

APOLLO HOSPITALS ENTERPRISE

PHARMACEUTICALS

22 FEB 2018

Quarterly Update

BUY

Target Price: Rs 1,336

Entering its best phase

Apollo Hospitals' Q3FY18 revenue (adjusted for GST) increased 16% YoY to Rs 19 bn, while EBITDA increased 14% YoY to Rs 2.2 bn. Results could have been better had it not been for (1) Regulatory caps on stent & knee implant prices, (2) Rs 105 mn loss from Navi Mumbai facility; (3) Rs 70 mn guarantee money paid to doctors; & (4) Adverse GST rate revisions on input service.

We expect EBITDA swing of Rs 1.6 bn over FY17-20E, as Navi Mumbai hospital (EBITDA loss of Rs 0.5 bn) & clinics (EBITDA loss of Rs 1.1 bn) breakeven. Apollo's growth to be led by (1) 2,400 new beds achieving maturity, (2) Matured hospital's EBITDA margin to recover to 23% (21.4% currently) as (a) Apollo increases procedure prices & (b) guarantee fee reduces as doctors migrate from fixed fee to 'fee for service', & (3) margin expansion in pharmacies as stores mature and proportion of in-house brands rises

CMP : Rs 1,138
Potential Upside : 17%

MARKET DATA

No. of Shares : 139 mn
Free Float : 66%
Market Cap : Rs 158 bn
52-week High / Low : Rs 1,357 / Rs 959
Avg. Daily vol. (6mth) : 503,466 shares
Bloomberg Code : APHS IB Equity
Promoters Holding : 34%
FII / DII : 48% / 9%

Segmental highlights

- ♦ **Healthcare services** (56% of FY17 revenue): Q3 revenue increased 13% YoY backed by growth in volumes. EBIT increased 19% YoY to Rs 1.2 bn resulting in EBIT margin of 12% (up 60 bps YoY). New hospitals (excluding Navi Mumbai facility) clocked EBITDA of Rs 209 mn. EBITDA of matured hospitals improved to 21.3% (20% in Q3FY17) while clocking RoCE of ~19%.

For 9MFY18, matured hospitals clocked 7% revenue growth while new hospital revenues grew by 36%. Excluding Navi Mumbai loss of Rs 330 mn, the new hospitals reported EBITDA of Rs 430 mn (Rs 236 mn in 9MFY17). In 9MFY18, APHS has seen 7% growth in in-patient volume, 2% improvement in ARPOB (Rs 31,984) and shorter ALOS (3.95 days). Occupancy was flat YoY at 65% for 9MFY18; expected to improve with maturity of new hospitals. ~2,400 beds commissioned in the past 3 years will start yielding fruit over time.

(Continued on page 2...)

Financial summary (Consolidated)

Y/E March	FY17	FY18E	FY19E	FY20E
Sales (Rs mn)	72,549	81,981	94,175	107,801
Adj PAT (Rs mn)	2,210	2,213	3,445	4,941
Con. EPS* (Rs)	-	15.3	27.5	39.4
EPS (Rs)	15.9	15.9	24.8	35.5
Change YOY (%)	0.2	0.2	55.6	43.4
P/E (x)	71.7	71.5	46.0	32.0
RoE (%)	6.3	5.9	8.8	11.7
RoCE (%)	4.9	4.4	6.1	7.6
EV/E (x)	24.3	22.5	17.3	13.9
DPS (Rs)	6.0	6.0	6.0	6.0

Source: *Consensus broker estimates, Company, Axis Capital, CMP as on 16 Feb 2018

Key drivers

EBITDA (Rs mn)	FY18E	FY19E	FY20E
Matured hospitals	7,439	8,384	9,140
New hospitals	(358)	215	644
Pharmacy	1,656	2,070	2,583
AHLL	(842)	(549)	10

Price performance

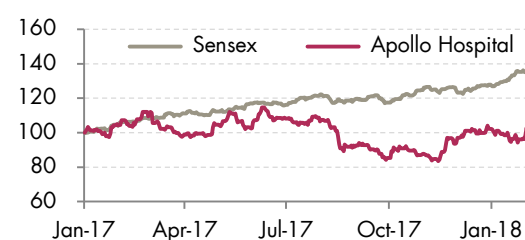


Exhibit 1: Results update

(Rs mn)	Quarter ended					12 months ended		
	Dec-17	Dec-16	% Chg	Sep-17	% Chg	FY18E	FY17	% Chg
Net sales	18,961	16,806	13	18,516	2	81,981	72,549	13
EBIDTA	2,213	1,941	14	2,212	0	7,895	7,286	8
Other income	79	31	-	26	199	250	225	11
PBITD	2,291	1,972	16	2,239	2	8,145	7,511	8
Depreciation	678	618	10	665	2	3,867	3,140	23
Interest	635	513	24	588	8	2,751	2,574	7
PBT	978	841	16	986	(1)	1,527	1,797	(15)
Tax	304	112	170	277	10	504	910	(45)
Reported PAT	674	728	(7)	709	(5)	2,213	2,210	-
No. of shares (mn)	139	139	-	139	-	139	139	-
EBIDTA margin (%)	11.7	11.5	-	11.9	-	9.6	10.0	-
PBITD margin (%)	12.1	11.7	-	12.1	-	9.9	10.4	-
EPS - annualized (Rs.)	19.4	20.9	(7)	20.4	(5)	15.9	15.9	-

Source: Company, Axis Capital

(...continued from page 1)

Update on Navi Mumbai facility: Operational beds being ramped up to 250 (currently 140 beds operational). While Q3FY18 EBITDA loss stood at ~Rs 100 mn, management indicated that the hospital will breakeven by Q1FY19 as it ramps up occupancy (currently 110 beds occupies)

- ♦ **Pharmacy division** (40% of FY17 revenue): Apollo, which has the largest pan-India network with 2,849 pharmacies, plans to add ~2,000 stores over the next 4-5 years. Apollo is evaluating structures which will add value. Matured pharmacies (opened prior to FY10) are posting ~7% EBITDA margin, while those opened prior to FY12 have EBITDA margin of 5.6%. Matured pharmacies are clocking RoCE of over 24%. Adjusted for GST, in Q3FY18, the division reported 19% YoY increase in revenue to Rs 8.9 bn, while EBITDA margin was flat YoY at 4.5%. RoCE stood at 18%. For 9MFY18, revenue and EBITDA increased ~16% Rs 24.8 bn and Rs 1.1 bn (4.3% EBITDA margin). There was a steady progress in trends in same-store sales across batches of stores. Going ahead, we expect pharmacy division's profitability to be boosted by store rationalization, turnaround in Hetero & higher in-house brands in the sales mix.
- ♦ **Apollo Health and Lifestyle (AHLL):** While 9MFY18 EBITDA losses of Rs 2.3 bn is depressing, Apollo Hospital's overall profitability and RoCE, management expects EBITDA breakeven by FY20.
 - AHLL is trying to create a portfolio of healthcare services comprising clinics across primary care, dentistry, diabetic clinics, dialysis centres, and diagnostics. Moreover, it has specialty formats viz: Cradles (birthing centres) and Spectra (day surgery / short stay surgery). IFC Washington has recently invested in AHLL, valuing it at ~Rs 15 bn.
 - The primary clinics (consisting of Sugar and dental clinics) have reported significant operational improvement and have achieved EBITDA breakeven in Q3. 'Spectra' (Speciality healthcare) continues to show strong performance and expects to reduce EBITDA losses by end of the year. Apollo is investing significantly in diagnostics and expanding its network
 - With tremendous growth potential and steady state EBITDA margin expected at 18-20%, we believe AHLL is a great asset for Apollo Hospitals.

Exhibit 2: Segmental analysis

(Rs mn)	FY16	FY17	FY18E	FY19E	FY20E	FY21E
Old Hospitals						
Revenue	32,832	33,915	36,289	38,829	41,547	44,456
EBITDA	7,417	7,182	7,439	8,348	9,140	10,003
EBITDA margin (%)	23%	21%	21%	22%	22%	23%
New Hospitals						
Revenue	4,201	7,448	8,938	10,725	12,870	15,444
EBITDA	(181)	(60)	(358)	215	644	1,390
EBITDA margin (%)	-4%	-1%	-4%	2%	5%	9%
Pharmacy						
Revenue	23,220	28,745	34,494	41,393	49,671	59,606
EBITDA	803	1,233	1,656	2,070	2,583	3,219
EBITDA margin (%)	3%	4%	5%	5%	5%	5%
AHLL / Others						
Revenue	1,894	2,441	2,807	3,228	3,712	4,269
EBITDA	(1,162)	(1,069)	(842)	(549)	-	171
EBITDA margin (%)	-61%	-44%	-30%	-17%	0%	4%
Consolidated Revenue	62,147	72,549	82,528	94,175	107,801	123,775
Consolidated EBITDA	6,877	7,286	7,895	10,084	12,067	14,782
EBITDA margin (%)	11%	10%	10%	11%	11%	12%

Source: Company, Axis Capital

Recovery ahead

Over the past 3 years, APHS has added ~2,400 beds and is further adding a mere 265 beds in FY19. Management is now focusing on operationalizing the new capacities and consolidating its leadership position. With the investment phase of APHS nearing completion, we expect 15% revenue CAGR coupled with gradual improvement in EBITDA margin as beds and pharmacies mature.

PAT of Apollo Hospitals over the past 5 years has remained flat on account of higher investments in setting up new hospitals and clinics. However, over FY17-20, Apollo is adding mere 265 beds and we expect beds which were commissioned over the past 3 years to show margin expansion.

Expansion plans: Total capex estimated for FY17-20 is Rs 7.8 bn. Of this, Rs 3.9 bn has already been spent.

Exhibit 3: Hospital expansion plan

	No. of beds	Total Est. cost (Rs mn)	Capex/ bed (Rs mn)
Addition in FY19			
South Chennai (Incl Proton)	200	7,500	37.5
Indore (Expansion)	65	280	4.31
Addition in FY21-22			
Byculla, Mumbai	500	3,500	7.00
Total	765	11,280	

Source: Company, Axis Capital

Of the 9,948 beds owned hospital beds capacity, ~7,100 beds were operational and had occupancy of 65% as of 9MFY18.

Financial summary (Consolidated)

Profit & loss (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Net sales	72,549	81,981	94,175	107,801
Other operating income	-	-	-	-
Total operating income	72,549	81,981	94,175	107,801
Cost of goods sold	(38,454)	(42,630)	(48,736)	(55,518)
Gross profit	34,095	39,351	45,440	52,284
<i>Gross margin (%)</i>	<i>47.0</i>	<i>48.0</i>	<i>48.3</i>	<i>48.5</i>
Total operating expenses	(26,809)	(31,455)	(35,356)	(40,217)
EBITDA	7,286	7,895	10,084	12,067
<i>EBITDA margin (%)</i>	<i>10.0</i>	<i>9.6</i>	<i>10.7</i>	<i>11.2</i>
Depreciation	(3,140)	(3,867)	(4,147)	(4,347)
EBIT	4,146	4,028	5,937	7,720
Net interest	(2,574)	(2,751)	(2,289)	(1,839)
Other income	225	250	250	250
Profit before tax	1,797	1,527	3,898	6,131
Total taxation	(910)	(504)	(1,286)	(2,023)
<i>Tax rate (%)</i>	<i>50.6</i>	<i>33.0</i>	<i>33.0</i>	<i>33.0</i>
Profit after tax	887	1,023	2,612	4,108
Minorities	1,323	1,190	833	833
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	2,210	2,213	3,445	4,941
<i>Adj. PAT margin (%)</i>	<i>3.0</i>	<i>2.7</i>	<i>3.7</i>	<i>4.6</i>
Net non-recurring items	-	-	-	-
Reported net profit	2,210	2,213	3,445	4,941

Balance sheet (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Paid-up capital	696	696	696	696
Reserves & surplus	36,018	37,255	39,723	43,687
Net worth	36,714	37,950	40,418	44,383
Borrowing	27,098	27,098	22,098	17,098
Other non-current liabilities	2,269	2,269	2,269	2,269
Total liabilities	68,244	70,671	68,972	68,770
Gross fixed assets	58,950	64,450	67,450	69,950
Less: Depreciation	(16,192)	(20,059)	(24,206)	(28,553)
Net fixed assets	42,758	44,391	43,244	41,397
Add: Capital WIP	3,467	3,467	3,467	3,467
Total fixed assets	46,226	47,859	46,712	44,865
Total Investment	4,357	4,357	4,357	4,357
Inventory	4,669	5,275	6,060	6,403
Debtors	7,482	8,630	11,772	13,475
Cash & bank	5,264	5,060	3,376	4,430
Loans & advances	3,321	3,689	3,767	4,312
Current liabilities	13,132	14,255	17,128	19,128
Net current assets	7,605	8,399	7,847	9,492
Other non-current assets	10,057	10,057	10,057	10,057
Total assets	68,244	70,671	68,972	68,770

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Profit before tax	1,797	1,527	3,898	6,131
Depreciation & Amortisation	3,140	3,867	4,147	4,347
<i>Chg in working capital</i>	<i>1,634</i>	<i>(1,249)</i>	<i>(1,382)</i>	<i>(841)</i>
Cash flow from operations	8,236	6,393	7,665	9,453
<i>Capital expenditure</i>	<i>(7,302)</i>	<i>(5,500)</i>	<i>(3,000)</i>	<i>(2,500)</i>
Cash flow from investing	(8,695)	(5,250)	(2,750)	(2,250)
<i>Equity raised/ (repaid)</i>	<i>(61)</i>	-	-	-
<i>Debt raised/ (repaid)</i>	<i>771</i>	-	<i>(5,000)</i>	<i>(5,000)</i>
<i>Dividend paid</i>	<i>(835)</i>	<i>(835)</i>	<i>(835)</i>	<i>(835)</i>
Cash flow from financing	(2,841)	(3,728)	(8,265)	(7,815)
Net chg in cash	(3,300)	(2,585)	(3,350)	(613)

Key ratios

Y/E March	FY17	FY18E	FY19E	FY20E
OPERATIONAL				
FDEPS (Rs)	15.9	15.9	24.8	35.5
CEPS (Rs)	38.5	43.7	54.6	66.8
DPS (Rs)	6.0	6.0	6.0	6.0
Dividend payout ratio (%)	37.8	37.7	24.2	16.9
GROWTH				
Net sales (%)	16.7	13.0	14.9	14.5
EBITDA (%)	5.9	8.4	27.7	19.7
Adj net profit (%)	0.2	0.2	55.6	43.4
FDEPS (%)	0.2	0.2	55.6	43.4
PERFORMANCE				
RoE (%)	6.3	5.9	8.8	11.7
RoCE (%)	4.9	4.4	6.1	7.6
EFFICIENCY				
Asset turnover (x)	1.3	1.4	1.6	1.8
Sales/ total assets (x)	0.9	1.0	1.1	1.2
Working capital/ sales (x)	-	-	-	-
Receivable days	37.6	38.4	45.6	45.6
Inventory days	26.1	26.0	26.3	24.4
Payable days	67.2	64.3	68.7	67.8
FINANCIAL STABILITY				
Total debt/ equity (x)	0.7	0.7	0.5	0.4
Net debt/ equity (x)	0.5	0.5	0.4	0.2
Current ratio (x)	1.6	1.6	1.5	1.5
Interest cover (x)	1.6	1.5	2.6	4.2
VALUATION				
PE (x)	71.7	71.5	46.0	32.0
EV/ EBITDA (x)	24.3	22.5	17.3	13.9
EV/ Net sales (x)	2.4	2.2	1.8	1.6
PB (x)	4.3	4.2	3.9	3.6
Dividend yield (%)	0.5	0.5	0.5	0.5
Free cash flow yield (%)	0.6	0.6	2.9	4.4

Source: Company, Axis Capital

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HOLD	Between 10% and -10%
SELL	Less than -10%

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