# Apollo Hospitals Limited

## Q3 FY19 Earnings Conference Call
February 11, 2019

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**Moderator:** Ladies and gentlemen, good day and welcome to Apollo Hospitals Ltd. Q3 FY19 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 Mayank Vaswani from CDR India. Thank-you and over to you sir.

**MayankVaswani:** Good afternoon everyone and thank you for joining us on this call to discuss the financial results of Apollo Hospitals for Q3&9M FY19 which were announced on Saturday. We have with us on the call the senior management team comprising Ms. Suneeta Reddy – Managing Director, Dr. Hariprasad – President of the Hospitals Division, Mr. A. Krishnan – Group CFO and Mr. Chandra Sekhar – CEO of AHLL.

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.

Documents relating to our financial performance have been shared with all of you earlier and they have also been posted on the corporate website. I would now like to handover the floor to Ms. Suneeta Reddy for her opening comments.

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

We are pleased to have sustained our growth momentum since the start of this fiscal year. The third quarter has traditionally been a slow quarter due to festival holidays, however, this year we have been able to register a good performance, both in the hospitals and in the pharmacy division.

In our earlier earnings calls last year, we had indicated that we would strive to recoup the impact of regulations capping prices of stents and knee implants, GST implementation over a 12 to 18 month period. We have achieved this, and have expanded margins and EBITDA through our implementation of service pricing and assured pricing plans, with a clear focus on higher margin profile case mix. We have also paid particular attention to our clinical talent pipeline, and enhanced clinical engagement.

As a result of these efforts, we have delivered a healthy result from our Mature hospitals which reported a revenue growth of 14%, and were significantly able to accelerate revenue through volume growth. Mature hospitals EBITDA margins have improved to 21.7% this year; an improvement of 50 basis points from the same period last year, and is well on the way to the 23% target that we promised over the next few quarters.

New Units have also delivered on growth. They have registered volume growth of 21%, and a revenue growth of 25% compared to the same quarter last year. While EBITDA margins for new hospitals have improved to 6.6% from 5.3% in the same quarter last year. We have delivered on our commitment to ramp up occupancy in the Navi Mumbai hospital, resulting in an EBITDA breakeven this year.

As we move into the next year, the focus for these units will be to ensure that volumes continue to grow at a healthy pace, and that revenue and profitability growth is achieved by carefully calibrating payer mix and case mix.

Q3 Revenues year-on-year grew 17% to Rs. 2,169 crore; aided by SAP growth of 18% and Healthcare services growth of 16%. New hospitals reported revenues of Rs. 257 crore representing a 25% year-on-year growth, while existing hospitals revenues grew 14%.

Q3 total Inpatient Volumes grew by 6% on a year-on-year basis, supported by 21% IP volume growth in new units. Overall Q3FY19 occupancy across the Group was at 5,017 beds or 70%, compared to 67% in Q3 FY18. The occupancy in mature hospitals was at 3,823 beds or 71%. New hospitals had occupancy of 1,194 beds or 66%.

Q3 overall EBITDA was at Rs. 268 crore as compared to Rs. 221 crore in Q3 FY18,a year-on-year growth of 21%. Within this, Healthcare services EBITDA grew by 17% to Rs. 213 crore. Healthcare services margins were at 18.4% in Q3 FY19 vs. 18.2% in Q3FY18 aided by New hospitals which reported a 6.6% EBITDA margin for the quarter as compared to a 5.3% EBITDA margin. Existing healthcare services margins were at 21.8%.

On SAP, Revenues grew 18%year-on-year on back of both same stores sales and network growth which saw us add 251new stores in FY19 of which 105 new stores were added in Q3FY19 itself. SAP EBITDA grew 39% year-on-year to Rs. 55 crore. The EBITDA margins have inched up further to 5.4%. With improved efficiencies and asset turns, SAP ROCE is now at 21%.

PAT grew by 29% to Rs. 87 crore. Interest costs were higher by 9% year-on-year at Rs. 69 crore and Depreciation was higher by 13% at Rs. 77 crore on account of additional capex in new facilities added. Effective tax rate for Q3 FY19 was 33%.

Present Debt as of 31st Dec 18 is Rs. 3,252 crore; Cash and cash equivalents of Rs. 246 crore. Net Debt of Rs. 3,006 crore, Debt-equity ratio of 0.85 and Net Debt to EBITDA of 3.

Mature Hospitals ROCE has crossed the 20% threshold and has reached 21% in 9MFY19. SAP ROCE is at 21%. 10 new hospitals with capital employed of nearly Rs. 1,900 crore will begin contributing to ROCE from the next fiscal.

Consolidated performance too grew in line with standalone financials reporting 17% revenue growth and EBITDA growth of 28% in Q3. Consolidated PAT grew 24%, to Rs. 61.9 crore.

Apollo Health and Lifestyle recorded revenue growth of 30% for Q3 FY19, and is maintaining its growth momentum across formats. The team is committed to achieving EBITDA breakeven by Q2 FY20.

These results reinforce the internal resilience of our business model which is well diversified across specialties, geographies and maturities. We still have significant headroom for growth at current capacities of the total 7,000+ operating beds (excluding AHLL & Manage beds) that we have Group-wide. 14 hospitals with over 1,809 operating beds are new and increased utilizations and volumes in these will aid growth and further margin expansion.

Before I close, I would like to share a couple of updates on network expansion, the highlight of which has been the commencement of our 'Proton Cancer Centre'. This state-of-the-art facility introduces a new frontier in cancer management and puts India on the global map for the best and latest in cancer treatment. We are excited as this center will not only serve patients in India, but also neighboring regions across South East Asia, Africa and the Asia Pacific.

We also took a step forward to strengthen our pan-India presence by making a foray into the Kerala region. We signed an operations management contract for a 250-bed super-specialty hospital where Adlux Group will serve as infrastructure partners. The strategically located hospital will provide world-class treatment and health care services to people of all socio-economic strata and help us increase our Medical Value Travel offerings to International patients as well.

We made a few changes to our Board of Directors this quarter. Mr Sanjay Nayar, who has been a trusted and respected Board member, resigned on account of his increasing professional commitments. As you are aware, KKR recently increased its stake in Max hospitals.

<u>We have inducted two new independent directors:</u>

Mr. MBN Rao: He is the former Chairman and Managing Director of Indian Bank and Canara Bank. He was the chairman of Advisory Panel on Financial Stability Analysis and Stress Testing formed by Committee on Financial Sector Assessment constituted by Government of India and RBI. Mr. Rao was on the Boards of EXIM Bank, General Insurance Corporation Ltd. and Cholamandalam Insurance Co. among the many. He is well respected in the field of finance and will be a great value to Apollo Hospitals.

Ms. KavithaDutt: Joint Managing Director, KCP Limited. She is also the chairperson if SCWEC, a sub-council for Women Entrepreneurs in the SAARC Chamber of Commerce and Industry. She is co-chairperson of the Tamil Nadu chapter of FICCI.

Both of them bring immense experience and credibility to the table, and is reflective of the utmost importance we attach to high standards of Corporate Governance.

I now open the floor for questions. Dr. Hari Prasad, Chandra Sekhar and Krishnan are here with me to take your questions.

**Moderator:** Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Rakesh Nayudu from Haitong Securities.

**RakeshNayudu:** I have two questions. My first question is on the Gleneagles Hospital in Kolkata. Now given that the partner has bought a stake in competing entity, understand that assets now need to be integrated into the Apollo. So, can you please explain as to how that would be done and what is the budgetary outlay that we should be looking at for this transaction? My second question is on the promoter's pledge on shares. I understand that is one of the concerns which has been overhang on the stock. So, can you please explain as to how we should be looking at this pledge shares scenario and what is the management and promoters view on this?

**Suneeta Reddy:** With regard to Kolkata, we are awaiting legal opinion with size conflict of interest which will enable us to if required buy Gleneagles 50%, but this again I think we need to have discussions between the partners before we arrive at a conclusion and I do not think funding it will be an issue, we should be able to find funding for that. With regards to the pledge of shares, the pledge of shares has gone up by 5% recently. And this is because of the unwinding of the KKR instrument which will back-ended its structure, where we had closed out in January and this is a 5% extra pledge; however, we are very confident of the liquidity event happening within the next six months, which will definitely reduce the number of shares that we have pledged.

**RakeshNayudu:** Could you please elaborate on the 'Liquidity event' part?

**Suneeta Reddy:** I think we have several assets in our pool. All of you must be aware that we are also 51% holders in Apollo Munich Health Insurance. So that is one opportunity. We also have one other opportunity which we will discuss at the appropriate time.

**RakeshNayudu:** Regarding this Gleneagles asset, is there any shareholders agreement attached to the valuation at which the asset needs to be crossed?

**Suneeta Reddy:** The Kolkata asset?

**RakeshNayudu:** Yes.

**Krishnan A.:** Nonot yet,this is as per the shareholders agreement, it would be at the fair market value. So the fair market value will have to be determined and discussed and basis that you will have the valuation.

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

**NehaManpuria**: My first question is on the existing business. We have seen a strong growth despite the seasonality in the quarter. However, margins have remained flat. Was this growth due to some shift in low margin seasonality into the quarter which is not reflected in margins? This is because if you are growing double-digits, I would have expected margins to improve from the 21.5%, 21.8% that we have been seeing in the last few quarters.

**Krishnan A.:** You should remember that if you look at our annual rate that happens somewhere in the August timeframe, and the annual rate impact would be fully impacting in this quarter, this will be the first quarter of assuming all the annual wage impact which has come in. Despite that we have been able to get in at a 21.8% margin. So as we move forward, you would see that this should keep moving higher than the current number as we continue on the growth momentum.

**Suneeta Reddy:** And if you were to look at our nine months performance, we have actually improved ourhealthcare services from 17.4% to 18.3%, 90 basis points improvement.

**NehaManpuria**: Yes ma'am, but I am assuming a large part of that would also be driven by new hospitals. I was just looking at the existing hospitals number.

**Krishnan A.:** Yes,for existing hospitals it was predominantly because of what I said and also there has been some guarantee fee doctors whichwe have added in two of our units. But that it okay, you know we are quite aligned to the 23% that we have told that we would be achieving and we are aligned to that number that we would over a period of time achieve.

**NehaManpuria**: So the guarantee fee doctors we have added in our existing units?

**Krishnan A.:** That is correct, we have added a couple of them, - one in Chennai and one in Hyderabad.

**NehaManpuria**: And that is the reason we have seen an improvement in our ARPOB? This is because the ARPOB in both Chennai and Hyderabad have been pretty strong.

**Krishnan A.:** If you remember in Tamil Nadu we had said that we are looking at some of this low paying corporates being churned out and then working on cash patients build up also. So it has been a combination of cash and insurance improving the case mix as well as some high-end cases which we have added especially in oncology as well as neurosciences, etc. So you are right, it is a combination of high end cases plus case mix which have benefited us on this top-line and ARPOB.

**NehaManpuria**: My second question is on the new hospitals. If we look at the number of bed in the new hospitals, they have gone down slightly from the last quarter, and from the last year, they have pretty much been in the same level of 1,440, 1,445. Are we not ramping up beds in Navi Mumbai? And if that comes in,should we expect the new hospital profits to come off?

**Krishnan A.:** No, if you ask us, one is we have been focusing on the case mix again here. One thing that we do in all new hospitals is when we start off, our first focus is to fill the beds make the hospital busy so that then over a period of time then we focus on case mix, we focus on ARPOB, we focus on the high-end cases, etc.This is exactly how you will see the new hospitals also play out in direction as we move forward. Now if you look at the overall occupancy of the new hospitals it is now coming to good levels and next year you will see Navi Mumbai also open another 50-100 beds as we speak. So that is the plan that we have. Currently, the focus is on profitable growth. The first focus was to ensure that we get the hospital busy and focus on revenue and ensure that the costs are recovered first which we have done quite well and now the focus is on profitable growth. So that and then you will get to the occupancy increase over a period of time.

**NehaManpuria**: Sir, just to recap, Navi Mumbai, can you tell us how much are you operating, what is the occupancy like and nine months what is the numbers have been please?

**Krishnan A.:** So approximately if you look at the current occupancy it is around 160 that we have in Navi Mumbai and we have almost around 200 plus beds operational, next year we would hope to operationalize another 50-100 of them as we move forward, but again the incremental cost because of that will not be high.

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

**AnubhavAggarwal**: Just continuing on the major hospitals; on the AP and Telangana region have you taken any price increase? This quarter it seems almost like 5% kind of bump up in prices?

**Suneeta Reddy:** So revenue grew by 8% and definitely there was some price increase.

**AnubhavAggarwal**: So is 5% right reflection?

**Krishnan A.:** So there has been a price increase of almost around 3 to4% across the hospitals there and then there have been case-mix uplift also again there.

**AnubhavAggarwal**: Also I need one clarity; so this price increase was only for in-patient but out-patient also shows a very significant increase?

**Krishnan A.:** It was across the Board.

**AnubhavAggarwal**: In Karnataka, we were struggling for the last two quarters for the volumes. Now this quarter was a big surprise. Certainly, our utilization seems to have just for the quarter seems to go up to 85% plus but at the same time average length of stay also increased dramatically. So what has happened in the Karnataka cluster?

**Suneeta Reddy:** So in Karnataka, we are doing a lot of not only joint replacements have increased, but we started liver transplant program there, and we are starting to accelerate our oncology program.

**AnubhavAggarwal**: But such a sharp increase in utilization from just these two programs?

**Krishnan A.:** So Oncology plays a very significant driver, right. Oncology definitely has a play in outpatient revenue because clearly oncology has radiotherapy attached to it, which is the reason that if you look at Karnataka, the outpatient volumes grew by 1% whereas outpatient revenues has grown by 14% year-on-year. This has aided significantly by the oncology uplift that we have this year. So oncology definitely is a significant addition to the revenue and again if you look at other hospitals in the cluster, Malleswaram is a new hospital which has started doing well, we have seen good uplift in the overall revenue as well as profitability in that hospital. So as we move forward, we hope to maintain that momentum there.

**AnubhavAggarwal**: But how do we grow from here because we have almost reached a very high kind of utilization in the Karnataka cluster…?

**Suneeta Reddy:** So we do have enough land to enlarge the facility that we have.We are thinking of adding additional rooms in Bannerghatta and I think not this year, but in 2021, we will add additional rooms there.

**Krishnan A.:** In Bannerghatta and Malleswaram there is still capacity. You know, as we speak, in Malleswaram there is still capacity. We have not opened up all the beds. The number of operating beds that you are seeing currently is 745. We still have some operational beds that we can get in Malleswaram. Separately even in Bannerghatta, as we speak, we have other plans. For example, the administrative offices continue to be in the same hospital building. There are plans to figure out how we can add another 50 more beds within the hospital building by taking the administrative office to a close by this premise. So have plans for that. We have plans for these hospitals, be it Bannerghatta, be it Malleswaram, be it Mysore or Jayanagar, we have clear plans on how we can continue to grow that as we speak.

**AnubhavAggarwal**: For the nine months period, can you just give a rough indication about same-store sales growth kind of number for the pharmacy business?

**Krishnan A.:** Same-store growth has been 10% for the pre-2012 branch.

**AnubhavAggarwal**: But your presentation shows that to be 5.8% number. Why is the difference?

**Krishnan A.:** That is because of the GST. As there was GST netting off effect which was there; which is why if you exclude that it will show at 10%.

**AnubhavAggarwal**: For the system as a whole?

**Obul Reddy:** System as a whole 18% revenue growth and 39% EBITDA growth.

**AnubhavAggarwal**: But same-store sales growth, because you have opened 15% stores as well?

**Krishnan A.:** So Pre-2012 has been 10%, the post-2012 has been higher than the 10%. So the same-store growth has been between 10% to 12%.

**AnubhavAggarwal**: Is this 5% now a base for us, let us say kind of this becomes 5% plus kind of EBITDA margin becomes a flow for us now?

**Krishnan A.:** Yes.

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

**DamayantiKerai**: Can you update us on the progress on AHLL part like how we are doing on reducing losses and what are the current utilization level right now in Spectra and Cradle?

**ChandraSekhar:** On YTD basis, growth rates in the revenue have been good and we are clocking 28% plus growth. There is also a margin improvement roughly around 2 to 2.5%. EBITDA has seen a growth YTD last year to this year is a clear 33, 34% growth. We are on track as Ms. Suneeta mentioned in the earlier comment on AHLL mid of next year, we should get the EBITDA positive. Spectra saw a little muted Q3 on account of elective surgery etc., because these are elective, they get postponed and not canceled, we would assume to have a robust growth in Q4 and Q1 next year also. The utilization levels of theatres are over 38-39% at this point of time. We are expecting this to stabilize around 50% for the next year in terms of the utilization. On Cradle also, we are looking at mid-30s current utilization. We are also budgeting for 45% to 50% utilization going forward next financial year.

**DamayantiKerai**: Just one follow-up query on that. So both in Spectra and Cradle, for last few quarters, we have been seeing utilization level broadly stabilized on this mid-30s kind of level and we have not been seeing much improvement coming on that front. So what are the key challenges there like what is the key hindrancein taking our utilization levels up?

**ChandraSekhar**: I first answer on Spectra, one is that we have actually done a lot of improvement. We had crossing over 2.2 kind of percent on the length if average stay but that is an area where we have actually made some specific initiatives and that actually will reflect in occupancy, on the Spectra side. The second area where we have mentioned challenges, these are largely elective cases and I think doctor engagement has been a challenge in a few locations but I think we have come up with widening our services within this space of elective surgery, and that I think we are starting to see very good results. We have done a lot of doctor engagement in the last couple of quarters and that is going to pay off in the coming quarters, increases our span of services. Our main drivers of course have been orthopaedics, general surgery and some bit of ENT largely but then we are adding few more specialties around pediatrics surgery, increasing the span of surgeries in terms of vascular surgery, etc. These are also having very good results and we will see that this will help us overcoming challenges on utilization on the Spectra front. On the Cradle front, there is nothing significantly untoward report. We are now seeing a significant pipeline of expected days of deliveries and online bookings that are coming in, because this is a long-term engagement with patients post their first trimester. So that I think, we have managed to create that pipeline and we will see robust numbers clocking in the quarters coming ahead.

**DamayantiKerai**: As you said, like you have taken 3 to 4% increase in the AP and Telangana region hospitals, what about other hospitals say in Chennai or Bangalore, we have any plans to take price increase and by how much?

**Krishnan A.:** So we have plans across. Even as we move into the next year, we think we should be able to take prices higher by at least 3%, that is our plan and this year we did take some increase in Chennai and Tamil Nadu in the second quarter, we phase it out across clusters and across geographies, that is how we work on, so a 3% to 4% increase is something that we will do every year.

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

**Sameer Baisiwala**: On Proton facility, have you started to book the depreciation, interest commensurate for this and what kind of operating losses should we expect, going forward?

**Krishnan A.:** So theProton facility will be as you know will be operationalized in phases because there are three galleries in the facility itself which have three treatment rooms – one will be operational shortly would be one gallery or one treatment room, the other two galleries will take over the next full year to get operationalized. Apart from that the hospital also which is attached to the Proton therapy will be operationalized sometime mid of FY20. That is the plan that we have on this. Next year you would see that the one gallery is something that we will start off soon hopefully by this year itself and the next gallery would operationalize sometime after June or July. That is the plan that we have for Proton. The overall EBITDA losses from Proton as we see the full-fledged losses will not be over Rs.20 crore on EBITDA front. And depreciation will over a period of time pick up to almost around Rs.30 crore that will be two years from now. But even as we speak, the point is as we have stated, we are working on plans to put in into a separate SPV, but we are looking at options around that, probably in the next six months we should get an answer for that too separately. But nonetheless, the impact of that on the results will not be impactful from a cash perspective.

**Sameer Baisiwala**: But because you have commissioned this I think in Q3, is some of these already part of Q3 results or?

**Krishnan A.:** Q4, you know January is when we had the launch of the facility. The treatment is still to start, the first patient, it was just beta testing that we had, and we will operationalize the first gallery sometime this quarter. That is not a significant number, that will be Rs.200 to Rs.250 crore of capex which will have to be capitalized for the phase-I

**Sameer Baisiwala**: Just on the Tamil Nadu cluster, it seems to be a very nice inpatient volume breakout from earlier what you were doing about 29,000 to 30,000 to 31,000 patients which has moved to about 35,000. So what is really helping us over here? Second, the AP, Telangana still continues to have much lower occupancies actually both of these clusters; so both of them are much below your Company average 69%. So how should we think about it going forward?

**Dr. Hariprasad:** AP, Telangana, specifically we were looking at the margins more importantly. So we are not doing some of the low value patients and we are focusing on the high value customers and that is the reason the occupancy has not gone up. Like the Hyderabad main hospital does not treat the State Government patients like Arogyasri, so it only handles insurance and cash patients and that we found to be a good strategy for the region because margins are much better. If we start treating these patients, occupancy level should go up but the margins would be impacted. That was the strategy we had adopted for the Hyderabad, Telangana regionand similar strategy for the other regions also because none of our main hospitals are treating any of the low value patients or the low tariff patients that are available in the market.

**Sameer Baisiwala**: On Tamil Nadu cluster, what is helping us getting such good volumes?

**Dr. Hariprasad:** For Tamil Nadu the reason is; lot of patients who used to come from the Northeast have started coming back. The International volumes have increased and most importantly the local Tamil Nadu patients' volumes have increased in the Chennai region specifically, and that has helped in the volume bump-up.

**Sameer Baisiwala**: So how should we think about both these clusters going forward. I meanshould we expect 5 to 7% volume increase year-on-year going forward?

**Suneeta Reddy:** I think that would be a reasonable expectation. I would like to spend a minute on our strategy. So what we are doing is first by looking at our consumer base, so like I said, local Chennai customers, International customers and those from outside of Chennai. These are the three markets. And the fourth of course is our referral segment which is also strengthening. So, we are definitely focusing on these four. I think it has shown good results especially in Chennai. The second thing is that we are doing is the Center-of-Excellence focus. So if you look at our outpatients have actually and our preventive patients, those have grown by 11-12%, cardiac has improved over 10%, neuro has improved by over 10% and orthopaedic. So if you look at the four centers of excellence their volumes have improved significantly and therefore they have contributed also to margin. So, I think this is the way that we should look at it.

**Krishnan A.:** Just to add on, this is aligned to the earlier point on ARPOB that I think someone else asked on the call, why the ARPOB of Chennai or Tamil Nadu has gone up. This is also aligned to the fact of the high-end cases. So the focus on these specialties, as Ms. Suneeta said has been high and some of the medical cases, some of those low end cases like general medicine, etc., have come down. That is why if you look at it, the emphasis on this high-end cases is showing on the revenue growth and the overall ARPOB growth.

**Moderator:** The next question is from the line of Kashyap Pujara from Axis Capital.

**KashyapPujara**: My question is related to Tamil Nadu and the AP, Telangana region. If I actually were to see the ARPOBs have obviously shown a great improvement and losses a bit lower than what we were. The occupancy while the 'Others' are trending close to 75%, 77%, 80%, etc., these two regions are still around 60% which explains the occupancy overall at 69%. So what are the thoughts on growth here because any incremental occupancy from here given the current mix if that is maintained, would be hugely margin accretive for us?

**Dr. Hariprasad:** We want to make sure that the strategy of high margin patient volume growth is maintained and we are looking at increasing that by different tools – One is as Ms. Suneeta just now mentioned is increasing the referral base of the Tamil Nadu region and the Hyderabad region and more importantly the International market which has started to show growth in both the regions, especially Tamil Nadu. This will add significantly to the revenues and the volumes in the next couple of quarters and we are pretty confident that the occupancies in these two regions will go up without diluting the margins. That is the basis of the strategy that we are adopting and focus on the 'Centers-of-Excellence' as just stated would continue and we will increase volumes in these focus areas of specialties.

**KashyapPujara**: So the thing is that in and around Chennai, we had expanded footprint quite a bit. So is the situation of cannibalization to the main hospital, has that kind of situation kind of stabilized and are we seeing growth coming back, what are your thoughts on that?

**Suneeta Reddy:** Yes, I think there was 25% growth in the new hospitals. In terms of cannibalization, it is a good thing that we did it because the Chennai main hospital hasvery high end tertiary care work but we still need to be able to do some of the State schemes and therefore lower cost per bed units in Nellore and all having the ability to do this and still deliver on EBITDA is important and I think we have captured both ends of the spectrum and most importantly we are working with the Government and we are compliant with what they want us to do.

**KashyapPujara**: Lastly, as far as ROCE is concerned, healthcare matures of the business at 21% standalone is now at 18%. Like I can understand CWIP would definitely weigh on the ROCE but excluding that what are the thoughts on new hospitals and the investments in subs and the JVs? How do you see the ROCE improving on these two entities?

**Krishnan A.:** The first focus for next year if we were to look at it, overall EBIT even now for the new hospitals is negative, next year we are hoping that we get a positive EBIT on the post-depreciation because depreciation on the new hospitals is Rs.100 crore. So the new hospitals post depreciation should come close to breakeven or even higher than breakeven next year. That is our target first. Once that comes in, then you will see that over a period of time, this should also start growing and getting to the 10% to15% ROCE over the next two, three years. That is the plan. Clearly, the opportunity of new hospitals if you look at this year, the new hospitals have been Rs.708 crore of top line for the YTD December, so close to Rs.1,000 crore top line this year. So, as we move forward and get this to Rs.2,000 crore of top-line over the next couple of years and three years, you will realize that most of this will start flowing well into EBITDA and falls into EBIT. So that is exactly when you will see the positive EBIT will start contributing to the ROCE of this business as well.

**KashyapPujara**: So overall on a blended basis, you should head towards 15% plus ROCE in the next two or three years?

**Krishnan A.:** I think that is a good number to have. This is what we are focusing in the next three,four years.

**KashyapPujara**: So essentially to sum up, I think narrative remains unchanged that the mature facilities still have room to increase their occupancy and margins, your new hospitals are clearly showing a visible ramp up, pharmacies have made the floor and they are doing well, AHLL you are saying will reverse and breakeven in FY20 and there could be a positive event in terms of us unwinding Apollo Munich at some point in the next year or so?

**Krishnan A.:** You are right, further focus as Ms. Suneeta said, one more change in the narrative has been that we clearly are focused on high end cases, specific specialties like we focused on the four as we said and profitable case mix. This is clearly something that will show more on the value side of the business than this volume which means even in the existing hospitals you will note even though that the head room is not as high, from the profitability perspective we should be working on the 23% plus EBITDA margins this time.

**KashyapPujara**: On the capex front, as compared to whatever has been announced, there is incremental big bang capexplan now until we sweat these assets out more appropriately.

**Krishnan A.:** Yes, that is correct.

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

**Swati Madhabushi**: My first question is regarding the pledge. So you guys must have seen in the market what has been the reaction to 'Zee', even though it is an underlying good business because of this pledge, the share price has taken a beating. So I just want to ask you guys if you see the urgency and the severity of this pledge given that it is a very high number?

**Suneeta Reddy:** Let me respond, yes, we do, we have found a solution, we have created value in another Company which is obviously insurance Company and we are looking to bring down our pledges while liquidating that holding.

**Swati Madhabushi**: Is there a target timeline for this?

**Suneeta Reddy:** I told you within the next six months. It should happen maybe next quarter but let me say outer limit of that it will definitely happen.

**Swati Madhabushi**: Just a few more questions on this. Are there any key covenants of this pledge with respect to stock price or anything after which there could be major change in the…?

**Suneeta Reddy:** I do not think there will be an increase in the absolute amount of additional pledges required in spite of the stock price because I think we have taken a really low threshold for the price. So I do not think that will be an issue.

**Swati Madhabushi**: I know the reason for the increase in pledges because of the KKR issue you already explained. But overall, what has been the use of these pledged shares fund? Has it been to maintain your shareholding in the Company or…?

**Suneeta Reddy:** The majority has been to maintain our shareholding in the Company.The second is that we did invest in Apollo Munich and that investment happened almost first to meet the solvency ratios, there was investment required from both the partners and we kept up our part, but I think we realize the value right now as we exit, we would have realized an incredible value on that investment.

**Swati Madhabushi**: My second question is regarding the lack of sequential improvement in this Gleneagles Hospital and also AHLL. AHLL you have partly explained because they said the facilities and they postponed the treatment, etc. But what is happening in Gleneagles, with every quarter we would expect to see improvement right, because now things are settled down, but that has not happened?

**Krishnan A.:** Gleneagles, last year same quarter, if you look at quarter-on-quarter, they are doing well and if you go into the next year, they will start doing even better than this year. Clearly if you look at YTD December versus YTD December on last year, they have come back to Rs. 26 crore – Rs. 27 crore EBITDA and mind you this is after the operations and management fees at both Apollo Hospitals and the other partner gets from them to the tune of almost around Rs. 20 crore. So clearly if you look at from the perspective of the performance, yes, last quarter, same year last quarter there were medical cases which was out there and which was not there in this quarter, which is the reason for the EBITDA being a bit muted for this quarter but they are committed to take this to Rs.10 plus crore EBITDA as we move forward on a run rate basis.

**Swati Madhabushi**: Okay,I was mainly speaking on Q2 versus Q3 kind of scenario, is it sensible to expect every quarter should see an improvement over the previous quarter or there is a lot of seasonality and that should not be how…?

**Krishnan A.:** There is some bit of seasonality in this business, so you cannot just look at Q4.Q3 has always been a seasonal low for this business across. This year in the 'Others' clusters outside of Gleneagles, we have done well because of the reasons that we stated to focus on specialties, etc., Otherwise, Q3 is typically a seasonally low quarter. Despite that we did well in the 'Others' clusters. Here the seasonality gets impacted. But we should come back in Q4 and going forward.

**Swati Madhabushi**: My next question is on competition. There is like a big competition coming in, maybe some few years later with IHH entering. But what about competition at Tamil Nadu and Hyderabad and AP and Karnataka clusters? I know that in Hyderabad, at least, I have been told that Yashoda is opening like a very big maybe, I donot know if I am wrong, but 1,000 bed hospital soon.

**Suneeta Reddy:** Let me say that I feel that the competition will be good for us, because first it will show very realistic ARPOB, because foreign investors coming into the Country will focus on ROCE. So we will eventually focus on ROCE. So, I think in terms of players who are focusing on a very low margin business this will change and that is very important. The second thing that we probably have to be worried about is attrition on doctors. I think Apollo has seen the lowest attrition; it was 0.29%. So both on improved ARPOB, improved revenues, I think having competition like IHH would be very good for the system. If you look at attrition of doctors, I think this has really been minimized. So I think we are in a very good position.

**Swati Madhabushi**: But you do not think any specific region has a lot of capacity coming up like IHH?

**Suneeta Reddy:** So I think, each region has local competition, like in Bangalore, we have Narayana Hrudayalaya, but still our Bangalore cluster's revenues have grown 14%. So, I think the longer competition the markets are getting larger and we have to also look at the way we view markets which is just both local, outside and international.

**Krishnan A.:** If you look at also capacity addition has happened outside of these clusters, in base like Hyderabad, we have not added any new beds in the last few years now only because we knew this was coming and we wanted to focus on the value side and this is what we are doing currently. And the hospitals that are there in AP and Telangana, outside of Hyderabad, clearly we have one hospital in some of these locations where we know that the capacity of the staying population will be high. So that is what we are focusing on and that is aligned to our strategy of ensuring that it is ROI accretive.

**Swati Madhabushi**: My next question is on the pharmacy structure. I know that the rules have not been changed for FP and retail, but only in the e-commerce part, because the Government is enforcing spirit of the law rather than just wording of the law. So does it change anything with how you have structured the deal because even though we have...?

**Krishnan A.:** This structure is very different from the e-commerce market based structure completely. It is not like the other structure. Here is the wholesale. If you look at the wholesale trade, it can be 100% held by foreigners and Apollo will continue to be the wholesale supplier to the front end pharmacy. So to that extent this structure is very different from that structure which is the market place structure and hence we do not think this has any challenge.

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

**NitinAgarwal**: On the existing hospitals, this is still especially bulk of the contributor to our EBITDA. At the scale of size where they are, when you look ahead like a 3 to 5year view, do you think these hospitals can still generate for you 8% to 10% revenue growth on this cluster?

**Krishnan A.:** Yes, we can, north of 10% is what we can do, combination of volume plus price put together.

**NitinAgarwal**: You do not see a challenge in that over sort of broader4 or 5year period?

**Krishnan A.:** No.

**NitinAgarwal**: On newer hospitals we have been struck around this Rs.20odd crore a quarter sort of contribution in the EBITDA. When do you see a sort of breakout from this sort of range this cluster has been?

**Krishnan A.:** We are working on it, and I think next year you should see the breakout hopefully coming from Q1 itself,things go well.

**NitinAgarwal**: And is there any specific reason why as a cluster despite the increase in revenue you mentioned about some of the doctor guarantee fees, but is there anything else holding back the profitability in this cluster?

**Krishnan A.:** No, nothing, as we said there have been increase in salaries also which typically happen and the full impact this quarter. But otherwise you will see that in this cluster of new hospitals, hopefully from next year of Q1 you should see significant value uplift overall on the profits.

**NitinAgarwal**: Lastly on the AHLL, we sort of stick to targets of FY20,for turnaround for this business?

**Krishnan A.:** Yes, previously Chandrasekhar did mention to you that we are looking at this Q2 FY20 breakeven, and we are committed to that.

**Moderator:** The next question is from the line of Harith Ahamed from Spark Capital.

**HarithAhamed**: Can you provide the year-to-date capex number and your estimate for this year-end FY20?And secondly this CWIP of Rs.870 crore, which asset is this related to or which hospitals is this related to?

**Krishnan A.:** Rs.870 crore, bulk of that will be Proton Therapy, so there is brownfield capex additions in Vizag as well as Bhubaneswar which is on, which is part of our Brownfield expansion, which is the oncology expansion which is happening in both these hospitals, because we did not had the oncology when we started bothin Vizag and Bhubaneswar. So bulk of these almost around Rs.750 to 780 croreof this would be around in Proton and the balance is the Bhubaneswar and the

Vizagoncology hospitals. If you look at the YTD capex number for which I will come back to you in a moment. Maybe you can move to the next question?

**HarithAhamed**: On the transaction for the front-end pharmacy, can you provide an update on the timelines? How should we think of the leverage situation post transaction next year, how much of a net debt reduction are we targeting?

**Obul Reddy:** We expect to complete the transaction in the next 6 months from the legal process.Net debt should come down by about Rs.500 crore.

**HarithAhamed**: Can you comment on some of the recent developments in the Madras High Court related to the enquiry around the former CM's death, there has been quite a bit of news flow around that in the last few days?

**Suneeta Reddy:** Let me just give you the background. Since the commission did not currently have multispecialty medical advisory Board to interpret the medical information, Apollo had provided to the chief minister, the beds in medical protocol which were validated by both AIIMS, Doctors and by Dr.Richard Bealefrom UK. We have therefore moved the high court to set up a medical Board of experts independent of Apollo to examine the modalities of the treatment to the CM.

**Krishnan A.:** Overall capex for this year, there has been a routine capex of almost Rs.100 crore that has happened so far and if you look at the project capex majorly in the Photon Therapy which is Rs.100 crore and sort of around Rs.125 crore have been the total project capex. So,Rs.225 crore has been the total capex between routine and project.

**HarithAhamed**: As a follow-up, given this year has been a low capex year, it has not really reflected in the net debt reduction. So just trying to understand the…?

**Krishnan A.:** So net debt has not increased, right and if you look at the overall capex it stands at Rs. 225 crore. So one other thing is, as some of these new hospitals ramp up, you would require some capital for working capital too, especially given that these are fixed costs which needs to be incurred upfront and there is going to be also the insurance takes almost around 90days to settle the bills, so there has been an increase on account of working capital to that extent. So you will start seeing net debt reduction from FY20 or FY21 onwards and we also pay dividend of Rs.125 crore. So if you do your numbers you would realize that we are a full tax Company now. Earlier it was a 22% tax, now we are at 33% tax. So it you put all that into perspective you will realize that you should start seeing net debt reduced from next year.

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

**ShyamSrinivasan**: Just on the wage hike, the annual increment, can you just help us quantify what that number could be on margins during the quarter, so that we have some idea?

**Krishnan A.:** Sorry I do not have that off-hand, maybe you should take it offline and discuss with Krishnakumar. The wage increase has been in the tune of 8% to 10% across the Board.

**ShyamSrinivasan**: My second question is on the Proton Therapy Center. Now that it has been kind of opened, can you just help us understand the typical customer profile we are targeting? Is there a medical tourism angle that is involved here, what could be the ticket size, anything that you can share qualitatively on whom are you targeting, how is it going to work, and what is the likely breakeven of this particular center?

**Suneeta Reddy:** So if you were to look at cancer, radiation is a big form of treatment. So within the Apollo system itself we do annually 10,000 radiation sittings and outside the system there must be another 30,000. Even if take about 20% of them are people that benefit from the Proton which means even by just looking at India itself you will get around 600 patients which is breakeven. And if you were to add International, this is the only center this part in Southeast Asia apart from China, where they have a center of this quality with the latest technology. And if you look at the pricing, we are at half of International pricing level and therefore we do believe that International patients will take the advantage of this opportunity. The focus for this is thatthe clinical benefit that we get up for all pediatric patients those with head and neck cancer, those with brain cancer, and also those with lungs and prostrate. So it pretty much covers most of the cancers that are relevant in India and across the world and therefore it should do very well.

**ShyamSrinivasan**: I think Rs.20 crore is what the operating cost, so when is the likely break even for this?

**Krishnan A.:** So we will break even sometime by the end of FY20 itself on this facility.

**ShyamSrinivasan**: Would medical tourism be over indexed in this hospital per se and that would drive the faster break or relatively higher ticket sizes, would that be a fair way to think about it?

**Krishnan A.:** Yes medical value tourism is definitely an important factor; we are expecting almost 25% to 30% of the facility coming from medical value tourism. With that said, I think it is also important you realize that across Apollo we have a very strong network of hospitals on cancer in each of the geographies, and we are expecting a lot of referrals from these centers on to the proton itself. If you look at the proton therapy center over a period of time, the maximum number of patients that it can treat only on the Proton Therapy is 900 to 1,000 per year, and if we look at last year, across our centers we have at least 9,000 to 10,000 unique cases of radiotherapy alone i.e unique cases of radiotherapy treatments that we had and this will only grow 15,000 with time. So if you look at it from that perspective clearly a good chunk can also come from the internal referrals apart from the medical value tourism.

**ShyamSrinivasan**: Do you think affordability in the Indian market is not an issue?

**Krishnan A.:** Within the Apollo network, if you look at the number that we are looking at is 5%. So, we are first saying that in Apollo network we are not looking at the set of patients, most of them are the affordable type. Second point is within cancer also, now the kind of insurance products that are available today we believe that over the next four and five years, some of that will also start adding up meaningfully because there are significant people are taking top-up policies, today top-up policies of health are available which are significantly higher than normal. All of this will also help get the number; and we have seen in the past, it is not as though we have not seen, for example, n liver transplant, the average ticket size is Rs.30lakhs, we have seen so many liver transplants coming, we have seen that when it comes to health, at the end of the day you need to pull up your resources and get this going. Not that we are expecting a lot out of this, so a combination of all the three should help which is internal referrals, external and medical value.

**ShyamSrinivasan**: My last question is just a philosophical one on the doctor engagement model. You said attrition is very low but you also mentioned that we had to give guarantees to doctors in Chennai and Hyderabad this quarter. Just want your broader thoughts on how hospitals will in general now deal with doctors? We have seen some of your peers talk about dismantling the whole guaranteed compensation. So how should one think about how hospitals go about engaging with doctors?

**Suneeta Reddy:** Unlike our peers, Apollo hires a lot of doctors from overseas. So they do need some guarantee money. And the good news is after a period of one or two years, they move to fee-for-service. So it is critical that we get onboard quality doctors because clinical differentiation is far more important and it compensates the amount of money that we might lose upfront.

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

**RakeshNayudu:** I wanted to understand the monetization aspect of Apollo Munich given that the stake is at two levels, the Promoter level and at the Company level. If you could give some color as to you see a) what could be exit valuations of these assets and how we should be looking at the exit, itself and b)how this potential transaction could itself impact the current leverage situation?

**Suneeta Reddy:** If you look at the valuation, you should look at the market to see how Companies in health insurance business have been valued, 'Star' for example, if you look at GWP, it is a factor of GWP and invested capital. So probably about six to seven times invested capital and that is probably the way that you should look at the value that has been created.

**RakeshNayudu**: What is the invested capital currently?

**Suneeta Reddy:** About Rs.650 crore.

**RakeshNayudu**: And 12% of it rests in the Company?

**Krishnan A.:** 10% rests in Apollo Hospitals and the balance will be with Promoters.

**RakeshNayudu**: My next question is with regards to the pharmacy restructuring exercise that we have carried out in the recent quarters. Can you explain the implication of this in terms of having the limits on Apollo Hospitals itself being lifted? My query is given that the ownership of the pharmacy itself is now with the third-party entity, now does that make Apollo sit out of the current legal structure whereby there is a restriction on the multi-brand retail, does it put us in a situation where you can get our FII limit increase on the stock?

**Krishnan A.:** On the listed Companies, it is under the 100% automatic route and typically held completely by FIIs, there is no limitation at all on the FII in the stock. With the SPV structure falling in place, we can continue to ensure that FIIs can continue to hold whatever levels they want to hold. So clearly there will be no restrictions on the FII levels.

**RakeshNayudu:** Final question on the current debt on the books. How we should be looking at the interest outflow? There is a fair bit of profits which have been taken out as interest payouts. When we could expect debt on books to come down?

**Krishnan A.:** We do not see significant increase in the debt from current level. The balance capex that we have is only around only Rs.300crorewhich is again going to be spread over the next twelvemonths. So, we do not see any significant increase in the debt from this level. And even after that as I said, from FY20 itself you should see reduction overall in the net debt levels of the Company. The interest that we pay overall is just 8.75%in that range. So you will see the benefits of the lower debt plus the fact that higher EBITDA will straight away flow down will start showing on the overall EPS and PAT. So the next three, four years, you will see significant accretion to the PAT, you can do the numbers yourself.

**RakeshNayudu:** The Gleneagles integration would definitely add on to the operating cash flows, right, and what do you see the cash flow situation?

**Krishnan A.:** Gleneagles is early now, I think you should wait to hear more from the partner because once we get to understand what is the structure that it will take; then we will discuss about that, at this point in time I think it is a bit early to get what the structure that it will take.

**Moderator:** The next question is from the line of Prashant Nair from CITI Research.

**Prashant Nair**: Just one follow-up question on the pledging side. So can you explain once again what led to this increase? I could not follow exactly.

**Suneeta Reddy:** With regards to the pledge, there was a 5% increase which happened because we had an instrument with KKR and in January we had to unwind that instrument. In order to unwind it, we had to put in another 5% of additional shares towards unwinding the KKR instrument. But we have planned two liquidity events which will happen. They would be late, but we do believe they will happen in the next six months.

**Prashant Nair**: Would these liquidity events be enough to unwind the entire pledge that you have now or …?

**Suneeta Reddy:** Not the entire pledge, but a significant par i.e 60% of it.

**Moderator:** Ladies and gentlemen, this was the last question for today. I now hand the conference over to the management for their closing comments. Over-to-you.

**Suneeta Reddy:** Thank you ladies and gentlemen for joining us on this call. We believe that if you look at the structural demand for healthcare it continues to grow.More importantly, Apollo Hospitals has shown its ability to weather many storms whether they were external and having to do with the environment or internal. Clearly, we have come out stronger. We have shown you growth of 17%. On behalf of the Promoters, I would like to mention that we do have a plan to reduce our pledge significantly by at least 50% in the next six months and you will see that happen. Thank you, again and all the best.

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