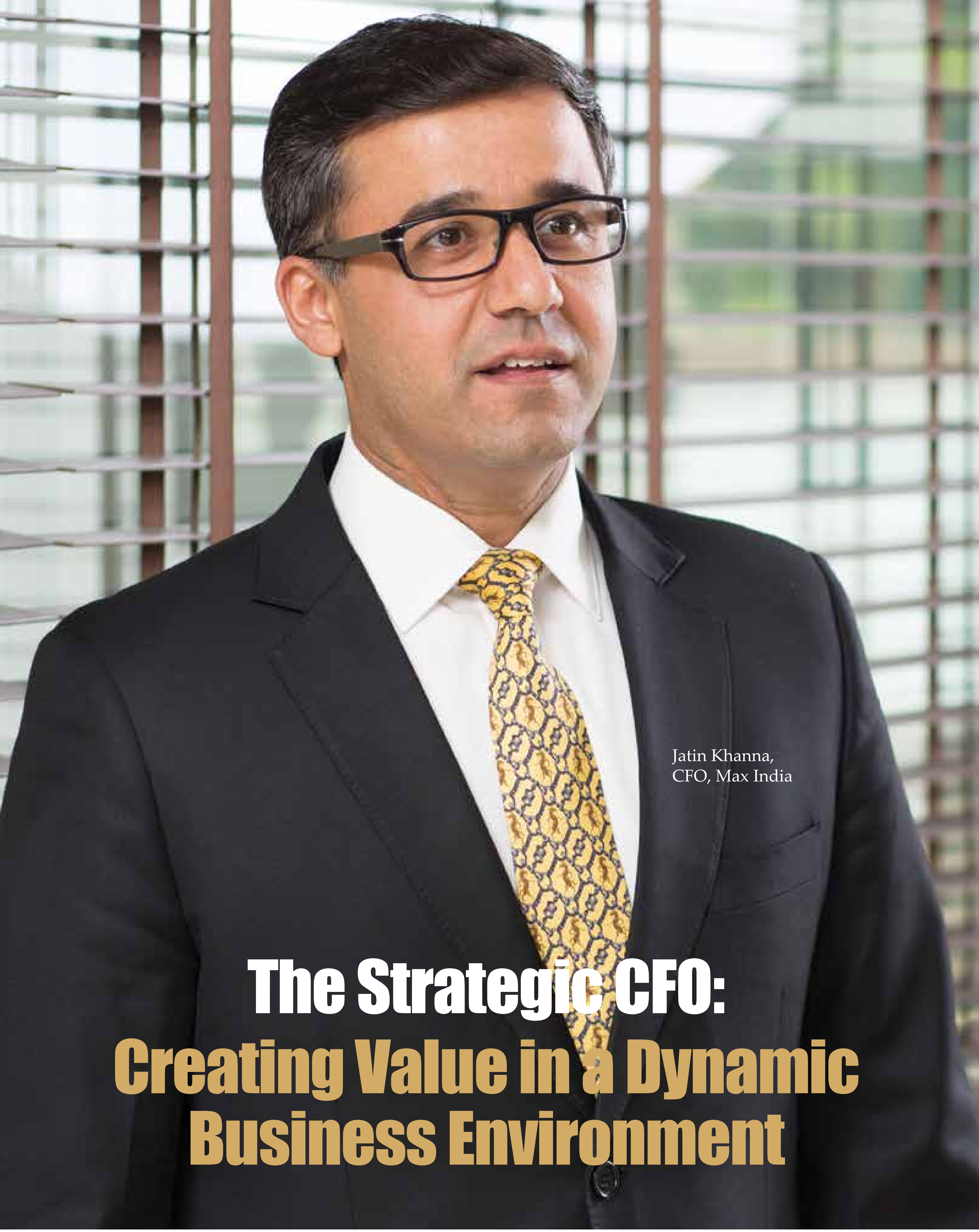

Jatin Khanna,
CFO, Max India

The Strategic CFO: Creating Value in a Dynamic Business Environment

In today's world, for organisations to stay relevant and build scale, CFOs must possess specialised skills, including the ability to navigate inorganic growth paths. M&A as a route to acquire unique capabilities or product portfolios, or indeed, to expand internationally, will see considerable activity, but in ways markedly different from the last phase of Indian industry's expansion. The CFO's position is crucial to the success of an M&A deal. From the identification of targets, to due-diligence, risk mitigation, fund-raising and post-close execution, CFOs are expected to have well-rounded capabilities that help effectively manage acquisitions, and deliver the promised shareholder value. Jatin Khanna, CFO of Max India, is one such multi-faceted individual who has actually delivered to promise.

At Max India, Mr Khanna wears many hats, as head of both Corporate Finance, and the Shared Services SBU. Truly, he is a strategist, dealmaker, risk officer, and growth leader, all in one. Under his guidance, all of Max India's operating companies have gained strong momentum, and are set on a path to profitability, despite facing multiple headwinds during the year, including demonetisation and regulatory interventions.

Mr Khanna architected the plan to demerge Max India into three listed companies – Max Financial Services, Max India, and Max Ventures and Industries. This included restructuring the businesses to provide structural clarity to investors, thus giving them the choice of participating in the growth of different verticals. The demerger helped segregate services businesses from the manufacturing ones, while ensuring that the Group's entrepreneurial spirit was kept alive. The task was complex, requiring approvals from shareholders, creditors, the Registrar of Companies, and from the Income Tax and PF authorities. A lot of thought went into structuring each of the three verticals in terms of Board governance and their individual management teams. A separate Shared Services Centre was created to optimise the utilisation of resources and pruning of costs. Today, the combined market cap of the three entities amounts to over Rs 20,000 crores, reflecting a 4x growth from Rs 5,500 crores pre-demerger.

Under Mr Khanna's leadership, Max Healthcare acquired two prime hospitals in the Delhi/NCR regions, which led to a sharp increase in the debt-EBITDA levels. To manage the financial risk, the entire debt was refinanced with new terms – an increase in tenure from 10 to 15 years; no prepayment for the initial two years; and marginal repayments for another two. The company's management is positive about the scale-up in earnings, and expects debt levels to be at healthy levels at the time of repayment. Other risks related to integration and people were effectively handled through a dedicated 'integration management team'. As a result of these efforts, both the entities were turned around from negative operating profits to high-teen margins within a year.

> The demerger of Max India into three separate entities provided structural clarity and an opportunity to investors to participate in the growth of different verticals

The next few pages evaluate Mr Khanna's role in strategising and executing M&A transactions to create lasting shareholder value.

The Big Picture

What are Max India's strategic goals for the next 3-5 years?

Apart from being in hugely under-penetrated sectors with high growth potential, Max India's key operating businesses are in the growth phases of their respective journeys, and represent a unique investment opportunity as well as a resilient business model. We have a clear vision of what we want to achieve in our businesses going forward. While growth is certainly an important aspect of this vision, we place equal, if not more, emphasis on our quality and service-delivery standards. The nature of our businesses is such that it requires constant self-vigilance and introspection for us to ensure that we continue to establish new industry benchmarks and treat our customers the way we would like to be treated with fair, honest and transparent pricing and communication.

Our flagship business, Max Healthcare is on its way to become an admirable institution known for service excellence, medical excellence, scientific research, and medical education. It has a clear objective of becoming the largest private healthcare player in North India by increasing its existing capacity from 2,500 beds to 5,500 beds over the next 5-7 years by capitalising on expansion opportunities in the existing locations and land parcels.

Additionally, we have recently started investing in certain alternate business models such as Max Labs (our pathology business) and Max @ Home (our digitally delivered home care vertical) and Onco day care centres. Over the next few years, our focus will be on scaling up these verticals profitably to grow a few of them to Unicorns.

With Max Bupa, the objective is to create the most admired health insurance company, which helps customers live healthier, more successful lives. Through product and service differentiation, we seek to create a profitable franchise that delivers sustainable growth. Since inception, we have launched various first-to-industry innovations, including highest sum insured options, no age restrictions for enrolment, no claim loading, guaranteed renewability, in-house claims processing and 30 minutes claims settlement. We have recently launched a 'Health ATM' through which a customer can instantly buy a policy in less than 3 minutes. There are further product innovations in the pipeline that will sharpen the differentiated positioning of Max Bupa.

Antara is all set to make a perceptible difference in the life of progressive seniors who believe that age is just a number. With its first community at Dehradun delivering the promise of quality, cost and time, something very rarely observed in this sector, Antara is all set to grow its business in an asset-light manner by partnering with credible developers, and by bringing Antara's experience at home for the prospects till such time they make up their mind to move to one of Antara's communities.

Where would you position Finance in the achievement of these objectives? What role does finance play to enable business to manage change effectively?

Finance plays a critical role in all aspects of strategic planning, decision-making, implementation and monitoring, managing cash flows, financing decisions and capital allocation. While all of our operating businesses have their own autonomous and tenured Finance functions, the role of Corporate Finance is more geared towards fund-raising, capital allocation, and driving the overall corporate strategy, which includes formulating joint-ventures, crafting strategic partnerships, creating inorganic growth opportunities, steering corporate restructuring, and ensuring capital adequacy. Depending on the value creation potential of the each of these businesses, we balance out capital allocation from the holding company and new capital generation at the business unit level itself.

We are optimistic about the planned scale-up in earnings, which will help us service our debts comfortably

All the operating companies of Max India have gained strong momentum, and are set for a path towards profitability despite multiple headwinds during the year, including demonetisation and regulatory interventions. Are there any structural changes happening to the product or pricing mix? Going forward, what challenges do you foresee in maintaining this momentum?

At the outset, we appreciate the government's intent of ensuring the provision of affordable healthcare through regulatory interventions. As a consequence, healthcare providers will have to go through some structural changes in their pricing strategy, requiring rebalancing of price charged to under various heads. This price realignment is evident across the industry. Over time, this realignment would give hospitals the opportunity to differentiate themselves and hence command a premium on the basis of customer experience and service delivery, rather than on commodities like consumables, thereby improving overall service delivery standards in the industry.

Another key change has been the optimisation of cost structures to mitigate the impact of pricing regulations, so that the benefits of price regulations can be easily passed on to consumers. The supply chains are being reworked where healthcare providers are going direct to suppliers, thus eliminating the trade margins, which were earlier shared with distributors.

As we move forward, a key focus will be on ensuring that we continue to engage with the government and other key stakeholders in a structured and meaningful manner to arrive at mutually-agreeable solutions to some of these pressing issues. We will enhance our dialogue with the Ministry of Health and Family

Welfare, the Delhi State Government, industry bodies, and other key stakeholders.

Our health insurance business, on the contrary, is seeing regulatory tail winds. The regulator acknowledges that pricing is at an unsustainable low, with the combined ratios for PSU general insurers and top ten players running at around 131 per cent and 123 per cent, respectively. The regulator is now approving the much-justified price increases. At Max Bupa, we focus more on the B2C segment maintaining an attractive claim ratio of 55-60 per cent over the years. We avoid the B2B segment, where the claim experience is generally adverse. Needless to say, pricing tailwinds are helpful to keep this at sustainable levels. Beyond price regulations, certain other key focus areas include cost rationalisation, developing the capacity for direct procurement from manufacturers to eliminate trade margins and addressing the severe shortage in clinical talent and nursing staff.

The Indian healthcare system continues to grapple with myriad challenges, such as the focus on curative rather than preventive healthcare, a lack of healthcare financing, the significant trust deficit between patients and institutions, and limited skilled manpower. How will Max India continue to drive forward in its endeavour to deliver value for all its stakeholders?

Max India will continue to create value for its stakeholders through organic and sustainable growth. There are various aspects to this – augmenting existing capacities by ramping up occupancy rates; improving the service and channel mix by increasing focus on identified tertiary care specialities (i.e., oncology, neurology, transplants and cardiac); growing our revenues from international and walk-in patients in the overall mix. There is also prioritisation of structural cost rationalisation, where we were in the midst of taking out ~Rs 100 crore costs in FY18 further to Rs 100 crore costs taken out in fiscal 2016 and 2017. Brownfield expansion is also on the cards. New business models (Max Labs, Max @ Home, Onco Day care centre), and creating value arbitrage on account of inorganic acquisitions of distressed assets, make Max India the fastest growing healthcare chain in the country. Resilience in the fast-growing health insurance business, with its regulatory tailwinds, is the other factor that will ensure that Max India creates superlative value for its stakeholders.

> The dedicated integration management team helped us to effectively manage post-merger integration-related risks

Mergers and Acquisitions:

Recently, Max India demerged into three listed companies that unlocked massive shareholder value. What were the driving factors behind this decision? How long did the process take?

One of the main objectives of the restructuring was to provide structural clarity to investors and give them the choice to participate in the growth of different sectors/verticals. The second objective was to provide a sharper management focus to each underlying business. Due to their inherent features and priorities, each of the three holding companies is optimally positioned to guide its operating business on its respective growth journey.

The third was to unlock value for shareholders by eliminating the holding company discount, which was perceived to be in the 20-25 per cent range because of the conglomerate structure. A more accurate price discovery of each business vertical led to a 150 per cent increase in the share price from the time we started working on the demerger.

The demerger enabled a separate platform for investors to invest in businesses in a high-growth phase like healthcare and health insurance (Max India), as well as relatively stable business like life insurance (Max Financial Services). It helped segregate services from manufacturing without hampering the entrepreneurial spirit of the group.

The detailed business case was presented to the Max India Board and received an in-principle approval from Board in January 2015. It took one-and-a-half years to complete the entire process from filing of application with the High Court, to the listing of respective demerged entities, which was reasonable given the complexities involved.

What were the challenges that you had to undergo - at the level of regulation and then at the level of the organisational structures themselves?

The demerger was structured to vertically split Max India into three listed entities with mirror image shareholding. Though it had to go through a court process requiring approval from shareholders, creditors, the Registrar of Companies, and the Income Tax and PF authorities, the key challenge was essentially to timely navigate through these processes and secure multiple approvals. We had strong cross-functional core teams of 5-6 members from Finance, Taxation, Legal, Secretarial and Communication. Structuring the demerger required careful planning so that there are no issues around tax neutrality of the demerger. The ground work that we did with the help of our legal advisors was extremely helpful, and the entire process of getting the requisite approvals from various regulatory bodies and the High Court, despite being time consuming, was relatively smooth and free from any notable roadblocks.

Separately, a lot of thinking was required to structure each of the three verticals in terms of their Board Governance and respective management teams. Most of the corporate employees were transferred to Max India, while some of the employees were retained in Max Financial Services and Max Ventures and Industries, based on their competencies and skill-sets. We created a Shared Services SBU under Max India to ensure that the Group continues to capitalise on the strengths of its Corporate resources uninterrupted without any costs being duplicated for the holding companies and underlying businesses. In fact, as part of the demerger process, I transitioned from my role of managing Corporate Finance function to CFO of one of the verticals i.e. Max India, and I am also responsible for the Shared Services SBU, amongst others. Through this shared service set-up we have been able to achieve efficiencies in cost allocations with almost 50 per cent of the costs being cross-charged to the operating companies basis the time spent on various initiatives.

In terms of teams and morale, the softer elements are very hard to manage. How was this handled?

Employee retention was the most important challenge for us, and through active dialogue, and ensuring that the rights of employees were fully protected, we were able to retain most of the employees during the transition. Our employee communication on demerger was straightforward and consistent right from the beginning. At every stage, from the first announcement in January 2015, to the day of the demerger itself, we reassured the team through our communication that the restructuring would not impact them in any way. Internal flyers were sent to employees on every significant development on the demerger. It is equally commendable on the part of our HR function, which took proactive measures to ensure that the transition was as smooth as possible for the employees.

Clear, consistent and straight-forward communication with employees during the M&A process helped us retain most of our people

How do you expect to now unlock this value for the Group going forward? How does this reflect the Group's strategic vision? What is the vision, and how do you see the demerger aiding that?

We want to be, in a sense, a life operator, providing services through a person's life journey in healthcare, protection, education, savings, living, lifestyle and life-care through our businesses in life insurance, healthcare, health insurance, senior living, real estate and education. The demerger has enabled sharper focus on each of these verticals through Boards and management teams that have been configured as per the needs of the three verticals

I have already outlined our key priorities in the short-to-medium term for Max India, i.e., our healthcare, health insurance and senior living business. There are similar plans to grow each of our other verticals and underlying businesses profitably, both organically and inorganically. In the longer term, we would continue to explore various ways of unlocking shareholder value through corporate restructuring, hiving-off some businesses and listing the ones that achieve meaningful scale and profitability.

We have a distinct, engaged and thriving investor base for all three holding companies, who possess immense faith in the vision and promise of each of these companies. Since the demerger, we have seen various new institutional investors being added, including marquee global investors such as KKR, GIC, Prudential, Schroder's, Ward Ferry, Vanguard, Amundi, Wasatch, and Target Asset Management. There has also been an increase in interest from DIIs (mutual fund and insurance companies). As of today, the institutional shareholding of both Max India and Max Financial Services is almost equally held by FIIs and mutual funds.

Last year, Max Healthcare also acquired two companies back-to-back. How was the deal structured? How did you manage the added leverage on the balance sheet? What is the impact on debt-EBITDA levels?

We recently acquired a majority stake in Pushpanjali Crosslay Hospital, Vaishali in 2015 and a 51 per cent stake in Saket City Hospitals Pvt Ltd, which has the rights to manage the Saket City Hospital. We have already completed their integration with our hospital network.

In the case of Saket city Hospital, we acquired the stake with a put/call option to acquire the balance stake within three years at a pre-agreed valuation, essentially to ensure two things. Firstly, we would not over-leverage the balance sheet till matching cash flows are realised. Secondly, part of the consideration was being paid for managing operations in the expanded facility in future.

In the case of Pushpanjali Crosslay Hospital, we acquired 78 per cent stake with a put/call option to acquire the balance stake within four years at fair market value. The considerations for part acquisition were different in this case. The key shareholder of the facility was a highly reputed doctor, who wanted us to ensure continuity of his practice and involvement post the divestment. Without compromising on full statutory control, which comes at above 76 per cent shareholding, we helped him achieve that objective by letting him continue with minority shareholding, and also offering him the position of Chairman of the acquired facility.

As a consequence of these leverage-backed acquisitions, debt:EBITDA levels increased. To minimise the financing cost impact, we refinanced the entire debt increasing the tenor from 10 to 15 years, with no repayments for the initial two years, and marginal repayments for another two. We were able to achieve this largely by leveraging relationships and credibility built over the years with marquee lenders such as IDFC Bank, Axis Bank, and Yes Bank, who are all associated with the Group in other capacities as well. Due to the planned earnings scale-up, our debt: EBITDA is estimated to be at reasonable levels by the time the repayment kicks in. In addition, Max Healthcare is a joint-venture with strong shareholders, Max India and Life Healthcare, who have the availability and are committed to contribute equity, as the need arises, for further organic and inorganic requirements of the business.

What challenges did you face with post-merger integration? What were the learnings? What things would you do differently in the case of future acquisitions?

> We have developed a strong in-house capability to execute complex M&A transactions

There are some key risks that are inherent to any acquisition like this. One part of it is the people risk, which involves assigning the right jobs to the right people, loss of high-performing employees, a lack of employee buy-in and commitment, and conflicting corporate cultures. The other part is the integration risk, which stems from the failure to maintain focus and achievement of synergies, failure to deliver on expectations, and lack of transparency during the integration process.

Though my role was to consummate the acquisitions, it was more for the operating team to drive the integration aspect of these acquisitions. The integration management team that was set up especially for this purpose, comprising 8-10 members both from MHC as well as Max India, managed it very effectively. What also worked for us in both these instances, and was a significant factor in our decision to acquire these hospitals, was their physical proximity to our existing hospitals where we were operating to their full capacity – Max Patparganj and Noida in the case of Pushpanjali Crosslay and Max Saket which was adjacent to Saket City hospital. As a result, the process to harness clinical, management and financial synergies with the Max Healthcare network was initiated almost immediately through sharing of resources, cost efficiencies, optimisation of occupancy, and focusing on high-growth specialties (such as oncology, neuro sciences, renal sciences including kidney transplant program, orthopaedics, and cardiac sciences).

Through seamless integration, we turned around both these facilities from negative operating profits to high-teen margins in a year or so, which is a benchmark of sorts.

There was a massive escalation of legal and professional fees last year on account of these acquisitions. Were the deals executed with the help of investment bankers? Is there a dedicated internal team that looks after M&A? If yes, what is the role of the internal team? How is it

Both the life insurance and the health insurance industries are significantly under-penetrated, offering great opportunity for organic and inorganic growth

structured? Who leads it? What are key areas of competence that you seek in your teams?

The Group is very entrepreneurial when it comes to growing its businesses, including through inorganic growth opportunities. We have a strong interest in, and proclivity for M&A transactions and have developed a unique and strong in-house expertise to mange such transactions and lead them from negotiations to structuring to execution largely in-house.

We implement these transactions by pooling together a cross-functional team comprising in-house experts drawn from tax, legal, secretarial, communication and human capital teams. As the head of corporate finance function, I drive these projects, under steering of the Group President and the Managing Director. Having done 20-25 seminal transactions in-house, our core competencies are all-encompassing. We also rope in AZB as our legal counsels and EY as structuring advisors for some of these transactions to ensure comprehensive risk mitigation and impeccable execution.

The legal and professional expense includes the cost of Shared Services support that is rendered by the holding companies to each other and the underlying businesses, which is why the legal and professional expenses may seem high. The increase in costs because of transactions is rather limited, given we outsource only select functions in some of these transactions.

What was your personal role in this entire process? Who were other key players that drove this strategy?

My role in the entire process is that of a programme manager, wherein I drive the project from conceptualisation, structuring, commercial negotiations, fund-raising, documentation, right till the completion of the transaction. Obviously, large transactions such as these cannot be executed without the steering of our top leaders – our Group President and the Managing Director, who play a pivotal role in providing overall direction and leadership to these transactions.

The proposed merger with HDFC life has been called off on account of regulatory hurdles. What were the specifics of the deal and the challenges that were difficult to overcome? What are the learnings? How can one now move forward?

We have resumed our focus to the growth initiatives that we were driving in early 2016, where we were looking to acquire other life insurance companies that are owned by the banks. Consolidation in the private life insurance space is imminent at this stage, and we are back to actively exploring some of these opportunities. Our growth plans otherwise remain as robust as ever. Last year, Max Life witnessed its best performance in over a decade, and that continues even in FY18. We are on course to meet our 20-20-20 aspiration by 2020 on percentage growth in sales, margin, and EV. There is a lot that we have done in the last few years to achieve this momentum. We are making significant investments in our proprietary channels such as agency, direct sales and digital. We are also improving the product mix by increasing protection from the current 5 per cent to 10 per cent in the next 3 years, which will help expand margins. All our channels are delivering positive profitable and productivity-led growth with a balanced product mix and increasing contribution from protection products. The quality of the business across vectors remains top quartile. Finally, we are actively considering inorganic growth opportunities and new bancassurance tie-ups, while also elongating our relationships with existing distribution partners.

Is inorganic growth a continued growth strategy for the firm? What is the quality of demand at the consumer/customer end that you foresee in the Indian market? Could you define that both numerically and qualitatively?

Our business interests are in sectors that offer significant growth opportunities. Both the life insurance and the health insurance industry are significantly under-penetrated, healthcare is under-provisioned, senior living is a new concept for India, real estate has a significant trust deficit, and there is so much that one can do in the niche of value-based education. This gives us a tremendous opportunity in each of these verticals at a pace we can possibly manage to grow these profitably.

The Indian life insurance industry has grown at 25 per cent for the first half of this financial year on back of a 21 per cent growth last year, aided by a perceptible shift towards the 'financialisation' of savings. Life insurance penetration to GDP in 2016 was a small 2.7 per cent, compared to 7-16 per cent for most of the developed Asian countries. Premium per capita in India was $47 with the developed countries in Asia ranging between $3,000-7,000. The level of protection as measured by sum assured to GDP in 2015 was a low 60 per cent, where some of the developed nations are at 260 per cent, signifying under-insurance. Aided by these tailwinds, the industry is growing sharply and Max Life is also growing at a similar pace while improving its profitability along the way.

Similarly, in the health insurance space, the penetration (premium as per cent of GDP) is only ~0.2 per cent. Only 27 per cent of population has any kind of health insurance. India has high out-of-pocket expenses (62 per cent versus ~10 per cent in US/UK, and ~30 per cent in China). Led by rising income levels and healthcare spend per capita, a rise in the incidence of chronic diseases (such as cancer, heart diseases) and lifestyle-related diseases (such as diabetes), and regulatory and policy level interventions, the health insurance industry has grown by 20 per cent in the first half of 2017-18, and is expected to grow at a CAGR of at least 15 per cent over the next three years. Max Bupa is growing at 25-30 per cent and is outpacing the industry-level growth, which we expect to continue, going forward.

Likewise, the healthcare industry is growing at around 15 per cent, which it is expected to continue to deliver, for a fairly long-term and get to $350-450 billion size levels by 2025. Private hospitals are expected to contribute almost half of these revenues. Industry growth has, though, seen a temporary slowdown because of a slew of measures by the government to make healthcare costs more affordable for patients, but we remain confident about the prospects of the industry and more particularly, Max Healthcare, encouraged by the way we are navigating some of these interventions through a multiplicity of actions, and also, alternate growth models like Max Labs, Max@Home, an dOnco Day Care. Max Healthcare is the fastest-growing corporate healthcare chain in the country, and has grown its revenue at 22 per cent CAGR over the last four years, with earnings (EBITDA) growing at a CAGR of 42 per cent.

We are witnessing similar trends in other businesses that the group is focused in and therefore, are very encouraged to grow these businesses both organically and inorganically. ■

On a lighter note

1. Being a CFO to you means....

   Being a business partner in value creation, effective communicator and influencer, stakeholder manager

2. Three important learnings as you look back upon your career?

   - Filter every opportunity through the lens of maximising value…it removes the clutter

   - There is a life beyond numbers

   - There are no better teachers than the people you work with, hunger to learn is important

3. Another CFO you look up to and why? I would look at the mirror… nothing inspires as much as self-introspection and self-development

4. What was the toughest decision you had to make in your role as a CFO? It's not just one that you take in this role, but many. Just take those in the best interest of the stakeholders, and use the frame of doing the right thing and doing it right. No decision is then tough.

5. What is the first thing that comes to your mind when I say the following:

   a. Communication and the CFOs: Get this right. You are a strong contender to be CEO

   b. CFO & Strategy: Should be an enabler (insights, capital management, analytics), gatekeeper (risk manager), communicator (investors, analysts etc.)

   c. CFO & Risk Management: Asking the right questions, data driven, balancing growth with profitability

6. Top three things still pending on your bucket list: Transformation to a CEO, relaxed holiday, buy a unit at Antara after retirement, and teach in the schools next door

7. Favourite book/movie: Start-up Nation / 3 Idiots

8. Comfort food: Bhel Puri

9. What do you do to keep yourself operating at optimum level?

   My best way to unwind is to spend time with my family in a meaningful way. I'm also an ardent tennis player and try to swing my arms a few days every week.

10. What does the horizon hold for you in the future – where do you want to go? Why be bound by horizons? Even the sky is not the limit