Apollo Hospitals

Q2FY14 Earnings Conference Call Transcript

November 13, 2013

Moderator Ladies and gentlemen, good day and welcome to the Apollo Hospitals Q2 FY14 Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Mayank Vaswani of CDR India.

Mayank Vaswani Good afternoon and thank you for joining us on this call to discuss Apollo Hospital's Financial Results for the quarter and six months ended September 30th 2013. We have with us today the senior management team comprising, Ms. Suneeta Reddy – Joint Managing Director; Mr. S.K. Venkataraman – Chief Strategy Officer; Mr. Krishnan Akhileswaran – Group CFO.

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 shall start with Ms. Suneeta Reddy who will discuss the operating highlights for the quarter, Mr. Krishnan will then discuss the financial highlights and expansion plans and Mr. Venkataraman will cover the Retail Pharmacy and Health Insurance businesses.

Documents relating to our financial performance have been e-mailed to all you earlier and have also been posted on our corporate website. I now invite Ms. Suneeta Reddy to provide key highlights of our performance.

Suneeta Reddy Good afternoon, everyone and thank you for taking time out to be on our call. As shared with you earlier we are in the midst of our expansion at Apollo Hospitals. The next 12 to 24 months will see us scale up both in terms of capacity and our own capability. In the current year itself, we plan to operationalize around 500 beds which will include REACH Hospitals in Nashik, Nellore, and Trichy as well as additional capacities in urban clusters of Chennai and Bengaluru. We are also simultaneously making steady progress on several initiatives ranging from Doctor Engagement to Physician Connect Programs and enhancing our Retail healthcare presence through Clinics and Cradles.

Our plan to rapidly improve operating profile at newer facilities will begin to show up in the forthcoming quarters. This helps to set the stage for the roll out of the new beds in the second half of the fiscal.

We have a very clear focus to build and enhance our capability. The COE initiative is one such focused strategy which has allowed us to positively influence the case mix in order to garner a proportion of high acuity cases in all our hospitals. We have crossed the landmark number of over 500 Robotic Surgeries this year across our hospitals making us leaders in this space. The adoption of Robotic technologies at major urban centers across the network was introduced last year, and is in line with our constant quest for providing newer and better technologies to our patients and thereby improve clinical outcomes.

Now, on our financial performance, our standalone revenues grew by 17% from Rs.836 crore in Q2 last year to Rs.975 crore in Q2 this year. Sequentially, quarter-on-quarter performance has been 9%, aided by strong revenue growth in both the Hospitals and Standalone Pharmacy. We are happy to note that even on the difficult economic environment the existing businesses have grown 15%. Also, both Healthcare Services and Standalone Pharmacy have improved on margins.

The new Hospitals at Vanagaram, Ayanambakkam in Chennai and Jaya Nagar in Bangalore had operating losses of Rs.5 crore this quarter as they are in the initial stages of operation. Reported EBITDA hence grew 11% from Rs.144 crore in Q2 to Rs.160 crore in Q2 this year. Profit after tax was up by 5% to Rs.87 crore.

Specific to our Hospital business we witnessed good quarter-on-quarter traction in most of our large hospitals group wise. Some of our units like Ahmedabad, Hyderabad, Bengaluru and Kolkata had improved their performance in Q1.

The Physician Connect program in Hyderabad has begun to deliver with improvement in outpatient volumes and enhanced specialty mix. More importantly, I think they have also started to rationalize the patients' mix which has led to a higher ARPOB. At Chennai, the focus on Daycare Surgeries and Outpatient facilities has helped to drive continuing strong growth in OP volumes and revenues.

Our Tier-2 hospitals in Bhubaneswar, Mysore and Madurai continue to grow well. Bhubaneswar has now reached a state of 85% percent occupancy and we are evaluating further expansion of this facility. Mysore revenue has also grown 30% year-on-year and Madurai, Karur and Karaikudi have grown 16%. Our focus is currently on aggressively strengthening on medical teams for our new start up while adding on new specialties. While we are slightly behind in Vanagaram, Ayanambakkam in Chennai and Jaya Nagar in Bangalore, there were a few delays in the statutory approvals which also delayed tie-ups with large PSUs and insurance companies, which have now been addressed. We hope that this will help us catch up on performance in both these hospitals. The next two quarters actually do present an opportunity to fill up nearly 500 beds in our new facility which should lead to a healthy growth in both the top line and EBITDA. Volume growth, increased occupancy and reduced average length of stay had combined to drive sustained double-digit growth in ARPOB which have been a result of a hefty case mix. We also believe that Hyderabad will show an increase in ARPOB. Now that transplant facility is in operation and it will be aided by a decrease in CGHS and Arogyasree patients.

The Pharmacy business has also performed well this quarter with 22% growth in revenues and 36% growth in EBITDA. The improved operating performance has come about due to a higher proportion of private labels in the product mix as well as consolidation of stores in existing locations through closure of unviable stores. We expect the momentum in the Pharmacy business to continue and grow to accelerate in H2. We also expect our net addition to Pharmacies to be higher in H2 as compared to H1 due to reduced store closures as anticipated in H2.

On a consolidated basis, revenues grew by 17% to Rs.1,111 crore while EBITDA was higher by 10% at Rs.179 crore in Q2 FY14. This after absorbing an EBITDA loss of Rs.4.5 crore in our subsidiary Apollo Health and Lifestyle due to the addition of two working centers and two new clinics which were added last fiscal.

Before I close, I would like to share with you that Apollo celebrated its 30th Anniversary this quarter. It has been a fantastic journey from our first hospital in Chennai to over 50 hospitals across the length and breadth of our country. From day one, our focus had been on the pillars of excellence in the areas of clinical outcome, patient care, adoption of technology and offering value for each our patients and customers. We are pleased to share that these core values continue to drive us as we endeavor to touch a billion lives.

Before I hand over to Krishnan, for further details of financial performance, I would like to share with you with immense pleasure that Apollo Hospitals Chennai, Apollo Health City Hyderabad and Apollo Hospitals Vanagaram, Ayanambakkam have been assessed and certified by (HIMSS), Health Information and Management Systems Society, Level-6 on our IT adoption and maturity model. This is a significant step forward. We now fall into the elite of 2.3% of the hospitals in the Asia-Pacific region who have this unique distinction. Apollo Prism, a Web-based Patients Health Record (PHR) has been awarded the first HIMSS ICT Innovation Award in recognition of Apollo's efforts, commitment and dedication to leveraging on Healthcare ICT to transform patient care and outcomes. The Apollo Hospital Group was a recipient of multiple awards in the 12th Edition of Asian Hospital Management Awards, 2013. Apollo Hospitals is the winner in 9 out of 10 categories and won 10 awards out of a total of 39 Gold and Excellence awards. Also thereby winning special awards for outstanding achievements by the hospital and group. Now, let me ask Krishnan to brief you on our financial performance.

A. Krishnan Good afternoon and thank you for joining our call. I trust all of you have read our 'Earnings Presentation' which has been circulated earlier and is also available on our website.

On a standalone basis, revenues were higher by 17% at Rs. 975 crore compared to Rs.836 crore in Q2 last year. EBITDA increased by 11% from Rs.144 crore in Q2 FY13 to Rs.160 crore in Q2 this year, and EBITDA margin stood at 16.4%.

To get a fuller insight of our margins broken by segment as well as existing and new businesses, please refer to Slide #8 of our presentation. You will notice that EBITDA margins on our existing Healthcare Services have actually improved by 60 basis points to 24.6%. This is despite the increase in consumable cost that we have because of the rupee depreciation as well as the higher manpower cost on account of our increments that we had with effect from July. The Retail Pharmacy business has also reported an improved EBITDA margin of 3.1%. The impact of the reported EBITDA number has come from the new hospitals which were launched in Q4 of the previous fiscal that is a 200-bedded hospital at Vanagaram, Ayanambakkam in Chennai and 140 beds Ortho and Spine Center at Jaya Nagar in Bangalore. These hospitals have reported an EBITDA loss of Rs.11 crore in H1 FY14 which has impacted the standalone EBITDA on an overall basis. This of course was in line with our plan and we hope to see this reduce as we move forward. PAT margins were at 8.9% in H1 FY14 as compared to 9.5% in H1 FY13. Depreciation increased by 20% from Rs. 52 crore to Rs. 62 crore in H1 FY14 on account of new facility beds added in the last one year. Finance cost also increased from Rs. 32 crore to Rs.43 crore due to expansion in CAPEX. Other income which constitutes income earned from investments and liquid mutual funds and bank deposits was Rs.11.6 crore in H1 FY14 as compared to Rs.18.4 crore in H1 FY13 primarily due to low returns from liquid funds on the back of the recent rate hike. Effective tax rate in H1 FY14 was 22% as compared to 27% in H1 FY13 due to the applicability of 150% depreciation under Section 35 AD of the Income Tax Act on new projects.

Coming to Slide #9 – Healthcare Services ROCE is at 17% for the first half on an enhanced capital employed which includes Jaya Nagar and Ayanambakkam capital employed of over Rs.200 crore. Excluding the new hospital, ROCE of existing Healthcare Services is at 19.8% in H1 FY14 as compared to 18.9% in H1 FY13. Consolidated revenue grew 16.6% from Rs.953 crore in Q2 last year to Rs.1,111 crore in Q2 FY14. EBITDA has grown 10% from Rs.162 crore to Rs.179 crore in Q2 FY14. H1 FY14 revenue grew 16% from Rs.1,834 crore to Rs.2,133 crore. H1 FY14 EBITDA at Rs.339 crore has grown 9.5% over H1 FY13 with a 15.9% margin. However, as you can see on Slide #12, after adjusting for the impact of the new hospital at Vanagaram, Ayanambakkam and Jaya Nagar Hospital and the operations of Apollo Health and Lifestyle, existing operations have reported a higher EBITDA margin of 17.3% in H1 FY14. This improvement in consolidated EBITDA from existing business have been primarily driven by the improvement in Healthcare Services EBITDA which has improved from 24% to 24.6% and is supported by enhanced constitution from our subsidiary and JV Hospitals in Ahmedabad, Bengaluru and Calcutta.

I will now walk you through Slide #14 which contains details of key operating metrics in the Hospitals business. Operational beds as of September 30, 2013 were 5,659, the net increase of around 400 beds over the same period last year has largely come about through the launch of the new hospitals in Chennai and Bengaluru. There have also been bed additions at our standalone hospitals in Madurai, Mysore, Karim Nagar, and Karaikudi as well as Delhi and Ahmedabad. Overall Inpatient volumes grew by 6% and Outpatient volumes by 8%. Total occupancy was 72% in H1 FY14 at 4,094 beds compared to 76% in H1 FY13 at 3,988 beds. The lower occupancy in percentage terms in the current year as you would notice is due to increase in bed capacity as absolute occupancies have increased. This is also supported by lower ALOS across clusters with blended ALOS declining from 4.7 days in H1 FY13 to 4.55 days in H1 FY14, which in turn directly benefits ARPOB. Across the network, we are witnessing Inpatient revenue growth outpacing Inpatient volume growth indicating that the case mix is getting richer in favour of high acuity cases. The rise in Outpatient volume growth with an accelerated increase in Outpatient revenue is a result of the focus on Daycare Surgeries and improved Outpatient facilities.

Slide #18 has our expansion plans for the next 3 financial years and related CAPEX. Of the total planned expansion of 2,685 beds over the next 3 years, about 1,000 beds across 7 locations will be added in the current fiscal. Over 500 of these beds will be in 3 REACH hospital at Nellore, Nashik and Trichy. Another 200 beds will come up at North Bangalore and the rest will come through 3 new facilities in Chennai. As mentioned earlier, our funding for these expansion plans will be through a combination of debt and internal accruals in a phased manner.

That is it from me. I will now hand over to Mr. Venkataraman who will walk you through developments on Retail Pharmacy and Apollo Munich Health Insurance.

S. Venkataraman Good afternoon, everyone. The Standalone Pharmacy business continues to be strong as revenue grew 22% from Rs. 278 crore in Q2 last year to Rs. 339 crore in Q2 this year. This is from a mix of same-store sales as well as continued expansion of the pan India store network. We added 51 Stores and shut down 17 Stores resulting in a net addition of 34 Stores in Q2 FY14. We now have a pan India network of 1,560 Standalone Pharmacies as of 30th September 2013.

Over the last 24 months, we have shut down several Stores that were not meeting our objectives and targets. The evaluation is now almost complete and we expect the number of closures to reduce and believe that the net Store expansion will pick up pace from the second half of the year. We continue to focus on our long term plans of consolidating the performance of our existing Store network while simultaneously enhancing our presence in new locations. At the same time, the focus on margin improvement remains intact through emphasis on higher volumes and mature stores as well as a sustained increase in contribution from our private label products. Growth in same-store revenues remains fairly healthy as revenues from the pre-2008 batch of stores grew over 10%, the 2009 batch reported revenue growth of over 14%, and the 2010 batch reported over 15% growth. Overall EBITDA is higher by 36% from Rs.8 crore in Q2 last year to Rs.11 crore in Q2 this year. The EBITDA margins for the entire network of stores have increased by 34 basis points to 3.3% in Q2FY14. The accelerated expansion plan is also expected to result in an operating leverage which will help us further expand our margin in H2. The EBITDA margins of the 2008 batch is now at 5.5%. We have in our network over 1,200 Stores which is more than 75% which are now EBITDA positive.

Coming to the Insurance business, Apollo Munich Health Insurance has recorded an increase of 25% total income during the quarter. We are confident of the value that we offer in this industry and this is validated by the appreciation from the customers and awards received by the company. We continue to expand our network and customer base and are certain that this business will begin contributing more meaningfully as we attain greater scale. That is it from me. We can now take your questions. Thank you.

Moderator Ladies and gentlemen, we will now begin the question-and-answer session. Our first question is from Krishnakiran Konduri from ICICI Direct.

Krishnakiran Just looking at Hyderabad cluster numbers, if I look at Inpatient volume and Outpatient volumes from backend calculations it comes to hardly 0.5% and 4.8%, can you just explain what is actually happening in this Hyderabad cluster?

Suneeta Reddy In the Hyderabad cluster, like I mentioned earlier, the ARPOB has gone up because we are filtering the patients. We are doing a certain amount of rationalization on the type of patient mix that we have currently. Earlier, we were taking more of CGHS and Aarogyasree. Now we have actually capped the number of beds that we are keeping for CGHS and Aarogyasree which means that the volumes will be compromised for a short period. But I think that our focus on Retail Patients, on our GIPSA patients and on foreign patients is the right way forward.

Krishnakiran Secondly, occupancy rate, whatever my calculations are right, I do not think we have any increase in Hyderabad cluster occupancy rates in the Q2. Correct me if I am wrong?

A. Krishnan The Q2 numbers have gone up to 67% as compared to 64% in Q1. There has been an increase in the occupancy.

Krishnakiran I understand that you are comparing Q1 with H1, what I am trying to understand is my calculation says Q2 of this year compared with Q2 of last year, which is more kind of a stagnant at 70%?

A. Krishnan That is right. Last year it was 66% now at 67%, but as Ms. Suneeta said, the mix of patients that we have in this 67% is different and you can see that in the Q2 of this year, even Outpatient volumes have gone up well. That is also aided by our focus on cash patients**.**

Krishnakiran Typically this Aarogyasree or any other this kind of government schemes, how many days typically you will get back the money from government?

Suneeta Reddy 90 days.

Krishnakiran One more question from my end before I join the queue, our promoter pledge shares percentage has gone up from 41% to 56% in the first half. Can you shed some more light on that?

Suneeta Reddy I think it is a temporary blip, it will be corrected over the next quarter.

Moderator Our next question is from Bino Pathiparampil of IIFL.

Bino Pathiparampil Could we get some colour on the ramp up in capacity in Ayanambakkam and Jaya Nagar in Bangalore?

Suneeta Reddy In its current state it is ready for a full ramp up. Earlier we did not have all the licenses in place, but today I am happy to say that we have extremely good doctors which is critical, we have all the licenses in place and I think it is all about now informing Bangalore and drawing patients towards these two facilities which I believe they have a plan and you will see improvement in the coming quarters.

Bino Pathiparampil Could you give a broad range of what you are seeing now, is it like 10% type or 30% type?

A. Krishnan The current occupancy levels at the scale down operation in Ayanambakkam is around 35% and in a place like Jaya Nagar it is now closer to 30% odd. But we expect Jaya Nagar to actually pick up much faster because we already have doctors in place there, we already have added an Orthopaedics Specialist, we have Pulmonologist, we also have a Neuro because it is a specialty center we expect that the volumes in this would be much better in Q3 of this year as compared to Q2 that we saw now. So we have Rs.6 crore revenue that we had out of Rs.7 crore of revenues in Jaya Nagar in this quarter. We think that should be over almost around Rs.10 crore in this coming quarter.

Bino Pathiparampil Just one clarification, this 30%, 35% that you said is as a percent of overall commissioned beds or…?

A. Krishnan Operating beds which in Ayanambakkam for example today is around 100 beds is what we have operationalized.

Bino Pathiparampil What is your current CAPEX for an Individual Pharmacy Store including the deposit that you may have to pay for rental?

Obul Reddy Anywhere about Rs.1.5 million.

Bino Pathiparampil So currently you are making about Rs.40 crore EBITDA and you are adding maybe around 150 Stores a year. So you will be completely able to take your CAPEX required for growth of that business from your EBITDA, right?

Management That is right.

Bino Pathiparampil So that should continue or do you plan to put more money into ramping up the growth?

Obul Reddy We continue to add about 150 to 200 stores p.a. that will continue.

A. Krishnan So that is in line and the cash flow from the Pharmacy business will sustain that growth momentum.

Bino Pathiparampil Finally I see that MLCP in your list of Hospitals to be added. What is that and that has seen a movement from FY15 to '16 so what is that because of?

Suneeta Reddy MLCP is actually a piece of land which is close to our main hospital in Chennai where we are doing an automated parking lot, but it is giving us besides space so that we free up space in the main hospital, It is giving us close to 35,000 square feet of Outpatient facility for check-up so that our intention is to increase

OP volume and we do have captive clientele so that space will be used for the OP patients.

A. Krishnan MLCP stands for Multi-Level Car Park.

Moderator Our next question is from Neha Manpuria of JP Morgan.

Neha Manpuria My first question is on the Chennai cluster. If I would look at your ARPOB for this quarter, they seem pretty strong, whether I look at it year-on-year or quarter-on-quarter. Ma'am, you mentioned that obviously our case mix is helping, how much more growth do you think is there with the COE initiative, do you think there is more improvement expected in Chennai cluster as far as ARPOBs are concerned?

Suneeta Reddy For 30 years we have heard this question. I think for 30 years we have managed to show growth. Clearly, our focus is on delivering outstanding clinical outcomes and Patients are willing to pay for this. So whether it is through introduction of new technologies like Robotics or it is through shorter stay, improving the way that we handle patients through Laparoscopic Surgeries, improving the way we handle new Patients and also removing those with lower ARPOB out of the cluster to less expensive facilities, we will continue to focus on increasing ARPOB. But I do believe that we have several levers to do it.

Neha Manpuria Second is on Pharmacy, again, we have continued to improve our margins there too, and I would have thought that there would be some impact from the entire NLEM that would have come into this quarter. Has that postponed or can we assume that the margins have improved despite that NLEM impact?

Obul Reddy We could not feel that impact fully because it was implemented part of the quarter, number one. Number two, all the major pharma companies have gone back to the original margins for the distributors and retail, so that the extent our margins have not been impacted.

Neha Manpuria So going forward we expect the margin improvement in that case to continue to reach upwards?

Obul Reddy Yes, we expect to move forward.

Neha Manpuria What would be your improved margin in the medium term that we are looking at?

Obul Reddy We expect to improve at least add 1% every year with continued growth.

Neha Manpuria My last question is on debt; obviously, with the expansion we are seeing an increase in debt. What is our target comfort level when we are looking at debt by the end of FY15 or thereof, what is the level we will be comfortable at and we have a good balance sheet?

A. Krishnan We have said that we are looking at all our expansions, through a combination of debt and internal accruals. We have around Rs.500 crore of cash with us now, of course, the gross debt is at Rs.1,000 crore and our net debt is now at

Rs.500 crore. We are at 0.3 debt-equity, we are comfortable on the debt EBITDA levels as well. We have said again that we will be comfortable going up to 0.7, 0.75 debt-equity over the next couple of years.

Suneeta Reddy But I think that it would be calibrated?

A. Krishnan Yes, that will be calibrated over the next 2 years as I said, and so we will look at it going to around Rs.1,500 crore or that number over the next 2 years.

Moderator Our next question is from Praveen Sahay of B&K Securities.

Praveen Sahay My question is related to the Hyderabad cluster. If I look at just the Q2FY14 ARPOB then sequentially we are seeing some decrease in our ARPOB, so like last quarter you had set some tariff hike in the Hyderabad cluster that has also impacted the increase in ARPOB. So what exactly happened, so the sequentially down ARPOB?

A. Krishnan ARPOB has actually increased from Q1 to Q2. The ARPOB in the first quarter was 20,166 and second quarter is actually 20,222. So it has not come down.

Praveen Sahay Sir because I just calculated on the basis of the first half number you had provided 19,707.

Suneeta Reddy No, no, there has been increase, we have been tracking this.

Praveen Sahay Just coming to an expansion plan from the REACH Hospitals like Nashik, Nellore and Trichy our project cost has not increased from the last quarter numbers to this quarter. Is there any delay in this or we are progressing as per the plan for these REACH Hospitals?

A. Krishnan So Trichy would be commissioned in the coming quarter and Nellore by the end of this fiscal is what we would commission it by. There are not going to be any major increases in these costs of Trichy and Nellore more around Rs.110 crore which is what we have considered at this point in time and that is because of the increase in Medical Equipments that we have changed a bit of a scope on that.

Praveen Sahay And also like for the Patna facility which commissioning in FY-'16 there has been a decrease in project cost, so we have reduced something there or because the number of beds is 240?

A. Krishnan That is again a change in scope in the Patna project, so it has been lowered now to Rs.200 crore.

Praveen Sahay So that is as per the plan by '16?

A. Krishnan May be more towards the end of FY-'16.

Moderator Our next question is from Nitin Agarwal of IDFC Securities.

Nitin Agarwal On the REACH Hospitals, in most of the expansion that we are talking about over the next 3-years there is a relatively limited component of REACH. Is there some consequence of we are seeing more opportunities and again in the metros or larger towns and not only focusing too much on REACH going forward?

Suneeta Reddy No, we view it in two ways; one is that because of urbanization clearly we have this cluster approach in Tier-I cities where we want to strengthen our presence because our brand is very strong and that is the priority. We have twin priorities; the second is identifying those Tier-II cities which were feeder markets to us where we are sure that patients recognize the value of having an Apollo Hospitals. So we are continuously looking at Tier-II, in fact we have a team that is allocated for these Tier-II cities. I believe that 1,000 beds are coming up in Tier-II cities which is not a small number.

Nitin Agarwal But I am saying that its per se the REACH concept for all the hospitals that you have listed out and the expansion plan only 3 of these in the incrementals for the next 3-years, so that REACH Hospital per se the concept you do not seem to be focusing too much on it as far as the key growth driver is what I was wondering?

Suneeta Reddy No, I don't think that is correct at all because as the plan develops we are looking at Indore, we are looking at Ludhiana, there are other facilities, other ways of doing it, we are looking at both organic acquisition, quarter-to-quarter you will not be able to see growth in REACH facilities but the fact remains that it is part of our strategy to grow in Tier-II, we have already acquired land in quite number of Tier-II cities and we are in the midst of construction of those facilities. And we are also looking at some opportunities for acquisition of facilities. So I do not think that it is a strategy that we have set aside. It is clearly Apollo operates with a focus on both -- consolidation in Tier-I and growth in Tier-II.

Nitin Agarwal And on the inorganic growth that you talked about in terms of opportunities what is the kind of landscape that you see as far as these opportunities are concerned, do you see lot of these standalone hospitals which are where typically the existing owners are willing to sell out or you see more of management contracts, what kind of opportunity do you see on that bit?

A. Krishnan So these opportunities can either come out of our managed hospitals already, we have a very platform of managed hospitals, some of whom would want us to take ownership, it can either be a majority ownership or even full control or there are also small hospitals in places like Tier-II locations where they have recently set up in the last 2-3-years, the hospitals that are getting closer to completion, they then want to pick out a partner who can then come out with 51% and with the path to complete acquisition over a period of time. Some of these opportunities will help us getting to the market faster like Indore as we see now which we have at in FY-'15 could probably be an acquisition opportunity, again as we have other opportunities in East of India as well one or two, because not that there are many such opportunities, but yes, we actively keep looking at this across.

Suneeta Reddy Yes, so that is along with the consolidation of our facilities in Kolkata, Ahmedabad, Bangalore offers opportunities for organic growth.

Nitin Agarwal And when we talk about this peak debt-equity of 0.7-0.75 does it actually take into account some of these inorganic growth plan that you have or will that be something that we will have to revisit?

A. Krishnan At this point in time include some of these because these are small ones we do not see these as big capital requirements.

Nitin Agarwal And as a group what is your thought on this whole REIT structure, assuming if this gets facilitated, would Apollo as a group be interested in exploring the same?

Suneeta Reddy We are in the process of exploring it. There are some issues which do not make it extremely attractive at this point of time. We hope that we have an opportunity to debate with both Finance Ministry and with SEBI to see that the REIT structure really becomes viable as it is in Singapore.

Nitin Agarwal Given the fact that we seem to be comfortable on a gearing right now and with accrual sort of picking up, unless and until we really stepping up our expansion plans what would be the motivation for us to go for this, if you were to explore it?

A. Krishnan So as Ms. Suneeta said we do not have any urgent requirement to go for this, we are only studying the REIT option outside as well as in India. Unless it is going to be helpful for the next phase of expansion, etc. we do not really require for the space.

Nitin Agarwal And lastly on the Pharmacy side, what is the proportion of the private label that we have right now?

Obul Reddy About 5.5% of the total turnover.

Nitin Agarwal And how do you see thing moving forward?

Management We have moved in last 2-years from 3% to 6%, and we expect at least to add 1% every year on the turnover.

Nitin Agarwal And lastly if I can squeeze in, Suneeta, in the presentation you guys mentioned about this primary care health centers, all these primary formats are being explored in lot more detail, if you can probably help throw some more light on that strategy?

Suneeta Reddy You mean the Clinics?

Nitin Agarwal The Clinics and other Primary Clinics.

Suneeta Reddy Retail, as part of Apollo strategy we have always incubated new business models and I think Retail helps just like the Pharmacy which has a huge opportunity. The way we look at it is that it is really not such a high CAPEX business but it benefits us in terms of reference for Patients, access is an issue and I think that it enables that access. Second, it allows the referral. I think the third issue is that if we manage to get scale and size just as we do Pharmacy it could be considered as a separate business, and at that time I believe we would have created immense value which is why we are strengthening the Clinic business at this time, we have taken over some of the franchisees who are no longer doing it on a franchisee model, we have moved to an ownership model because we want to capture the value that we have created so far.

Nitin Agarwal But do you have any numbers or anything in mind for let us say 2-3-year view for RHC business?

Suneeta Reddy Yes, I think that really a 100-owned clinic in 3-years it is something that we can expect to see. We are looking at a lower CAPEX model. So the investments in these

Clinics will not be very high, but we believe that the focus is definitely on ROCE and on referrals to the main hospitals.

Nitin Agarwal But are there any specific streams that you are going to be focusing on in these RHCs or these are all broad-based, primary GP-based sort of Clinic?

Suneeta Reddy You are right, its GP-based with health checkup, but in this is the Cradle as well where we are looking at setting up Cradles in Tier-I cities, and I think Apollo has already been successful in this space because unfortunately we did it in a franchisee model which became Cloud 9 and it became Fortis La Femme. So we decided we would not do this anymore, we will do it with our own branding. So the Cradle has always been part of our strategy and it has proven to be extremely successful, we do have a plan to set up 10 Cradles.

Moderator Our next question is from Krishna Prasad of Kotak Securities.

Krishna Prasad My question is if I look at your expansion plan over the next 2-3-years I was just wondering at any point in time you would have sort of new hospitals which keep coming up and increasingly so let us say in newer geographies which sort of will have impact on the margin going forward. So if you were to take a 2-3 year sort of trajectory would you still think margins would actually see any meaningful upward bias or could we still see this expansion sort of suppressed margins over this period?

Suneeta Reddy This is a good question. It is a challenge that we think about very frequently. And while we are growing our business it is done in a calibrated manner. While we open new facilities the previous one gets mature, for example, Bhubaneswar has now started contributing, in the same way we believe that Jaya Nagar, what we have opened in Ayanambakkam and soon Trichy will start contributing when we open the next set of 100 beds. So we believe that there will be positive contribution coming from the 2-year-old facilities which will enable EBITDA growth.

S. Venkataraman In pursuance of the strategy that we have to have a pipeline of projects given the fact that growth here is quite high, and the important thing is look at it from two angles; one is to look at it from a unit wise margins, where all our facilities the margins are actually are going up. The only reason you are seeing a margin contraction at the company level is because the Standalone Pharmacies ratio compared to the total turnover is going up, and also new units as Suneeta said, they will be under pressure for some time. The same thing happened two years back when Bhubaneswar was on stream. EBITDA margin and other margins were under pressure but now it is fully recovered. So as a company we have a strategy that we have to have a pipeline of projects, and as long as the unit margins are intact and growing which is what we are doing all the time I do not think there is any cause for concern at this point in time.

Suneeta Reddy And just to add to what Venkat said it is the number of new beds as a percentage of existing so does not dramatically go up in a single year. I think that is important to note. The second is that our portfolio is a mix of both Tier-II and metro hospitals, and we expect that to even it out to some extent.

Krishna Prasad Just a follow up on what you just mentioned, considering we have been in expansion phase for may be about a couple of years now and obviously have lot of plans going forward, I am just thinking, how do we view that sort of shift in environment, do you think there has been a need to sort of calibrate our expansion plans, may be delay it a bit more considering market may be been a bit more sluggish than what one would have expected, are those things sort of been taken to account when we are looking at the CAPEX plan currently, has there been some sort of moderation in our approach there?

Suneeta Reddy Yes, certainly, I think what we have done is this is a calibrated approach. Even though the facility could take 300 beds the way we do it is we open may be 150 we will make operational, then we understand the demand more deeply, we go into a full ramp up mode. So yes there is calibration. The second area that we are looking at is we are looking very carefully at our CAPEX and seeing what is absolutely necessary in that market before we make that investment. The third the issues with licensing and all I do not think we should slow down our efforts in anyway just because the environment is bad. Because it is important for us to go ahead with our plans to get, where we purchase the land and building work has started, it is very important for us to just go ahead and get those licensing in place. The doctors' recruitment pipeline which is important is something that functions continuously, it is a pipeline so even for the existing hospitals we continuously get new doctors, so it is something that very much part of our DNA.

Krishna Prasad My other question that I have is actually around the Hyderabad cluster. If remember correctly I think we started off with ARPOB growth focus and then I think somewhere down the line shifted to increasing volumes, I know I think you are back to sort of talking about case mix improvement. I know it has been a difficult market, but do you really think that is going to be sort of a recovery anytime over the next 12 to 18-months or is this going to be a bit more prolonged?

Suneeta Reddy We are focusing on 12 to 18-months. We are focusing on the next quarter itself. So we are quite hopeful, the times are good I think that we have good doctors in place, let me say that we are optimistic about it.

Krishna Prasad Just finally on Chennai I see, last may be the half year now, our ARPOB growth has actually been quite strong. Is there something that sort of changed despite the Ayanambakkam addition I see that you have done about 14% kind of ARPOB growth anything that we need to sort of take note of or how do we sort of see this panning out over the next half year and the year ahead?

A. Krishnan So it is a combination of as we said two or three things; one is the Outpatient volumes as you have seen in Chennai has done well; the Outpatient revenues have also grown well. The Robotics surgeries that we have been talking of has picked up substantially in Chennai that is again a high ARPOB surgery. Daycare Surgeries have again picked up in Chennai because if you look at the Daycare Surgery Center that we have put up now, we are doing very well, it has grown year-on-year almost around 30%. So those are a few factors which have actually helped contribute to the ARPOB of Chennai. Also Ayanambakkam per se if you look at the ARPOB we had actually planned for a lower ARPOB and then if you look at the ARPOB today it is good because we are doing good Tertiary Care cases there. To fill up the whole facility we have to focus on secondary care again which is what we are now trying to focus on and Outpatient volumes as well. From an ARPOB perspective Ayanambakkam has actually started off well.

Suneeta Reddy Yes, I think it talks a lot about the brand that people are willing to pay a premium especially in the Tertiary Care segment that we are the first choice for most patients which is why surprisingly in Ayanambakkam we got Tertiary Care cases instead of the usual primary, secondary and emergency cases.

Krishna Prasad Just a follow up on what you just mentioned now. When you do expansion and obviously you have a plan let us say Ayanambakkam like you mentioned may not have initially been looked up as a Tertiary Care unit but so how much of this is really planned and how much of this is sort of let us say trial and error which goes in to newer facilities, I know it is always a combination but how you have seen that play out in some of these new hospitals and facilities?

Suneeta Reddy We were always tracking performance against plan and we check why the variations have happened.

A. Krishnan So in this case we had a very good team of Tertiary Care consultants who joined us in Ayanambakkam ahead. So that is one of the reasons that the Tertiary Care cases actually picked up faster than the secondary care case.

Moderator Our next question is from Vivek Kumar of Anand Rathi Shares and Stocks.

Vivek Kumar I just wanted to know that going forward may be next 4-5-years how do you see the EBIT margin and ROCE of pharmacy segment?

Obul Reddy At EBITDA anywhere between 6 to 8% and 30 to 35% across.

Vivek Kumar Can you share some numbers like globally if you see the Pharmacy business is very profitable vis-à-vis your margins…

Obul Reddy I cannot share numbers.

A. Krishnan So we have been growing this business around 22% this year, north of 25% is what we will be looking at, and 3.1% EBITDA for H1 and 2.3% EBIT is what we have done. So we have a visibility to take it to around 6% over the next few years is what Obul said.

Vivek Kumar Second question regarding the lease rental if you can share for next 4-5-years it would be great?

A. Krishnan We will have to take this off line because this is more of an accounting question.

Vivek Kumar Can you share something about the marketing strategy like when you are going into new city what is the marketing strategy for the company?

Suneeta Reddy Marketing strategy for the company or?

Vivek Kumar When you are entering into new location what would be the marketing strategy?

Suneeta Reddy I think before we start a facility the marketing team is already there. We are actually in a process. We were documenting this where do some pre-marketing, we do pre-registration of patients, and in many of these cities these patients would travel to an Apollo facility for care, so it makes it that much easier for us to have access to them but there will be a marketing team in place that will do it. The second part of it is marketing our doctors which means that we plan CMEs and COEs which within the city so that people are aware that here these are the doctors who are going to come and this is the level of skill that is available in this city. The third is that there is an advertising plan but the advertising plan and the expenses only happen after the facility is opened. And of course we do have a field force for every hospital; part of the field force just meets with the referring doctors; the second part meets with corporates which is another segment of our business and third part of course is to handle our Retail.

Moderator Our next question is from Ravi Dodhia of Crisil.

Ravi Dodhia I have 2-3 questions; one with respect to the occupancy at Chennai cluster, if we also remove the occupancy at your Ayanambakkam facility still occupancy is in the range of around 73-74 patients which in the earlier years was in the range of 78-80 patients. So any reason for low occupancy?

A. Krishnan In fact occupancy is in line with our plan, there is no specific reasons that we have. Of course as I said one of the things that we have done is also the Daycare Surgery Center that we have opened up, so some of the Daycare cases which were earlier one day admissions, etc. have now got into the Daycare Surgery Center, so that has also brought down some of this single day staying patients. So that could be one of the reasons but otherwise broadly we are in line with plan and we still have some room to grow there and we are working on that.

Suneeta Reddy And I think the way to look at is to look at consolidation of the market rather than occupancy in a single facility because the patients find Ayanambakkam and Vanagaram is closer to them. Hopefully they will go there, that is what we want them to do plus there is a slight tariff differential between both. So to capture another segment of the market which is expansive. So one is it answers your question of access to a facility, and second what is the price which people are willing to pay, so we are actually reaching out to new markets within that metro.

Ravi Dodhia And with respect to the Outpatient volumes in the earlier part of the call you highlighted that there has been increase in volumes. But if you look at the Q1 and Q2 numbers it has declined on Q-on-Q basis in both the quarters. So if you can explain that?

A. Krishnan So there was a reclassification in the Q1 numbers there was an error in the Q1 number that was given that could be the reason that you are seeing Q2 number which is computed by you as a lower number. Please get offline with Krishnakumar and he will provide you, there was a wrong number which is otherwise from H1 perspective we have grown 10%, and Q1 and Q2 both grew almost around 10%.

Ravi Dodhia My last question is with respect to the potential margins in the Pharmacy business. If you look at the mature stores up to 2008 batch, in past 2-years margins have been in the range of 5 to 5.5%, and we are talking about margins of around 6 to 8% margin potential but still the mature stores which is the most mature up to 2008 batch has not been able to see that kind of margin. So what will be our strategy?

Obul Reddy We are working on improving the private label in the matured store and also this quarter we have some matured store turnover impacted because of the agitation in

Andhra Pradesh because most of the matured stores are in that region and also implementation of DPCO drug implementation that has disrupted supplies. So other than that we do not see any reason, we will be back on track in the next two quarters.

Ravi Dodhia So in the matured stores we are targeting 6 to 8% EBITDA margin over next say 2-3-years?

Management Yes.

Moderator As there are no further questions from the participants I now hand the floor back to the management for closing comments.

A. Krishnan Thank you so much for joining the call everyone and that is all from our side.

Moderator Thank you very much members of the management. Ladies and Gentlemen, on behalf of Apollo Hospitals that concludes this conference. Thank you for joining us and you may now disconnect your lines.