Apollo Hospitals Enterprise Limited

Q1 FY 2018 Earnings Conference Call Transcript
August 17, 2017

Moderator: Ladies and gentlemen, good day and welcome to Apollo Hospital Q1FY18 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: Good afternoon and thank you for joining us on this call to discuss the financial results of Apollo Hospitals for Q1FY18 which were announced on Monday. We have with us the Senior Management Team comprising: Ms. Suneeta Reddy – Managing Director, Mr. S.K. Venkataraman – Chief Strategy Officer, Dr. K. Hariprasad – President, Hospital Division and Mr. Akhileswaran Krishnan - Chief Financial Officer.

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 our investor presentation.

Ms. Suneeta Reddy will discuss the financial performance for the quarter along with the operating metrics, expansion plans and other highlights following which we shall open the floor for Q&A.

Documents relating to our financial performance have been shared with all of you earlier and have also been posted on our corporate website. I now invite Ms. Suneeta Reddy to touch upon the key highlights of our performance.

Suneeta Reddy: Good afternoon everyone and thank you for taking time out to join our call. I trust all of you have been able to refer to the earnings documents which we shared earlier.

We are in the midst of a challenging macro-economic environment. The GDP is currently at 6.5%, inflation rates are low, and manufacturing and consumption indices are falling, except for a few bright spots. While the effects of demonetization are largely behind us, there does seem to be a 20% drop in cash holding in individual hands. Along with the cash transaction limit at Rs 2 lakh, there appears to have been a tangible impact on buying power.

Against this backdrop, AHEL standalone revenues grew 15% to Rs 1,684 crore; aided by SAP growth of 21% and healthcare services growth of 10% on a year-on-year basis. Healthcare services growth was driven by growth of 9% in volumes and 1% through pricing and case mix.

New hospitals reported 35% year-on-year revenue growth of Rs 172 crore aided by volume growth, while existing hospitals revenues grew 6%. We believe this is creditable growth, especially after the setbacks we had during the Chennai Cyclone and the impact of a VIP admission and demonetization which was felt across Q3 and Q4, last year. But we have seen a general pickup especially in the mature hospitals, which is a positive sign. We have seen an uptick in volumes and revenues in Chennai main as well as in Hyderabad, Mysore, and Bhubaneshwar. Navi Mumbai, Vizag and Guwahati are our new hospitals which have shown a healthy pick-up in demand. On the back of strong doctor recruitment and marketing efforts, Nellore and Nashik as well have demonstrated encouraging revenue growth this quarter.

The Specialty-wise inpatient volume performance is encouraging. Our focus now is on developing a broad-based, well-diversified portfolio with specific attention to Oncology, Orthopedics, Neurosciences, Transplants, Pediatrics and General medicines.

EBITDA was lower by 8% at Rs 174 crore as compared to Rs 188 crore in Q1 FY17. The reason is primary due to three factors. The stent price cap has impacted our revenues and EBITDA by Rs 25 crore per quarter. While we have been able to recover 50%, we are yet to recoup the balance impact of almost Rs 10-12 crore per quarter on this account. We plan to recover this over the next 3-4 quarters.

Secondly, the Navi Mumbai EBITDA loss for the quarter is Rs 15 crore. The hospital was launched in November 2016 and this was the second full quarter of operations. While we have seen very good traction in demand here, we had anticipated that it will take until March 2018 to breakeven; post which we anticipate a positive EBITDA contribution from Navi Mumbai in FY19.

The Guarantee Money pay-out to doctors are yet to be recovered fully from patients through services and it is at Rs 8-10 crore per quarter. The total impact of the above factors on EBITDA is approximately Rs 35 crore per quarter which will be recouped fully only at the beginning of FY19. As a result of these factors, the EBITDA margin on Healthcare services was 15.4% in Q1FY18 vs.19.9% in the corresponding quarter last year. The margin in existing healthcare services was at 20.1% in Q1 this year vs. 23.3% last year Q1.

Revenues in the Chennai cluster grew by 3%, IP volumes grew by 1%. ARPOB grew by 13% to Rs. 48,055. The ALOS declined from 3.77 in Q1FY17 to 3.42 in Q1FY18. Occupancy in the cluster hence was 55% at 827 beds as compared to 901 beds last year. In Hyderabad, revenues grew 17% while IP volumes grew by 4%. ARPOB was at Rs. 36,768 higher than last year by 13%. Occupancy in the cluster was 63% at 528 beds vs. 509 beds last year. Strong ARPOB growth at Chennai and Hyderabad represent the yields from initiatives undertaken earlier to drive clinical differentiation through medical programs.

The Bangalore region including Mysore has seen good growth this year in the local client base. Malleswaram which was commissioned recently has seen a ramp up in volumes. Occupancy in the cluster was 500 beds at 70% occupancy as compared to occupancy of 458 beds last year.

New hospitals revenue grew 35% to Rs 172 crore as compared to Rs 2 crore in Q1 last year.

Within the new hospitals, Malleswaram and Vizag which was recently added have shown rapid progress. Trichy, Nashik and SMR have shown good momentum and will build up to an EBITDA break even in Q1FY18. Nellore has progressed well and has reported a revenue growth of 43%. We are now confident of doing well in these locations over the next 2-3 quarters and the teams have a clear plan focused on local market needs.

Out of 6,955 operating beds Pan-India, 1,578 operating beds are new. Occupancy across the Group was 62%. The occupancy in mature hospitals was at 63%. New hospitals had occupancy of 55%.

Standalone Pharmacies continued to report strong growth of 21% year on year and have now in the trajectory of 4% + EBITDA margins. The Standalone pharmacies reported an EBITDA margin of 4.2% in Q1FY18. This is in line with the strategy of sustainable profitable growth that we have been pursuing for the past over 16 quarters. The ROCE on this business is now 15%.

Standalone PAT declined by 51% to Rs 35 crore. Interest costs increased by 25% year-on-year to Rs 55 crore and depreciation increased by 16% year-on-year to Rs. 65 crore on account of the new facilities added. The effective tax rate for Q1FY18 was 29% vs 22 % in Q1FY17.

The present debt as of 30th Jun 17 is Rs 2,720 crore; against which we have cash and cash equivalents of Rs. 273 crore leaving us with net debt of Rs 2,447 crore. The debt equity ratio is at 0.75.

We are confident about the intrinsic structure and direction of our business. We have recently concluded a multi-year expansion plan which has resulted in addition of significant new capacity. This has been supplemented by increasing volumes of robotics, minimally invasive surgery and day care and short stay surgeries increasing turnaround times of beds. Occupancy levels at most of our facilities are in the mid 60s. With several top quality facilities located in some of the best locations in the country is supported by strong medical teams. We have strong headroom for growth and are aptly positioned to ramp up these volumes.

In summary, we believe that the volume pick-up in our mature and new hospitals is a very good sign. We are well-positioned to leverage this in the upcoming quarters, as we have completed our capital expansion by adding over 2,400 beds in the last 3 years. The real cost of capital is 5.7% and we believe this was a prudent thing to do, and a timely investment in growth. Though higher interest and depreciation cost are compressing our bottom-line, this is a transient price to pay, and we are well-poised to leverage the long-term demand story, which remains intact. Notwithstanding the headwinds and one-off developments in the last few quarters, we are confident that our thoughtful strategic interventions will provide levers for high quality growth and fortify our profitability.

I now open the floor for questions. Dr. Hariprasad and Krishnan are here with me to take your questions.

Moderator: Ladies and gentlemen, we will now begin with the question-and-answer session. We take the first question from the line of Saion Mukherjee from Nomura Securities.

Saion Mukherjee: My first question is with regards to our consolidated financial performance which has reported a significant decline in profit. Could you take us through the key elements which have impacted the performance? Could you also explain what is happening at our JV in Kolkata as it has also shown some decline?

Mr. A. Krishnan: Yes, you are right. There were two factors which impacted our consolidated performance. One is, we did have issues in Kolkata in the last six months that we have been seeing also because of the adverse media coverage on the hospital and certain Government intervention. It is not just our hospital; it is about all hospitals in West Bengal where we have seen some active interventions done by the Government in particular as well as the media which has actually blown it out of proportion. Due to this, we have seen a dip in volumes by almost around 20-25% and that has impacted our EBITDA. So as we speak, the EBITDA of Kolkata hospital was almost down by almost Rs.20 crore for the quarter and it should come back a bit in this quarter but it is going to take two-three quarters to get the Kolkata hospital's performance to come back. This is clearly an impact of something that we could not have done anything about and that has impacted our profitability also on the consolidated numbers as there was a reported loss of almost around Rs.10 crore from Kolkata because of this. Apollo Health and Lifestyle (AHLL) is the second aspect which impacted our numbers. While the growth of AHLL has been good, in fact, the top line growth has been 18%. Even there, the profitability if you look at the EBITDA or the PAT, the PAT loss has been more around Rs.26-27 crore now. These are the two numbers which have impacted. They have seen two specific centers which have got ramped up last quarter which is why they saw some element of PAT impact this quarter. AHLL should do better in the next two quarters. We should see that also do better by Q3 at least. The third aspect which impacted our performance is Munich. Munich changed their way of accounting because of which there was a loss which was reported in Q1FY18 which should be off by Q4FY18. That is more about the way they are accounting for it wherein they have changed the accounting. IRDA has provided two accounting methods for insurance companies; one is the 1/365 method and another is a 50% method. Munich adopted the latter and because of their revenues i.e 40% of their revenues come by Q4, you will see that Q4 will do significantly better in Munich and they will go into PAT positive. So we consolidated Rs.6 crore PAT negative on account of Munich which should actually swing to positive trajectory for the full year. So for a quarter it looks pronounced. So these are the three reasons.

Saion Mukherjee: My second question is on Navi Mumbai. Is it possible for you to share occupancy revenue numbers and how it has done on a sequential QoQ basis?

Mr. A. Krishnan: So at a broad level, we would not want to give specific numbers on revenues because we do not disclose that. But you know we have done well in this. There are 60-beds occupied now i.e as we speak in June-end, but if you look at the quarter which is September which is Q2, we are now almost close to 100 beds. So clearly the reported quarter was June and close to 100 beds is where we are in Q2. The trajectory is good and if you remember we had said that even in Q4 we had Rs.22 crore EBITDA loss. The EBITDA loss in Q1FY18 is Rs.15 crore and we should do better in Q2 and as we go into Q3 and Q4 we are hopeful and we are continuing to hope that by Q1 of FY'19 we should completely break even in that facility.

Saion Mukherjee: My next question is with regards to our Chennai cluster. Here, we are seeing low volume growth, its ALOS improving which is probably also contributing to lower occupancy. But it is like an all-time low kind of number that I am seeing. So I am just wondering how should we think about further drop in ALOS improvement in ARPOB? Do we have any indication of volume growth over the next couple of years? How should we think about it?

Mr. A. Krishnan: See, with regards to Chennai, we do not have visibility to the hospital wise growth. I can tell you that in our flagship Chennai main hospital where we had issues in Q3 and Q4, due to demonetization and also due to issues around chief minister admission, etc., has bounced back very well and we have seen a 6% growth in the Chennai main hospital in Q1FY18. Now, what we have also been doing in Chennai main is something similar to what we did in some way in Hyderabad. We have seen some low paying corporates including public sector units, etc., where we have assessed and especially with some of this pricing challenges around regulations that we have seen, we have had to go back to some of these corporates and renegotiate with them on tariff and that renegotiation will impact volumes for one or two quarters because even now we have at least 15-20% of our volumes coming from corporates. We are seeing that large corporate such as Indian Oil, ONGC, Neyveli Lignite, etc., some of these corporates, while the volumes were good, their procedure charges, etc., were not completely paying for some of our services. So we had to take a tough stand there. It is something that we have done knowingly. You have seen us had get a payback in Hyderabad over the 12-months or 18-months period. You will have to wait with us and we will get the payback from this also in the next 12-months.

Saion Mukherjee: Do you see any scope for the ALOS to further come down as it has already improved quite a lot?

Suneeta Reddy: Yes, it is at the right level now.

Moderator: The next question is from the line of Neha Manpuria from JP Morgan.

Neha Manpuria: If I were to look at our existing hospital margins on a quarter-on-quarter basis(q-o-q); I understand that the stent pricing is based on ma'am's opening commentary where she mentioned that we have been able to adjust 50% of the impact. So what is the reason for the declining q-o-q margins of our existing business?

Suneeta Reddy: So, with regards to the declining q-o-q margins of our existing business, you did mention that stent is one issue. The second issue is that even for our old hospitals, we are recruiting new doctors i,e for second generation of doctors who do laparoscopic and robotic surgeries. These doctors come at guarantee money and this aspect has impacted us even in our mature hospitals. The third issue is that we were committed to increase our staff cost because this is the settlement that is done once in three years and that is one of the reasons why our mature hospitals were also impacted.

Mr. A. Krishnan: So 23% EBITDA margin is what we have been used to in mature hospital and we came in at around 20% EBITDA margin. Out of the 3%, around 1.5% was because of stent pricing impact and the other 1.5% was predominantly because of what we mentioned about the guarantee money that we paid to some of the existing doctors including in places like Chennai and Hyderabad as well as the settlement cost which we have fully not recovered through tariff increases especially because today we felt that given the occupancy levels we are doing increases, it is not that we are not increasing, we have increased by 3% as opposed to maybe a 6%.

Neha Manpuria: So this 3% increase has already been taken for this year?

Mr. A. Krishnan: No, just now in July we have taken it. So you will see the impact of that coming.

Neha Manpuria: In addition to stent pricing, there is also noise about how the other devices might also get included including ortho implant. Are we proactively changing how the pricing of these devices as well, so that we do not see incremental impact? If at all

let us say something like an ortho implant gets included, would the impact be as high as it is for stent pricing?

Suneeta Reddy: Well, I do not think it will be as high as the stent pricing. But I think we need to look at the way that we socialize the healthcare sector and healthcare services apart from just looking at the cost of consumables. At Apollo, we have several centers of excellence which contribute to our EBITDA. This in itself is a de-risking factor. So if cardiac contributes 22%, orthopedics contributes 15% and apart from these we do have others including a large outpatient and preventive healthcare checkup. So, we feel that the impact of limiting the cost of consumables is something that we have to deal with in the short-term. In the long-term, Apollo is really about the quality of services and the clinical differentiation it provides. Also, the fact that we do much more than just an orthopedic services working with stents, or working with the knee implants. So it is about the whole healthcare service and clinical differentiation that really creates value and will create margins for Apollo.

Neha Manpuria: There is a mention about Oncology in Navi Mumbai by year-end and you have also mentioned about commissioning Apollo Cancer Institutes to other centers. Could you throw some color with regards to this? Are we looking to add these two centers?

Mr. A. Krishnan: Oncology, we are planning in New Mumbai, Bhubaneswar and also in Vizag. So as it stands, the first two centers which will get Oncology will be end of the year in New Mumbai, followed by Bhubaneswar and Vizag maybe by the end of next year.

Moderator: The next question is from the line of Anubhav Aggarwal from Credit Suisse.

Anubhav Aggarwal: I still have not understood the reasons for our existing hospitals margins which declined sequentially. Am I right in saying that the impact of stent pricing was better and not worse? In a quarter, how many doctors will you recruit that it will impact margins so significantly for existing hospitals?

Mr. A. Krishnan: So if you look at it even in Q4 of last year, the stent impact was not fully felt, it did come part of the quarter and it was only there for 15-days. So this is a full quarter impact.

Anubhav Aggarwal: But it is lesser, right? Quantum you are saying now 10, 15…?

Mr. A. Krishnan: On the standalone basis, the impact of stent was around Rs.10 crore per quarter and if you look at the group or at a consolidated level, it is around Rs.12 crore per quarter, which is unrealized or un-recouped. What we have is an impact of around Rs.100-110 crore for the year, and we were able to recoup or recover half of that, the other half unrecovered is Rs.10-12 crore for the quarter. Most of this Rs.10-12 crore is existing because new hospitals did not have much of this impact as they were priced differently. So if you look at this impact here, if you do the math, you will get a number of 1.5%.

Anubhav Aggarwal: Just to clarify, I am not asking versus 23% margin, I am asking versus the March quarter?

Mr. A. Krishnan: Yes, the March quarter was 21.2%.

Anubhav Aggarwal: Correct, so I am asking why the margins have dropped sequentially?

Mr. A. Krishnan: So from 21.2% also if you look at it, as I said only half of the quarter had the impact of stent, but this quarter had full impact of stent.

Anubhav Aggarwal: But is the absolute quantum-impact, the same?

Mr. A. Krishnan: No, but if you look at the top line and then if you look at the impact of the full quarter, you will realize that it is a higher impact. This is because in Q4, our impact was not Rs.10 crore but the impact of stent was actually lesser than the Rs.10-12 crore because of the procedure charges that we have introduced. So the quantum is the higher quantum in absolute rupees crore number for this quarter. The second point as Ms. Suneeta also mentioned was the guarantee money that we have paid to some of the doctors and the settlement impact which has happened more around Q4. Both of these have also impacted the EBITDA margin.

Suneeta Reddy: So, once in three years we do a settlement for our staff and the impact of that has really shown in this quarter.

Anubhav Aggarwal: My next question is with respect to the guaranteed money which we paid to our doctors. So all the doctors who have been recruited are new to the system and are not replacement of the older one?

Suneeta Reddy: Well the old ones are still in the system, fee-for-service which is a good thing. But we now have new doctors who will be the next stars for the next decade. So these have been recruited, all of them have come from London and from the US, but we have been taking them on guarantee money.

Anubhav Aggarwal: I have a couple questions with respect to our Chennai cluster. I was just looking at the trend over last two years especially with regards to its average length of stay. In 2015, we were doing average length of stay of about 4.5-days which has now come down to 3.5-days. So this effect in itself is increasing our capacity by 25%. Was this a surprise to the management that the average length of stay can be reduced so significantly? I am saying this because if it was very well planned, we may not have added capacity at the first place in Chennai. Over the last three years we have added 300 beds because this has created 300 beds by itself?

Suneeta Reddy: Well, I think we understood this. One, this has happened because of case mix, second because of efficiencies within the system, third, we have always maintained that while we build 12,000 beds, we have 12,000 beds within the system. I think even in the last quarter I said the capacity within the system is far larger than the number of beds we have. But the asset utilization you would only see those numbers pick up in 18-months. Having said that, the rationale for creating new hospitals is the distance between where our main hospital is and where these new hospitals have come up which is clearly 1.5-hours away from the main hospital. So while the main does acute care, the transplant, some of the high end orthopedic work or cardiac work and also the oncology which is happening in the heart of the city, the ones at the periphery are actually doing higher secondary care work, which does include some amount of cardiac work. So this is the important thing. If you look at the driving time which is the thing that people really look at, it takes 1.5-hours and there are communities around these hospitals. So there are community hospitals which will refer quaternary care to our old Chennai main hospital, where the volumes have picked up significantly.

Anubhav Aggarwal: Yes, Chennai main hospitals volumes have picked up. My second question was regards to this only, but like 6% volume growth in Chennai main hospital. But for the rest of the 50% hospital, your volumes have declined. What has happened over

there? So, like total volume increase is 1%, where Chennai main is 6%, which means 50% of the beds we have, the volumes were down almost 4-5%?

Mr. A. Krishnan: So, there were two places where we saw a drop. One was Vanagaram which was the hospital which is in the suburbs again which was on the other side where we had two doctors actually going on some vacation and that actually impacted because they were star doctors there and that impacted the quarter. We are hoping that they should come back in the coming quarter. We have also seen one exit of a gynecologist from 'OMR Women & Child'. Though the impact of that on revenues and EBITDA is not so pronounced, but the impact on volumes is still pronounced because it takes some time to build Gynaec volumes in particular. So she left the facility and that was one of the reasons that we suddenly saw a drop in the Q1 volumes. So these were the two hospitals outside of main where we saw it. It is not a significant impact on the revenues and the EBITDA if you will. As much as the volumes which I do agree that because we add all volumes, right, it is not a weighted volume, it is every volume equal to one. If it is a cardiac or a liver, we just count it as one. So that is the reason the volumes are looking a bit low.

Suneeta Reddy: Just to add to that, the OMR facility now has NABH accreditation. Due to some other reason it took a long time for it to get. But I think you can expect to see an uptick in volumes, going forward.

Mr. A. Krishnan: Also again in 2%, that is the other point when I started, you know at least 2% at least if you look at Q-o-Q, if you look at Q1 FY'18 for Chennai division and if you look at Q1, at least around 300-400 in-patients were from PSUs which we have kind of been renegotiated and which we have now seen some drop in this quarter. Some of these do not impact EBITDA as much as it does volumes. So it is something that we have taken this decision knowingly and we will get it back hopefully. This is because some of these PSUs are renegotiating with us and we will get it back, it takes some long time and we are having discussions with them, we will have to wait it out for at least one-two quarters before we get some of them back. It is not like Hyderabad that it takes long. Hopefully two-three quarters we should be back there.

Anubhav Aggarwal: I just need a clarification. While answering the previous question, did you say that you have taken a 3% price increase in Chennai, in July?

Mr. A. Krishnan: We have taken it from July only; it is not in the quarter that went, we have taken it from July.

Anubhav Aggarwal: What about Hyderabad which has shown a very strong ARPOB increase sequentially?

Suneeta Reddy: Yes, Hyderabad actually is an example for the rest of the group. Hariprasad, will you please speak about Hyderabad.

Dr. Hariprasad: Actually, we have been working on Hyderabad for the last two-three years as margins were low and we wanted a clear strategy on improving volumes. So as Krishnan explained, we had taken a call to cut out some of the low paying patients and we tried to increase the occupancy with higher ARPOB patients. It took us a year or year and a half to actually implement the strategy and start seeing results. We are now actually seeing the results and the benefit of the strategy that has been adopted there. In addition to that, there were a couple of star consultant teams who joined group towards the end of Q4 of last year. All this constituted towards an improved ARPOB and volume in Hyderabad.

Anubhav Aggarwal: But was there any specific price increase in Hyderabad taken in this quarter or was it only …?

Dr. Hariprasad: It was a volume increase.

Moderator: The next question is from the line of Nitin Agarwal from IDFC Securities.

Nitin Agarwal: How should we look at our consolidated profits, going forward? Out of the three factors that you mentioned, couple of them seems to be fairly sustainable. So is it right to assume that our consolidated profit will kind of stay at these sort of low levels as we go through?

Mr. A. Krishnan: I think you will have to give us a quarter or two; especially Kolkata is something that is quite a black swan event for us. Honestly, it is something that we will have to wait for a quarter or two, to look at Kolkata in particular. We have plans to improve AHLL and the AHLL team headed by Neeraj is clearly working on plans to improve the profitability q-o-q. Yes, we do understand that this quarter has not seen an improvement in profitability as much as the growth on revenues. But in the next two quarters, we should start seeing impact of that flowing on the bottom line. For Kolkata, we will have to wait for one or two quarters because that is a big swing; the swing is almost Rs.15 crore in the PAT. So you will have to come to us offline in the next one-two months and we will have to wait for that to guide you better.

Nitin Agarwal: With regards to our existing hospital as a cluster, we had like 7% to 8% decline in EBITDA this quarter. For the full year, how should we look at this cluster? We have had challenges in growth in this cluster for some time now. A) Per se do you see a 5% to 10% sustainable EBITDA growth in this cluster possible, given the sort of various constraints that we have and by when do we see hitting those kinds of numbers?

Suneeta Reddy: I think it is possible to see 5% to 10%. As Krishnan mentioned earlier, you need to give us two quarters to recalibrate our strategy because there have been changes with Government policies. Like Krishnan mentioned earlier, Kolkata was in the price and the fact that now the new reality is that staff cost and star doctor cost are something that we have to deal with. However, with increased productivity, increased marketing, our plan to go to the International markets and increase our presence in International markets by setting up offices and increasing footfalls, I think that you will see this EBITDA growth coming back on track.

Nitin Agarwal: Secondly, with regards to 'Other' clusters, we have not seen too much improvement in ARPOB in a cluster despite presumably Mumbai ARPOB would be much higher compared to the average which is there. Also, likewise Bangalore also would be a large part of this cluster which should be a much higher ARPOB business. So why is it not reflecting in the ARPOBs in this cluster?

Mr. A. Krishnan: It should and over a period of time it will start reflecting. It is just that the volumes are not enough to show that number. This is because, if you look at the overall number of operating beds, out of the 2,000 beds Mumbai is still at only 100 beds. Over a period of time as Mumbai becomes higher, you will see this ARPOB getting improved.

Suneeta Reddy: And the case mix also has to mature. So when we start, we just fill the beds with which is maybe some tertiary care, but it becomes quaternary care in a while. So you will see the ARPOB improve as the case mix changes.

Nitin Agarwal: What is the proportion of the Bangalore beds in this 'Others' cluster?

Mr. A. Krishnan: One of the Bangalore is in that significant sub-JVs and associates which is around 250 beds. So this has only Malleswaram and Jayanagar. So you can get offline with Krishnakumar to check those bed details. So whole of Bangalore is not in that 'Others', one hospital is in that subsidiary.

Moderator: The next question is from the line of Shariq Merchant from Quest Investments.

Shariq Merchant: I wanted to understand the piece on staff cost better. So the one-time adjustment that you mentioned; do you take this once in every three years or this is an increase on the base pay which is sustainable or is it a one-time payout that you incur?

Mr. A. Krishnan: So, the settlement happens once every three years. And after the settlement happens; what happens is then it is pretty much just the inflation adjusted or inflation plus that we give them because most of these are blue collared or also technicians, etc., So last year, the increase that we had to take on account of settlement was between 25% and 30% as a one-off for one year. The next settlement will happen only after three years.

Shariq Merchant: So the way I should be looking at your staff cost going into say FY'19, FY'20 will be more flattish as the settlement will not recur and also the guarantee money will then start switching into more …?

Mr. A. Krishnan: Guarantee money, yes. But the staff cost you will see the regular inflation nonetheless, because it is not that they will not be paid, they will be paid the inflation of 8-10%. Guarantee money, you are right, you would not see higher cost coming there unless we have a strategy for growth which we decide to follow which is different.

Shariq Merchant: My next question is with respect to standalone pharmacies. So is the current quarter's run rate of 80-odd stores are a fair number to assume for the rest of the year going forward as well?

S Obul Reddy: As planned, we are adding about 250 stores every year. You will see that addition on a Q-o-Q basis. That is in line with even earlier year.

Shariq Merchant: Also, with 2,600 pharmacies now, do you think that the low hanging fruit of the juicy locations has already been done? So incrementally as you go forward, getting newer pharmacies at current revenue per store would be increasingly difficult and the newer pharmacies will generate lower revenue and will take longer breakeven period?

S Obul Reddy: We study the market and go to the suburbs and district headquarters and choose the location so that we are still within the range of about 15-months to achieve the breakeven at the store level. Opportunities still exist, because we are only about 2,600 stores in a country which has about 6 lakhs stores in the retail segment.

Mr. A. Krishnan: See the sector is hardly mature.

S Obul Reddy: Organized sector is very-very minimal at this level of numbers.

Shariq Merchant: So the 250 or 300 kind of run rate that you are currently doing, that should be…?

S Obul Reddy: It should be quite possible to add on y-o-y and which you have seen on the numbers without impacting the revenues and data, we are achieving that.

Shariq Merchant: My next question is with regards to AHLL. How I should be looking at the revenue growth for AHLL? Given that a) you are in expansion mode and b) seeding the market and these segments are yet to fully mature. Should you not be looking at growth much higher than the mid to high teens that you are currently doing?

Mr. A. Krishnan: You are right and the team is focused around that. The issue here is many of these are in early stage in terms of formats also; like what we have done with regards to some of the formats like the day care or the short surgery centers. Patients are adapting to this only now. We have had to rebrand from the earlier Nova center to Apollo Spectra and we have definitely seen a marked improvement in volumes there, especially the Spectra model because after we took over we have done very well. Maybe you are right that we are targeting on higher growth but it is also a question of where the market exists today. The market is slowly getting there. Unlike pharmacies where we are at 20-25% growth, we will probably have to wait it for 1-1.5 years before we get to a higher growth in some of these formats. So most of these formats are in initial stages of growth as it stands and which is where we are more at around 18%. But with that said, most of the fixed cost in the system is all there as we said and they are focused more on EBITDA and PAT which is what is impacting us as a Group and which is where the team is also seeing what they can do to ensure that they get to breakeven. You are aware that IFC is also part of AHLL. They have come in at 30% and all of us are looking at seeing how we can first make it breakeven over the next two years and then see how we can accelerate on growth.

Shariq Merchant: So it would be fair to say that probably end of FY'19-early FY'20 is when you will be close to a breakeven?

Mr. A. Krishnan: Yes.

Moderator: The next question is from the line of Swati Madhabushi from East Capital.

Swati Madhabushi: My question is regarding Chennai cluster which has been facing some one-off for the past, say at least six quarters that I can remember. So I just want to understand if there is any other factor like doctor attrition or supply/demand situation in the city? If possible, can you share with us the doctor attrition numbers and maybe the sector level addition of beds in Chennai, where there are other players are ramping up bed capacity very aggressively? What is happening because something does not add up with respect to occupancy in the Chennai cluster?

Suneeta Reddy: I think, in a sense, you might have answered part of it. But the fact is that in Chennai when we started, the bed to population ratio was heavily weighted in our favor. As you know 10-years later, people have realized that we do have a monopoly here and that the monopoly has also yielded in very profitable margin. So the new players have entered the market. Having said that, I do not think in terms of market share we will continue to retain 22-25% market share and this is really the focus of the team in Chennai region. The other focus is to make sure that the International patients where the margins and the yields are much higher; we increase our share of International patients. It has been challenging, considering the fact that International flights do not come into Chennai. But we are seeing an improvement in International patients and there was a 14% growth in International patients. So the focus has shifted away from just the domestic market to the International market. The third is that with competition, the need to create a clinical differentiation which is what Apollo started with, to see that we maintain it which is why our guarantee money to young new doctors has increased. But this is critical for the business that we are in that we continue to create clinical differentiation. It might come at a cost and you might see it is one quarter but I must tell you that for the long-term that there is demand not only in Chennai but in Southeast Asia for the

type of clinical work that we do for the quality we do and the value that we create in this space. So there have been one-offs I do admit, there has been competition. But having said that, we are focused on retaining our market share and to increase the volume of International patients that come to us.

Swati Madhabushi: But would you say that the doctor attrition is on uptrend?

Suneeta Reddy: The doctors' attrition has happened two years ago. We have not lost anyone in the past two years except for one gynecologist. I think the people that we want who are focused on quality and good clinical work will be retained within the system.

S Obul Reddy: The attrition is not on an uptrend.

Swati Madhabushi: What is the volume percentage of International patients if you could share with us and how much more profitable are they compared to like domestic patients?

Mr. A. Krishnan: System wise 12% of our volumes come from International and they are at least 25% more profitable than domestic.

Swati Madhabushi: With regards to our Chennai cluster, you said that the competition has increased. So you have taken price increases but do you think that you perceive this a very expensive place that one is paying out of one's own pocket?

Suneeta Reddy: Expensive is only relative to the value that you create. So maybe for some small procedures we might look expensive, but we are really in terms of relative what we do for tertiary and quaternary care, no, I do not think the perception of expensive is relevant.

Swati Madhabushi: I need one data point with regards to Navi Mumbai. You were guiding for 100 occupied beds. So is it as we speak now and this number can increase by the end of Q2 or is it an estimate for end of Q2?

Mr. A. Krishnan: As we speak now, they are between 90 and 100.

Swati Madhabushi: So this number can go up by the end of Q2?

Suneeta Reddy: It should, yes.

Swati Madhabushi: For the Oncology center in Navi Mumbai, the CAPEX data point is mentioned in your presentation. But what is the capex number for the Bhubaneswar and Vizag centers?

Mr. A. Krishnan: As we said, Vizag will be later, we will start with New Mumbai first and follow that up with Bhubaneswar and then Vizag. So Bhubaneswar will take at least 8-9-months to begin operations.

Swati Madhabushi: I know, but in the CAPEX plan you have till FY2022. I was wondering, if you can include the Bhubaneswar and the Vizag numbers too because it will help us understand the CAPEX plan going forward better?

Mr. A. Krishnan: That is not a big number.

Swati Madhabushi: Yes I understand. I was reading a press article where the Chairman mentioned that we have completed one cycle of bed addition and we will look to start the second

cycle of bed addition of at least 2,000 beds in the next three years. So is it true? I think it has not been conveyed by the company and this is only a media article.

Suneeta Reddy: So let me put this on record about one thing that we are adding. One thing which we are adding which we have declared in all of our communication is that we are adding an Oncology center in 2018-end-2019. This will be a very high-end Oncology center which is part of our CAPEX plan. We have signed for a hospital which is really on a lease model in Byculla which is three years away. So beyond that, I think our Chairman was referring to the fact about what I mentioned earlier that if you look at our ALOS, we have really got 2,000-3,000 beds extra in the system and I think one of the other analysts also alluded to that. So, I think Chairman was alluding to the fact that with the current trend in ALOS and the way that we are looking at robotics, etc., the 2,000 beds exist within the system.

Swati Madhabushi: How should we look at your focus on near-term profitability? I mean you are doing fantastic with respect to planning for the long-term and I have no doubt about the long-term thesis. But on the near-term profitability and the focus on it, how should we look at it?

Suneeta Reddy: I think quarter-to-quarter to look at Apollo Hospitals where we have added 13 new hospitals in the last thirty-six months. If you look at near-term profitability, it would be quite challenging. But if you were to wait for this one-year, then I think both in terms of revenue, EBITDA and profitability, it would be worth your wait. Just to get back to this question on our capital structuring and why we have taken on a lot of debt;- we did that knowingly because the real cost of debt is around 5.7% and I do not think we could have accessed cheaper capital. And we did it because we wanted to establish a leadership position in healthcare. So we have to maybe compromise a short-term profitability because in the long-term we will have not only the bed strength but the capability built into the system to maintain our leadership position.

Swati Madhabushi: The technologies keep evolving, you can do more and more, there is no clear end to how technical you want to get with respect to medical procedures, etc., So I just wanted to understand your plan with respect to end of CAPEX cycle?

Suneeta Reddy: I think truly the major part of our CAPEX is behind us. I think I shared with you that we just have one more addition that we have planned. The Byculla one which is three years away is the leased model where we are not investing in the infrastructure. So clearly there is no major CAPEX that is going to come as a surprise.

Moderator: The next question is from the line of Prashant Pandey from Birla Sun Life.

Prashant Pandey: My question was basically with respect to the pledged shares portion. Do you have any plans for reducing that pledged share proportion and what is the purpose for that pledge?

Suneeta Reddy: We do have plans for reducing that. I think you will see most of this unwinding around '2018-19.

S Obul Reddy: The look more bigger, they were created at historical prices. So there will be some offset as there are releases in between.

Suneeta Reddy: So we will get some releases.

Moderator: The next question is from the line of Rakesh Nayudu from Haitong Securities.

Rakesh Nayudu: I wanted to understand from the management as to how they are looking to calibrate this balance between compulsion to commit growth capital and profitability; specifically if you look at FY'18 there is an incremental cost hit because of Vizag of around Rs.15 crore and Rs.48 crore from AHLL. So if you look at over next one year, how do I see these cost line items panning out and when do we see these operations normalizing? My next question is with regards to the AHLL capex plans. I want to know that are there any further spending plans which are in stream that could come through for AHLL?

Suneeta Reddy: With regard to your first question, I think that you are quite right, we do have a large fixed cost base, we are looking at economies of scale and we do have an initiative which is really looking at reducing the fixed cost base and reducing also what we can and improving our operative leverage. But you will see the benefit of that like I said again it will take us two quarters. But there will a definite improvement. With regard to AHLL, no, I do not think they have a huge expansion plan at this time. What they are looking at is to reach profitability and improve asset utilization. They are currently at 97% of their capital in terms of turnover and they are going to push that.

Rakesh Nayudu: So what caused this Rs.50 crore spike in this quarter i.e the EBITDA loss which you reported in AHLL in Q1FY18? Were there any new additions? What has actually happened in AHLL during this quarter?

Mr. A. Krishnan: If you look at the AHLL EBITDA loss for the quarter is at Rs.28 crore and if you look at last year, same quarter it was at Rs.27 crore. So there is not an increase in that. Yes, while the revenues grew, it did increase on the EBITDA only because of the fixed cost of the two centers that we spoke of.

Rakesh Nayudu: On this Oncology center, which you have commented in the call at Vizag, this is your new facility, right which you have…?

Mr. A. Krishnan: That is a bit away, Vizag is the third one that will take at least one year before we start.

Rakesh Nayudu: Max India on their Q1FY18 earnings call mentioned that their clinical payouts increased by around Rs.35 crore on a quarterly basis, mainly because they have taken bone marrow transplant teams from Apollo. I just wanted to understand, what exactly has happened and what is the impact on the business at Indraprastha because of this?

Mr. R. Krishnakumar: No, there was only one doctor, I think Dr. Raychaudhuri who went from Indraprastha Delhi to Max India. I do not think it will impact us.

Suneeta Reddy: It will not impact us as we have got a new doctor in his place.

Rakesh Nayudu: Is it possible to get some numbers in terms of the costing and the revenue loss which could have happened at Indraprastha because of this?

Mr. A. Krishnan: We can take it offline and you can discuss. It is not a number that you said for sure. It is a much muted number, we will give that.

Moderator: The next question is from the line of Anubhav Aggarwal from Credit Suisse.

Anubhav Aggarwal: What is your expectation for the margins only for the mature hospitals where you are currently doing 20%, right? For next year, by that time stent prices would have normalized and some of the cost would have normalized?

Mr. A. Krishnan: It should come with a combination of two things. One is some of the pricing changes that we should be able to take. Second, we are working aggressively on the cost as well as Ms. Suneeta already mentioned. Thirdly, the volume also should pick up. So with the combination of all three, there is definitely headroom for growth as one of you alluded on the call and it is definitely something that we are focused on as well. So with the combination of all the three, we are planning for at least 22-23% in fiscal 2019 after this.

Anubhav Aggarwal: I need some clarity with regards to AHLL. You guided for a breakeven by fiscal 2019 end. Now if I just take fiscal 2017 top line for AHLL, grow it by 20% CAGR over two years, I just had Rs.100 crore in the top line and that is a loss we are making in the EBITDA and there is a gross margin in the business as well. Is there a chance that the targets for AHLL breakeven may slip by one year? That is what at least the number suggests unless you say that AHLL can grow by 30% top line which you just said that is difficult?

Mr. A. Krishnan: They are working on an accelerated plan. Their plans are at 25% growth but as of now they are at 18%, you are right. They should get to 20-21% at least on the growth which is what they are working on and most of that should flow, if you look at the incremental cost of that other than some bit of doctor fees which is around 35%, at least around 60% should flow down rather than a 50%. But you are right that as it stands, we are all hoping that they will get to the breakeven by FY'19-end which is what has been the target at which they are working on. So let us first see the progress and we will get to that hopefully by FY'19 we will see whether they are there or maybe one quarter here and there.

Moderator: The next question is from the line of Nitin Agarwal from IDFC Securities.

Nitin Agarwal: You have put out 12 new hospitals over the last two to 3 years with CAPEX of almost Rs.1,700-1,800 crore. Even if you exclude the Mumbai hospital, our EBITDA is only about Rs.8-odd crore for the quarter and it is not too much of an improvement over the last year. At what point in time do you see this cluster of Rs.1,700-1,800 crore CAPEX becoming meaningful from a contribution perspective? This is because the progress in EBITDA has been pretty slow even in this cluster. So how do you look at it?

Suneeta Reddy: If you look at the hospitals that we created, a lot of them have been in tier 2 cities. So we actually have a business model where the tier 2 cities hospitals have yielded us Rs.25 crore of EBITDA on Rs.100 crore CAPEX within 5-years.

Mr. A. Krishnan: So most of these hospitals if you look at it, like Madurai and Mysore, we are presently at Rs.25 crore of EBITDA. If you look at Bhubaneswar, we are probably even higher there. All these hospitals have the opportunity to get between Rs.25-35 crore of EBITDA i.e most of them, leaving some places like Mumbai and Bangalore where it is going to be much higher. So the opportunity of doing a Rs.300 crore EBITDA definitely exist between all of these. It is going to take a couple of years before we get there. It is not going to be a quarter. We are all looking at that number and trying to see where we can get that. It will be two years before we get there.

Moderator: The next question is from the line of Dev Raj who is an individual investor.

Dev Raj: There is a proposal in the Karnataka Medical Bill Establishment Act. So will there be any impact?

Suneeta Reddy: We are aware of Karnataka Medical Bill Establishment Act. But we are working with other healthcare providers in the city to see that the Act gives credit to the type of work that the hospitals of our stature do. So while it might be relevant for smaller mom and pop establishments, I think it can be fine-tuned in a better fashion so that it really appreciates the type of work that is being done by corporate hospitals. But this is something that is being done with all the healthcare providers together making a representation.

Dev Raj: Similarly, the proposal even from West Bengal also, their State Government?

Suneeta Reddy: I think in both these two States, this is the plan that we have is to work with local healthcare providers because it is clearly a disincentive to create new beds in those two states and I am sure that the Governments do not want that to happen.

Dev Raj: Okay. So will it be like the hospitals sending maximum costing or to the health secretaries maximum and minimum, something like that? In between that?

Suneeta Reddy: Right now, it is difficult for me to share it with you but rest assured that we are working with each of the hospital associations in both these States to handle the situation.

Dev Raj: My next question is with regards to the Kolkata fire. Looking at the media reports, I mean, was there any lapse by the hospital that they did not initially reveal and afterwards the West Bengal minister mentioned about the lapse on part of Apollo Hospitals, Kolkata?

Suneeta Reddy: Not at all, I can guarantee you that. If there was, we would not be getting our insurance also.

Dev Raj: In our 'Other hospitals'; are the fire safety in place or again some issues may come up?

Suneeta Reddy: No. I do not think we have issues in any other hospitals.

Dev Raj: Regarding this stent pricing control, can it come in other products as well?

Suneeta Reddy: There is a mention of knee but I think we have said that a hospital is a services provider. These are inputs that go into the service, so that we need to sensitize everyone and look at the service cost rather than be concerned about the input cost which has been a dent on profitability but we are reworking how we can recoup in each of the service lines.

Dev Raj: It is like they will be again considering the input cost also whatever the hospitals are incurring?

Suneeta Reddy: I think they are defining the input cost.

Dev Raj: Will GST be beneficial to the pharmacy business like unorganized/organized sector?

S. Obul Reddy It will be beneficial for the pharmaceutical side. We can even take credit for other service inputs, which is good.

Moderator: That was the last question. I now hand the floor over to the management for their closing comments.

Suneeta Reddy: Thank you, ladies and gentlemen for attending this call. I have noted your concern on profitability. But I would like to reassure you by saying that the long-term demand is intact and Apollo's strategy for capturing this demand especially is important. We are creating single specialty units which are focused on Orthopedics, Oncology, Cardiac, Pediatric, General and Emergency Care within Apollo countrywide. As per our strategy, we have opened 13 new hospitals and we expect the volumes to pick up in the next two-three quarters. All our units are focused on asset utilization for the coming quarters. We are also hiring new clinical talent that we believe will cement the clinical differentiation which is critical to the DNA of our brand. Thank you for joining this call and we hope to meet with you again in the next quarter with a much better set of numbers.

Moderator: Ladies and gentlemen, on behalf of Apollo Hospitals, that concludes this conference. Thank you for joining us.