



Apollo Hospitals

Q4 FY10 Conference Call Transcript

11:00 am May 31, 2010

Moderator Ladies and gentlemen, good morning and welcome to the Apollo Hospitals Q4 FY10 Results Conference Call. As a reminder for the duration of this conference, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal an operator by pressing * and then 0 on your touchtone phone. Please note that this conference is being recorded. At this time, I would like to hand the conference over to Mr. Mayank Vaswani from Citigate Dewe Rogerson.

Mayank Vaswani Good morning and thank you to all of you for joining us on this call to discuss our financial results for financial year 2010. We have with us today Ms. Suneeta Reddy – Executive Director, Finance; Ms. Shobana Kamineni – Executive Director, new initiatives; Mr. K. Padmanabhan – Group President; Mr. Venkataraman – CFO; Mr. Krishna Kumar – Senior General Manager, Finance; and Mr. Obul Reddy – Senior General Manager, Finance.

Before we begin, I would like to state that some of the statements made in today's discussion may be forward-looking in nature and may involve risks and uncertainties. For a more complete listing of such risks and uncertainties, please refer to the investor presentation posted on our website.

We will start with Ms. Suneeta Reddy who will discuss the operational highlights and progress on new hospitals. Mr. Venkataraman will then discuss the financial highlights and Mr. Padmanabhan will discuss highlights of the pharmacy operation, insurance, and BPO. Documents relating to our financial performance have been e-mailed to all of you earlier and have also been posted on our corporate website.

I now invite Ms. Suneeta Reddy to provide key highlights of our performance for the quarter.

Suneeta Reddy We closed the year 2009-10 with 26% growth in consolidated revenues, the number is close to 2,058 crore. Our EBITDA margin expanded to 17%, 335 crore of EBITDA and 137 crore of PAT. We did this by increasing the number of beds. Apollo Hospitals opened 500 new beds this year and we opened 300 beds in Bhubaneswar, 80 beds in Pediatrics, and about close to 200 beds in Mauritius. Out of which, we had 250 operational beds.

For many of you who are not familiar with the hospital industry, it is not just about opening beds but actually making them operational through strong clinical capabilities. Today, if we have the ability to drive revenues at a premium if we were able to reduce our ALOS and prescribed case mix and thereby improve margins, it is because of our strong clinical capability and the business model that has sustained the leverages and outstanding clinical performance from our doctors.



Apollo Hospitals' strategic priorities, however remain, to sustain leadership in the fields that we call CONORCT which includes Cardiology, Oncology, Neurology, Orthopedics, Radiology, Critical Care, and Transplant. We also will build focused centers of excellence for the best of technology facilities and clinical practices in each of our tertiary care hospitals and to develop and retain the best care providers which are of importance.

We plan to expand and invest strategically through capital efficient expansions into target geographies within India with a focus on having a dominant position in each cluster. This will be implemented within capital norms for each delivery format. We also plan to seed and build strategic businesses, example Apollo Munich that support the core value proposition, while doing this, we hope to increase shareholder value by guiding growth and profitability in our mature hospitals through a continuous improvement culture and KPI driven performance and to focus on new hospitals and associate businesses to target profitability and return on capital employed. Our third initiative is the timely divestiture of non-core units.

Apollo strength clearly has been our focus on the ability to innovate not only in the way we deliver clinical outcomes, but in the way we develop our business models. We have seen that through what we have done in all our towns. In Chennai, for example, we were able to create tertiary care hospitals. We were able to reinforce the Hub and Spoke model by creating First Med which is a community hospital. We have also created the Pediatric Hospital.

As we move on into the next year, we will strengthen our presence in Tier II cities by development of Reach hospitals. We planned to open at least 500 beds in this area. Innovation is also about reaching out into the Tier II cities with lower cost per bed tertiary care hospitals that deliver both tertiary and primary care, clearly capturing pent up demand in Tier II cities where the cost per bed will be under Rs. 40 lakhs per bed. Innovation at Apollo Hospital is also about our public and private partnership. With the Government of India, we have planned to set up dialysis units. Our unit in Bilaspur which is a joint venture with Coal India is a clear example of how public-private partnership can win benefits and profits to both.

Innovation in the clinical space is one that sets Apollo apart from the rest of the hospitals. We have conducted the largest number of cardiac surgeries which is 7,600 with a success rate of 99.2 which equals Cleveland Clinic. During the year, we conducted 450 liver transplants. Apollo Hospitals, Ahmedabad completed 20 stem cell transplants. We started a neuro rehabilitation program in Chennai and for the first time, the ceramic coated knee replacement was done in Apollo Specialty.

I think I can go on with the list of clinical achievements that we have done and the new equipments that we brought but we are continuously innovating in the clinical space where we combine the best of technology with the newest in procedures to produce the best clinical outcomes.

In the bed capacity, we added 350 beds in Bhubaneswar, in Lavasa we added 100 bed facility. The newest in the group is the 80-bed Children Hospital which really turned EBITDA positive in the first year itself proving that there is pent up demand in the pediatric space and Apollo has been able to get the best doctors to really deliver outstanding clinical outcomes in this space.

Coming to our CSR initiatives, we were the first to actually set up swine flu centers. We have conducted 15 mega health camps. We have done 2,500 cardiac surgeries for SACH which is Save a Childs Heart. Of all our initiatives it completes our strategy of being a 360-degree provider of health care services. We have adopted a



holistic approach to the health care industry through our presence in different parts of the spectrum ranging from specialty health care to insurance to pharmacies. We believe that there are niche synergies in our portfolio and are sure that they will be more pronounced as we acquire greater scale.

I will now ask Mr. Venkataraman to take you through the financial highlights.

Venkataraman

I will now go to slide #13 which shows the performance as a snapshot. The important thing here is the significant turnaround of the subsidiary which you can see there is a 2.39% increase in the EBITDA margin with Bangalore, Ahmedabad, and Calcutta in the turnaround mode.

Coming to the Mature Hospitals, the important point to note here is the generally prevalent in the mindset that mature hospitals will reach a plateau in occupancy and growth. If you can focus on the Chennai cluster, you could see that the average revenue bed per day has gone up from 13,265 to 16,218 and also in Hyderabad, it has gone up from 8,900 to 9,600 while in the rest of the group, it is 4,800 to 5,390. So you will see that not only the new facilities are turning around, the mature Hospitals are also improving through increasing average revenue per bed day by focusing on reducing average length of stay through pricing and through case mix improvement and this is I think a very important trend and the hospital based pharmacies also grow revenues at 15% and EBITDA at 35% plus.

Now, we can go to slide #9 which shows the consolidated financial performance. This is just a repeat of what I said. The top-line has grown by 26% and the profit after tax by 30.4% which is a significant improvement showing that all the work that we have put in to creating these joint ventures and subsidiaries is now paying off and they are in turn around mode as I said earlier.

Going to slide #11, we talked about the standalone financial performance, here again the top-line growth is 25% and the bottom-line growth is 29% and there has been a PAT improvement of around 22 basis points.

Going to slide #12, this shows both the quarterly as well as the YTD numbers for the year. The important thing to note here that this is not unaudited, but audited sorry for that mistake. The important point in the slide is the ROCE; the Rs. 18,571 million that you see compared to Rs. 12,554 million of last year, there has been an increase of around 600 crore in the capital employed in the health care services. Of which the 300 crore is towards capacity creation. The other 300 crore is actually cash on hand, so to this extent the ROCE though appears different has to be viewed in that context.

Now, we had standalone pharmacy's operational performance which I request Ms. Shobana and Obul Reddy to take over.

Shobana Kamineni

I think that in the standalone pharmacy segment, our turnover has increased from 45% over the previous year which is significantly what we have expected and that performance will continue. The GP has increased from 19.5% to 21.25% in standalone which is an increase of 152 basis points. The employee cost and administration expenses are being controlled. We have among the lowest in terms of rental cost in the country over a complete segment of 1,000 stores compared to our competitors and even in an analysis in terms of our mature stores of sales per square foot we've increased.



We brought down losses from the previous year from 18 crore EBITDA losses to 9.4 crore and I am happy to say that in the last quarter, we have actually turned profitable as per expectations with EBITDA neutral and actually of plus point 2 million for quarter 4.

The overall turnover in terms of the standalone pharmacies and the hospital-based pharmacies has crossed 1,000 crore which is a significant milestone and you might say what does that translate into? It actually shows that in this division, we are a significant player in that, only the army and the state governments actually turnover and reach and procure more medicines than Apollo Hospitals. So we are among the largest purchasers in the group and I think I must say this is forward-looking, but we will be one of the great beneficiaries when GST comes into play and we can move our material across states with this.

This year, we closed about 80 pharmacies. In our portfolio, we have 1,050 pharmacies and with strong performances being shown.

We bettered our expectations in Apollo Munich, the turnover increased from our expectation of 105 crore to 115 crore, but having said that, we changed the case mix from loss making as you all know group sales are loss making. We moved more towards retail and profit making and we have actually been able to bring down our portfolio to about 98% in terms of the overall spend whereas most insurance companies in this health segment are running a book at about 120% to 130%. Apollo Munich is running it at 98% to 105%. So I think we are better than our peers in this. We actually projected a loss of 94 crore. We were able to contain that to 87 crore, so what we are seeing in the last quarter is that we achieved a positive technical result on our retail portfolio and I think that is very significant and our agency portfolio our digital is turning profitable.

So the indicators are, that we are completely set this year again - we expect 100% growth and the segment itself is starting to look very exciting with many players tying up with life insurers and actually leveraging strength. So I think as a forecast for the sector, the next 3 years will be extremely bright. This year, we also effected a name change as Munich Re realized that they re-organized their health portfolio into a separate vertical which comes directly under Munich Re rather than the subsidiary which was DKV and having said that, we were the first JV to be given the name of Munich from Munich Re and I think it shows significant confidence in this operation and in the India story for this. About the medical value travel that last year Apollo did add 200 beds for this and we have definitely done very well on this segment and we think now for this year especially there are big plans on given the trouble in Thailand.

Suneeta Reddy

When you look at the growth of foreign patients, our hospitals have done exceedingly well. Most of our patients are from the Middle East but we have started getting patients from Canada and the U.S. Total growth in foreign patients has been 10% on a system-wide basis, but hospitals which are closer to airports where there are more international flights for example Delhi has seen a growth of 20%, so we believe that this is the segment that is growing dramatically with trouble in Bumrungrad in Thailand. A lot of patients are being considering India as an option and Apollo with JCI accredited facilities, we believe is the first option that they are looking at in India.

I will now ask Mr. Padmanabhan to speak on our CAPEX plans and to give an overview of Apollo Health Street.

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Coming to CAPEX plan, we have just completed a 45-day expansion of Oncology Center at Apollo Gleneagles in Calcutta. We are also in the process of completing an expansion of 100 new beds at Hyderabad; this is the international block at Hyderabad catering predominantly to foreign patients. We will also be commencing operations by the end of the year in four reach hospitals approximately of about 100 to 150 beds each in Nellore, Karaikudi, Nasik, and Sriperumbathur. This complete expansion which will take place during the year will cost approximately about 250 crore.

Very briefly on the pharmacy side, I would like to take a look at the EBITDA growth among the mature pharmacies and you will find there has been a dramatic growth in the EBITDA in the mature pharmacies, clearly that is the road map of how the pharmacy business will unfold. While the pharmacy business continues to be a very important part of our business, we are looking at when we could actually extract value out of this business, get in a strategic partner at some point of time and therefore unfold value in the Apollo parents' balance sheet.

With regards to Apollo Health Street while revenues and profits have depressed marginally during the current year, largely as a result of the rupee-dollar movement where the previous year we had \$110 million of revenue while this year it dropped to about 96 million although in rupee terms the drop is only 8% and in dollar term actually, the drop has been fairly significant at about 14%. This actually resulted in lower EBITDA, but besides that lowering of EBITDA, we also had to take some write-off by way of bad debts as well as some Forex write-off that we had to do during the year; however, the complete restructuring of the work is now complete and we are poised to look at a significant growth during the year. During the year 2010-11, we should see improved revenues coming through.

Apollo Health Street also added new management and new centers and clients. We have named Ms. Karen Farrell, the President and CEO of Health Street, Karen has over 25 years of experience in health care industry and previously has served marking names in the industry. AHS also launched specialized accounts receivable service line by the client to recover challenging reimbursements which includes zero balance recovery and denial management services. Apollo Health Street is setting up its first self owned operations in Siruseri near Chennai. This facility will have 3,000 seats and will be at an investment of \$20 million. Apollo Health Street also opened new office in Boston.

New business during the quarter included a contract to provide accounts receivable management at Hazel Hawkins, California and a contract to provide accounts receivable management at St. Mary's Health System at Indiana.

A quick word on some of the corporate development, it has been a fantastic year for awards and recognitions for us and I am pleased to share that with you.

The Government of India honored the Apollo Hospital Group with a release of postage stamp on November 2, recognizing the group's contribution to the nation's health.

Mr. Narayan Wagul Director at Apollo Hospital was awarded with the prestigious Padma Bhushan award.

The founder of our group Dr. Prathap. C. Reddy was honored with a Padma Vibhushan, the country's highest civilian award for his contribution towards the development of health care in India.



Corporate Affairs Minister, Mr. Salman Khurshid, presented Dr. Prathap C. Reddy, Chairman Apollo Hospital Group with a Rotary Lifetime Achievement Award in February 2010 for his pioneering work in providing high-quality affordable health care to Indians.

Apollo Hospital, Chennai; IMCL Delhi, and Satguru Partap Singh Apollo Hospital Ludhiana have been accredited by the JCI U.S.A.

Apollo Specialty Hospital, Madurai was awarded the NABH accreditation in March 2010. It is the first hospital in the Apollo Group to be awarded this accreditation.

The week, IMRB Annual Survey of the best hospitals in the country had Apollo Hospitals Chennai and Apollo Hospital Delhi in the top 10 lists of hospitals. Apollo Chennai was rated in the best private hospital in India while Apollo Hyderabad and Kolkata were rated the best in the respective cities.

Apollo Hospitals is the only health care organizations to achieve the super brand status in India and the International Finance Corporation has featured Apollo Hospital in its annual report for 2009. That is it from me and we are now ready for the questions.

Moderator We will now begin with the question - answer session. The first question is from the line of Kaushik Poddar from KB Capital Markets.

Kaushik Poddar I have not been able to get the results on your website. The last result that is showing is of 31st December 2009, the presentation is also not there the website is www.apollohospitals.com, right?

Venkataraman No, there has been a change in update, because the rest of the investors have been able to get it, may be you are logging on to the wrong website. We will send you the correct website address.

Kaushik Poddar Okay fine.

Moderator The next question is from the line of Rahul Gaggar from Centrum Broking.

Rahul Gaggar Good set of numbers, basically given that the business we are in, the capital intensity of the business and the amount of money you have to pump into the business, will this keep the returns like ROCEs and the balance sheet always under pressure, depressed in that respect or do you actually see the ROCEs in probably due course of time, if you could give me some visibility, going into the plus 15-20% range approximately?

Padmanabhan Currently, our ROCE is depressed on account of 2 counts. One is fairly heavily bunched up capital investments that we have undertaken over the last couple of years and will continue to do so over the next 2 years. The second is of course our investment in businesses subsidiaries and businesses like Health Street, insurance and also our investments done in other subsidiary companies where we expect the returns to come in the due course. What we do expect is that because of our reach initiatives which tend to be low capital cost in nature, we expect the returns to come in from this reach hospitals at a much quicker pace and added to the fact that the mature hospitals have actually started delivering much larger growth rates and profitability, we expect ROCEs to improve as we move forward, but I would think that getting to the 15-16% would take about 2012-13 or thereabouts.

One more question I would like to ask is, I am assuming there is no cyclical in the business at all probably a marginal one if at all during the rainy season and all that stuff, what would be the future CAPEX in the sense, in the sense your four Reach hospitals coming up and another 100 bed, if I remember Hyderabad clinic which is supposed to be completed like when would they come into the picture over the period of the year?

Padmanabhan Hyderabad will come in during the second quarter of this year and we would expect the Reach hospitals to come towards the fourth quarter of the year.

Rahul Gaggar Can you give me the figure about the Reach hospitals like you said 250 crore at an operating cost of roughly Rs. 40 lakhs per bed?

Padmanabhan It is within 35 to 40 lakhs a bed.

Moderator The next question is from the line of Vikas Sonawale from Religare Capital.

Vikas Sonawale Would you like to provide some color in terms of the future growth potential of each of your business verticals?

Padmanabhan As far as the mature hospital businesses are concerned, we expect to grow at about anywhere between 18% to 21% and the newer hospital obviously now will grow at a much faster rate. The pharmacy business is expected to grow at about 35% to 40% a year over the next 2 to 3 years and we could accelerate that growth, but that will depend on how many new pharmacies that we will open. As far as our subsidiary business is concerned, I think Shobana already covered, that during the year 2010-11 we will do about Rs. 2 billion of gross premium and that business is expected to grow by about 35% to 40%. Health Street now, that we have consolidated will also grow at a fairly quick pace.

Vikas Sonawale Secondly the average length of stay is about 4.3 to 6.5, what kind of numbers are you looking at over the period of next 2 to 3 years and for your mature hospitals?

Venkataraman Mature hospitals have an ALOS range from about 5.2 to 4.2. For example Delhi and Chennai are around 5.1-5.2 whereas Hyderabad is around 4.2 and this is as far as tertiary care hospital is concerned and we expect that we can go towards the Hyderabad level within the next 2 to 3 years. This will depend on the kind of number of day procedures and the number of cardiac interventional procedures that we will do, but our continuous focus is actually to drive down ALOS. As far as secondary care hospitals are concerned, they tend to be in the order of only 3 to 3.5 and those would actually benefit because of newer facilities coming in and therefore we can expect blended ALOS to drop across the group.

Vikas Sonawale What would be the proportion of insurance based patients to the overall patients?

Suneeta Reddy At this time, it is around 15%.

Vikas Sonawale How is it actually panning out, is there any significant impact on your revenue because of health insurance majors or no.

Suneeta Reddy No, the tariff remains the same.

And also could you please highlight the case mix in terms of each of your hospitals or at least for the four verticals that you have mentioned in the presentation in terms of proportion contribution to sales, cardiac, kidney or other diseases?

Padmanabhan No, the main five or six verticals that we mentioned constitute almost 80% of our revenues.

Vikas Sonawale Which kind of verticals do you think overall for the industry and for Apollo in particular will drive growth in next 2 to 5 years?

Suneeta Reddy I think we have focused on those, that is why the CONCORD specialties that we mentioned.

Padmanabhan Cardiac and Oncology in particular.

Suneeta Reddy And Orthopedics. These are three that we expect.

Vikas Sonawale The last question is you have mentioned about increasing ARPOB now besides reducing average length of stay and actually changing the case mix. Which are the other factors which will drive this?

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Padmanabhan Apart from case mix, we will also look at reducing, going in for daycare procedures where this can significantly bring down average length of stay, but at the same time increase the revenue per bed day. Just to give you the kind of numbers that we are talking about, we have revenue per bed day ranging from somewhere around Rs. 6,000, to as much as about Rs. 23,000. So we have our facilities like Chennai where it is around Rs. 23,000 where we are fairly close to a rich product mix and also in terms of getting to some level of intensity of cases, but gives us optimum revenue per bed.

Vikas Sonawale The Chennai cluster is doing about 30% EBITDA margin. How this particular cluster is different from all the other facilities and when would other facilities look at doing 30% kind of EBITDA margin?

Padmanabhan The Chennai facility consists of three major facilities. One is the Chennai main, other one is the Oncology facility which is Standalone Oncology facility. The third one is high secondary care similar to the reach model. The EBITDA margins in the Chennai main is about 26%. In Oncology, it is about 44% and in the secondary care, it is about 48%. The new children's facility which has come in this year has an EBITDA margin of around 32%. Now, our plan is to actually replicate this kind of model across other clusters as well and towards this end, we are actually building out two facilities in Hyderabad.

Venkataraman Besides Hyderabad, also got a Novalis which is similar to the Cyberknife that we have in Chennai, so that is also a high EBITDA margin business.

Moderator The next question is from the line of Vinay Paharia from Religare Mutual Fund.

Vinay Paharia The Hyderabad cluster has shown a decline in volumes since the last few quarters on a YoY basis. What is the strategy there?

Venkataraman Basically, during the fourth quarter, we had Telangana issue there which actually reduced the traffic along with that during the third quarter, we also had the JCI accreditation process that was going on in Hyderabad where we had to actually



close down about 50 to 60 beds while this process was on, but it has now kind of retrieved its position and is coming back to normal. So once normalcy will restore the things will jump back.

- Vinay Paharia** How much was the in-patient volumes down in the fourth quarter in Hyderabad?
- Venkataraman** I think we have the full number
- Vinay Paharia** We have the full year dip of 3% in the Hyderabad cluster.
- Suneeta Reddy** We have reduced the number of insurance cases that they have taken.
- Venkataraman** No, we will send you that offline. (36:10-do we keep this part)
- Vinay Paharia** But has the normalcy been restored or still there is a dip which you are seeing on a YoY basis?
- Padmanabhan** No, it was actually restored towards middle of March itself.
- Vinay Paharia** Second is during your comments, you mentioned that Health Street EBITDA fall is down because of two reasons. One is because of the business decline in dollar terms of 14% and second is write-offs. How much was the write off for the full year, the EBITDA decline is almost 30-35 crore.
- Padmanabhan** On account of revenue drop alone, we have had an EBITDA drop of close to about 17 to 20 crore and we have also taken a \$4 billion write-off pertaining to some bad debt and exchange fluctuations which pertain to our Lavasa acquisition.
- Vinay Paharia** Okay, so it is predominantly bad debt or is it exchange fluctuations?
- Venkataraman** Yes, it is both.
- Vinay Paharia** Third is, in the hospital-wise services performance slide which you have shown, I think it excludes the hospital-based pharmacy business?
- Venkataraman** Hospital-based pharmacies are integral to the hospital business and are included in the hospital business.
- Vinay Paharia** So for example in this hospital services performance, the slide which you have shown your standalone business EBITDA was 211 crore. Would that include the hospital pharmacies EBITDA also?
- Venkataraman** It excludes hospital pharmacies, it is only hospital.
- Vinay Paharia** Right, so it excludes the hospital pharmacies, right in terms of profitability?
- Venkataraman** Yes, in this particular slide, yes.
- Vinay Paharia** So how much is the EBITDA in those hospital pharmacies and how is that performing overall?



Suneeta Reddy

It has reflected in the hospital and this could bear some of these numbers in that and I think it is completely in sync with the hospital's growth, if you get those patients you will get the numbers

Vinay Paharia

So basically hospital business EBITDA minus whatever is shown here, the difference is hospital based pharmacies?

Venkataraman

That is right.

Vinay Paharia

Also in this presentation in the appendix you have shown your number of subsidiaries, JVs, and associates, I see 3 new additions in this entire thing. One is Apollo Cosmetic Surgical Center, second is Quintiles Phase 1 Clinical Trials and third is Stem Cell. So are these three new additions in this quarter?

Suneeta Reddy

In this year, yes.

Vinay Paharia

So they have been added, specifically this Apollo Cosmetic Surgical Center it seems a slightly larger investment of 15 crore overall?

Suneeta Reddy

It is not 15 crore, it is 1.5 crore, cosmetics.

Vinay Paharia

Okay, it shows \$150 billion.

Moderator

The next question is from the line of Rahul Gaggar from Centrum Broking.

Rahul Gaggar

This question is based among the slides in your presentation. You opened up a hospital in Secunderabad this April. Could you tell me the size and basically whether is it an owned hospital or subsidiary?

Shobana Kamineni

It is actually a 120-bed hospital and we have complete facilities there, the other hospital in Secunderabad was full. So we had to open this additional facility and we were able to open it in a 100 days and it is already showing great progress. They have something like 50% occupancy already in the first month.

Rahul Gaggar

Okay, so basically this is not an owned hospital right?

Suneeta Reddy

The building is on lease.

Venkataraman

It is not a franchise hospital, it is an owned hospital.

Rahul Gaggar

Okay that is what I wanted to ask.

Moderator

The next question is from the line of Himani Singh from Elara Capital.

Himani Singh

My question is with respect to the recent developments that is happening in the health care space, I wanted to know what are the plans of Apollo Group for the next 2 to 3 years. How are we going to expand our reach and what are the broad numbers of bed base and number of hospitals that we would be looking at?

Padmanabhan

We are looking at over the next 2 to 3 years setting up an approximately another 2,000 beds at an additional investment of 760 crore. Currently, we have already funded part of it and another 760 crore need to be raised in terms of funding and completing these projects. These are not only the Reach hospitals, but they include hospitals in other cities including the one in Mumbai and so we will also have our



plans to set up one additional hospital in Chennai where we are already pretty much full and also we have planned to set up a 300 bed hospital most probably in the heart of Mumbai.

- Himani Singh** So our total bed count target would be how much?
- Padmanabhan** Including owned and managed, we should cross 10,000 beds in the next 3 years.
- Himani Singh** Sure and what would be your broad focus area for the management going 2 - 3 years?
- Padmanabhan** We will continue to focus on making our significant part of our investments in the direct health care delivery which we believe is the core to our business and we will continue to do Brownfield expansion where it is possible in places like Hyderabad and Kolkata and in Delhi where we have enough land to do Brownfield expansion. While at the same time, looking at new markets where we are not present to make either acquisitions or Greenfield investments.
- Himani Singh** And last question is regarding our pharmacy business. What is the scale that we are looking at around which we would be comfortable divesting some part of our stake or total divestment?
- Shobana Kamineni** I think there is such as no comfort level at all in a growing business, we are keeping sharp and we will continue to grow this business at 45% plus. We have understood the business, we know the space but having said that we think that at some time that there will be a shareholder value in bringing in either we have the option of an IPO or strategic investor, but I think we have the luxury of time because we have proven that we can open in scale that we can dominate this space and number three that we can be profitable. So it actually meets the three important criteria for Apollo.
- Himani Singh** What would be the current count of our standalone pharmacies?
- Shobana Kamineni** We have 1,050.
- Himani Singh** And is the management currently in talks with any international pharmacy chain player or such investors?
- Shobana Kamineni** Right now retail FDI is not allowed. So while many have expressed interest. There is no point till the government allows this.
- Himani Singh** That would be all from my side.
- Moderator** The next question is from the line of Neelkanth Mishra from Credit Suisse.
- Neelkanth Mishra** This is a question just following on to Himani's question on the organic part. On the inorganic side, there has been a persistent speculation that you are also interested in making acquisitions. Would you be looking at acquisitions in India and abroad?
- Suneeta Reddy** We are continuously looking at acquisitions, but I think if we find a hospital that gives us required return on capital employed because that I believe is a key milestone and also fits into Apollo's philosophy on what we want to deliver in terms of clinical environment and care, I think that we would consider the acquisition. The third important criteria is location. We are already present in about 40 locations in



India. So we would not want to duplicate our presence by making an acquisition at an expensive cost. So these are the three criteria's that we would keep in mind when we make an acquisition.

Neelkanth Mishra On the ROCE side, any particular targets that you would have and are you at all interested in the counter bids that are going on for Parkway.

Suneeta Reddy No we are not part of the counter bid.

Neelkanth Mishra And on the ROCE targets, what kind of targets would you look at when you acquire it , may be 2 to 3 years down the line?

Padmanabhan Basically I mentioned earlier before we went on this fairly significant expansion spree, our ROCE was in the range of about 20 to 21% about 7 to 8 years back and since then it is actually because of our investments in various subsidiaries and expansion it actually dropped to this level. We think at the first stage, within the next 2.5 to 3 years, we want to take it back to 15 and then hopefully, we will restructure our business to make sure that our investments are significantly in the health care space and therefore may be get back to the ultimate target of 18 to 20%.

Moderator The next question is from the line of Rajiv Ghosh from Wealth Management.

Rajiv Ghosh I wanted to know what is the CAPEX for this year and what is the expected CAPEX for the next 2 years if you can give some idea on that?

Venkataraman For the current year CAPEX, the indication we give is, the depreciation that we had provided in the book and for the next 3 years we have a bed addition of a 1,700 , for which the CAPEX is around 1,000 crore. For which the funds have almost been tied up.

Rajiv Ghosh So you have a CAPEX of 1,000 crore this year, FY11?

Venkataraman FY13, which is what Padmanabhan was referring to earlier. I think around 1,700 beds in the next 3 years.

Moderator The next question is from the line of Gaurav Chugh from B&K Securities.

Gaurav Chugh Can you just throw some light on your pharmacy business, what kind of target number of stores are we looking at in pharmacy in the next 1 to 2 years?

Shobana Kamineni I think that we are definitely focusing on keeping this business profitable growing by 45 to 50%, if not more and we already have a good geographic reach. We will continue to deepen our presence within the clusters that we dominate. So I think that we are moving from number of stores and I mean it was never about stores because we know that we can open 200 to 300 easily every year. It is really about the market share and I think this will continue to drive our strategy.

Gaurav Chugh Next question is what is the peak revenue of a mature pharmacy I mean if you take a single pharmacy, what could be the peak revenue of that pharmacy?

Shobana Kamineni Peak revenue, it really depends, our average store size is about 350 per square feet in that range of the mature stores and it could be as high as 1 lakh a day for the average to 25,000, but what we are trying to do is to bring our entire portfolio into



that range and we continue to grow quite strongly, you will see in Q4 our mature stores grew at 15% and I think that is the key target.

Gaurav Chugh And any mature pharmacy, what is the kind of margin are we looking?

Shobana Kamineni 10+ EBITDA.

Moderator The next question is from the line of Kunal Bhakta from Lastaki Advisors.

Kunal Bhakta My question is on the pharmacy business. We have reached an EBITDA margin of 5% plus on the mature stores in Q4. I wanted a sense in terms of what is the achievable margin on a longer term mature basis for a store and what is the kind of gestation period which we consider as a period for which the store will have to operate before it reaches a mature phase because as of now we are considering roughly 3 years in terms of the bifurcation between mature stores and new stores?

Shobana Kamineni I think the first part of your question is about EBITDA margin, I think that about 8% to 9% is realistic, once our private label and generic sales kick in of EBITDA because you must understand this it is a very controlled business and the AIOCD continues to control it and on the other side, we are under the price pressure of the organized chains because the only ones available are huge discounters especially in the South where they are giving big discount, so we are under pressure, but we think that with our performance and our brand loyalty, we can bring this to about 8-9%. One is that GST needs to kick in and two our private label and generic sales. So it will continue to grow.

Your second question is about the gestation period. I think for us if store doesn't breakeven in 8 months, we actually put it in our own little ICU where we track it very intensively for 3 more months and then we will close it down. To move towards full gestation becomes a lot of loyalty in that particular area that we are from because a pharmacy is a business, that actually in that locality people have a relationship with other pharmacies so for us to mature, we have been able to bring down their period from 3 years to about 2 years. We can make this happen.

Kunal Bhakta Have we closed down some stores during the last year?

Shobana Kamineni Last year, we closed down 75 or 78 stores.

Kunal Bhakta So whatever addition we are talking about is the net addition.

Shobana Kamineni Yes. The net addition includes 1,050 stores in our portfolio after closing, close to 80 stores.

Kunal Bhakta What is the product mix in terms of our standalone pharmacies?

Shobana Kamineni We are very focused on pharma. Our product mix is about 75-25.

Kunal Bhakta 75% prescription drugs and 25% OTC, is it?

Shobana Kamineni No, not OTC, it is FMCG.

Kunal Bhakta How has this mixed moved over the years, has it been shifting.



Shobana Kamineni

The last year we moved about 5%, but earlier it was actually in the region of 90-10 in some areas. So we consciously want to keep it at about 70-30.

Kunal Bhakta

Okay because if you look at some of the other organized pharmacy chains which are standalone players, they would have a much higher contribution from FMCG and OTC Products?

Shobana Kamineni

Yes, I completely agree with you, but I think that the Apollo brand and the fact that we have become the community healthcare station, we should leverage more on that.

Kunal Bhakta

Right and you mentioned a point about the controlled nature of the business where the AIOCD essentially has a significant control on the distribution of prescription drugs, don't you think that by focusing more on the product which are not controlled, let say the OTC products, you would have higher margins?

Shobana Kamineni

The OTC also and in fact the FCMG has lower margins.

Kunal Bhakta

I mean I am referring to imported products which some of the other organized pharmacy chains are selling?

Shobana Kamineni

The health supplements and things like that, I think that it really depends from locality to locality where we situate our pharmacies that in some areas it sells and I think if we done that data analysis, we will move more into private label. For us, our best case scenario is that in 5 years, if 30% of my store is private labels I think that is where the great benefits of this business because just imagine I will have 2,000-3,000 stores / outlets in the country and so I own the distribution and the pipeline and I think there is great benefit in that future forward looking.

Kunal Bhakta

So in that case once of the mix changes, your EBITDA margin could even improve beyond 8%?

Shobana Kamineni

Very likely but I think what we started in is with our current portfolio of 120 private labels and generic items which is quite large, larger than anyone else today in this space, we are looking at 8%.

Kunal Bhakta

And what is the contribution of these 120 products as of now?

Shobana Kamineni

Right now, it is very small, it is about 2%.

Kunal Bhakta

What is the strategy in terms of opening new stores, are we also acquiring some of the Mom & Pop stores and re-branding it as Apollo or are we going for franchisees or how?

Shobana Kamineni

No franchisee, but Mom & Pop, really good stores, we will take them over because we can find them at a reasonable price. I think that acquisition of this chain we moved away from it again because it did not meet our ROCE, the fact that there was no necessity for us to pay a premium for someone else's brand and for the fact that we have set up a store because we can do it cheaper than anyone else and we can move it in but when I don't have to do this and I acquire single stores of established Mom & Pop, it is definitely a strategy that we have done in the past and we will continue to do.

On that note, if we look at Medicine Shoppe or Medplus or any of these players, a number of them have expanded in terms of stores simply because they are waiting for the FDI guidelines to get relaxed so that they can sell out, so don't you think that in the last couple of years, the expected time of exit has got lengthened because of the market conditions?

Shobana Kamineni We got into it with that strategy, I do not think Apollo ever thought about it with that. We got into it as a proper business model and by becoming profitable we have proven that and the very fact that retail continues whether you have a strategic player or not, it meets Apollo's ROCE criteria, it meets Apollo's investment criteria and say forward looking it can stay strong, whether it stays in Apollo or not. I think Apollo has the luxury of time on its side.

Kunal Bhakta And what is the ROCE that we are targeting in the standalone pharmacy business in terms of sustainable ROCE?

Shobana Kamineni At 24 to 30% steady state.

Kunal Bhakta So you are actually saying that it will be higher than the other business?

Shobana Kamineni Yes because the cost is so small, those are the detailed figures.

Kunal Bhakta This improvement in margin is going to be driven by increase in the revenues or product mix change or cost rationalization.

Shobana Kamineni You nailed all three, we spoke for all. We still have things on the table which is great in terms of upside and future.

Kunal Bhakta So you have certain targets in terms of cost reduction at a store level which you think you can manage in the coming quarter?

Shobana Kamineni Absolutely. I think there is less in that and more in terms of revenue realization.

Kunal Bhakta Do you also track your hospital based pharmacies performance separately in terms of what would be the kind of margins on those, I believe those would be significantly higher, right?

Venkataraman No, I would like to intervene here, I think hospital based pharmacies we do not publish separately.

Moderator The next question is from the line of Priti Arora from Kotak Securities.

Priti Arora Can I have your FOREX number included in the interest cost, if there is any for the year?

Venkataraman We actually made a FOREX gain of around 3 crore and we have shown that as other income so the interest cost shown in the debit actually does not include any FOREX gain or loss.

Priti Arora And if we look at slide #12, your health care services EBIT margin has gone down for the quarter and it is substantially down quarter-on-quarter from 19 to 14. What is causing that, any one-time in cost etc?

Basically, we had bagged it right up at about 9 crore vis-à-vis 3.6 crore in the previous year and then we also had pre-operative expenses which we had to write-off in Bhubaneswar which amounted to about 6 crore. Both of them happened during the month of March and we also had fees that we accounted for which we paid to McKinsey during the quarter. All of them are actually a one-time expense which is expensed off during the fourth quarter, otherwise it is just an aberration otherwise you will see that the revenue growth reached its momentum at about 20% miscellaneous cost will remained in line, therefore it is just additional expenses we have to work on for during the quarter. These are nonrecurring in nature.

- Priti Arora** These have been included largely in general administration cost?
- Venkataraman** Yes, that is right. It is a delta of 20 crore that you see there.
- Priti Arora** To the earlier question you mentioned that the Chennai Main EBITDA margin for the year is 26%. Can I know how it is moved over the year?
- Venkataraman** The average revenue per bed day has moved as we have in the slide from 13,600 to around 16,500. so every year in the past 2-3 years it has been moving at the rate of around 1 or 2% point and which we continuously to track. Padmanabhan was referring to the latest EBITDA margin and we can expect that this 26 could move up to 28 to 30 in the next 2 to 3 years.
- Priti Arora** The last question is if you can just provide a slide on the CAPEX plan, I see it in your second quarter presentation, but I do not see the updated one in the latest presentation?
- Venkataraman** We will update and we will send it across.
- Priti Arora** You have been absent in the Bombay health care services market till now. So is Apollo doing anything to expedite opening a hospital here and what is your latest on the Navi Mumbai, Thane expansion plans?
- Suneeta Reddy** In the next 3 years, you may probably see 3 Apollo Hospitals in Bombay where have started work on two of them and hopefully we should get another one in the next 3 months, but we are working on a hospital in Thane which is with Yash Birla and one in Belapur.
- Priti Arora** And where is the third one?
- Suneeta Reddy** The third one we are looking at a property right now in South Bombay, but that is yet to be finalized.
- Priti Arora** So does your CAPEX plan include the South Bombay property?
- Padmanabhan** No, it does not include the South Bombay property, but it won't be a significantly large CAPEX because we will only do an operating company there. So it won't be an investment in land and building.
- Priti Arora** But it will be through a JV?
- Padmanabhan** It will be 100% owned by Apollo. It will be an operating company which will own it. The property will not belong to us.



Moderator

The next question is from the line of Amish Kanani from JM Financial.

Amish Kanani

Considering the way real estate prices are once again going up, I just wanted your thoughts on one, what is the broad mix of cost of your hospital in terms of real estate cost versus the other facility one and two how do you see that in the context of your low ROCE and third do you see any regulatory support which really helps to improve your ROCEs?

Padmanabhan

I mentioned to you as far as Apollo is concerned, we are looking at a strategy of making investments where we need to be in strategic markets where it can be capital intensive and probably depress ROCE in the initial years but also have a mix of investments in tier II and tier III cities, there has not been runaway inflation as far as real estate is concerned, but from a very longer time perspective, we are now looking at if real estate is going the way it will with us then we will have to increasingly look at investment structures, capital structures that have only operating company in Apollo's balance sheet and the property company else where, so we are also looking at some of those deals, but given that real estate can be 60 to 70% of the capital of the hospital, as high as that, it is inevitable that if this is not reduced, then the health care cost continuously will go up in the country and therefore I do expect at some point of time that some direction from Central Government will be there which will probably relax floor space index for the state. We are talking to some of the state governments in this regard also, to give us a higher FSI so that it brings down our investment in land.

Suneeta Reddy

Another point with regards to regulations, we think one is that in the recent budget the Finance Minister announced a 100% tax relief for hospitals not only in rural areas, but those in urban areas. The second thing is that the government is looking at land which it will allocate for hospital at a different pricing and that will help us. The third is that while talking about our expansion plans all the facilities, all the cities that we mentioned we have already purchased the land at historical cost.

Amish Kanani

Do you see this as a critical differentiator in making India as a health care definition vis-à-vis other South East Asian facilities and how do you see yourself as of now vis-à-vis the other competitive medical tourism centres?

Padmanabhan

Basically our core of business is Indian health care and in fact I need to say we are not looking at making investments outside the country. Our preference outside the country will only come through managed hospitals. So we believe that the Indian health care business offers the best opportunity not only to grow but to grow profitably and in terms of cost norms, India will continue to be a low cost provider of these services in spite of the fact that real estate prices could run up, but I think we are looking at how we can re-engineer our businesses to ensure that we remain a low cost provider.

Amish Kanani

What is the current FSI size that is typically available for our hospital project?

Suneeta Reddy

That changes from city to city.

Venkataraman

Normally we would get roughly about 2 to 2.5 in most cities. We could get a much higher FSI in Mumbai.

Moderator

As we have no further questions, I would now like to hand the floor back to the management of Apollo Hospitals for closing comments.



Ladies and gentlemen thank you for being present at this conference. If there are any unanswered questions, we are always available.

Moderator

Thank you ladies and gentlemen of the management and on behalf of Apollo Hospitals that concludes this conference call. Thank you for joining us and you may now disconnect your lines.