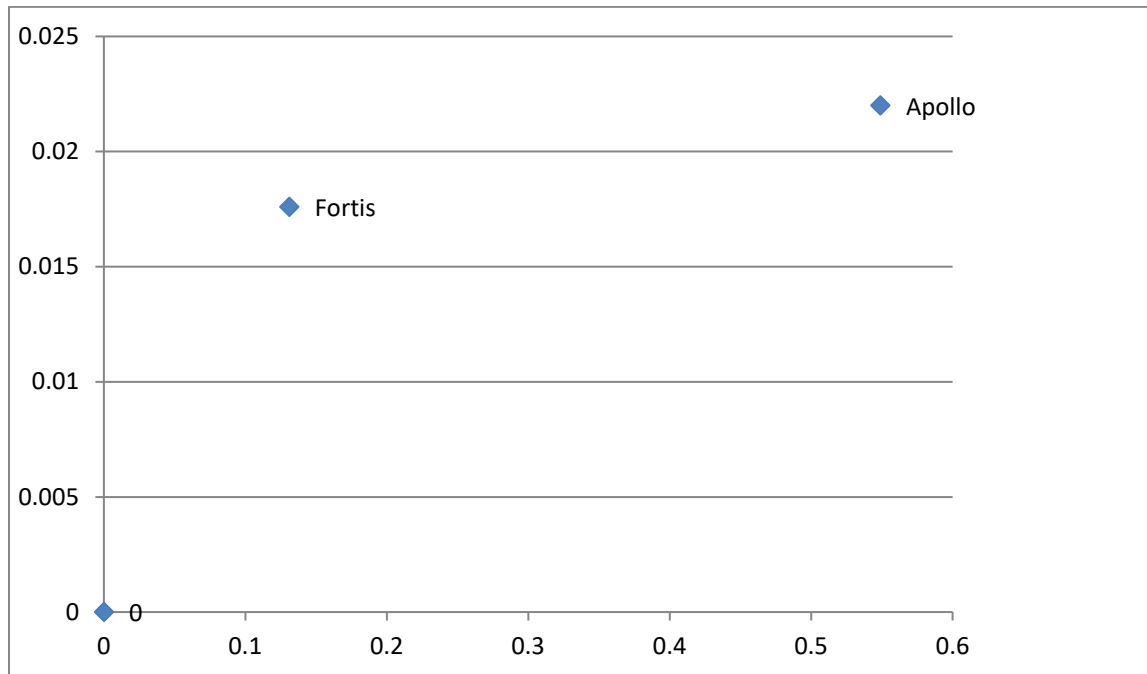
Year	2008-09	2008-09	2009-10	2009-10	2010-11	2010-11
Particulars	Apollo	Fortis	Apollo	Fortis	Apollo	Fortis
RoOA(return on operating assets)			0.047	0.017	0.051	0.019
RoOA / WACC			0.549	0.131	0.059	0.146
P/ BV	0.0139	0.0154	0.022	0.0176	0.0261	0.01085

We draw graphs between P/BV on y-axis and RoOA/ WACC on x-axis:

For 2011:



For 2010:



The variations in the above two graphs is mainly due to the change in P/BV of Fortis which is because of change in its capital structure. For Apollo, change from 2010 to 2011 is healthy as the company has moved towards better operating efficiency.