Moderator: Ladies and gentlemen, good day and welcome to Apollo Hospitals Ltd. Q3 & 9M FY20 earnings conference call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “*” and then “0” on your touch tone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Mayank Vaswani from CDR India. Thank-you and over to you sir.

Mayank Vaswani: Thank-you. Good afternoon everyone and thank you for joining us on this call to discuss the financial results of Apollo Hospitals for Q3 and 9M of FY ’20 which were announced yesterday. We have with us on the call today, the senior management team comprising Ms. Suneeta Reddy – Managing Director, Dr. Hariprasad – President of the Hospitals division, Mr. A. Krishnan – Chief Financial Officer, Mr. C. Chandra Sekhar – CEO of AHLL and Mr. Obul Reddy – CFO of the Pharmacy business.

Before we begin, I would like to mention that some of the statements made in today’s discussions may be forward-looking in nature and may involve risks and uncertainties. For a complete listing of such risks and uncertainties, please refer to the investor presentation circulated yesterday.

Documents relating to our financial performance have been shared with all of you earlier and these have also been posted on our corporate website. I would now like to turn the call over to Ms. Suneeta Reddy for her opening remarks.

Suneeta Reddy: Good afternoon everyone and thank you for taking out time to join us on this call. I trust that you have received our earnings documents which we had shared earlier. I am glad to report that this quarter we have continued to demonstrate the momentum of earlier quarters.

Firstly, our new hospitals achieved occupancy of 68%, with a volume growth of 16%. EBITDA margins in the new hospitals crossed the double-digit mark for the first time, with margins improving from 6.6% in Q3 FY19 to 10.1% this quarter. This is in line with our guidance, that with time, our Rs. 2,300 plus crore investments in the new facilities excluding Proton will deliver mid-to-high teen EBITDA margins.
Secondly, our margins in the mature hospitals continued to improve, moving from 21.8% in Q3 FY19 to 22.3% in the same quarter this year. This margin performance was possible, even if mature hospitals recorded occupancy of over 70%. The 50 basis points improvement in a traditionally low quarter indicates that these units are on track to deliver 23%-24% margins over the next 18-24 months.

Thirdly, AHLL continued on its profitable path and achieved positive EBITDA of Rs. 5.7 crore for this quarter, against Rs. 16.1 crore losses in the same quarter last year. The business has demonstrated a healthy growth in top-line at 22%, while delivering positive EBITDA in all its business segments, further solidifying its trajectory.

SAP also recorded a good quarter, with organic revenue growth of 22% y-o-y and EBITDA higher by 37% against the same quarter last year, at Rs 75 crore. Sales from Private labels are now at 8.1%. On profitability, network wide EBITDA margins are at 6.1% and mature stores at 8.5%. SAP ROCE is now at 26.5%.

In a seasonally low quarter, we must acknowledge that there were seasonality of festivals, north-east traffic dipping due to political uncertainties and theater closures. Despite these, we have achieved an overall revenue growth of 12% in the healthcare services.

Against that backdrop, I am pleased to share the results for Q3FY20.

Q3 Revenues grew 17% year-on-year to Rs. 2,530 crore aided by Healthcare services growth of 12% to Rs. 1,297 crore and SAP growth of 22%. SAP now constitutes 49% of our top line in the Standalone financials. New hospitals reported revenues of Rs. 297 crore, representing 16% year-on-year growth, while mature hospitals revenues grew at 9%.

Q3 total Inpatient volumes grew by 8% on a year-on-year basis supported by 16% IP volume growth in new units. Overall Q3FY20 occupancy across the Group was at 5,298 beds or 71%, compared to 5,017 beds or 70% in Q3 FY19. The occupancy in mature hospitals was at 3,929 beds or 72%. Our New hospitals had occupancy at 1,369 beds or 68%.

Q3 overall EBITDA Post Ind AS 116 was at Rs. 377 crore. The Pre Ind AS 116 Q3FY20 EBITDA stood at Rs. 319 crore as compared to Rs. 268 crore in Q3 FY19, a growth of 19% on a year-on-year basis. Within this, Healthcare services EBITDA grew by 15% to Rs. 244 crore. Healthcare services margins were higher by 40 basis points on a y-o-y basis at 18.8% in Q3FY20. New Hospitals registered an EBITDA of Rs. 30 crore in Q3FY20 vs. an EBITDA of Rs. 17 crore in Q3FY19. In SAP, revenues grew 22% y-o-y on the back of strong same store sales and increasing off take of private label products. We added 93 stores on a net basis during the quarter taking the total to 3,700 stores. SAP EBITDA (pre Ind-AS 116) grew 37% to Rs. 75 crore. The EBITDA margin was at 6.1% and with high asset turns in the business, SAP ROCE is now at 26.5%.

Net Debt as of January 2020 is Rs. 3,184 crore. We have a Debt-to-equity ratio of 0.82. and Net Debt to EBITDA of 2.6 times. We have in January repaid debt worth Rs. 340 crore which came from sales of the Munich transaction. We are on track
with our plan to reduce our Net Debt to around Rs. 2,500 to Rs. 2,600 crore post the pharmacy restructuring. I am happy to share that the Board has approved an interim dividend of Rs. 3.25 per share.

This quarter, we have stayed true to our mandate of consolidation, and have shown improved performance in both our mature and our new assets. Our assertion that focusing on asset utilization in the coming few quarters will show results with respect to occupancy and margin was validated by our performance this quarter.

Within the theme of consolidation, we continue to prioritize delivering a superior margin profile, through our focus on Centres of Excellence. We are confident that all these measures including our efforts to cut some cost will put us on the path of profitable growth that we have seen in the past several quarters.

That’s it from me. I have Dr. Hariprasad, Krishnan and Chandra Sekhar with me to now answer your questions. Thank you.

Moderator: Thank you very much. We will now begin with the question-and-answer session. The first question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: My question is on the operating metrics. So, we have seen some cost optimization, percentage of sales to staff cost and other expenses have come down quite a bit, even on pre-IND AS levels. We just started the journey, but how much percentage of say a total of 100 we are able to achieve currently and how much is pending in terms of cost optimization?

Krishnan A: So you are right, we have started few cost optimizations across three areas. One is the productivity on the manpower especially in some of the mature hospitals where over time we believe that with some of this automation that we have introduced, we think we can bring down the manpower and there is a team which is focused on productivity and manpower cost. There is also a focus around savings around energy cost, etc., where we believe that there is an opportunity to save some costs. And the third area has been consumables and utilization around that. So, we have a focus there. We believe there is overall opportunity of Rs.80 crore to Rs.100 crore that we would want to focus on over the next 12-months which is what we are focusing on. We have got some benefit of that in this quarter. You will see more benefit out of this in the next one year.

Prakash Agarwal: Secondly, you spoke about consumables. But if I see the gross margins per se, those are particularly flat. So am I missing something here or it has just started and we will see it in the ongoing quarters?

Krishnan A: So, you would probably not see it at the overall consolidated level because at the consolidated level what happens is you are looking at the new units as well, whereas in existing units and mature units is where some of the focus is. So, you will see that in the mature units’ margins as opposed to seeing it at the consolidated level. So that is the point there.
Prakash Agarwal: On the timelines for this pharmacy restructuring where we expect that further net debt reduction will happen. What are the approx. time lines for that?

Obul Reddy: We could achieve that by March end. The NCLT approval is expected in the next month and then we will ensure that the actions are taken within 30-days and the debt will come down.

Krishnan A: So, we are hoping it should be happening by March-end.

Moderator: The next question is from the line of Damayanti Kerai from HSBC. Please go ahead.

Damayanti Kerai: My question is regarding the margin pick up which we have seen for new hospitals. So, can you please elaborate more on which hospitals are mainly contributing towards this and which are the hospitals where you need to put more efforts?

Suneeta Reddy: I think of all the new hospitals that we started all of them are contributing significantly to margins. We do have a little less traction in Nashik and we hope that in the next quarter we are able to improve volumes and margins coming out of Nashik. But I think all of them are on track with budgets.

Damayanti Kerai: Which is the most prominent? Would you say Navi Mumbai is the most prominent among these hospitals or any other?

Suneeta Reddy: Surprisingly when we started the tier-2 hospitals, people were, let me say, that they were not fully confident about the strategy, but it is our tier-2 that has significantly turned around this quarter including hospitals like Nellore, Trichy. So, I think it is a validation of our investment strategy.

Krishnan A: Navi Mumbai independently is doing well and we are hoping that it gives a good set of numbers into the next year in particular.

Damayanti Kerai: My next question is regarding your centres of excellence offering. So, in a highly competitive market say, Bangalore or Chennai, how are you in an advantageous position compared to some of the competitors who have a larger focus on a particular therapy, say Narayana in cardiac care or HCG in oncology?

Suneeta Reddy: So, there are two things that we look at, one is creating clinical differentiation, and second look at how because of the clinical differentiation, we were able to increase our market share and thereby improved pricing. So, if you look at Chennai, we are doing laparoscopic heart surgery. We have a 23% market share in cardiac. And even in oncology, we are among the largest in terms of market share. So, it takes a little time for this strategy to play out and convert into numbers that we can share with you, but it is happening across the Group. If you look at Bangalore for example we have a surgeon called Sathyaki who does minimally invasive heart surgery. He is among the best in India. And even our orthopedic volumes are really high. We do about 900 knee replacements. Just going into the different segments, together, our orthopedic numbers are high, our cardiac numbers are high and we do look at market share, we not only look at market share of Apollo Hospitals within each of
the segments, but we look at the market share of each of the CoEs. And with that, oncology, now that we have got Proton is actually growing at about 17%.

**Damayanti Kerai:** So, you remain confident with the kind of clinical differentiation, which you mentioned, that should be helping you in continuous growth on the volume side on the crowded metro markets?

**Suneeta Reddy:** Yes.

**Damayanti Kerai:** My last question is regarding this Viability Gap Funding Scheme which the Government announced during the recent union budget to incentivize private hospitals to join Ayushman Bharat Scheme. So, any thought from your end, are you looking forward for the same?

**Suneeta Reddy:** Actually, it is a little bit early because we have not got all the details of how this could work. And when the details are out, we will definitely look at it and see what we can do to make sure that the hospitals are eventually viable.

**Moderator:** Thank you. The next question is from the line of Neha Manpuria from JP Morgan. Please go ahead.

**Neha Manpuria:** Sir, I just wanted to confirm, have all our gantries in Proton been commissioned?

**Krishnan A:** No, there is a second one which has just got recently commissioned, so it is not fully utilized and we would see full utilization of the second gantry in this quarter and the third gantry in the next quarter. So, it will be by April when we would see that all the three gantries are fully functional.

**Neha Manpuria:** And therefore, the loss number that we had given for Proton about Rs. 25 crore, that number still holds, or could the loss be a little lower because the utilization is being pushed out?

**Krishnan A:** It could be a bit lower and we would think that next year we should get into profitability as well.

**Neha Manpuria:** As we reduce debt and generate cash flow next year, how do we prioritize new investments by the way of M&A versus Greenfield expansion, what would be our focus market thoughts there?

**Suneeta Reddy:** So clearly, we want to be dominant players in certain markets where with the free cash flow we will generate, we will be able to do that. Definitely, Chennai is one of them where we already have a substantial presence and we will continue to operationalize more beds and therefore take a dominant market share in Chennai and Tamil Nadu. The second place is of course Hyderabad, Telangana and then the State of Andhra Pradesh, where we have Vizag, Kakinada and Nellore. The next one, of course is Bangalore, Karnataka, where we have three hospitals in Bangalore and one in Mysore. The first thing we will look at is operationalizing more beds where we have the opportunity to do so or constructive beds in places where we have like for example Bannerghatta Road. The second would be to look at some bolt-on acquisitions that would enable us to garner market share in these
markets. As you know we have been looking at a property in Mumbai so that our presence is significant and we will continue to do so. So, like we made bolt-on acquisitions, for example in Guwahati, Indore, Lucknow, we will look at some of these markets and see whether it makes sense and whether it is feasible.

Neha Manpuria: If we look at our new beds, we can operationalize the new beds that are already being constructed quite significantly over the next two years and then we are talking about potentially looking at adding bolt-on acquisitions or constructing new beds. Which would be our priority, if you are looking from a five-year perspective, do you think we need to continue to add more hospitals in markets where we think we are under-penetrated, is that the way to look at it?

Suneeta Reddy: Yes and I think on the land that we have…

A. Krishnan: So this plan, most of this bolt-on and some of these plans obviously will be more for three years and beyond. The next three years, you are right, we have capacity, but some of this will start, we will have to start doing it now, so that we see the benefit of that coming by say FY24 or FY25.

Neha Manpuria: Which markets would these preferably be in?

Krishnan A: Bangalore is one area of interest for us, Calcutta is obviously interesting for us, and Mumbai is an area of interest for us. So, we have been looking at markets and we will keep looking at it.

Neha Manpuria: My last question is on the Kolkata JV. We will buy that out sometime next year, right, because of IHH now acquiring a competitor?

Suneeta Reddy: I think we should discuss this some other time. But we do have an interest in buying out that JV. And like our CFO said, we think Kolkata has potential, and that Apollo’s brand name in that market is very strong.

Moderator: Thank you. The next question is from the line of Anubhav Aggarwal from Credit Suisse. Please go ahead.

Anubhav Aggarwal: My question was on the utilization that we have in the hospital segment. Our systemwide utilizations are about 65% to 70% right now. Just a simple question, in the last call, we said that we need to have a low capex next year, let us say Rs.250-Rs.300 crore kind of capex. But for how many years can we have that leeway? We are at 65%-70% utilization, we do not spend. We may just be good for another two, three years, right? So, after that we may start becoming capacity constraint?

Krishnan A: So, two things, one is from an overall perspective, we still have not operationalized all our beds. There is still capacity within our existing hospitals especially the new ones, where we can add more beds. So, while you look at the overall percentage, at least around 1,000-odd beds can still be added across these, for example, Mumbai, we can add in the existing facility another 200 beds, we have Vizag, so many of these new hospitals, Trichy, Chennai, we still have capacity where we can just add it. It is already there, structure is there, just beds needs to be added. So, to
that extent, the 68% when you look at it, it is the operational beds, and it is not of the full capacity. So, you should give us the benefit of that for the next couple of years. And beyond that too, you would see that even as we grow now, you would realize that the free cash flow that we are going to be able to generate will be sufficient enough for us to look at some of these acquisitions and we know that the Net Debt to EBITDA and the debt to equity, etc., will be at comfortable 2-2.5 levels and it would not go above that.

Anubhav Aggarwal: What is the capex that you have done for the nine months?

Krishnan A: The project capex for the nine months period has been around Rs.250 crore. This includes the Proton facility and we have also showed the oncology and neurosciences facilities in Hyderabad where we have added some capex around that. The Vizag also we have started oncology which is around Rs.20 crore-Rs.30 crore which we have added there. All of this included the project capex was around Rs.250 crore in this year. The non-project capex up to now has been around Rs.150 crore. The non-project capex is in line. This is what we have been guiding, saying that the routine and recurring capex going forward from the next year would be more around the Rs.200 crore to Rs.225 crore to Rs.250 crore at best. even if we added some of this new capacity, etc., you can at best look at Rs.200 crore to Rs.250 crore of overall capex from next year.

Anubhav Aggarwal: Just to understand the debt increase that we have seen in nine months. We have seen almost Rs.250 crore debt increase. So, you also paid a dividend of Rs.100 crore in nine months. So, Rs.400 crore of capex, Rs.100 crore of dividend, Rs.500 crore, we would have generated cash flows of about Rs.600 crore roughly?

Krishnan A: You have considered the interest and you should consider tax as well because we are on the full tax regime. And in this year, you would have seen that we would expect in the next six months, some of our working capital to also get released because you would have seen that there has been slowdown in the payment from some of the Governments like ECHS, CGHS, etc. Though we do not have significant focus there, but still, we know that around Rs.100 crore of cash is locked in there incrementally in the last one year. Some of that should start getting unlocked over the next six months. So there has been some working capital lock up also in this year which is more than what we have seen in the past.

Anubhav Aggarwal: Just one clarity on AHLL. Sequentially, our revenue increase is not as much as our EBITDA increases. I was just wondering that have you cut down a lot of cost in the Specialty Care segment?

Chandra Sekhar: So, we have over 4% gross margin. Some of the businesses have had 7%-8% gross margin which is on account of our focus on costs on direct expenses. Besides that, our fixed costs also we have managed to keep it at a low level. Year-on-year with the new shops also we are at 6% against previous year on fixed costs. So that I think is a combination of that. Our growth rate though is still being maintained at 21% in Specialty Care and Diagnostics at 34%-odd, primary care which saw previous year degrowth, has actually started delivering 18% year-on-year growth, that is nine months versus nine months comparison. It is a combination of top line growth, steady, profitable top line growth and focus on both items above gross margin as well as fixed costs.
Anubhav Aggarwal: Can you talk about a little bit on what is the nature of items that you have been able to contain some of the fixed cost?

Chandra Sekhar: Major area is on consumables and we have also rationalized and optimized our doctor payout structures and we have had good oversight on our manpower cost. In a sense, the manpower cost is similar; we have been appreciating the utilization. So, in that context, the manpower cost on a count basis does not change, but on a cost basis as a percentage to revenue changes.

Moderator: Thank you. The next question is from the line of Shyam Srinivasan from Goldman Sachs. Please go ahead.

Shyam Srinivasan: My first question is on the ARPOB trends. I recollect last quarter you had said that most of the growth is coming because you are moving to surgical versus medical procedures. The trend again this quarter has been good. So, I just wanted to understand what is happening there and Karnataka I notice like very high 15% ARPOB growth. So, is there some like base effect or some change last year versus this year?

Krishnan A: No, there has not been any. So, it has been the specialty mix which has enabled in the Karnataka region. There has not been any base effect which we have seen particularly in Karnataka, it is Bangalore and we have seen a good increase specifically in neuro cases, etc., in Malleshwaram and as Ms. Suneeta said, we have a very strong orthopedic team in Jayanagar. And Jayanagar is also performing well and that are high ARPOB units. So that is one specific reason in Karnataka why we have seen increase in the ARPOB.

Shyam Srinivasan: Krishnan, I just looked at the Q3 FY19 presentation. That time ARPOB had grown only 1% in Bangalore versus the year before. So, if I do two-year CAGR seems okay, 7% to 8% whatever. So that is what my question was based on but you think nothing else is there, right?

Krishnan A: No-no, nothing else.

Shyam Srinivasan: And on the overall, are we like confident and is there visibility that we can do this kind of ARPOB increase next year also? Is it a function of pricing power or mix?

Krishnan A: Combination of both. We are still looking at 4% to 5% price increases which is happening every year. We are focusing across our CoEs, oncology is a specific area of focus. So, all of these should enable the other 3%. So, we would still continue to think a 7% to 8% ARPOB is possible.

Shyam Srinivasan: Just linking to one question earlier on oncology. I think the numbers mentioned, was it 17% growth? Sorry I did not get that.

Krishnan A: Yes, that is correct, 17%.

Shyam Srinivasan: Absolute number for oncology and what is it for the network now?
Krishnan A: We will get that to you later. I think we should be shy of Rs.1,000 crore this year for overall, but we will get back to you later.

Shyam Srinivasan: Last question on Proton. I think revenue seems to be inching up nicely. How many patients did we do this quarter? Are we on track for the 400 next year and losses like I think what Neha’s question was?

Krishnan A: That is true, in fact, next year, Proton should turn profitable as we said at the EBITDA level and should give us a good Rs. 25 plus crore of EBITDA. Let the third gantry get operationalized in April. The availability of the gantry is also only for eight hours. Only from April, we are going to be seeing it being available for 16-hours. So, it is then that we can take more patients and then be able to start off with 20-25 patients and then accelerate with time.

Shyam Srinivasan: So what’s the number of patients in this quarter?

Krishnan A: 40 patients.

Shyam Srinivasan: Versus 53 last quarter I thought. I may be wrong.

Krishnan A: So, should be around the same number. So, I do not have the exact number.

Moderator: Thank you. The next question is from the line of Sameer Baisiwala from Morgan Stanley. Please go ahead.

Sameer Baisiwala: How do you think about the top line growth for mature hospitals over the next couple of years?

Suneeta Reddy: So top line growth for mature hospitals will come from two things, one is that as we reduce our ALOS, our ARPOB is going up significantly and we will therefore have more capacity utilization. The second that we spoke about is our CoE strategy which again is increasing ARPOB and we are seeing significant growth because of that. The third initiative that we are looking at is to increase our OP volume because we are focusing now on preventive health and we are creating space to take in more volumes in the OP space and also start conversions from OP to IP. So, I believe, that these three significant initiatives will help grow both top line and the EBITDA in our mature hospitals and we have shown that, if you look at Tamil Nadu, we grew by 13%. A lot of that growth came from the Chennai cluster. Even the Chennai cluster, which is quite a mature cluster showed about 9% growth.

Sameer Baisiwala: So, all of these efforts put together, should get us to double-digit growth over the next couple of years for top line mature hospitals?

Suneeta Reddy: Yes, it should, I think we are working towards that. Also like I said earlier, if you look at the mix of medical and surgical, we are focusing on the surgical work and that will get us into double-digit growth.

Sameer Baisiwala: Just on the ALOS reduction, I am just looking at the last three, four quarter trends. We have pretty much stuck at 3.9 to 4 or actually five, six quarters on overall
broad? So, what is going to accelerate this journey down 2 or 3 that you once mentioned?

Suneeta Reddy: So, if you look at the new hospitals, average length of stay is about five and six. And in some of the old ones where PPP with the Government; we have almost eight. So, the average is looking a bit high. But if you look at mature hospitals like Chennai, it is only 3. So even post open heart surgery, we are able to discharge a patient in the third day. So, I think that with technology and with our clinicians being so good, we are able to do so much in three days and that frees up our assets where we can actually improve asset utilization as well. So, as new hospitals mature, the same thing will happen in new hospitals as well.

Krishnan A: So, this is a gradual change you will see. It would not be a sudden change in the next year, but you will definitely see directionally in the next couple of years that we should be able to bring down the overall ALOS.

Sameer Baisiwala: My next question is on AHLL. What can accelerate the revenue growth? I think last couple of quarters we are at gross Rs.185-odd crore and net Rs.135 crore. Which format is going to help us, can this move up dramatically 20%, 30% growth, is that possible?

Chandra Sekhar: The Diagnostics division we have got plans and the growth rate in the diagnostics division will continue to grow at mid-30s level even we are targeting new market entries, which will help us accelerate the growth further. So, that is a division which will continue to grow. Primary care and other segments, the clinic segment, we are hoping to cross the 20%-odd. Similar focus on preventive health which Ms. Suneeta mentioned applies to the primary care outpatient centers. We are hoping to continue to keep the growth rates beyond 20%. Our growth rates in the burning space will be continuing to be around 25%. And the IVF space, the fertility space is where we are planning for an accelerated growth. The growth rates there will be a combination of better utilization on existing centers, plus small expansion opportunities that we are considering.

Moderator: Thank you. The next question is from the line of Prashant Nair from Citi Research. Please go ahead.

Prashant Nair: One follow-up question on the average length of stay. So, in new hospitals, the current level is more a function of us not putting much pressure on this lever or has it got to do with case mix or any other factor?

Suneeta Reddy: No, I think in new hospitals, clearly, what you want to do is to drive volume growth and cover fixed cost. For example, in Trichy and Nellore and all we really started to focus on CoE where you will start to see improvement in margin and reduction in our loss. But the key is to start by covering fixed costs and make sure that in that city they have significant market share.

Prashant Nair: Second question is on Proton. Are we still thinking of some kind of structure for this or do we now intend to keep it as a regular part of our own business?

Krishnan A: That is still something that we are looking at and we will get back to you as we get closer to it.
Moderator: Thank you. The next question is from the line of Prakash Agarwal from Axis Capital. Please go ahead.

Prakash Agarwal: Did I hear correct on the Capex, around Rs.300 crore for next year and Lucknow, Guwahati and if at all Kolkata happens, those are separate, would that be correct to assume?

A. Krishnan: Lucknow is already done, we have already completed the Capex. So, Kolkata would be outside. So, the routine capex would be Rs.250 crore. Some bit of Proton overflow if it goes beyond March will be there, which should probably hence take it from Rs.250 crore to Rs.300 crore, otherwise Rs.250 crore as the routine capex. And Kolkata alone we will have to see how it works which is where we will also come back on Proton if there is an opportunity, we will do that.

Prakash Agarwal: Anything on Guwahati?

Krishnan A: Guwahati, not much, nothing specific now.

Prakash Agarwal: One more thing on the pledges. So, what is the target that we are eying, since the big event has happened, so we would probably see in the March update, so, what is the target we are looking at by March of this year and what is the ultimate target going ahead?

Suneeta Reddy: I think we are currently at 29%, where we think that we could do around 25%. March, April we should be able to bring it down.

Moderator: Thank you. The next question is from the line of Harith Ahamed from Spark Capital. Please go ahead.

Harith Ahamed: My question is on the pharmacy business. We have added around 100 stores this quarter and we have been tracking a similar number for quite a few quarters now. So, I am trying to understand which geography or States most of these stores are getting added, whether these are Tier-1 or Tier-2 locations and then do we expect to maintain this level of additions going forward?

Obul Reddy: Yes, as informed earlier, we have been adding about 300 to 325 net stores every year, primarily in South, Odisha, West Bengal and Delhi. We will continue our expansion in this range in the same geographies.

Harith Ahamed: And could you give us a sense of the geographic breakup of the current 3,700-odd stores, what percentage would be in the south?

Obul Reddy: About 65% of the stores is in the south and the rest is from the States that include, NCR, Odisha, West Bengal, Gujarat, Maharashtra. And the four states combined, Andhra, Karnataka, Tamil Nadu gives us close to 65% of the stores.

Harith Ahamed: Second question is on the front end pharmacy deals which you said will close sometime in March. So, when I look at the numbers for the pharmacy business when you announced the deal around 18-months back and from then to now, we have had quite a significant ramp up in this business from around Rs.30 to Rs.40
crore quarterly EBITDA to now over Rs.70 crore. So, does this require a relook at the valuations for the deal, the consideration of Rs.530 crore for what is roughly 20% of the economics of the business, does it still hold, any thoughts around that?

Obul Reddy: The economic interest for Apollo is structured in the business plan that we have taken at the time of the transaction. Anyhow the transaction is effective from 1st April 2019 and going forward we will maintain the same economic interest for the Apollo.

Krishnan A: And this was as per the plan. Whatever has been generated now as you are seeing is as per the plan that we had, of course, you would not have visibility to that, but this was in line with our plans as well. So, the back-end would still capture the bulk of the economic value.

Moderator: Thank you. The next question is from the line of Shantanu from S&M. Please go ahead.

Shantanu: My question is do you track metrics like readmission rates, success ratio and death ratio?

Suneeta Reddy: Yes, we do track readmission, and this is done on a monthly basis for every specialty, every surgery and every in-patient admission. What was the second part of your question?

Shantanu: How much is the operation success ratio and death ratio?

Suneeta Reddy: Yes, we track success ratio for each of our surgeries, for example, in heart surgery, our success rate is 99.6%, about the best in the world. Death ratio, yes we do that too. In a high acuity hospital, ours is pretty low; it is about 0.02. So, we have something called age parameter which are tracked by the audit committee and the board periodically. But beyond that, we have access to that information which we look at monthly. So, there is a dashboard, and this comes from all our hospitals. So, it is a little different for each of our hospitals. But let me tell you that we benchmark with the best in the world; we benchmark with Cleveland Clinic in heart and every quarter we watch this.

Shantanu: So, on a consolidated basis, can you share three final numbers for these readmission, success and death for nine months?

Suneeta Reddy: I think we can take it off-line and share it with you.

Moderator: Thank you. The next question is from the line Sameer Baisiwala from Morgan Stanley. Please go ahead.

Sameer Baisiwala: Any update on the profit capping for in-house pharmacy?

Krishnan A: Nothing specific that we have so far.

Obul Reddy: We keep hearing those things in the news. We do not have any specific thing on the table.
Krishnan A: But as we said, we have already moved to the service pricing across and we have procedures pricing for almost 100-plus procedures and even if there were any changes around the capping, we think we should be able to overcome the same.

Sameer Baisiwala: Can you just update us on the payer profile, cash patients, insurance, scheme patients, etc.

Dr. Hariprasad: The cash would be something of 50% now. The insurance is around 25%.

Krishnan A: And the balance would be PSU, CGHS, ECHS.

Sameer Baisiwala: How do you see this going forward in next three years or so?

Krishnan A: Insurance is growing and we think the insurance could probably move up from the 25% to maybe 30%-35% in the next couple of years. That is what we think should move up and that should probably also help us because we also believe that as insurance penetration in India is increasing, there is also a general tendency for the patients to opt for quality hospitals such as us. Because they are otherwise worried about the cost, etc., which sometimes with the insurance pay, making the payment they are more comfortable getting to hospitals like us. So, which is where we believe that should actually do well for us. We have seen that it is helping us in markets like Bangalore and Mumbai already and I think other markets should also see that benefit coming over time.

Sameer Baisiwala: What goes down if insurance goes up?

Krishnan A: Walk-ins can go down, but that is okay as that does not change the overall revenue intensity for us. In fact, in insurance, we have seen that we typically get higher ARPOB cases also because it is more the complex cases, etc., that people opt for us. So, that should typically help us.

Sameer Baisiwala: And the margins on an average would be higher for cash versus the other two?

Krishnan A: Cash and insurance are typically the same.

Sameer Baisiwala: One final question for Proton, what is the split between the international versus domestic patients?

Krishnan A: 70% domestic, 30% international.

Sameer Baisiwala: For next year, etc., you expect this to change or to remain same?

Suneeta Reddy: Yes, I think we expect it to remain the same.

Sameer Baisiwala: Are you surprised that such a big take up from domestic at this high price point?

Suneeta Reddy: No, I think that if you look at the way that oncology is developing, it has become the gold standard for treating tumors in certain areas which include the brain, the lungs, the heart and for all pediatric cancers. So clearly, it is the gold standard. So, the demand will continue to grow.
Krishnan A: They had done this recent study in the JAMA Journal where they said that overall, they found that when there was this cancer which was more localized, which is where there is a specific use of Proton. They realize that there was a reduced acute adverse event, also reduced unplanned hospitalizations and overall survival rates were also higher. That was a very recent study which was done. There is a very good offtake of Proton as we see in the west specifically in places like MD Anderson where last year, they have treated 800 patients. So, we are quite hopeful that the offtake should be good over the next couple of years.

Moderator: Thank you. The last question is from the line of Raj Mohan, who is an individual investor.

Raj Mohan: You have previously indicated the margins for new hospitals heading towards 15% in two, three years. We have seen impressive improvements in the last few quarters. Do you think as you accentuate further on this execution, the resulting operating leverage could be higher than the 15%? With such execution on mix and its resulting benefits, by when would you head towards the current mature hospital margins of around 21% to 23% in the new hospitals?

Krishnan A: So, I think the first step for us is to get to the mid-to-high teens. That is what we have said we should get to. We are hoping that we get there by the next 12 to 18-months. That is the hurdle that we need to get. And then we will get to 22% after that. So, let us first get to the 15%-18% over the next 12 to 18 months.

Raj Mohan: But as you see the trends that are currently showing, do you feel you would be able to achieve your targets of mid-teens before what you had previously anticipated?

Krishnan A: Yes, we could. So definitely, there would be an acceleration to the mid-teens. From the mid-teens to the +20% is also a factor of how we are able to get our doctor mix right, the specialty mixes right, how the business of the hospital, etc. A lot of the utilization of the hospitals and the case mix will also play a big role to get it higher. From 15% to 18%, we can still get, from 18% to 20% we can get. So, get to the 22%-23% will take a couple of years.

Raj Mohan: Next is growth in pharmacy as well as the operating leverage at play have been pretty impressive over the last few quarters. In this context, have operating margins in old established pharmacies settled at 8%-9% peak or are they moving further up? Apart from the private label share improving, are we also seeing a core structural growth with better visibility for all pharmacies, better logistics control, etc.

Obul Reddy: You are right in all the statements that you made, it is the logistics, then store level focus on achieving the sales as targeted. Then as you see that private label has increased in the last three quarters from some 6.5% to 8% plus, so all this contributed. We continue to focus on that and see how it works. And our mature stores as you said rightly it is at +8% margins at this point in time.

Raj Mohan: But further scope for improvement possible?

Obul Reddy: We should improve further because we have some plans to increase the private label ratio which will have all these things coming together.
Raj Mohan: Based on the impressive trends in the operating cash flows and basic running Capex for immediate future also being low, what is the thought process on reduction of debt annually post this fiscal?

Krishnan A: So, as we said, we would anyway see that our Net Debt to EBITDA level should be comfortable. So, we can do a combination of debt reduction and planned expansion. So, we would be guided by opportunities that we have around the strategic interest that Ms. Suneeta guided and the overall Net Debt to EBITDA. We would keep the Net Debt to EBITDA as we said below 2.5 for sure. That is the plan that we have. And basis that we will see what are the opportunities, and if there are not many opportunities we will pay down the debt.

Moderator: Thank you. We take the last question from the line of Damayanti Kerai from HSBC. Please go ahead.

Damayanti Kerai: Could you broadly indicate in our hospital network what is the ratio of doctors on fixed pay compared to the visiting doctors or visiting consultants?

Krishnan A: We will have to take this question offline.

Moderator: Thank you. That was the last question. I would now like to hand the conference back to the management team for closing comments.

Suneeta Reddy: Thank you for taking time out to attend our call. As always, Apollo is committed to excellence in everything that we do. Our investments in technology, clinical talent and our management has resulted in the great clinical outcomes and our strong financial performance. Thank you for being part of this journey and we look forward to continued interaction with you next quarter.

Moderator: Thank you very much. On behalf of Apollo Hospitals Limited, that concludes this conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.