



Apollo Hospitals Limited

Q1 FY15 Results Conference Call Transcript August 13, 2014

Moderator: Ladies and Gentlemen, Good Day, and welcome to the Apollo Hospitals Q1FY15 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Mayank Vaswani of CDR India.

Mayank Vaswani: Thank you for joining us on this call to discuss the Financial Results of Apollo Hospitals for Q1FY15 which were announced yesterday. We have with us today the senior management team comprising Ms. Suneeta Reddy – Managing Director; Mr. S.K. Venkataraman – Chief Strategy Officer and Mr. A Krishnan – Chief Financial Officer.

Before we begin I would like to remind all of you that some of the statements made in today's discussion may be forward looking in nature and may involve risks and uncertainties. For a complete listing of such risks and uncertainties please refer to our 'Investor Presentation'.

We will start with Ms. Suneeta Reddy who will discuss the "Operating Highlights" for the quarter following which Mr. Krishnan will discuss the "Operating Metrics", "Expansion Plans" and "Other Highlights". Documents relating to our financial performance have been shared with all of you earlier, and these have also been posted on our website.

I now invite Ms. Suneeta Reddy to touch upon the key highlights of our performance.

Suneeta Reddy: Thank you for taking the time out to join our call. We have begun FY15 on a firm footing with standalone revenues in Q1 crossing the milestone of Rs.1,000 crore despite the difficult economic environment and dislocations in travel during the general election.

I am pleased to inform you that we clocked a top line growth of over 18% this quarter. This includes 13% year-on-year growth in revenues from Healthcare Services and 27% year-on-year growth in Standalone Pharmacies. More importantly, we are happy that the new hospitals performance has begun playing out broadly in line with our plan and expectations.

Within the newer facilities, Vanagaram Hospital in Chennai has reported impressive growth rate on a year-on-year basis. Occupancy has recently crossed over 100 beds. As we have shared earlier, we had strengthened our team of

doctors in the middle of the quarter in key specialties like Cardiology and Neurosciences, and the results are visible. On the back of a strong clinical team, the plan is working now to enhance market penetration and patient flows even further. This should translate into a stronger operational performance from Vanagaram over the rest of the year.

Our hospital in Jayanagar has also reported improved traction this quarter. The facility has now over 55 beds occupied and is now progressing as planned on the back of some focused initiatives targeting the local market. We have a dedicated operations team to monitor both these new hospital performances and we should see them contributing positively to EBITDA in the next few quarters.

The team in “Trichy” and “Nasik”, both of which are recent launches are similarly working on inducting a good set of doctors and clinicians for these locations. Clinical excellence has always been our focus and has been the bedrock of our performance and it will continue to remain at the forefront of our practice as we expand and scale up. Growth in the existing hospitals are reasonably healthy at 8.4% on a year-on-year basis, but more importantly what is heartening is the fact that most of this increase was led by volume growth. Our efforts to rebalance our case mix, redistribute patient volumes across other hospitals in Chennai cluster has paid off with the overall cluster reporting a growth of 7%.

Hyderabad has reported a much stronger quarter. The team has done well in terms of reducing lower value cases from the Government scheme, which as you are aware is more prevalent in this market than others. This was supported by the “GP Connect” initiative as well as the drive to enhance volumes at high acuity cases. Hyderabad cluster is now clearly benefiting from these initiatives with renewed momentum and performance.

Similarly, growth in existing hospitals like Bhubaneswar, Karur and Bilaspur remain strong, whereas there was a small dip in volume in centers like Madurai, Karim Nagar and Karaikudi, primarily due to the elections.

The mature geographies have been largely resilient in terms of margins and maintained them in spite of not so favorable environment of exchange rate, driving consumable prices higher and overall inflation resulting in a higher input and staff cost.

We have recently launched an initiative across three of our flagship hospitals in Chennai, Hyderabad, and Delhi to further augment our services around three core areas which we believe are key drivers of value for our consumers; which are “Patient Service Focus”, “Patient Loyalty” and “Advocacy”. Secondly the Practices, Systems and Capabilities to be developed would improve for sustained leadership in clinical differentiation, Processes and Operational Efficiencies. We expect this effort to start yielding results over the next six to eight months and help us further strengthen our core value proposition.

In our Standalone Pharmacy business, EBITDA has grown 33% from Rs.9 crore in Q12014 to Rs.12 crore in Q1FY15. We had committed that we will grow this business in a calibrated way without compromising on growth or profitability, and the pharmacy team needs to be congratulated for a very consistent performance which has now made it a formidable player in the Indian retail sector. The continued progress and profitability has been driven by increasing maturity of the store network and a higher proportion of private labels in the revenue mix. The EBITDA margins of the Standalone Pharmacy expanded by 14 basis points to 3.1

in Q1 FY15. This is despite the DPCO pricing regulations impacting the revenue as well as the margins. On a consolidated basis, revenues grew by 17.7% to Rs.1,203 crore. Consolidated EBITDA grew by 7.7% to Rs.173 crore.

Within our subsidiary JV Hospitals, Kolkata and Ahmedabad reported healthy year-on-year growth rate followed by Bangalore. The consolidated operations had an operating loss of Rs.4.8 crore from the Apollo Health and Lifestyle, our retail health subsidiary.

When one looks at the healthcare landscape in the country, there is clearly a fragmenting of catchment areas given the increasing number of healthcare institutions being set up. This is resulting in more aggressive pricing. In this scenario, we strongly believe that our cluster strategy offers us a significant advantage to attract patients from different strata which enables us to cover a particular market more effectively.

We are also focused on driving clinical differentiation to enhance doctor and patient advocacy. Each of our hospitals is working on deepening its connect with the local market through increased coordination with specialists, nursing homes and clinics. This strategy to enhance the case mix through focus on high acuity cases continues.

We remain well positioned to serve the increasing number of international patients. The reaccreditation of our Delhi hospital for the fourth consecutive year and increasing number of accredited facilities in the group enhances the attractiveness of these facilities for such patients. We continue to actively canvas in the high potential markets through a mix of medical camps, telemedicine and in person consultation by our specialists. We are also enhancing the brand salience in this market through value-based PR and digital marketing activities. This is further supported by initiatives such as the arrangement with Emirates to facilitate seamless patient transfers from select locations.

We also recognize that there is a larger shift taking place with healthcare moving from a transaction based system to a relationship based system. Reference from existing patients, while always important, are now even more relevant in driving new patient growth. Here again, our comprehensive approach to patient care through multiple touch point through the integrated healthcare delivery model is paying off through the large number of ambassadors who endorse our services. Apollo Hospitals with this record of having touched 40 million lives is clearly a leader in this space.

Our planned expansion continues to progress well with projects at Nasik, Nellore, and Vishakapatnam comprising nearly 600 beds scheduled to be on stream by the end of six months. We will also operationalize another 300 beds in locations in Chennai. With the acquisition of 51% controlling stake in 125-bed hospital in Indore in April, we are poised to operationalize 1,000 beds in the current financial year.

I would like to conclude by informing our audience today that Fortune India has declared Apollo Hospitals among the Top Pharma and Healthcare Companies. In fact we are ahead of noted companies like Abbott, GSK Pharma and the evaluation criteria is based on Corporate Governance, Endurance, Social Impact, Investment Value, Product Service Quality, Innovativeness, Leadership Quality, Talent Development, Employee Empowerment, Global Footprint. I believe that these are the cornerstones of our business philosophy and in the long run they will

definitely put us ahead of the pack. Now, over to Krishnan for details of our financial performance.

A. Krishnan:

Thank you, Ms. Suneeta. Slide 8 of our Investor Presentation provides a comprehensive view of the performance of existing and new hospitals as well as pharmacies. You can see that our new facilities have picked up pace on the revenue front and the improved contribution has helped to reduce the EBITDA losses.

The FY13 hospitals in Jayanagar and Vanagaram were EBITDA-neutral for the quarter ended 30th June 2014. The FY14 hospitals which are Trichy and Nasik reported an EBITDA loss of Rs.1.6 crore during the quarter. Nasik commenced Inpatient services only from June 201, while we had commissioned the OP services in the last quarter.

Standalone EBITDA grew 7.1% from Rs.146 crore in Q1 last year to Rs.156 crore in Q1 this year. The EBITDA margin is 14.8% compared to 16.3% in Q1 last year. This is partly due to the decline in the margins of existing Healthcare Services business from 24.5% to 23.1%. This quarter had the impact of expenses of hosting the “Future of Health Conclave in Delhi”, which was an initiative to bring together the Government, industry, and the three knowledge partners McKinsey, KPMG and Bain to comprehensively address the needs of the Indian healthcare industry.

Also, this quarter saw us make some corrections to the compensation of a medical fraternity in line with our talent retention initiative. In addition to this, the Pharmacy business now represents a larger proportion of the standalone revenues at 37% in Q1 this year as compared to 34% in Q1 last year, which also results in the reduction of our reported consolidated margins.

EBIT in the existing Healthcare Services business has been impacted by increase in depreciation year-on-year due to the application of higher depreciation rates as per the new Companies Act and additional depreciation due to commissioning of “Trichy” and “Nasik” hospitals in FY14. This led to a year-on-year decline in the EBIT of the existing Healthcare Services business, and consequently, the standalone EBIT only improved marginally.

If you come to Slide 9, you will notice that the annualized ROC from the Healthcare Services has dropped from 17.1% in Q1 last year to 14.8% in the current period. This decline is partly attributable to lower operating profit as well as the increase in depreciation. Also, the new hospitals added in FY13 & FY14, which are Vanagaram, Jayanagar, Trichy, and Nasik, with capital deployment of over Rs.400 crore are yet to start contributing to ROCE.

Slide 11 and Slide 12 provide details of our consolidated financial performance. Consolidated revenues grew 17.7% to Rs.1,203 crore. Revenues from existing Healthcare Services business grew 10% on a year-on-year basis, primarily enabled by a robust performance witnessed in Ahmedabad, Kolkata and Bengaluru.

Apollo Health and Lifestyle reported an EBITDA loss of Rs.4.8 crore as compared to a loss of Rs.4.1 crore in Q1 last year. Consequently, the consolidated EBITDA was Rs.173 crore, up 7.7% year-on-year.

Coming to Slide 14, which covers the operational performance by clusters, you will notice that there has been a healthy growth in both inpatient and outpatient volumes on an overall basis. In Chennai, inpatient volumes stood at 7%, enabled by good growth in Vanagaram which now has occupancy of over 100 beds. While the new outpatient registration remains stagnant, there was an increase in the repeat outpatients which resulted in the outpatient volume revenues increasing by 18%. The occupancy was healthy at 70% as compared to 71% in Q1 FY14. This occupancy is on a larger capacity utilization of 1,305 beds as compared to 71% occupancy on a capacity of 1,229 beds in the previous year. Given our bed constraint in the main hospital in Chennai, the team continues to try and convert minor procedures to daycare which is reflected in the lower ALOS. While this appears to impact occupancy, the fact is the beds get turned around faster resulting in headroom which can be used to increase IP volumes. The ARPOB at Chennai including Vanagaram grew 4.3% to Rs.34,840. Excluding the impact of Vanagaram the ARPOB actually has grown year-on-year by 7%.

The initiatives in Hyderabad to reduce both low complexity and low paying and subsidized cases to enhance the overall case mix continued to progress well resulting in improved revenue realization and profitability. Inpatient volumes increased by 10.5% whereas inpatient revenues expanded 11%. Due to the initiatives undertaken as expected the occupancy however continued to remain at 65% in Hyderabad with a marked reduction in ALOS. The momentum from the GP Connect Program has led to an increase in OP footfalls by 16.6%. The Hyderabad ARPOB was higher by 8.7% to Rs. 21,929.

The hospitals which are included in the "Others cluster" and account for 1,683 beds have delivered revenue growth of 21.6%. Both IP and OP volumes have grown 10% and combined with richer case mix have led to a growth of 22.6% in IP revenues and 16% growth in OP revenues. The occupancy is at 64% on a larger capacity as compared to the previous year. This also includes two new hospitals added in FY13 & FY14. While Jayanagar which was added in FY13 has ramped up very well, the Trichy Hospital is still in the initial stage of operation. ARPOB in these hospitals is higher by 16.3% as compared to the previous year.

Our joint venture and subsidiary hospitals also displayed a healthy growth; OP revenues were higher by 16% aided by over 10% growth in OP volumes. IP revenues have increased by 12% aided by 8.5% growth in IP volumes. Strong volume growth has helped increase the occupancy in these hospitals despite a larger bed base this year. ARPOB grew 2.8% to 26,167.

Slide 16 provides you details about the batch wise performance of Standalone Pharmacies which continued its growth momentum with 27% increase in revenues and 33% growth in EBITDA on a year-on-year basis. Despite the DPCO pricing policy impacting revenues by 2% and EBITDA by 48 basis points, the overall EBITDA margins improved by 14 basis points to 3.1% in Q1FY15. The increasing proportion of sales from private labels and increasing maturity of our store network has helped EBITDA to continue its upward trajectory. The batch wise margin indicators were favorable with FY2008 batch of stores reporting a margin of 5.8%. We added 53 stores and closed 21 stores in Q1FY15 for a net addition of 129 stores. Our store expansion of around 150 to 200 stores every year is on track and we are confident of further improvement in our EBITDA margins in this segment.

Coming to Health Insurance, Apollo Munich Health Insurance reported an increase of 25% and gross written premium at Rs.176 crore. However, a rise in

the incurred claims ratio and expenditure towards growth of network have led to pressure on the EBITDA margins. The EBITDA was at Rs. 6 million as compared to Rs.2 crore in Q1FY14. The company is nearly at breakeven at the PAT level. Q1FY15 PAT loss was at Rs. 1.4 crore as compared to 0.6 crore of PAT in Q1FY14. That is it from me, we are now ready to take your questions.

Moderator: Our first question is from Ruchi Vora of UBS Securities.

Ruchi Vora: My question is with respect to the EBITDA margins. I wanted to understand in detail regarding how do we view the staff costs and the EBITDA margins going forward in the existing Healthcare Services?

A. Krishnan: There are two points as we said; one is that in the present quarter, if you look at the Chennai cluster in particular, the volume growth was a bit muted because we were working on rebalancing across the cluster. As you know, we look at it as a cluster and if you look at it from the cluster perspective, compared to the 4.3% growth that we had last year, we had 7% growth in the present quarter. So from the overall volume perspective, the growth of the cluster has been good. But since we have done some of the rebalancing, you would realize that some volumes have actually got into some of the other facilities as well. We also think that we should be able to recoup over time as some of the new doctors settle in. This quarter saw the exit of two doctors especially in the existing hospitals in “Main” as well as “Specialty”. This we had let go off to competition and especially if you look at it from a tradeoff between a short term and long term basis, we thought it is better to induct a couple of new doctors and over a period of time we expect them to catch up and the volumes to pick up in the existing facility.

Suneeta Reddy: One thing I would like to assure you is even though we get new doctors, the skill sets remain very strong and that I think is very important. This is because Apollo would not compromise on clinical quality or the skill of a doctor while taking on new doctors. So people are known more as being Apollo doctors rather than individually by their names.

A. Krishnan: The second point was as we said; we had some compensation reset for the medical fraternity, especially doctors and some of the medical fraternity in select locations. This was done because we wanted to retain our talent and we certainly had to do this reset and therefore we have done that in the present quarter.

The third thing was the “Future of Health Conference”, which we had and there is an increase in marketing expenses to Rs.3 crore due to this. So if you pretty much look at it, the margins has compressed on the existing business predominantly because of Chennai which we think over the next six to eight months should correct itself as the volumes pick up.

Ruchi Vora: What has been the average salary inflation, as you mentioned that there has been a compensation reset at certain locations?

A. Krishnan: 14% has been the salary increase including the reset.

Ruchi Vora: I think my question comes from the fact that we fully appreciate that you have a significant CAPEX over the next two years and there is potential for margin compression from initial start-up costs and potentially some delays, because over a period of time your margins have come off on the consolidated basis. We fully appreciate the pharmacy contribution, etc., but how do we view your Healthcare

Services margins of existing hospitals over the next two years? Should it stabilize at 23-24% as it was historically the case?

A. Krishnan: Our aim is to keep it around the 23% level as it stands currently and the fact is, you should realize that Chennai margins have been very high, and what we report here is the blended margins. So we are also pushing for growth in the Hyderabad cluster. The Hyderabad cluster EBITDA margins are more around 20% to 21% now and it will go higher as we look at the growth in this cluster coming up and helping us also. So, we are looking at 23% to 24% even now as it stands.

Suneeta Reddy: I think it is quite a challenge for us, but we remain focused on maintaining it between 23% and 24%. The reason I say that it is a challenge, is because as we open up new hospitals in Tier-II, we also take CGHS and the patients of lower income group. So I think like Krishnan said, it is a blended average that you are seeing, whereas in Chennai it is much higher.

A. Krishnan: The other thing is, we have also decided on the marketing cost. We are looking at increasing some bit of marketing especially in the communities and the local communities especially because of competition and everything else. So we think over the next couple of quarters, you will see some marketing cost coming in, but that is again we would be able to recoup that as we move forward.

Ruchi Vora: After taking all this into account our expectation should be set at around 23% for the Healthcare Services margins is what you are saying?

Suneeta Reddy: I think for the next year if we open new facilities, yes.

Ruchi Vora: How does AHLL and Apollo Munich fit into the corporate strategy? We have been reporting an EBITDA loss especially in AHLL. What is the strategy of the company going forward in terms of ramping up this particular subsidiary?

Suneeta Reddy: I think that when Apollo has incubated some small companies within its fold, some of them have the potential to really grow. We believe that Apollo Health and Lifestyle in the Wellness segment which we believe has huge potential. Having said that, I think it has a trajectory of its own and like anything which is in the nascent stage, you will expect to see losses. But because we believe that it has the potential to become a high growth big company, Apollo is looking inwardly, we are looking at a structure in which we can enable this growth. We are working with consultants and investment bankers to see how we can capitalize this Company, see that it is better capitalized, and enable growth in this segment.

I also have Sangita Reddy who has just joined the call, who has taken responsibility for the Clinics segment.

Sangita Reddy: Good Afternoon. I think the new focus on Clinics, is most appropriate considering the fact that patients are looking for quick, friendly environments that they can access us. And also for Apollo one of the important strategies is to ensure that all the patients who meet us do so not only in their acute conditions, but also in their routine and day-to-day care, so that we become top of mind for them. So, the enhancement of clinics and integration with the main hospital are two important parts of the strategy. The detailed theme by itself is focused on growth and profitability but its integration to the overall ecosystem is also crucial to bring about these enhanced synergies.

So, Cradle as a segment is one of the parts that we are looking at. Cradle show us breakeven within 24 months, show profitability within 36 months and we are addressing the masstige as well as the middle income segment, we have a good line of sight in terms of expansion of this division, and we believe that it will grow into an extremely profitable area. With Clinics, we are rationalizing the numbers. In terms of quality, we working with franchisees. So, our key franchisees are performing and improving in their performance and the relationship with us. Overall, we are feeling good about the Retail Healthcare division. We are stabilizing the 'One-Day Surgery Center' that we have in Chennai. And post perfection of that model, we will then look at further rollout and scale up.

Ruchi Vora: Any numbers that you would like to share on the potential revenue that one could see from this segment over the next two-three years and also the EBITDA?

Suneeta Reddy: I think that would be a forward-looking statement. At the appropriate time when we are completely ready with the strategy, we will be willing to share some numbers with you.

Moderator: Our next question is from Neha Manpuria of JP Morgan.

Neha Manpuria: My first question is on our existing business revenue growth. Sir, you gave us some color on how we saw some slowdown in Chennai. If I look at the ARPOB growth in Chennai for example at 7% even if we exclude Vanagaram, this has been sort of lower versus the strong growth that we have been seeing in the last year. Does this in some way highlight the increasing competition that we are seeing in Chennai market which is limiting our ability to take tariff increase, would that be the correct way to look at it?

A. Krishnan: Neha, more importantly it has been our internal strategy that we have put in place because we wanted to focus on volume growth this quarter. This is, because we are increasing the capacity and as we go out, because Chennai has predominantly been a referral center for us and there have been a lot of outstation patients who have been coming for their care to Chennai. As we get into the local market, we wanted to keep the prices at the same levels for some time as we increase the growth, get the volumes in place and thereafter look at some of the price increases to take care of our cost. So this quarter we have not increased the prices. Typically, we do some tariff increase in Q1, which we have not done this time. This should not to be read as any issues with competition and we would be looking at it at an appropriate time as we move forward.

Neha Manpuria: So we can still assume the ARPOB growth picking up as and when we can take appropriate price increases to pass on cost?

A. Krishnan: That is right.

Neha Manpuria: The second question is just a clarification. Ma'am, you did mention some amount of impact from the elections during the quarter. So can we put that also in the muted revenue growth and the flattish margins impact from that in our business in the quarter?

Suneeta Reddy: Yes, I think so because in the months of April and May the outstation patients did find it difficult to travel, which resulted in a drop in that segment. It has picked up now. So, it is clearly because of elections.



Neha Manpuria:

My third question is on Standalone Pharmacy margins. If I look at the margins quarter-on-quarter, they seem to have come off. This was despite some commentary made by the manufacturers about the price hikes that had been taken in April were passed on to the retailers. Also if you look at the batch wise detail, most of that has come from the new stores. The new stores margins are pretty much half quarter-on-quarter. If you could give some color on that it would be helpful.

Obul Reddy:

In Q4 FY14, there is a volume-based annual discount advantage. Also, for the last four quarters we have had aggressive closure of pharmacies and the loss on those things have been accounted in those respective quarters. So if you see that in the last three to four quarters, we are at that stabilized level and in the next quarter we will see that our planned closure of pharmacies is over. So we should see that improvement coming back in the EBITDA margins.

Neha Manpuria:

So it should improve from here going forward?

Management:

Definitely yes.

Neha Manpuria:

What would be the private label as a percentage of sales currently? Is it still at the 5-6%?

Management:

Closer to 6% as of now and we are in the process of inducting more products on that segment.

Moderator:

Our next question is from Chunky Shah of Credit Suisse.

Chunky Shah:

My question is with respect to the 'Future of Health Conclave'. Is this a one-off kind of event or you would be seeing them occurring every quarter, maybe in some other form or the other?

Suneeta Reddy:

We were celebrating Apollo's 30th Anniversary, and instead of the usual big party and advertising, we thought we would do something that will benefit the country and start a process where we could work with Government, other providers and knowledge partners to create a deeper understanding of the Indian healthcare market. So, I think this is not an event that happens every year. I think that when there is a shift in the environment and things are changing, it is probably a time to get a deeper understanding and that definitely it was one-off.

Sangita Reddy:

However, I think it is a great property now, which has been created. We had an outstanding success to the conference, the type of luminaries who participated in it and the four knowledge papers which were the outcome of it, we would love to mail them to you if you are interested. So I think that we need to now strategize on how we retain the brand property that we have created, find strategic partnerships so that we defray the cost of this. So we are actually thinking of something innovative in terms of crowd sourcing of ideas and to continue the theme without the type of expense that we had last year.

Chunky Shah:

With respect to the increase in "SG&A", you had mentioned that there would be some increase, going ahead. So would that be related more to existing hospitals or it would be also on the new hospitals?

Suneeta Reddy:

Marketing expenses with relation to new hospitals will have to be incurred and you will see that it will probably be in the same proportion of this. These one-off costs are something that we regulate very carefully.



Sangita Reddy:

I think if you see in the mature markets that we are in, whether it is Hyderabad or Chennai, competition has become a reality of life and the type of decibel level of their advertising is so high, it is essential that Apollo as a brand must retain the top of mind awareness, which necessitates some level of advertising. So we are rethinking some of the mechanics with which we communicate.

Chunky Shah:

Is some part of it also spent on our existing hospitals?

Sangita Reddy:

That is right.

Chunky Shah:

In terms of store rationalization, going ahead, we would be close to done with this or there would be still more to come?

Obul Reddy:

We are close to done with that, and you see less number of closures going forward.

Moderator:

Our next question is from Girish Bakhru of HSBC Securities.

Girish Bakhru:

My first question is on Chennai. I again see that the occupancy is low. But just going from how far Vanagaram will stress, if I remember it is a 200 bed facility and there are more than 100 beds which are occupied right now. So how much pressure can Chennai see till Vanagaram goes to into a steady occupancy?

Suneeta Reddy:

I think in Vanagaram, you should look at the 100 beds as an opportunity for future growth. This is because presently we have great clinical teams in place and over a period of one month it has moved from 40 beds to 100 beds. As this clinical team gets known in that area, we are quite confident that we will reach 160 beds by the close of this year.

Girish Bakhru:

When you say that you have not taken price increases, I would assume Vanagaram would be at say 20-30% discount to normal non-reach ARPOB rate. So do you see potential of taking tariff increases in Vanagaram?

Suneeta Reddy:

Definitely, it is already planned.

Girish Bakhru:

My next question is again on the Chennai side. You have added some 40 more beds in the quarter. When would be the rest addition happening of the 300 beds?

Suneeta Reddy:

That will happen over the period of six months.

Girish Bakhru:

So "Lifeline" will start by next quarter and you will also have "OMR"?

Suneeta Reddy:

Yes, "Lifeline" and "OMR" are the same.

A. Krishnan:

We have two hospitals in OMR; one which is the "Woman and Child", which will start, as well as the "Apollo OMR" which will be the high end tertiary care facility.

Girish Bakhru:

So do you see this occupancy of 70% going down further by the end of the year?

Suneeta Reddy:

It will be difficult to maintain 70% on an expanded bed base, but one thing I can assure you is that the volumes in the Chennai cluster will rise. This is because that is a whole different locality i.e the catchment area that we are addressing when we open this hospital.



- Girish Bakhru:** On the Hyderabad side, there has been very strong improvement in the Inpatient volume. What has basically been the reason?
- Suneeta Reddy:** We have Hari, our CEO with us, who joined for the call, which is happening from Hyderabad, so Hari, please.
- Dr. Hari Prasad:** It has been a sustained effort for the last two to three quarters in terms of trying to get in the right patient mix. There is a scheme here which provides insurance to the lower socio-economic groups and the major part of the population is covered under that scheme. What we have done over the last couple of quarters, is reduce the inflow of patients from these schemes and try to focus on cash and insurance patients and this has resulted in a growth that we are seeing in the last quarter.
- Girish Bakhru:** Would this translate equally to the growth in the Inpatient revenue as well, as this has not really happened so far yet?
- Hari:** Yes, that does translate into growth in Inpatient revenues.
- Girish Bakhru:** Just on the Pharmacy side, can you share the input cost in terms of percentages, like how much would be staff to sales and consumable to sales?
- Obul Reddy:** It is about 9.5% on the employee cost and rental is in the range of 3.3% plus, and admin expenses is around 3%.
- Girish Bakhru:** Lastly on Mumbai, could you give any updates on the Byculla and the Navi Mumbai project?
- Suneeta Reddy:** We have already started equipping the Navi Mumbai project, so it should take another 8 months for us to operationalize it. With regards to Byculla, I believe that we will finalize the terms because with the new Government there was some delay, but we believe that in the next five months we will have closure and begin work there.
- Girish Bakhru:** On a very general sense, I know it is a bit of forward-looking question, I would like to know that when you see the Mumbai market, you would probably estimate that ARPOBs in Mumbai would be even higher than Chennai. Is that right?
- Suneeta Reddy:** Certainly, I think one of the reasons why we believe that even getting in at this stage it would definitely deliver the return on capital employed that we benchmark ourselves, which is around 20%.
- Girish Bakhru:** I think, it is more of a difference to the competition which is also looking at this region very actively by creating a facility which can generate ARPOBs as high as Rs.4-5 crore per bed. Do you think that kind of number you would also look at earning?
- Suneeta Reddy:** Even without Rs.4-5 crore, we believe we can reach a very healthy ROCE and EBITDA margins. I think that speaks for Apollo, its brand and the ability to attract good doctors and to have a very transparent healthcare system operating out of Mumbai.
- Moderator:** Our next question is from Sudharshan Padmanabhan of Sundaram Mutual Fund.

S Padmanabhan:

What I wanted to understand is if I am looking at your numbers that is primarily the Pharmacy numbers, there has been a dip in your EBIT margins, primarily from about 3.4% to 3.1%. Because if you are looking at the historical last 4-5 quarters there has only been a gradual increase in your EBIT margins per se. So what has happened in this quarter and if you can also throw some light as to where do we stand as far as bringing a strategic partner into the fold in terms of unlocking value in the Pharmacy business?

A. Krishnan:

Your first point on EBIT margins, EBITDA was already explained by Obul on what happened there and what is it, that we had some volume discounts last year. Also, when you look at the EBITDA margins of 3.1% this year versus 3% last year, you should bear in mind that last year to this year there has been an impact of the DPCO pricing, which has impacted the top line by 2% and the EBITDA by 0.5%, so despite that we are seeing an EBITDA of almost around 3.1% now. On the EBIT, we did say that there is an impact on the depreciation because of the new Companies Act. The new Companies Act has an accelerated depreciation provision for furniture and fixtures and some of those categories of items as well which is there more in Pharmacy, so which is the reason for this correction, but after that going forward you would see that it would correct itself. That is the first point. The second point I leave it to Ms. Suneeta to answer about the Standalone Pharmacy strategic partner.

Suneeta Reddy:

Before I do that, I must say that the Pharmacy is a retail play. It calls for a high degree of dynamism and I think the ability, one is to increase your customer base, which this discount policy has helped them to do and the second thing is to be dynamic about closing stores which are really not contributing to EBITDA. I think the team is very well placed to grow this business to increase the number of customers, and when we do that we create value. Every quarter, we are building value in this space, and I think that we do have a plan to bring in a partner, and with every quarter let me tell you that the valuation of the pharmacy looks better. So hopefully by the end of the year we will be in a position to announce something, but at this time I have no specifics to tell you.

Moderator:

Our next question is from Praveen Sahai of B&K Securities.

Praveen Sahay:

Can you just give us some break up in the case mix? How much is the maximum percentage we are getting on an overall basis, like how much from the Cardiac or where we are improving in the sense like Oncology?

A. Krishnan:

So we are seeing a very good increase in Oncology volumes across the group. That is because we have some of the best technologies here as well as doctors, we have seen a good rise there; it is almost around 10% of our group wide revenues. Cardiology has been at 25%; it has been around 25 to 26% for a while now, because we are seeing some of the other high end tertiary care work, like Neurosciences and Transplants in particular, are seeing a very good increase. Transplants, as you are aware, that we are the largest solid organ transplant provider in the world" now with over 1400 transplants that we have done last year, and we are seeing transplants pick up across most of our hospitals now. On the back of that we are also seeing a good pick up of Robotic surgeries, which are being used for Urology as well as Gynaecology, we have seen a very good increase in Chennai and in Delhi in particular. Hyderabad is catching up as well in this regard, and we think these are some of the other areas, this is increasing apart from the traditional COEs that we have been focusing on.



Suneeta Reddy:

But just to add to that, I think we also want to capture the space which is the 'Woman and Child' space, and I think through the evolution of 'Cradle', this will be a high growth area too. The fact that we will create birthing centers that we are looking at the delivery space, not a sickness, but as a moment of joy. The contribution that it will make, the spin off that it will make to our pediatrics is also something that is significant.

Praveen Sahay:

We are spending more towards Oncology and the Transplant with Robotics and advanced technologies. How much can you just differentiate the ARPOB level? Earlier, these new segments are where we our growth has been a higher?

Suneeta Reddy:

While we have the data, it is pretty exhaustive, so let us take this offline. You can communicate with Krishna Kumar.

Praveen Sahay:

My next question is related to the foreign patients. How much contribution is coming from the foreign patients and how is the growth in that particular side which we are seeing?

Suneeta Reddy:

The foreign patient is very dependent on the airport infrastructure. For example, Delhi currently has 20% of its patients as foreign patients. But, there has been a 9% growth in volume of foreign patients across the group, and it accounts for nearly 12% of our total revenues.

A. Krishnan:

That is correct. Also, within markets, there has now been a specific focus in new markets like Africa. We have seen that Africa in particular has seen a growth of 25% year-on-year. So we think, that is going to be helping us to move some of these International patient businesses higher as well over the next few quarters.

Praveen Sahay:

My next question is with respect to the expansion side. In the expansion plan we are stating "Reach Hospital Nellore". Is that not yet commissioned or not yet started? Why is it still showing in the expansion plan for FY15?

A. Krishnan:

No, we have just started the pilot based on the outpatient side. We have still not commissioned it officially, so we will commission that in this quarter.

Moderator:

The next question is from Lalit Kumar of Nomura Securities.

Lalit Kumar:

My question is related to the breakeven period of the "Reach Hospitals" and the hospitals that we have opened in tier II-III towns and cities like Patna. Currently our hospitals break even in 18 to 24 months. So how do we see these hospitals break even?

Suneeta Reddy:

I think as per plan, they start to reach EBITDA breakeven in 18 months, within 2 years they become profitable.

Lalit Kumar:

If I have to look at these hospitals, because going forward these hospitals will be the key growth driver. So in terms of margins in a steady state, how do you see margin for "Reach" and tier II-III towns and cities hospitals?

A. Krishnan:

The cost of operating a "Reach Hospitals" is very different compared to the cost of operating a tier-I hospital in Delhi, Chennai, or Hyderabad. The costs are lower. So with that if you look at it, the existing Reach Hospitals in places like Madurai are at an EBITDA margin north of 20%. Even Bhubaneswar is now close to 20%. Also Bhubaneswar as you know is the last hospital that we had opened around

three years back, which now has 300 beds with over 80% occupancy, so the EBITDA margins would be north of 20% even here.

Moderator: Our next question is from Prashant Nair of Citi Group.

Prashant Nair: What portion or what percentage of your revenues in Chennai roughly come from outstation patients; patients who travel in from other states?

A. Krishnan: Almost around 40% of it comes from patients traveling from other states.

Prashant Nair: On a slightly longer term basis, as you reach out into more cities or tier-II locations, is there a risk that you cannibalize by some of your own patients who maybe travelling into your bigger hospitals in places like Chennai. If you actually capture some of that demand closer to the source, is there headroom within the Chennai market itself for you to make up that space?

Suneeta Reddy: I think you are right, Prashant. When we thought of this “Reach” concept, we thought whether we would be cannibalizing our patients, but the fact is that facilities would have come up in these towns anyway and we had a very strong brand reputation in these cities, say, for example, Madurai, Nellore, we were getting patients. So it just made logical sense that we capture that market with our own presence, and I think earlier on, we said that we had done some expensive marketing activities, invested in referral doctor relationships and also relationships with existing GP Clinics so that our presence in the local market would be much stronger, it was one of the reasons why we opened a hospital in OMR, so we were able to capture that catchment area. So I think that the local market is definitely big enough. Having said that the quaternary-care facility that we created Chennai will continue to draw patients from all over India if not all over Southeast Asia as well as Middle East and African countries, because of the intensity of work that is being done, including international patients which is increasing steadily.

Moderator: The next question is from Ravi Dodhia of CRISIL.

Ravi Dodhia: If we look at the occupancy even after adjusting for lower occupancy in the new hospital, your overall occupancy is still lower across different clusters. One of the reasons which you mentioned was collection in the month of April and May. But how do you see it panning out in the current quarter, July and August?

Suneeta Reddy: Occupancy is also a function of ALOS; our ALOS is currently at 4.1

A. Krishnan: Also it has come down 4% year-on-year. So, if you look at the adjusted occupancy, you would realize that it has been good, and it also gives us more headroom for increase in volume.

Ravi Dodhia: Is the occupancy of the hospitals in tier-II-tier III cities; Madurai, Karaikudi and Karur under pressure?

A. Krishnan: Madurai had some dip as we said in this quarter particularly because of elections. But having said that, we think the Madurai volume should come back in this quarter.

Ravi Dodhia: What portion of interest you have capitalized in the current quarter?

A. Krishnan: Approximately around Rs.9 crore.



- Ravi Dodhia:** What is the consolidated gross block as of now?
- A. Krishnan:** Can you take this offline? I would not have that number off hand.
- Moderator:** Ladies and gentlemen due to time constraints we will take our last question from Krishna Kiran of ICICI Direct.
- Krishna Kiran:** My first question relates to a total number of hospitals. Comparing the Q4FY14 presentation to Q1FY15 presentation, it can be seen that there has been a three hospitals increase. Can you help us out from where we have taken managed hospital and where we have other two hospitals are commissioned?
- R. Krishnakumar:** Two hospitals were there in Trichy and Nasik and the Bhilai hospital, the managed one, we have got it back again.
- Krishna Kiran:** Two-three years back, we had talked a lot in terms of the growth potential in “Reach Hospitals”. Now, if I look at our current expansion plan, other than “Nellore Hospital” which is going to be commissioned this quarter, there is no pipeline for “Reach Hospitals”. Can you throw some light on this when we are looking for further expansion of “Reach Hospitals” business?
- A. Krishnan:** Nellore is getting opened, Nasik is something that we have opened now, Trichy was something that we opened last year, Vizag will be ready soon. We have several “Reach” Hospitals. In fact you know Indore is a place, which is again a tier-II location, where we have taken 51% stake in an existing hospital of 125 beds, with an aim to take it to 200 beds over a period of time. So our “Reach” strategy is intact and will continue to see us grow in the tier-I locations as well.
- Krishna Kiran:** I also want to understand a broad classification. What is the classification difference between the “Reach Hospitals” and “Super Specialty Hospitals”? “Reach” is like a tier-II, tier-III cities kind of specialties concept which is broadly different from other hospitals. What is the broad difference between the hospitals which is coming in “Nellore” which is “Reach” and what is the difference in “Vizag” which is a “Super Specialty”?
- A. Krishnan:** Pretty much, as you said, one is the tier-II the city or the location itself, second is, given that it is tier-II, we would not do some of the Quaternary-Care like Oncology. This is something that we typically do not start off in some of the locations, but over a period of time some of these will move into Oncology as well. Transplants and some of the high end work will get referred back to the hub.
- Suneeta Reddy:** Also the robotic work.
- A. Krishnan:** Robotic work and some of the others will get referred back to the closest hub. So Cardiac is certainly part of steady state now and so we will certainly have Cardiac and then you have Orthopedics and some of the others.
- Suneeta Reddy:** It depends on the intensity of work, the level of specialists available and also the infrastructure. So a city like Chennai, Hyderabad i.e the big cities will take the quaternary-care work and tier-II cities will have “Reach Hospitals” which is more about higher secondary care and of course Cardiology. Also, Orthopedics is something that we do well and we are able to actually scale that business across our hospitals.



A. Krishnan:

The other thing is rather than widen our presence across disciplines in tier-IIs we try to deepen it. So based on the local requirements, for example, if there is a gap in Cardiac and Neurosciences in a market like Bhubaneswar, we would concentrate more on these two specialties as the mainstay. So these are certain things that we do in the “Reach” as opposed to the tier-I where we would kind of broad base our specialties across.

Suneeta Reddy:

Having said that I think what we are really doing is creating excellent operating theater infrastructure, excellent ICU beds, which means that most of the surgical cases in those cities will start coming to us.

Moderator:

I now hand the floor back to Ms. Suneeta Reddy for closing comments.

Suneeta Reddy:

Ladies and Gentlemen, like industry in all over India I believe the healthcare landscape has been changing. And while the demand remains extremely strong Apollo's focus on clinical differentiation and its ability to attract doctors will continue to fuel growth in this space. Thank you for being part of this call, and we look forward to a good quarter next in September. Thank you, Ladies and Gentlemen.

Moderator:

Thank you. On behalf of Apollo Hospitals that concludes this conference.