Apollo Hospitals 9MFY13 Results Conference Call

February 8, 2013

Moderator: Ladies and gentlemen, good day and welcome to the Apollo Hospitals Q3 and Nine Months FY13 Earnings Conference Call. As a reminder, for the duration of this conference, all participants' lines will be in a listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. At this time, I would like to hand the conference to Mr. Mayank Vaswani of CDR India.

Mayank Vaswani Thank you, Inba. Good afternoon everyone and thank you for joining us on this call to discuss Apollo Hospitals financial results for the quarter and nine months ended December 31, 2012. We have with us today the Senior Management team.

Before we begin I would like to clarify that some of the statements made in today's discussions may be forward-looking in nature and may involve risks and uncertainties. For a more complete listing of such risks and uncertainties please refer to our Investor Presentation. As always, we shall start with Ms. Suneeta Reddy who will discuss the operating highlights for the quarter; Mr. Krishnan Akhileswaran will then discuss the financial highlights and progress of expansion plans, following which Mr. Padmanabhan will cover highlights of the Pharmacy operations and of Apollo Munich Health Insurance. Documents relating to our financial performance have been emailed to all of you earlier and have also been posted on our corporate website. I will now hand over the floor to Ms. Suneeta Reddy to provide key highlights of our performance. Over to you.

Suneeta Reddy: Good afternoon ladies and gentlemen and thank you for joining our call. We are pleased to share our results that demonstrate further progress in the pursuit of clinical excellence while sustaining momentum in revenues and profitability. I am proud to announce that We are today the "World's #1" in "Solid Organ Transplants" having performed over 1,200 heart, liver and renal transplants in this calendar year.

Apollo Specialty Hospitals, Chennai successfully completed its 500th bone marrow transplants in January 2013. In fact, Apollo Specialty Hospitals has been rated the "Best Private Sector Cancer Hospital" in India by the recently conducted 'Week-HANSA National Survey 2012'. We have some of the most comprehensive cancer treatment centers in several of our hospitals, including Chennai, Delhi, Hyderabad, Ahmedabad, Bengaluru, and Madurai; with all three treatment modalities which include medical, surgical and radiation.

We have been pioneers in bringing cutting-edge healthcare technology to the country and this quarter we have firmed up our plan to set up 'India's First Proton Therapy Center' at our upcoming South Chennai Hospital in OMR Chennai. In fact the Proton Therapy Center is expected to serve Asia, Africa and Australia and cover a population of approximately 3.5 billion. We believe that the increasing incidence of cancer where we are seeing a growth in excess of 15% will validate this investment.

The investment in this technology will be approximately Rs. 400 crore over the next three years and it is expected to further augment our Oncology offering in this region. Proton Therapy is a type of particle therapy which uses a beam of protons to irradiate diseased tissues in the treatment of cancer. The chief advantage of Proton Therapy is the ability to more precisely localize the radiation dosage when compared to the other types of external beam radiotherapy. This is increasingly considered the most advanced targeted cancer treatment and is highly beneficial for pediatric, head & neck, eyes, spine and prostate cancer.

We are also happy to share that our hospitals in Chennai and Delhi have been ranked 4th and 6th in the list of top 10 hospitals in India according to the Week-HANSA Best Hospital Survey.

Now coming to our performance, our Healthcare Services business has done extremely well with steady growth in Inpatient and Outpatient revenues across all clusters. This has come about through increased volumes as well as an enriched case mix. Volumes in specialties like Cardiology, Orthopedics and Oncology have moved upwards enabled by our 'Centers of Excellence' initiative and the continued roll out of robotics and minimally invasive surgery.

The Retail Pharmacy segment has delivered another strong quarter demonstrating that its trajectory of growth and operating improvements remains intact. Our subsidiary hospitals have also reported strong numbers while Apollo Munich Health Insurance has reported a significant expansion in premium.

Consolidated revenues grew 22.2% from Rs. 2,311 crore in the first nine months of FY12 to Rs. 2,824 crore in the first nine months of the current fiscal. Consolidated EBITDA expanded 22.8% from Rs. 382 crore in the nine months last year to Rs. 469 crore in the first nine months of FY13. Profit after tax in the first nine months of fiscal 2013 was higher by 35% at Rs.235 crore.

Standalone revenues grew by 20%. While revenues from Healthcare Services are higher by over 15% the Retail Pharmacy business continues to be a standout performer with year-on-year revenue growth of over 30% in the nine months FY13. This has been helped by some strong same-store sales contribution from private labels and continued expansion in the pan India network of pharmaceuticals.

Our subsidiary hospitals have also reported strong growth of 21% on a year-on-year revenue growth in Kolkata and Ahmedabad. This quarter also witnessed further roll out of robotics across our facilities as well as increasing preference for Minimally Invasive Surgery. In fact, doctors at Apollo Health City, Hyderabad undertook the "First Ever Bilateral Minimally Invasive Knee Replacement Surgery (MIKRS) in India." We repeat, as said earlier, increased use of this technology is resulting in improved clinical performance and rapid recovery by patients from reasonably complex surgeries.

Our expansion plan envisages setting up over 3,000 new beds over the next three financial years and this will enhance our network from the current capacity of 6,000 owned beds to over 9,000 owned beds in 51 hospitals for FY15. Over the next 12 months we are on line to commission new hospitals in Ayanambakkam, Women and Children Hospital in Chennai, two hospitals in Bengaluru; Trichy, Nellore and Nasik totaling to 1,000 operational beds. Ayanambakkam is poised to commence operations in Q4FY13 with an initial capacity of 100 beds gradually scaling up 200 beds.

In December 2012, Sutherland Global Services has entered into an agreement to acquire 100% stake in Apollo Health Street. This transaction is subject to customary approval and is expected to conclude by the end of the current month. AHEL holds 39.4% stake in Apollo Health Street. Divestiture is expected to net Rs.200 crore which will further be used for our expansion plans.

I will now hand it over to Krishnan, our CFO to provide you with further details of our financial performance.

Krishnan A.: Thank you Ms. Suneeta. I would like to begin with Slide #9 of the presentation which contains the standalone financial performance. Standalone revenues grew 20.1% from Rs. 2,056 crore in the first nine months of last year to Rs. 2,470 crore in nine months of the current fiscal. This was driven by 15.4% growth in revenues from Healthcare Services and growth of 31% in revenues from standalone pharmacies. Revenues from Healthcare Services have been driven by increased volumes including a healthy performance from Chennai as well as strong traction from our newer hospitals.

EBITDA grew 22.2% from Rs. 344 crore in 9MFY12 to Rs.421 crore in 9MFY13. The overall EBITDA margin has expanded by 28 basis points to 17%. We have been able to sustain EBITDA margins due to an enriched case mix in our mature hospitals as well as improved contribution and operating leverage from hospitals at Bhubaneswar, Madurai, Mysore, Karim Nagar as well as standalone pharmacies. Depreciation is higher due to the addition of capacity at Hyderabad, Bhubaneswar, Vizag, Hyderguda and Karaikudi. Other income in 9MFY13 increased to Rs.26.5 crore due to deployment of surplus funds in incremental deposits and mutual funds. These funds are now gradually been deployed as work on new facilities progresses. The effective tax rate for 9MFY13 is 26% compared to 32% in the corresponding period last year due to the tax benefits under Section 35 AD of the Income Tax Act on new projects that we can now avail of. As a result, standalone PAT grew 36% to Rs. 234 crore in 9MFY13.

If you now turn to Slide #10 on segment wise performance you will see that while Healthcare Services revenue grew by 15.4%, EBIT in the Healthcare Services segment grew by 19.3% in the nine months. The annualized RoCE on the Healthcare Services has been maintained at 18.2% despite incremental capital of Rs.387 crore on a year-on-year basis.

I will now take you through Slide #12 which contains the key operating metrics in the Hospitals business. The operational beds as of December 31, 2012 were 5,332. The year-on-year increase of 158 beds over the period has come through the net addition of 63 beds across our standalone hospitals in Madurai, Karaikudi, Karim Nagar and Bhubaneswar as well as 95 beds across key subsidiaries in Bengaluru, Delhi and Ahmedabad. Overall occupancy has increased to 75% compared to 70% in the same period. Volume growth has been healthy with double-digit growth in both Inpatient and Outpatient volumes. Outpatient volumes in Chennai grew 11% while IP volumes grew 3%. At 78% occupancy the Chennai cluster today has limited room for Inpatient volume growth. The new Outpatient center block which should be operational in the next 6-8 months would help us create additional 100 beds in the main hospital thereby providing headroom for growth in this cluster. Hyderabad cluster has seen some traction on occupancy which is at 66%. We have specific clients in place to augment the revenues further and profitability over the next few quarters. Volume growth at standalone hospitals outside of Chennai and Hyderabad like Madurai, Bhubaneswar¸ Karur, Karaikudi and Vizag was over 20% on a year-on-year basis. The JV, subsidiary and associate hospitals also registered healthy growth in both IP and OP volumes.

ARPOB has grown 6.3% on a year-on-year basis and it is currently at Rs.21,424 at a group wise basis. ARPOB in Chennai grew by 12.1% followed by 'Other' standalone hospitals at 9.2%. The Hyderabad cluster registered an ARPOB growth of 6.8% while subsidiary, JV and associates grew by 6.4%.

Ms. Suneeta has already covered our expansion plans which are detailed on Slide #16. This planned expansion will require an outlay of approximately Rs. 2,170 crore in a phased manner, of which we have already invested Rs.507 crore. As shared earlier our existing cash, internal accruals and debt funding position in addition to sale proceeds from Apollo Health Street will allow us to fund this expansion plan. That is it from me.

I will now hand over to Mr. Padmanabhan who will walk you through developments on Retail Pharmacy and Apollo Munich Health Insurance.

K Padmanabhan: Thank you, Krishnan. Revenues from the Retail Pharmacy business have grown 31% from 623 crore in 9MFY12 to Rs. 816 crore in 9MFY13. Growth has come through a healthy increase in same-store sale as well as continued expansion of pan India network of stores. The operating metrics have improved further. Our overall EBITDA has improved from Rs.10.6 crore in the nine months last year to Rs. 22.1 crore in the nine months of this year. The EBITDA margin has expanded 101 basis points from 1.7% for the nine months of last year to 2.7% in the nine months of the current year. This has been made possible by the rationalization of store network, buying efficiencies and improved contribution from private labels.

If you refer to Slide #14 of our presentation, the analysis of the Pharmacy business demarcates our stores into separate categories - the stores that were set up in FY2008 and earlier, stores that have been in FY2009, stores that have been in FY2010 and the metrics for all the stores on a combined basis. Like-for-like revenue growth has been 17.3% for the mature stores set up before FY2008 and 20% for stores set up in FY2009 and 23.5% for stores set up post 2010. The EBITDA performance has improved in each of these categories and you will also notice that all the stores that are prior to 2010 representing almost 850 stores are now significantly EBITDA positive. The pre-FY2008 category which contains the mature stores has reported an EBITDA margin of 5.4% in Q3 FY13 compared to 4.9% in Q3 FY12. In FY13 we made a net addition of 87 stores. We have added 135 stores and closed 54 stores wherever the operations were unviable. We now have a pan India network of 1,445 stores as on 31st December, 2012.

Coming to Health Insurance – Apollo Munich Health Insurance has recorded an increase of 27% in gross written premium from Rs. 263 crore in 9MFY12 to Rs. 359 crore in the nine months of the current fiscal. Total income is higher by 50.6% from Rs. 232 crore in the 9MFY12 compared to Rs. 350 crore in the 9MFY13. The EBITDA for the first nine months of this fiscal is marginally positive at Rs. 0.6 crore compared to the negative EBITDA of Rs. 20 crore in the same period last year. We continue to make progress in this business and we have plans to expand it further. Apollo Munich has a network of 50 offices across the country and Rs.465 crore of assets under management as on 31st December, 2012. That is it from me and we are now ready to take on questions. Thank you.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin the question-and-answer session. Our first question is from Farzan Madon of Axis Capital. Please go ahead.

Farzan Madon: This is Farzan over here. Just wanted to know about this Proton technology like the project economics. What kind of RoE are we looking at and will this 400 crore be spread across up to FY16-17?

Krishnan A.: You are right, this Rs. 400 crore is the total project cost, the equipment cost alone is around Rs. 300 crore, so 400 crore includes the project cost as well and this is something that we expect to incur over the next three years up to FY16 and the first patient treatment will happen end of FY16 or early FY17 and the ROI and RoCE on the business is in line with our existing RoCE and ROIs, and more importantly if you look at it, it is important that we are looking at South Chennai to be repositioned as a complete and comprehensive Oncology Center. If you remember the South Chennai project that we had, we have an expansion plan of almost around 300 beds that is now 200 beds and we have plans in place to reposition that as a comprehensive Oncology Center including Proton. So you will see some of this improving the project viability as well while the overall IRRs and the project IRR itself is between the 18-20% range.

Farzan Madon: Where do you see the Pharmacy EBIT levels stabilizing at because quarter-on-quarter there have been improvements even in the matured pharmacies, so can we see around 5% EBIT levels on the matured pharmacy stores?

Obul Reddy: It will be around 6-7% on the matured level and at least 30% of our partners are in that bracket now.

Moderator: Thank you. Our next question is from Aditya Khemka from Nomura. Please go ahead.

Aditya Khemka: If you look at the Chennai cluster then, we are seeing sort of low growth in the ARPOB levels of the Chennai cluster. So could you give us some color on how we should think about the ARPOB growth going forward and what are we doing to keep our double-digit kind of ARPOB growth in Chennai?

Krishnan A.: In fact ARPOB itself in Chennai has been a healthy double-digit 12%. If you look at it in fact ARPOB is something that is a combination of tariff as well as case mix and at around 12% in fact that has been because of the case mix and some of the high end work that we have been doing in Chennai is what has led to this healthy ARPOB increase and also ALOS, if you look at the average length of stay in the Chennai cluster it had already come down to 4.46 as compared to 4.70 across the group, which has further come down to 4.41. So clearly we are focusing on a better case mix, greater day care surgeries, reduction in ALOS and these are things that are showing up in the higher ARPOB which is reflecting in the higher net revenues as well. But to answer your specific question on growth on revenues if you are asking, as we said over the next 6-8 months, we are hoping to start this Outpatient center, second is the Ayanambakkam facility itself is also going to be commissioned in Q4 of this year and you have seen even in past that we have managed ARPOB growth in every cluster through increased utilizations and higher case mix, etc. which you would see coming through over the next 12 months.

Suneeta Reddy: Just to add to that, one of the reasons why we have invested in technology is that this technology will actually contribute to a higher ARPOB. Things like robotics and eventually when proton comes into play. I think that today if you look at the US 40% of all surgeries are being done using robotics and I think that in 3 years' time Apollo also will move to that level.

Aditya Khemka: Actually another concern I had on the Chennai cluster was if I look at it sequentially, in Q2, your occupancy rates were 80% and in Q3, the occupancy rates have fallen to 78%. So not to nix it, but there has been a sequential decline of occupancy rate. So has it got to do something with shifting out of the OPD center or some sort of exercise that you guys are doing there?

Krishnan A.: Not specifically, Q3 is one period when you have festivals, you have Diwali you have all this and typically if you look at it, there are some electives which gets pushed on to Q4. So Q3 is actually a seasonal low for the business across. In fact you would see it more pronounced in places like Kolkata where because of the Pooja holidays and everything, we do see some of the volumes dip. So other than that there is nothing that we are actually worried about here.

Aditya Khemka: Can you speak a bit more about the shifting of the OPD from Chennai? Does it show up in the list of projects? So what is the timeline there? What are we spending there? Some color on that?

Krishnan A.: We have not yet put it in the projects because we are just getting to close the lease agreements, etc. and this is around less than 500 meters away from the main hospital and this is 1,50,000 sq. ft. Outpatient building that we are planning here and we will give you greater details once the lease agreement, etc. is crystallized in the next quarter. But that is why we have said it is around 6-8 months away but the building is almost ready, so we are just in the final stage for getting it closed.

Suneeta Reddy: But I think the rationale behind that is clearly that, one is the margins in Outpatients are much higher than the margins in Inpatient; currently 30% of our total revenues come from Outpatient revenue. Second is that we will be able to seat a larger number of Outpatients and therefore the conversions will be higher. Third, it will free-up capacity in the main hospital so that we could add 100 beds in the main hospital. So using this rationale we realized that this is something that we need to do because there is a lot of congestion in the main hospital at present.

Aditya Khemka: The occupancy rates at Hyderabad have not really moved up sequentially again, I mean they are flat at 66%. So is there anything that we are doing to address the low occupancy levels that we are sustaining at Hyderabad?

Suneeta Reddy: Yes we definitely are, we did add a lot of beds without, I think, matching it with the type of medical infrastructure that we needed to do which we are in the process of doing. We are hiring new doctors, which means that referrals, etc. they are also revamping the entire referral system in Hyderabad. I believe that from next year we will see better occupancy and better performance from the Hyderabad cluster. In fact, they made a strategy presentation to us and we are quite confident that this will be reflected in next year's numbers.

Aditya Khemka: And regarding the ARPOB levels at the cluster, are we satisfied with the number that we are currently doing?

K Padmanabhan: I think as Suneeta was mentioning, as part of the strategy, there will be some amount of rationalization that will take place, in the sense that some of the low paying customers which are government service sectors we plan to phase it out over the next 3-4 months and will be filling it up with more private cash paying patients. That should improve not only ARPOB but will also improve profitability and EBITDA margin at the gross level. So hopefully we are doing a few of these steps over the next three months to bring it in line with what we originally had planned for Hyderabad. I think over the next three months we will be able to adjust this.

Aditya Khemka: The subsidiary revenue if I back out subsidiary revenue from your consolidated sales, we were doing roughly about 50 crore by the end of first quarter FY13 since Q2FY13 we have been clocking run rate of 65 crore in subsidiary sales. So just wanted to understand under subsidiaries we just have Kakinada and Bengaluru facilities, right?

Krishnan A.: Subsidiaries and JVs, if you look at subsidiaries we have Bengaluru, we have Kakinada and we have the clinics as well which come as part of the subsidiaries. And when you look at joint ventures we have Ahmedabad and Kolkata as well; 50% share of Ahmedabad as well as 50% share of Kolkata comes into the consolidated numbers.

Aditya Khemka: That is right, what I was saying was that if I take your consolidated income from operations without the JV sales and if I reduce your standalone sales from the consolidated sales what I am left with is the subsidiary sales, right?

Krishnan A.: Yes, you are right.

Aditya Khemka: Now that number was about 50 crore in Q1FY13 and it is about 65 crore in Q2 and Q3FY13. So there has been a sequential increase of about Rs. 15 crore.

Krishnan A.: Yes, the hospitals there, as Ms. Suneeta said, are doing very well; Ahmedabad and Kolkata are doing very well.

Aditya Khemka: Kolkata is a part of your subsidiaries, it is not, right, it is a JV?

Krishnan A.: Yes, that is right. And also if you look at it in July we had also transferred some of the Clinics business from the standalone financials into the consolidated financials. That is also reflecting into the overall turnover which is there in Q2 and Q3, because if you remember last year we had said that we are going to be driving the Clinics business into that. That is a 100% subsidiary of ours, the clinics itself, so the Chennai clinics were forming part of the Chennai hospitals which is now being transferred to the 100%

subsidiary of Apollo Health and Lifestyle which might also be one of the reasons that you have seen the uptick from Q2.

Moderator: We will take our next question from Girish Bakhru of HSBC. Please go ahead.

Girish Bakhru: Just on the Pharmacy side, if we look at the breakup given for the 2010 batch there has been a significant improvement in the margins from 1.4% to 3.1%. Just wanted to get the color on what is driving that and how much is the share of private label now and what is the strategy going forward?

Obul Reddy: During the year private label has increased from about 3% to 5% which is driving up the margin and we have a healthy same-store growth in the current year for the matured one. So this trigger has contributed for the higher margin.

Girish Bakhru: And this is broadly sustainable, right? Given the sustainable rate of 6-7% overall on the matured level, I am just trying to understand is all that traction coming from increasing the private label share or what is going to take it further from there?

Obul Reddy: It is a combination of both, increase in the private label and the same-store sales.

Krishnan A.: Because if you look at same-store growth, even if you look at the FY08 batch it has grown by almost around 17% and FY2009 batch has also grown by 20%. So all these will show up in the margins because of the operating leverage that we have.

Girish Bakhru: Any color on the potential, strategic entry in this business and where would the stores number go to say next 2-3 years?

Suneeta Reddy: There is a plan that we have to add 250 stores a year, but this plan depends clearly on whether we get the right locations to actually add these stores. While we are doing this there are some stores which we shut down; so net-net about 200 stores that we add every quarter. With regards to strategic investments into the Pharmacy, right now we believe that we can show a better performance and therefore attract a better valuation and that is why it will take us another 6 months before we firm up any strategy.

Girish Bakhru: Just on the technology side with this infusion of Proton Therapy, I am trying to understand would this kind of investment also allow significant premium pricing for these surgeries or how would that environment play out and how it will affect overall ARPOBs?

Suneeta Reddy: Definitely it will, because the one thing that I think very few people understand or consider is the fact that three years from now, Proton will probably become one of the most used technologies for Oncology. Right now, people are looking at the old equipment and CyberKnife and things like that are considered recent developments. Two years from now I think that the demand for Proton will definitely be because of better education and better understanding of the use of the therapy, utilization will be high. Second, yes, the margins on that will definitely be much higher than you would on conventional equipment. Third, I think is the demand because since Apollo has already started work on it, we would be the first in this region, serving about a population of close to 3 billion. So, I think all that will definitely contribute to enabling us to higher utilization and therefore better margins.

Girish Bakhru: But just on clarification on these overall investments like we had robotic investments in some past and not this Proton Therapy, overall what is the broad lead time when these investments start generating significant profit that we break even on those things?

Krishnan A.: Robotics if you look at it, we have already started work on it, the surgeries have already commenced on robotics. What happens is as some of these new equipment come, especially robotics is a very different way of doing a surgery, so we need to have skilled doctors as well to start practicing on the same and while as Ms. Suneeta said, the majority of work in US has is being done through robotics. We are gradually getting there. So we expect robotics to take another 12 months to start giving us the returns that we had originally planned. And Proton if you look at it as we said even earlier it is going to be part of a comprehensive cancer treatment plan that we are going to be putting around it as well, and with the international patients, etc. we think once it starts up in FY17 we think within a year again we should be able to get the returns that we envisage.

Moderator: Thank you very much. Our next question is from Eshit Sheth of Anvil Shares and Stocks. Please go ahead.

Eshit Sheth: Just wanted to check on the performance of our subsidiaries because in the last quarter if we see, we were actually back in the black and this quarter again there is a loss of 8 crore in terms of subsidiary PAT?

Krishnan A.: There are two reasons actually, if you look at subsidiaries on the Clinic side we have rolled out a few new clinics as well in Apollo Health and Lifestyle. And as we roll out a few clinics initial couple of quarters we do see some ramp up cost and losses around that which has shown up a bit on the quarterly number. And the second thing is of course when we look at the joint venture, if you are looking at it including the joint venture and hence the consolidated numbers, Kolkata again as I said because of the Pooja holidays, etc. there is a drop in Q3, and if you compare with the Q1 and Q2 numbers there has been 2.5 crore drop in EBITDA. So nothing major but yes, it does show up in Q3, we should be back on track by Q4.

Eshit Sheth: Sir also in terms of our clusters, if I look at the Hyderabad cluster and if I look at the others basically, what we are seeing is sequentially there is a drop in terms of ARPOB, definitely Chennai has done very well in terms of ARPOBs but sequentially there has been some drop. So is this again just a seasonal factor?

Krishnan A.: Nothing specific, it's just a change in case mix, because if we look at Q3 we had lot of Dengue and other cases also because of some of these low yielding cases you have seen some drop in the ARPOB marginal, nothing specific otherwise.

Eshit Sheth: Sir also just wanted to get your sense for the next year, next year as per our CAPEX plan we will be adding somewhere close to 1,200 beds. So what kind of growth do you all envisage going forward for the next year?

K Padmanabhan: I think we continue to grow at the rate at which we have been growing over the last 5-6 years over a 20% plus growth in top-line and because of operating leverage we should improve our profitability better.

Eshit Sheth: Fine, one more question I had was on the ALOS. You'll have very specifically emphasized that ALOS below 4 is not achievable ideally. But just wanted to get your understanding because if you got to see Max Hospital or even Fortis they have ALOS of as low as 3.75, 3.70. So if I compare that to our best hospital which is our main hospital at Chennai, we are still at roughly 4-4.5. So is there any chance of improvement in our ALOS?

Suneeta Reddy: I think you should compare the case mix between the two because the case mix here is richer and that is why the ALOS is higher.

K Padmanabhan: I think ALOS, as Suneeta was saying, Chennai main I think is close to about 4.1 or 4.2.

Krishnan A.: 4.4.

Suneeta Reddy: Which is equal to the best US hospitals.

K Padmanabhan: And we have some hospitals with lower ALOS at 4.1 or 4.2, but they tend to be more in the high secondary care where the case mix is not that high. But, I think there is a lot to do with the kind of case mix, the seriousness of the patient, there are some long-staying patients in ICU, etc. Because we have quaternary care hospitals generally in all large cities, we tend to have patients who stay little longer. The important thing is that we aim to see that because of or through technology, whether we can be able to reduce this ALOS. This is what we have demonstrated over the last several years that we are getting closer to an ALOS of 4 that we are aiming at.

Eshit Sheth: Then your strategy of having more surgeries done with robotics will lead to this reduction in ALOS?

Suneeta Reddy: Yes, certainly.

Eshit Sheth: So currently of the overall surgeries that we do our target is to get it to closer to 40%. What is the current ratio somewhere like percentage in terms of number of surgeries we do with robotics?

Krishnan A.: Currently, we have just rolled it out, just a couple of quarters back, we have begun to track that, so it is low single-digits now.

Eshit Sheth: In the longer-term we aim to get it to closer to around 40% level?

Krishnan A.: That is right, it will take some time.

Moderator: Thank you. Our next question is from Bino Pathiparampil of IIFL. Please go ahead.

Bino Pathiparampil: This Proton Center is coming up in Chennai OMR or South Chennai?

Krishnan A.: South Chennai and OMR are the same.

So South Chennai and OMR, they are different projects but actually not very far away, in fact this hospital and the other one also is only 5 kms away.

Bino Pathiparampil: So in your last quarter presentation it showed 350 beds, now it is 200. Is it because of Proton Therapy?

Krishnan A.: That is right.

Bino Pathiparampil: So it reduces the number of beds by 150. Where is the income from Health Street sale recognized?

Krishnan A.: It is not yet done, the deal is expected to close out in this month, and after that it would be recognized, but if you look at the total realization it would be in line with what we have in the balance sheet so you would not see any gain or loss in our P&L.

Bino Pathiparampil: And Chennai decongestion, in total from decongestion of Chennai main and Chennai Specialty, how many beds are getting added?

Krishnan A.: So if you look at Chennai because of the Outpatient Center we would be able to handle around 100 beds and we also have a plan to start the Women and Child which will be operational by the end of this fiscal which will again release another 40 beds in the main hospital because the Women and Child would be a 60 bedded hospital and out of that today we have 40 beds in the main hospital which again will provide us room to grow the centers of excellence.

Bino Pathiparampil: So in your presentation there is a Chennai main expansion of 30 beds addition in FY14?

Krishnan A.: That is in fact additional to the 140, so 100 plus 40 plus another 30 beds. The 30 beds will come because of the MLCP, which is the Multilevel Car Parking that has been done by end of FY14, so that will add another 30 beds hopefully by end of FY14. So there will be a planned release of 170 beds over the next 12-15 months which will help us in the Chennai main hospital.

Bino Pathiparampil: And finally in Pharmacy this year looks like you will be adding net about 100-120 stores. Will that go up to 200 next year, is that the plan?

Obul Reddy: Yes, that is the plan. This year we are more focused on the consolidation.

Moderator: Thank you very much. Our next question is from Praveen Sahay of B&K Securities. Please go ahead.

Praveen Sahay: The first thing is as we had discussed in our last call regarding the format store in the Pharmacy business. So would you please give some details over there, like any of that has opened?

Obul Reddy: We are working on the details and probably will start rolling that out from April in the next quarter.

Krishnan A.: The pilot stores are already on and we are looking at the response and we are looking at the profitability and uptick on the business. So that is where it is at this point in time.

Praveen Sahay: Another question is related to Pharmacy only. As in your presentation which has stated almost 34 stores in the last 24 months mainly from Delhi and Mumbai you had closed due to some expenses and high rental and all. So what I think in Delhi and the Metro cities the organized pharmacy sector is higher as compared to Tier-II and Tier-III cities. So will that affect?

Obul Reddy: You are right. The rentals in those two places are much higher than other places.

Praveen Sahay: So as we are closing due to expenses in these cities where organized Pharmacy sector is higher as compared to Tier-II and Tier-III, will that affect?

Obul Reddy: You are right. Entire organized sector is facing that problem in those cities and we are not an exception to that.

Praveen Sahay: In Bengaluru, you are going to add 125 super specialty beds by the end of FY13. What is the status on that, like by the end of fourth quarter?

Krishnan A.: Yes, we are hoping we should be able to commission that by March.

Praveen Sahay: And also when I compare with the last presentation, a few expansion plans have been delayed. So what facilities in a couple of hospitals in Chennai and one in Trichy has also delayed by a year, Indore also delayed. So any specific reason for this?

Krishnan A.: Trichy is on course to be commissioned in Q1FY14, so that is where it is. So even the major delay has been only Mumbai where we are still being saying FY15 for the three hospitals, may be one of those hospitals might even slip into FY16. But other than that if you look at it we have pretty much been on line. 3-4 months is something is because of permissions and other things, government permissions, etc. there could be delays in the same, otherwise there is nothing specific today. If you look at Trichy and Nellore, we are hoping we should be able to commence by Q1 of next fiscal and Q2 Nellore and if you look at Bengaluru we should be on track to commence it by March, Ayanambakkam again by March. So I think the next year we should be looking at the 1,000 beds that we have said, we should be able to add that as expected.

Moderator: Thank you very much. Our next question is from Ravi Dodhia of CRISIL. Please go ahead.

Ravi Dodhia: Just wanted to understand about the news with respect to talks for a strategic partner in the Pharmacy business?

Krishnan A.: There is nothing specific that we have at this point in time. We have said that we would be looking at a strategic partner over the next few quarters or at least couple of years. But the more important thing is we are today focusing on increasing the business, making it more profitable, etc. that is something that we understand, if we look at the next group after us they are not even as profitable or not even into profit zone. So clearly we realize, we really want to extract more value out of this for our next phase of growth in the hospital. So we are going to be looking at it over the next 12-18 months. We are not in a hurry to do this.

Ravi Dodhia: And Pharmacy business margins if we look on quarter-on-quarter basis, it has declined by around 20 basis points. So any particular reason for that decline?

Obul Reddy: Our gross margins are consistently improving. It is only the loyalty cost which we pass on to the customers. 20 basis points is something that we have to build into the business.

Ravi Dodhia: Also just want to understand what portion of interest is currently being capitalized?

Krishnan A.: So YTD, nine months I think the interest capitalization is approximately around 20 crore.

Ravi Dodhia: And what is the debt and cash figure around the consolidated book as of December?

Krishnan A.: Rs. 500 crore is the cash in the books and the work-in-progress is approximately around Rs. 470 crore which is where the interest capitalization comes from. Debt is Rs. 1,000 crore and the cash that we have which can be deployed is around Rs. 500 crore.

Moderator: Thank you very much. Our next question is from Perin Ali of Edelweiss. Please go ahead.

Perin Ali: Sir, want to understand that our Chennai cluster if you see operating beds from last year to this year has declined by 58. Now I remember you mentioned that some of the beds are under renovation. So do we expect these beds to come again on line and by when can we expect that?

Krishnan A.: Major part of these beds are because of the reconstitution we did this, intensive care units and the critical care units were reconstituted and this is one of the reasons that the number of beds have come down. We expect the beds to go up by another 20 but we are actually waiting for the Outpatient center and along with that is what we are going to be increasing that. So we would not see immediate increase in this over the next quarter.

Perin Ali: My next question is on your margins. If you see YTD, your margins are 16.6%, more or less stable versus previous year. Now closing on to this year and going forward how do we see margins panning for the entire business at a consolidated level?

Krishnan A.: We would not be able to provide you specific guidance towards that. But as Mr. Padmanabhan already said we are in line to continue the growth that we have been seeing in the past and we would expect the margins around the same levels for some time in the next quarter.

Perin Ali: And for next year do you expect margin expansion or you expect to maintain given that 1,000 beds are going to come on line?

Krishnan A.: So there would be some costs which are going to be coming up because of ramp up, etc. We have leeway to grow the EBITDA margins in our existing clusters through

Hyderabad, Chennai, etc. So our aim is to maintain the current margins as it stands. While if you look at the breakup you would realize that the new hospitals would have certain costs and the existing hospitals would actually continue to grow on the margins.

Perin Ali: And sir on the Pharmacy front can we expect further expansion in margin, I mean what could be your understanding over next 2 years, where can we target whether 4% or 5% is achievable?

Obul Reddy: We target to add 200 stores every year with an addition of 1% margin every year. This is our broad target for the business.

Perin Ali: So we can expect at least 5% at the end of 2 years?

Obul Reddy: In another two years we will be around 5% for the entire portfolio.

Perin Ali: Sir just a question on the Proton Center. Just want to understand a little bit, of your Rs. 400 crore investment; Rs. 300 crore will be on machinery and Rs. 100 crore will be on the facility. How many beds will be there in the center?

Krishnan A.: So we have said this is going to be a 200 bed integrated cancer center.

Perin Ali: 200 beds will be of the South Chennai facility you mentioned?

Krishnan A.: That is right, that is going to be converted into an integrated cancer center and so we would be doing some restructuring of our beds, etc. by the time this comes up in FY16-17.

Perin Ali: Sir, just want to understand the Proton Center as a technology, how do you think the treatment cost will vary from the existing and what kind of volumes or number of treatments do you expect in the first year of operations?

Krishnan A.: So if you look at it the expected number of treatments that we have in the first year of operation is almost around 300-400 and when it is fully ramped up it can do almost around 1,500 patients a year. That is what it is expected to be. As you would expect the cost would be higher than the traditional cost that we have currently been incurring here and it would be almost in the range of around 15 lakhs to 20 lakhs per patient. But if you look at it from an overall US standpoint etc., we would still be providing this in India at one-third or one-fourth of the cost in the US and the target as Ms. Suneeta also said is not going to be only India, it is going to be also this part of the region where we expect almost around 35% of this center to be filled up by international patients as well.

Perin Ali: And sir your Linear Accelerator kind of technology will be in 6 to 7 lakhs per patient and this is 15-20 lakhs, almost double of that or more than that. How do we see it attracting patients and what kind of significant benefit this treatment gives over the existing ones in order to attract such patients?

K Padmanabhan: In fact the LINAC will cost roughly between 2-2.5 lakhs and not 6-7 lakhs, that is what it currently costs for about 25-30 sittings. But these are not comparable. What we can say is patients who go to the LINAC, small percentage of them could be only cured through proton, whereas the bulk of the patients who go through LINAC also can be cured through the LINAC. So we are expecting a small percentage of patients who can't be cured through LINAC to come in for the Proton Therapy. Then there are also procedures with LINAC we find it extremely difficult to do. This has to do with pediatric oncology patients and also patients who have tumors which are close to the eyes and the spinal cord and to the brain where the Proton Therapy can come into play. We also do expect and I was saying about that this will be the only center as it stands now in Asia and we also do expect a small percentage of patients to also come from outside of the country for treatment for the Proton Therapy.

Suneeta Reddy: Also this factors in a number of sittings that are much lower than it would be for the conventional treatment. And one of the things is that why would a doctor choose Proton over any other conventional therapy is the fact that for the patient surrounding tissue doesn't get affected.

K Padmanabhan: Where there is a danger of collateral damage, then it is important that the Proton Therapy is used instead of LINAC, which is why I talked about near the eye, near the brain, etc.

SK Venkataraman: What we can do is we can send you a short write up on what is Proton.

Suneeta Reddy: From patient perspective I think the doctor would recommend proton because there is no exit harm at that site. Second is the tissue around the tumors doesn't get impacted with this treatment. Third is the number of sittings are less and it has been found to be highly effective in the regions that Padmanabhan has mentioned.

SK Venkataraman: And a detailed mail has been actually mailed to all you regarding this technology.

Perin Ali: I just wanted to understand the dynamics as per your strategy on this center. Also sir last question which I have is how do you expect ROCE over the next two years given that our CAPEX on the Proton Center and all these things will be front end while the cash flows will come over a longer period of time?

Krishnan A.: Capital employed in the proton center would not be front ended. The way we have structured it, it is almost 60% is going to be back-ended. So there is a vendor financing component, there are several things in this, so you would not see the RoCE getting impacted negatively because of Proton for sure. And the other hospitals that obviously you would see that when the capital employed goes up with the first year you would see some of those. Next year you will see the capital employed go up a bit and as you have seen even this year on the back of Rs. 400 crore of incremental capital employed, we have been able to maintain the RoCEs on the Healthcare segment. So you would see that it would come down a bit but after that you would again see it going back in the next year after that.

K Padmanabhan: And also what you would see is that like in Bengaluru there could be some additions in incremental capacity which could come through these beds which are not yet factored in, but these are very much on that.

Moderator: Thank you. Our next question is from Neha Malhotra of Citi Bank. Please go ahead.

Neha Malhotra: My question is around Apollo Health Street. You said that the gain on sale would not reflect in the P&L for the coming quarters. Can you tell me how would the entire sale affect the FY13 numbers?

Krishnan A.: So if you look at the FY13 numbers, today we have almost around Rs. 53 crore of NCDs with an accrued interest which is around 70-75 crore that will come into us and we have an equity contribution as well of around Rs. 123 crore, and as it stands now it is a breakeven transaction that may be a positive Rs. 5 to 10 crore that we would receive out of the sale.

Neha Malhotra: And I have another question on Apollo Pharmacy, it has been in the media that you are planning to hive off the Pharmacy business into another separate entity. So what is the progress on that?

K Padmanabhan: Basically we had been thinking about how to extract value out of the Pharmacy business and one of the things that we are definitely looking at is whether we can look at a strategic partner who comes with an international experience in the Pharmacy Retail. As it stands now, we still do not have full clarity on foreign direct investments in retail, and therefore what course of action we will take is going to be very much depend on the type of investment that comes in and when we will be actually be able to get an international investor into the business. Obviously, at that point of time we will look at whether we need to make this into a subsidiary and how we will actually deal with this.

Moderator: Thank you. Our next question is from Krishna Prasad of Kotak Securities. Please go ahead.

Krishna Prasad: My question is really on the South Chennai 200-bed facility that we got. If I understand this correctly I think initially when we had planned this unit, it was meant to be a multidisciplinary sort of super specialty hospital. Would that be the right assumption?

K Padmanabhan: Really that was how it was, that we would have a multispecialty hospital. What we have now decided is to have the Proton Therapy and have the full Oncology Center there and we will still have the flexibility of what we can do with the Oncology hospital in the city where we have about 250 beds, we still have the flexibility of how to deal with that and we are also looking at other options of how to expand in, that sort of matter through a multispecialty hospital. But what we thought at this stage was this location itself is very well to have an Oncology Center and since the Proton Therapy has to be housed as close as possible or at an Oncology Center we decided to make this into Oncology Center. As you know it's also fairly close to the Adyar Cancer Hospital and therefore we expect some spillover operations to come in from there.

Krishna Prasad: Over a period you would decide whether you would want to move the existing cancer facility to this new one, whenever it comes up essentially?

K. Padmanabhan: Yes.

Krishna Prasad: The other point is as you just look at all these new facilities which come up and our decision to move some of this cancer specialty to Chennai, I mean is it also the outcome of some of the competitive dynamics which are playing out in Chennai, I mean do we see space for another multidisciplinary super specialty in Chennai or is it that Chennai is now a game of case mix and one will have to necessarily keep sort of moving ahead of the other hospitals there?

K Padmanabhan: I think in Chennai we considerably own consumer share of mind about Healthcare and the idea is that we have not expanded as fast in Chennai as we have in the rest of the country and therefore I think what we have now done is to make sure we have a strategic plan for Chennai which is what we are now carrying out in terms of creating some multispecialty outfits in different parts of Chennai. Also creating some focus facilities like the Oncology that we talked about and the Women and Child and Pediatric Hospital. So a lot more single specialty or dual specialty hospitals combined with some business in the multispecialty is what we have planned in Chennai. We planned in Chennai so that we will completely own the space.

Krishna Prasad: Just the other question is on the ARPOB increase that we should expect for Chennai and Hyderabad. I think this year we have been doing about 12% growth in Chennai. Is this something that you think is sustainable, I mean, can there be improvements on this, how does one look at it let us say going forward?

Krishnan A.: I think even Chennai has seen in the past around 9-10% and 9-12% also. This year has been 12% because of the specific focus that we have in some of the high end work. Next year could probably be around the 10% number, but after the Outpatient center comes up we would again be able to accelerate it back to 12%+. But again you will have to note that some of the new beds that we are going to be creating here they may not necessarily be at the same ARPOB; the ARPOB might be lower, but then the profitability margin might still be higher. So you would realize that there will be some changes in the ARPOB and we will come back to you as the year progresses over the next few quarters.

Krishna Prasad: Sir if I understand this correctly what you are essentially saying is that you could actually see a slightly lower revenue growth; however, there would be a fair bit of margin expansion for the next year, is that correct, and that should broadly sort of reflect in the consolidated numbers as well, right?

Krishnan A.: Yes, on Chennai.

Krishna Prasad: But you don't think that will be the trend for the consolidated, considering Chennai is a large part of your operations?

Krishnan A.: For Hyderabad we have other plans, so we have plans for every cluster separately, Hyderabad we are hoping will be contributing better, Bengaluru, as you have realized you are going to be seeing one more hospital coming up this year. You will see one more by the end of next fiscal. So that would turn out to be another cluster over the next 12 months. So you would see some of the other hospitals also begin to contribute to the overall profitability and margins of AHEL.

Moderator: Thank you. We will take our last question from Mr. Dhiresh Pathak of Goldman Sachs. Please go ahead.

Dhiresh Pathak: I just want to know on a particular slide you had mentioned the RoCE for the Healthcare Services business which is about 18%. So is it possible to share in further detail based on the maturity profile of the hospital, what range would the RoCE be. Like my understanding is almost 75-80% of our hospital beds which are operational of about 5,000 plus beds, 75 to 80% are mature, in the sense greater than five years into operation. So for that bucket of beds what would be the RoCE?

Krishnan A.: Today, if you look at the RoCE, it ranges typically between 8% to 35% also. If you look at very mature cluster like Chennai we almost have North of 30% on RoCE and you will realize that in this business, as the hospital keeps maturing, and as the case mix keeps becoming richer and Outpatients are higher, you would realize that the RoCE keeps increasing. For example, Bhubaneswar today is at less than 10%, it is around 8%. But the target RoCE that we have is around 20-22%. We still have scope to increase the 18% to around 22% range. So medium term would be lesser than this. That is where it would be today. But typically Chennai is helping us today but over a period of time around 18-22% is something that we would be able to sustain.

Dhiresh Pathak: I want to understand is that like Chennai could be one exception on the higher end and there would be exceptions on the lower end. On an average, the number would be somewhere in the middle. When an average hospital attains maturity which is let us say after 5-6 years into operation?

Krishnan A.: Five or six years it would be around 20-22%.

Dhiresh Pathak: And is that the aspirational RoCE for an average hospital that you have in mind?

Krishnan A.: It is a target RoCE, in fact, it is not even aspirational.

K Padmanabhan: That's what we have been saying - that is where we want to move to , in spite of our growth, the blended RoCE is what we are aiming to take our business to.

Suneeta Reddy: And we have seen it happen in the hospitals. So it is not something that is not achievable.

Dhiresh Pathak: Given the maturity of the beds that we have, almost 80% more than 5 years I would have assumed this number to be much higher and given that Chennai is such a better cluster in terms of RoCE, the number could be higher?

Suneeta Reddy: Bu then you have to keep in mind that we have acquired land, we have taken capital to actually increase our bed capacity by 30%.

Dhiresh Pathak: But ma'am we are excluding the capital work-in-progress from this number right?

K Padmanabhan: I really don't know where you got this 80% number.

Krishnan A.: I think you should get off-line and get those numbers from Krishnakumar, it will be lesser than 80% for sure.

Moderator: Thank you. As there are no further questions from the participants I would now like to hand the floor back to the management team for closing comments.

Suneeta Reddy: Ladies and gentlemen, thank you for joining us on this call. Krishnakumar who is handling Investor Relations is always ready to take any questions off-line. So please feel free to call him and we look forward to our next call with you in the forthcoming quarter.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Apollo Hospitals that concludes this conference call.