Apollo Hospitals Enterprise Limited

Q2 FY 2018 Conference Call Transcript

November 14, 2017

Moderator: Ladies and gentlemen, good day and welcome to Apollo Hospitals Ltd. Q2FY18 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 Q2FY18 which were announced yesterday. We have with us the Senior Management Team comprising: Ms. Suneeta Reddy – Joint 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.

We will start with a brief overview of the Q2 performance by Ms. Suneeta Reddy following which we shall take your questions.

Documents relating to our financial performance have been shared with all of you earlier and these documents have also been posted on our corporate website. With that, I would now like to handover the floor to Ms. Reddy.

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 we shared yesterday.

We are happy to report that in Q2FY18, Apollo Hospitals reported a strong all-round performance. Standalone Revenues grew 13% on a year-on-year basis to Rs. 1,852 crore. Revenue Growth was 11% quarter-on-quarter. Within standalone revenues, 'Healthcare Services' grew 11% largely driven by volume growth.

Though Q2 is a seasonally good quarter for us; what was heartening this time was the contribution to growth that came from new hospitals especially the likes of Navi Mumbai, Malleswaram, OMR, Vanagaram and Nellore. New hospitals reported 37% year-on-year revenue growth of Rs. 196 crore aided by volume growth, while existing hospital revenues grew by 6%. Volumes grew by 13% on a year-on-year basis, and 15% quarter-on-quarter. This signifies an across-the-board recovery in patient volumes. Q2FY18 EBITDA was at Rs. 221 crore as compared to Rs. 174 crore in Q1 – a strong rebound, recording 27% growth over the previous quarter. EBITDA for the healthcare services segment grew 31% q-o-q.

As compared to Q2 FY17, EBITDA was stable. This was after absorbing an incremental cost impact of Rs. 35 crore, which was due to a mix of factors, namely:

- The regulatory capping of prices on stents and knee implants which contributed to Rs 10 crore impact per quarter.
- Secondly, GST impact of Rs 5 crore for the quarter. This was on account of high incidence of higher tax rate on all inputs services, as well a higher input tax on select consumables.
- Thirdly, the Navi Mumbai EBITDA loss for the quarter was Rs 10 crore. We expect the hospital to break even by the first quarter of next year.
- Lastly, the Increased Guarantee Money to Doctors which is yet to be fully recovered is about Rs. 10 crore per quarter.

We expect that with the measures we have put in place for pricing of services, and sustained momentum on volumes, the impact of the above factors on EBITDA will be fully recouped by FY19.

We are pleased to report that margins in the existing hospitals have rebounded from the low of 20.1% in Q1 to 21.4% in Q2 and we are committed to take this to 23% by FY19 through a combination of volume growth and cost control.

New hospitals posted an EBITDA of Rs. 8.7 crore in Q2FY18 as compared to an EBITDA of Rs. 13 crore in Q2FY17. This is after considering the loss of Rs. 10 crore in Q2FY18 in Navi Mumbai.

Overall occupancy across the Group was at 69% for Q2FY18. The occupancy in mature hospitals was at 71%, while new hospitals had occupancy of 62%.

ALOS for H1 FY18 was at 3.92 days, a marginal decline from 4.03 days in the same period last year. We believe that this is the right direction for it to move, and it is a result of our improved clinical protocols and operating efficiencies.

ARPOB in H1 FY18 improved by 4% over the corresponding period last year and was at Rs 32,174.

Coming to the Regional Performance, This quarter, we have recalibrated the reporting of our hospitals by regions as requested by several of you. This categorization now represents our strong regional presence through a combination of Tier 1 & Tier 2 hospitals as well as a pan-India presence through our JV's & Subsidiaries.

Tamil Nadu Revenues grew by 4%. IP Volumes have picked up, registering growth of 5%. ARPOB grew by 3% to Rs. 40,328. Overall occupancy for the cluster was at 57%.

AP, Telengana region Revenues grew by 19%. IP volumes grew by 6%. ARPOB was at Rs. 29,699, 13% higher than last year. Overall occupancy was at 61%.

The Karnataka region recorded a promising revenue and volume growth. Malleswaram, which was commissioned last year, recorded IP volume growth of

26%. Bangalore BG Road, Mysore and Jayanagar revenues grew by 4%, 16% and 18% respectively. Occupancy in the cluster was at 74%.

On SAP, the actual revenues grew by 23% year-on-year, we have reported a revenue growth of 17% in Q2FY18 on account of GST netting-off effect. SAP EBITDA grew by 2% to Rs. 35 crore. EBITDA margins were stable at 4.3% despite impact of higher GST on the value add. As more and more stores gain in maturity and break-even, we expect EBITDA margins to remain at these healthy levels. We have added 186 stores (net) in the first six months of this fiscal. We plan to continue this momentum into the second half of this year as well. This is part of our strategy to further enhance our dominant presence in the South India market and continue to be an undisputed leader in the all India market. The ROCE on this business is now over 15% on an annualized basis.

Q2 Standalone PAT declined by 23% to Rs.71 crore. The contributing reasons for this were:

- Interest costs increased by 25% y-o-y at Rs.59 crore.
- Depreciation increased by 10% y-o-y at Rs.67 crore on account of the new facilities added.
- The weighted deduction of 35AD is no longer available and the effective tax rate therefore for Q2FY18 was 28%.

The Present Debt as of 30th Sept.17 is at Rs. 2,800 crore; against which we have cash and cash equivalents of Rs. 265 crore leaving us with net debt of Rs. 2,542 crore. We have a strategy in place that is focused on the improvement of PAT through a higher capacity utilization and conservative capital outlay.

We are pleased to inform you that Deloitte has been appointed as our auditors from this fiscal, and these results have been the subjected to their limited review.

After a difficult start to the year, precipitated with the effects of multiple regulatory decisions including demonetization, price caps on stents and implants, and GST, we are pleased that our Q2 FY18 results are reflective of the resilience inherent in our business model, and vindicate our strong belief in clinical and operational excellence.

Several internal and external factors augur well for our future. Our planned capital expansion phase is behind us, and we believe we have reached peak levels of interest and depreciation costs. It is encouraging that our new hospitals are showing healthy volume and revenue growth, and are progressively making positive contributions to EBITDA. Mature hospitals are also recording good growth on a large base. Our business model has adapted well to the effects of regulatory policy, and our teams have developed agility in their responses to the external change. Our digital interface is now coming into play expanding our reach. Our integrated platform ask Apollo, offers appointments, bookings, online consultation to GP's**,** specialists, super-specialists, electronic medical records and currently generates about 3,000 appointments per day. We are also increasingly focused on the immense and unmatched potential of our distinct Centres of Excellence, for example Oncology, which is currently a Rs. 600 crore business with an opportunity to triple its revenue in the next 2 years.

I now open the floor for questions. Mr. SK Venkataraman, Dr. Hari Prasad and Krishnan our CFO and Mr. Obul Reddy representing our Pharmacy division, are all here with me to take your questions.

Moderator: We will now begin with the question-and-answer Session. The first question is from the line of Saion Mukherjee from Nomura Securities.

Saion Mukherjee: Can you share the total retainer fee to doctors that you have booked for the first half?

A. Krishnan: So currently, we have Rs.8-10 crore of under recovered guarantee fees that we said per quarter. But we would have paid two times of that.

Saion Mukherjee: So Rs.20 crore a quarter?

A. Krishnan: Yes.

Saion Mukherjee: Okay. How this number would have been changed on a year-on-year basis?

A. Krishnan: So typically the recovery gets to almost around 70% or 75% in over a period of 12-18-months,that is what typically they get to each of the doctors. So what has happened is in the last six months as you know we have added few of these doctors in guarantee money in some of our centers specifically in Chennai, Hyderabad, etc. Here, we have added doctors on guarantee money. For example, in Chennai we added someone who is doing kidney transplant, we added neuro, we added heart, cardiac, so we have added some of them. So the maturity is more like an aging, we will have to keep looking at it as it keeps moving. So currently the unabsorbed number is what we have stated. This will obviously get absorbed by Q1 of next year significantly.

Saion Mukherjee: Is this number sitting on 'Other expenses'?

A. Krishnan: No, it is in the 'Cost of Operations'. There is a specific line which is there of 'Guarantee Money for Doctors.'

Saion Mukherjee: My second question is on Pharmacy. Even though its margins seem to be improving, but it also appears that the rental costs are going up quite substantially. So is there any reason for that?

S Obul Reddy: While the absolute number has increased, it remains to be at about 3.2-3.3% of the revenues in the last two years. Also because of the new additions, etc., the percentage on the sales remain to be the same, we are under control of that number.

Saion Mukherjee: But it should not increase with sales, right? Is your rent linked to your sales?

S K Venkataraman: No, it is not increasing with sales is what we are saying. As a percentage, it continues to be 3.2%.

Saion Mukherjee: Actually, if I look at it, it is up almost 37% year-on-year and per store rent is up 21%. I think it is on the higher side.

S Obul Reddy : During the current quarter we have added about 100 stores, so that got factored into the H1. If you see last two years, our entire full year net additions will be around 200-225 stores, while in H1 itself we added about 190-stores. So the rental cost in an absolute number has increased while we maintained as a percentage on sales at the same level.

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

Neha Manpuria: In your opening comments, you mentioned that hospital had benefited from good seasonality in the quarter and therefore a lot of the growth was volume-driven. Is there anyway for you to give us some color as to how much of the existing business has grown because we have seen a strong margin improvement quarter-on-quarter as occupancies have gone up. How much of this is actually sustainable and how much of this is because of the seasonality in the quarter?

Suneeta Reddy: I think it is quite sustainable and the reason I say this is that if you look at the last quarter and what is different with what we have done in this quarter. I think by the end of last quarter, we were able to close out on a lot of corporate agreements which affiliated us with these corporates. So we now have relationships with corporates and these have filled our new hospitals. So they have really benefited in terms of volume especially starting this quarter and it is sustainable going forward. The second area where we have really grown is our penetration in International markets, especially Chennai, where there has been a growth of 21%. Across the group, there has been an 8% growth in International and I think all the hospitals have benefited from this and I believe this too is sustainable, because post that losing Pakistan, Delhi suffered. Now I think we have relationships with a lot of countries, which will continue going into the future. The third aspect is that we continue to be very strong in the retail market and we do this in several ways -- One of it is that we have introduced our digital presence through 'Ask Apollo'. The second is that we have a GP Connect which is very strong. We continue to have COE Programs. We have more feet on the street that are communicating with our local GPs. So, I think our retail base, our corporate base and our International base, all of them are improving. Most importantly, through the guarantee money, we have recruited very strong and good clinical talent that will see us through the next few years.

Neha Manpuria: So all of this has aided the quarter-on-quarter improvement that we have seen in the existing business margins?

Suneeta Reddy: Yes.

Neha Manpuria: You also mentioned that there is obviously a lot of cost impact because of several reasons and you are looking at pricing of services to make the business more sustainable and absorb these additional costs. Could you throw some color there as to what we are doing in terms of our mechanism of pricing to help improve our margins or recoup these costs?

A. Krishnan: So we have done two things. We continue to look at price increases aligned to inflation, which is 2% to 3% that we will do. Over and above that, what we are focused on significantly is the volumes, which is what we are focusing on. This is because there are still a lot of beds that are still not occupied and we still think we can work on the volumes at present with doing specific contracts with insurance, corporates and International, etc. as Ms. Suneeta mentioned, which is the major focus currently. We always have the pricing lever which we can continue to work on as we move forward.

Neha Manpuria: Last year sometime the Board of Directors had set up a committee to look at the business. Any updates on that? You had mentioned that this committee would come back with the plan in a year's time.

A. Krishnan: Not as yet, we will come back to you when there is answer to that.

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

Anubhav Aggarwal : My question is on the stent prices. If you compare first quarter loss due to stent or let us say the impact due to stent, it is same as the present quarter. The expectation was that this stent price impact will continue to taper down. What is the outlook here?

A. Krishnan So as of now we have not done anything specific in Q2 to address that. As we move forward, if there are opportunities to re-price our services over a period of time, we are looking at that. But more importantly, we are again looking at the volumes to compensate which is what happened this time, the volume of stenting in Q2 was higher and that helped us compensate a bit on the under recovery that we were doing on the overall level. But as we move forward, that is something that we will keep looking at and obviously address.

Anubhav Aggarwal : But just to understand, what is the resistance you are facing?

A. Krishnan: Competition, that is all, it is nothing more than that. It is just that we need to be competitive in a market and clearly we would want to go along with competition on that front and I think we will get there over a period of time.

Anubhav Aggarwal : My understanding was that as you also explained earlier that on cash patients whatever you lost, you have recouped it. It was mainly on insurance customers and Government subsidized patients that you are incurring loss right now. How does competition come into picture here?

A. Krishnan: No tactically, you are right, we can do that. It is just that from strategically we do not want to be amongst the only few hospitals to do some of these. We can obviously price it for the services, but we do not want to be on the wrong side of things, that is all it is.

Anubhav Aggarwal : Last clarity on this; for the cash patient today, the price of let us say…?

A. Krishnan: It is lower. So compared to what it was earlier, now it is definitely lower.

Anubhav Aggarwal : I need some clarity on the Pharmacy piece. In your presentation you carry that excluding GST impact, the growth was 23%, otherwise reported was around 17%. What is the GST impact on the Pharmacy top line?

S Obul Reddy: On the revenue side, earlier average VAT used to be around 6.3-6.4% which has now moved to 12-12.5%. So the additional revenue which you have to net from the sales, is the difference in the growth rates.

Anubhav Aggarwal: On the margins being weak, is that only because of the …?

S Obul Reddy: Even on that if you look at, Q2 is the transition quarter into GST. We have opening inventory which carries lower input tax at 6% whereas the sales are subjected to the GST of (+12%) and you have come credit available on only CGST which is something like 50% of your additional GST. So we expect margins to be impacted by about 50 basis points this quarter and next quarter. Also by 31st December we are statutorily supposed to liquidate the complete stock which was opening stock on 30th June. So this is the impact. Otherwise, margins would have been reported with about 50 basis points improvement over the corresponding period.

Anubhav Aggarwal: My next question is with regards to AHLL. The growth was very strong in the sales this quarter. But if I look at the business year-on-year, the EBITDA improvement was not commensurate with our sales growth that we have seen. Which part of the business is still making high losses?

A. Krishnan: So, they have added two Cradles in this year which was part of the overall business plan which they had earlier. Due to this, again the start-up cost of the 'Cradles' were present in Q1 and Q2. So if you ask me specific business which is still to absorb the fixed costs it is 'Cradle'. They have done much better on the 'Day Surgery' centers and 'Diagnostics' is also picking up.

Moderator: The next question is from the line of Sameer Baisiwala from Morgan Stanley.

Sameer Baisiwala: What was the price action that the company took in Q2FY18 across your clusters?

A. Krishnan: Across clusters, we did not take any price action. In Chennai alone we had 2% price increase which we did in a couple of hospitals. But across the hospitals other than Chennai we have not done that.

Sameer Baisiwala: What are the thoughts on the 'Other' clusters?

A. Krishnan: So we will look at it. At this point in time, as we said the focus is still on volumes and we will look at a 2-3% over the next two quarters.

Suneeta Reddy: But with our corporates, we do have an increase in tariff. So 25% of our patients who are actually corporate patients, there has been an increase in tariff.

A. Krishnan: Specifically in Chennai, as you remember last time we had come back on that volumes drop as well and what is happening and why is it that the volumes were a bit muted because we did go slow with some of the corporates where the volumes were not up to the mark. Wherever we are realigning the contracts with the corporates, we are getting at least a 20% increase in the pricing because some of them were almost 30-35% lower than the current prices of cash patients, whereas we are looking at 15% now versus the cash. Even in the Insurance side, on the GIPSA front, we have had a renegotiation impact which has been helpful.

Sameer Baisiwala: What is the average company-wide increase in the corporate tariff?

A. Krishnan: It is not company-wide, because across the company each of the unit does it at a different point of time. This was something which was peculiar and specific to Chennai which happened in Q2, where we got some impact which was beneficial.

Sameer Baisiwala: Krishnan, you also mentioned you would look at 2-3% going forward for ex-Chennai cluster; my guess is price increase over the second half of the year. Is that what you were saying?

A. Krishnan: Yes, more towards maybe Q4.

Sameer Baisiwala: My next question is on the operational beds. Is the count has gone up by 50 beds?

A. Krishnan: Yes, that is Navi Mumbai where the number of operational beds was added.

Sameer Baisiwala: On the regulatory front, we hear a fair bit of media news about Government tightening more controls, a) on implants across more therapies and b) on the overall package as well and not only just implants. Your thoughts on this space?

Suneeta Reddy: I think with regards to Government, they have done quite a bit. We believe that going forward we do not expect any further price controls. But having said that, I think by pricing services we are able to absorb any change that might come in input cost. So in fact, if they cap the cost will only improve margins if they do, do that. I think we are not really expecting any other change to happen. With regards to Government capping pricing services, the Central Government does not have the ability to do that because to put a cap on services would be extremely difficult and I do not think the Central Government will do that. But going forward, I think we are prepared, we have showed that we have resilience, last quarter was a big challenge for us and this quarter we have proved that we know to handle it. So I think we do have solutions for it.

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

Damayanti Kerai: I need few clarifications. In last quarter we spoke about some issues in the Kolkata hospital which impacted our corporate profit. So what kind of progress we are seeing there?

Dr. Hariprasad Kolkata has actually bounced back and second quarter has been much better than the first quarter. Kolkata has come back in terms of its occupancy and volumes and I will give you a specific number on the EBITDA margins.

A. Krishnan: So in the last quarter the revenues were almost down by 23%, so we have recovered almost 7-8% from the low that we saw in Q1. Q2 has been good. In Q1 there was EBITDA loss which they had and now they are close to around Rs.5-6 crore of positive EBITDA. The team is targeting to get to at least Rs.35-40 crore of EBITDA for the year between Q3 and Q4.

Damayanti Kerai: Sorry, Rs.35 to Rs. 40 crore over the next two quarters is what you are saying?

A. Krishnan: That is correct. And overall for the year is what they are targeting. So far if you look at the EBITDA for Kolkata, H1 has been close to Rs.5 crore or Rs.3 crore and that is what has been the number. But for the full year they are trying to get at least Rs.30-35 crore for now.

Damayanti Kerai: One question on this standalone balance sheet. We are seeing almost doubling of this capital work-in progress. So what is that regarding?

A. Krishnan: That is the proton therapy which is something we still have. So the capital work-in progress is still I think would be around Rs.600 crore and this is the capital work-in progress number that we have currently. This will get capitalized in the next two or three years because the way we have added Proton, it should be capitalized in two phases as opposed to one.

Damayanti Kerai: I need a clarification on the 'Day Care' centers which you mentioned earlier. We are seeing this Rs.26 crore kind of loss on the consolidated basis from the AHLL. So how do we look at the next 2-3-quarters? We expect to taper it down towards the FY'18 end, right? So what kind of improvements we should expect in the remaining two quarters and then fiscal year FY'19?

A. Krishnan: So I think they are still looking at ending the year with a positive number, hopefully. The team is targeting to see at least how lower their Rs.20 crore on EBITDA number they can get to by Q4. This is the first target that they have so that if they end the year at Rs.17-18 crore run rate, then the year after that next year by Q4 of next year which we have said we would want to break even, they are in line to achieve that commitment that they have. So that is what they are focusing on. Most important here is growth because all the fixed costs as we have said are sunk. We do not think there is much of cost optimization room here. So they are working on growth on both 'Diagnostics' as well as the 'Day Surgery' Centers, both of which have done well and also 'Cradle'. So we are hoping that we should be able to accelerate some more on the growth and then hopefully get to the committed levels of breakeven EBITDA by fourth quarter of next year.

Moderator: The next question is from the line of Shyam Srinivasan from Goldman Sachs.

Shyam Srinivasan: I have just one question on the Tamil Nadu region like you report now. Sequentially I think you have seen volumes improve. But in-patient revenue growth still seems slow, right? So can you kind of just take us through what is keeping it low at this point of time?

Suneeta Reddy: First, when you look at Tamil Nadu or Chennai, you have to remember that the base is really large. So it cannot grow like the Bangalore cluster. Secondly, Chennai got a lot of competition coming in. Not only did it get competition but I think we also added facilities, in fact, over a period of time, we have added three facilities. So when you add facilities like that, in a way you are spreading yourself out. But net-net I am happy to report that what we did was the right thing because both volumes and revenue have grown and we have maintained the highest ARPOB in the system which is close to Rs.50,000 at Rs.49,000. I think, the important things to note is that our margins in Chennai continue to be the highest. The ROCE of the Chennai cluster continues to be high. Also the potentials for growth will definitely come from Chennai as we have got a very good group of doctors. Also, the International patients have grown by 21%. Added to that this is where we actually incubated the 'Day care'. So not only have we added hospitals, we have two day care centers, both of which are doing well. Because of that Chennai now has about 30% market share in the formal healthcare market segment and that is important because going forward that is where at sometime we are able to drive a premium when you have that lot of market share.

Shyam Srinivasan: So a mid single-digit revenue growth is what one should be thinking about for this cluster?

Suneeta Reddy: I think because you have not added the Day Care which is taking some of our surgical volumes and both profitable Day Care work. So yes, high margin, single digit and high market share.

Shyam Srinivasan: My next question is on PSU on the corporate rationalization. I think you touched upon in an earlier question as well. So is that largely behind us, which was actually leading to weaker volumes in the previous quarter?

A. Krishnan: So it is an ongoing process, it will take at least two more quarters to get completed in Chennai. We will also look at it in 'Other' clusters, like Hyderabad and Bangalore. But as it stands, it will take two more quarters to get completely done in Chennai.

Shyam Srinivasan: I just need a data point. What is your International patient contribution in Tamil Nadu region or Chennai whichever you split out, can you just clarify?

Suneeta Reddy: So International patient contribution in Chennai has grown by 21% but overall for the group it is 8%.

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

Swati Madhabushi : I am asking you a repeat question as I did not get clarity when Anubhav asked about this Stent price increases for the cash patients. This is because my understanding was that we are consistently taking up the prices for the services to compensate for the cap on the Stents. Has it happened or not?

A. Krishnan: So we have done a one-step increase on this which we had said earlier itself that we have done it. So after that we have not taken the next step increase on that. So as of now, the overall cost to the patient is still lower by at least 10-15% as compared to earlier. So still there will be some benefit of this overall Stent price which will still move to the patient which will continue to be. But we will take another step increase over the next two quarters.

Swati Madhabushi : Could you quantify the numbers i.e what is the impact from this which might be recovered in the next two quarters and then what is the impact from this PSU rationalization, just want to weed out the one-off?

A. Krishnan: We have said that Rs.10 crore is something that is the impact of Stent, part of that we may recoup out of Stent, part of that we may recoup out of whatever else that we do, 2%, 3%, etc. So we may not recover entirely all of this from Stent itself, we have said we will recoup this Rs.10 crore impact by FY'19. We stand committed to that, that is how we are working on. The PSU thing is just the contract negotiation. Once that happens it should help in the overall realization of the company.

Swati Madhabushi : So you mentioned Rs.10 crore is the impact from Stents, right? What if we take entire medical devices plus consumables? This is because my understanding was that now we are operating on no profit for all the consumables. So what would be the impact and when will you recoup that one as well?

A. Krishnan: I do not think we work on that principle as of now. Currently, for the consumables we have a policy and we do charge it to the consumer. Even if the consumable price were to drop, I do not think there is going to be any great impact of that in our P&L.

Swati Madhabushi : So you do make profit on the consumables still?

A. Krishnan: Which is marginal, it should be in the range of 10-15%.

Swati Madhabushi : What is the number of operational beds in Navi Mumbai?

R. Krishnakumar: 100-130 beds.

Swati Madhabushi : Where will we get to by end of this year?

R. Krishnakumar: 180-200 beds.

Swati Madhabushi : On Gleneagles, is the damage control done? Has the perception changed? Have you done anything to improve the customer perception on this or it is just naturally the normalization is happening?

Dr. Hari Prasad: Actually, the perception has changed and our biggest strength is the confidence our own patients have on us. This is getting reflected in significant increase in Q2 in terms of numbers, one. Second thing is that there are a lot of other activities which are happening which are community-based, which always used to happen and we have enhanced those activities. Third thing is that, there are certain things which have been done within the hospital also which makes it more patient-friendly and makes sure that the customer who is walking into the patient actually is benefited both in terms of better services and clinical outcomes.

Swati Madhabushi : My next question is with regards to the CAPEX spending on Proton. How much have you already spent?

A. Krishnan: About Rs.400 crore.

Moderator: The next question is from the line of Dev Raj from Capital Research.

Dev Raj: Will the Medical Tourism business get impacted by price capping?

Suneeta Reddy: No, I do not think it will.

Dev Raj: But that high-end Stent and implant would not be available right now in India after this capping?

Suneeta Reddy: There are some suppliers that still keep it.

A. Krishnan: As we speak, there is a discussion which is happening between the NPPA and the manufacturers which has been opened up by the Government. We have been speaking with them even as providers for some time. There have been set of manufacturers who have been discussing with the Government saying that you cannot come with this pricing which is not really very rational. Of late you would have seen some softening in their stand in the last week or so and they have called in for the manufacturers for negotiation and discussion. I guess there could be some positive fallout of that which we could expect in the next two-three months.

Dr. Hari Prasad: Also the percentage of people coming in for stenting within the overall number of people coming in for medical treatment from abroad is much smaller. So the impact would not be significant.

Dev Raj: My next question is regarding the churn out for the stores by the Prime Minister's office in each and every State. Is this structurally negative for Apollo Pharmacy or will it…?

Obul Reddy: We do see that they are basically generics which will catch up in the retail market. So we have not seen that impacting us in any of the markets.

A. Krishnan: Also the other thing that we want to state here is that India has 600,000 pharmacy stores as you are aware and we have still 2,500 stores and we also pass on loyalty discounts of almost 3-7% actually ranging to most of our customers. If you actually ask us it is going to be Jan Aushadhi stores or whatever they do to offer pharmaceutical products is going to cause much more difficulties with the other pharmacy stores we feel than compared to people like us.

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

Nitin Agarwal: On Navi Mumbai, what have been our occupied beds over the last two quarters?

Suneeta Reddy: Operational beds are 150. So we have 120 beds which are occupied.

A. Krishnan: So that is as of now. That is currently what the occupancy is and if you look at Q2 that was there, we had 130 operational beds and occupied beds were almost around close to 85.

Nitin Agarwal: What was the revenue in Navi Mumbai last quarter?

Suneeta Reddy: Well the expected turnover should be for this quarter in the region between Rs.100 crore and Rs.120 crore.

Nitin Agarwal: On Proton Therapy, in your assessment, what is the business case for Proton Therapy project? What is the sort of breakeven period for this project?

Dr. Hari Prasad: Actually, Proton is a very highly specific mode of treatment for cancers. It is a curative form of treatment which is not available in this part of the world. There are very few proton centers available across the world and we believe that one center should be available for people in India. We are also confident that a lot of people who are coming from other countries where the proton therapy is not available will start using this facility in a big way. Tata is also coming in with a second facility but that is going to take some more time. So there is a compelling business case for Proton purely on the basis of the medical use of it and the medical benefit of it in terms of treatment of specific types of cancer.

Nitin Agarwal: We mentioned that there is some seasonality push which was there in the numbers for the quarter. So, when we sort of look through H2, is this current base that you have done across hospitals sustainable or do you think there is a pretty strong seasonality mix which is present which will probably not recur at this level going forward?

A. Krishnan: I think it is early to say that. October has been good and we continue to see good numbers in October. So we will have to play it by the quarter.

Suneeta Reddy: I think several of the initiatives that we have taken post last quarter, which is really like we spoke about our tie up with corporates, the fact that the guarantee money doctors have started to play out and also our improving relationships with the GPs. I think all of these will start to kick-in, in the third quarter too.

A. Krishnan: New hospitals definitely have done well and that is one place that we are different from some of the others. We have a good stock of new hospital beds which can continue to get into the momentum that we are driving.

Nitin Agarwal: You mentioned that the occupancy of the mature beds is about 71%. How much further can we optimize on the occupancy in this cluster which is almost 75% of our bed strength?

A. Krishnan: We can. Historically, we have seen it going all the way up to 80% also…

Suneeta Reddy: But also the ALOS is dropping; it is already come to 3.92 Vs 4.03. This is because of the technology also we have introduced…

Dr. Hari Prasad: The 71% of occupancy which you are seeing on a lowered ALOS is actually 75% of the occupancy on the ALOS we had last year which was 4+.

Nitin Agarwal: So you see some further scope for reducing ALOS which will keep increasing the effective capacity for the business?

Dr. Hari Prasad: Absolutely.

Moderator: The next question is from the line of Dheeresh Pathak from Goldman Sachs Asset Management.

Dheeresh Pathak: The Rs.10 crore stent impact that you mentioned was for the quarter or for the full year?

A. Krishnan: For the quarter.

Dheeresh Pathak: In AHLL, referring to Slide #13, revenues have gone up YoY but the EBITDAR impact improvement is not there. So the contribution that is coming from incremental revenues is hardly anything…?

A. Krishnan: This is the same thing that I answered sometime back regarding the fixed cost which came in because of two new cradles which have been added in this year along with the people that came along with that. This is what has added to some of that cost. But they should see the gap reducing as they move forward.

Dheeresh Pathak: Is this on our own building or land because the rent increase….?

A. Krishnan: No, it is on lease. Everything that they have is leased building and land.

Moderator: We have the follow up question is from the line of Neha Manpuria from J.P. Morgan.

Neha Manpuria: On the AHLL business, just on the Daycare Surgery, could you give us some metrics as to how are the occupancies now, how much have we ramped up in the first half, because from what I understand, Spectra is the largest component of the AHLL loss today, would that be correct? So we need to see ramp-up there to be able to reduce the AHLL losses?

A. Krishnan: Yes, Spectra and Cradle, both of them are contributing to the losses currently. If you look at the overall growth which has been quite good in both these businesses and Diagnostics is also picking up. So if you look at the revenue growth of Diagnostics it has been almost around 24% over and above Spectra and Clinics. Cradles have also done well. Spectra, while they have managed to contain the cost, the growth there is taking some more time, it has grown by almost around 10-12% this year, Cradles growth has been 39% in H1 whereas Diagnostics have been 24%. Overall while they have grown, as the fixed cost is pretty much there in the system and they will have to focus only on same-store growth which is what they are looking at in Spectra.

Neha Manpuria: In that case, do you think that the ramp-up in Spectra to a higher level of growth is required for us to be able to recoup the losses there? I just want to understand if fourth quarter FY '19 is partly aggressive for a breakeven?

A. Krishnan: You may be right on Spectra in particular because the growth may have to go a bit higher. But if you ask me, there is also the Diagnostics which is doing well. So we are also hoping that we should get some positive contribution from Diagnostics and Clinics, while Spectra picks up over a period of time. So we are hoping that some of that should also come in handy. But you are right, that growth needs to probably get to the 15% - 20% kind of range.

Neha Manpuria: My next question is specifically on the Chennai cluster. The occupancy there had come off because of main hospital getting impacted due to the PSU, corporate negotiation. How have occupancies trended from last quarter to this quarter in Chennai as we have seen improvement, could you just some more color that in terms of volume growth and occupancies in that hospital?

Dr. Hari Prasad: All the hospitals in Chennai have actually shown an increase in occupancy compared to the same quarter last year including the main hospital.

Neha Manpuria: And quarter-on-quarter?

Management: Yes, quarter-on-quarter also they have shown an improvement over Q1 of ’18.

A. Krishnan: So quarter-on-quarter for example, Chennai main saw an almost 10% increase in admission.

Moderator: The next question is from the line of Dev Raj from Capital Research.

Dev Raj: Sir, this is regarding the Karnataka medical establishment Bill. Can you tell us something regarding this on impact on the hospital?

Dr. Hari Prasad: One thing is that the bill is not yet passed. The doctors have been agitating against it. Only yesterday the Chief Minister called the doctors and tried to talk to them to stop the agitation. But without any concrete assurances, the doctors refused to stop the agitation. So we need to actually wait and see how many of the clauses that are there in the current bill will actually be passed to understand the impact. So we are yet to understand the impact because of lack of clarity on the bill and the clauses that will be retained in the bill.

Moderator: The next question is from the line of Sameer Baisiwala from Morgan Stanley.

Sameer Baisiwala: If I remember correctly, at the beginning of the year for 'Diagnostics', we had 23 lakhs and I think 163 Collection Centers. So what has been the progress in terms of adding these and what is your target for the current year?

A. Krishnan: Can you get offline on this? We do not have that numbers handy, Sameer, we will get into you.

Sameer Baisiwala: My next question is for International patients. What sort of pricing flexibility do you have over there?

Dr. Hari Prasad: To International patients we actually charge a bit of a premium and it is over and above the regular listed cash tariff of our hospitals by about 5-7%.

Moderator: The next question is from the line of Saion Mukherjee from Nomura Securities.

Saion Mukherjee: Ma'am, you said that Chennai is one of the most profitable clusters. Will it be possible for you to share the level of margin that we currently enjoy in Chennai?

A. Krishnan: So presently, we would have approximately around 28-30% margins in the old hospital.

Saion Mukherjee: So this does not have any corporate overheads, etc., right?

A. Krishnan: So the Corporate overhead is distributed. So after taking the impact of corporate overheads is what I am saying.

Saion Mukherjee: Another point you mentioned about the slower growth that we have seen is like there is a too much of supply, right. So if you look at whatever new projects are coming in some of the key areas that you are operating, how should we think about the supply situation over the next three-four years, particularly in Chennai, Bangalore and Hyderabad, some of the key clusters for you?

Suneeta Reddy: I think in all of these key clusters, we have established a leadership position which is critical. Having that beachhead I think gives us the ability to reach optimal scale and to consolidate our presence in each of the clusters. That is the way we think about it. Having said that, I do not think there is too much investments happening in any of the clusters that we are present in. In terms of new competition, I do not think it is as significant as it was in the last five years.

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

Damayanti Kerai: Are we broadly done with setting up all the required medical teams in all the new hospitals or we still have some work to do there?

Suneeta Reddy: There will always be some more work that will... I think our thing is ever finished because once we do the first line, then we prepare the second line, because Apollo is all about the brand and doctors are part of the brand, so it is never done.

Damayanti Kerai: All the new hirings which we have done are on guarantee fee basis, right?

Suneeta Reddy: Yes, I think a lot of the guarantee fee thing we have done because we put anchor doctors for each of the COEs. Though some of them will migrate into fee-for-service. So we should see an improvement in that.

Damayanti Kerai: Generally, what is the timeframe within which we can see movement from guarantee fee to fee-for-service?

Suneeta Reddy: One to two years.

Damayanti Kerai: We have one left managed hospital as per the latest presentation. Which one we have exited?

Dr. Hari Prasad: Victor, Goa.

Moderator: We will take the last question, from the line of Amit Kadam from LIC Nomura Mutual Fund AMC.

Amit Kadam: My question is on Navi Mumbai Hospital. So what is the planned capacity in terms of beds? Also what will be the optimum ARPOB we can generate out of this because the cost i.e the setup cost has been significantly higher than the rest of the hospital? So what should be the ARPOB, we should be targeting for this hospital?

Suneeta Reddy: We can go up to 400 beds and currently the ARPOB is at 37,000. So when we had done the projection, we were supposed to be 22,000. So we believe that if Chennai can do 50,000 Mumbai should be able to easily do 60,000.

Amit Kadam: You said that the planned total can go up to 400 beds. In the current phase how much we are like going for? Almost 150 beds is the current number, right ma'am?

Suneeta Reddy: Currently we are at 150 beds.

A. Krishnan: 200-beds operational by end of this year.

Amit Kadam: Then there is a further scope of another 200-beds?

A. Krishnan: Yes.

Moderator: Ladies and gentlemen, that was the last question. I now hand the conference over to the management for their closing comments.

Suneeta Reddy: Thank you for joining today's call. I believe that we have launched several significant new offerings including our Digital Interface and our focus on Centers of Excellence which would not only improve our revenue but our clinical outcome which is key to the DNA of Apollo Hospital. Our performance has shown that the long-term structural demand for healthcare is intact and that we have built sufficient capacity to effectively sustain future growth. We are confident that Apollo Hospitals is uniquely placed to carry forward the momentum of this quarter into the next 12-18-months. Thank you again, ladies and gentlemen.

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