AXIS DIRECT

23 FEB 2017 | Quarterly Update

APOLLO HOSPITALS ENTERPRISE

PHARMACEUTICALS

BUY

Target Price: Rs 1,505

Entering a rewarding phase

Apollo Hospitals' Q3FY17 profitability was impacted due to (1) initial set up cost associated with commissioning of its mega facility in Navi Mumbai, (2) demonetization impact (~50% of revenue is in cash), and (3) 25-30 beds non-operational due to security reasons at Chennai Main (flagship hospital), as Tamil Nadu's Chief Minister was being treated.

Apollo remains one of our top picks given 20% EBITDA CAGR over FY17-21E and FCF cycle from FY18 as capex phase nearing completion. With ~2,500 beds added over the past 3 years, management expects improved growth visibility where Apollo would be in a position to see 20% revenue CAGR over the next 5 years. As these beds mature, coupled with lower losses from AHLL (clinics), margin should improve. Maintain **BUY** with DCF-based **TP of Rs 1,505.**

CMP	: Rs 1,234
Potential Upside	: 22%

MARKET DATA

No. of Shares	: 139 mn
Free Float	: 66%
Market Cap	: Rs 172 bn
52-week High / Low	: Rs 1,544 / Rs 1,111
Avg. Daily vol. (6mth)	: 191,792 shares
Bloomberg Code	: APHS IB Equity
Promoters Holding	: 34%
FII / DII	: 43% / 3%

Investments in final phase; fruit bearing time ahead: Most expansion plans to be complete by FY19 and management focus now on consolidating existing operations and improving occupancy levels across hospitals. We expect strong FCF generation in FY18 and gradual improvement in EBITDA margin as Apollo focuses on (1) stabilizing new beds which were added in the past couple of years, (2) margin expansion in pharmacies as stores mature and higher proportion of in-house brands, and (3) lower losses in the clinics as investments mature.

Q3 and 9M highlights: Consolidated revenue growth of 18% YoY was led by 29% growth in pharmacy segment (~40% of revenue), and 10% growth in Healthcare (56% of revenue). In 9MFY17, new hospitals reported EBITDA of Rs 168 mn (loss of Rs 96 mn in 9MFY16). However, AHLL reported EBITDA loss of Rs 777 mn (loss of Rs 746 mn in 9MFY16).

Financial summary (Consolidated)

Y/E March	FY15	FY16	FY17E	FY18E
Sales (Rs mn)	51,785	60,856	71,417	81,981
Adj PAT (Rs mn)	3,264	3,019	2,943	3,702
Con. EPS* (Rs)	-	-	22.5	31.7
EPS (Rs)	23.5	21.7	21.2	26.6
Change YOY (%)	3.0	(7.5)	(2.5)	25.8
P/E (x)	52.6	56.9	58.3	46.4
RoE (%)	10.6	9.1	8.3	9.8
RoCE (%)	8.4	7.0	6.2	7.2
EV/E (x)	25.5	25.0	24.7	20.8
DPS (Rs)	5.8	6.0	6.0	6.0

Source: *Consensus broker estimates, Company, Axis Capital

Note: We have considered proportionate consolidation while arriving at our estimates and TP

Key drivers (Rs bn)

EBITDA (Rs mn)	FY16	FY17E	FY18E
Matured hospitals	7,590	7,961	8,610
New hospitals	(200)	(146)	(88)
Pharmacy	830	1,115	1,438
AHLL	(420)	(949)	(485)

Price performance

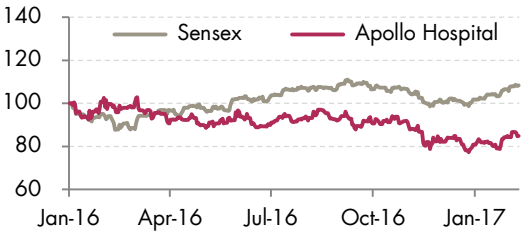


Exhibit 1: Results update

	Quarter ended					12 months ended		
(Rs mn)	Dec-16	Dec-15	% Chg	Sep-16	% Chg	FY17E	FY16	% Chg
Net sales	**16,806**	**14,250**	**18**	**16,341**	**3**	**71,417**	**60,856**	**17**
EBIDTA	1,941	1,857	5	2,219	(13)	7,981	7,823	2
Other income	31	662	(95)	94	(67)	250	267	(6)
PBIDT	**1,972**	**2,519**	**(22)**	**2,314**	**(15)**	**8,231**	**8,090**	**2**
Depreciation	618	538	15	603	2	2,761	2,533	9
Interest	513	320	60	469	9	1,934	1,685	15
PBT	**841**	**1,661**	**(49)**	**1,242**	**(32)**	**3,535**	**3,872**	**(9)**
Tax	112	181	(38)	322	(65)	742	1,002	(26)
Adjusted PAT	**728**	**1,480**	**(51)**	**920**	**(21)**	**2,943**	**3,019**	**(3)**
Extra ordinary income/ (exp.)	0	(181)	-	0	-	0	292	-
Reported PAT	**728**	**1,299**	**(44)**	**920**	**(21)**	**2,943**	**3,310**	**(11)**
No. of shares (mn)	**139**	**139**	**-**	**139**	**-**	139	139	**-**
EBIDTA margin (%)	11.5	13.0	-	13.6	-	11.2	12.9	-
PBIDT margin (%)	11.7	17.7	-	14.2	-	11.5	13.3	-
EPS - annualized (Rs)	**20.9**	**42.6**	**(51)**	**26.4**	**(21)**	**21.2**	**21.7**	**(3)**

Source: Company, Axis Capital

Segmental highlights

- **Healthcare services** (56% of FY16 revenue): Revenue increased10% YoY to Rs 9 bn, while EBIT margin declined 260 bps to 11.4% due to higher fixed cost. ~2,400 beds commissioned in the past 3 years will start yielding fruit over time. Excluding these, matured healthcare facilities are clocking EBIT margin of ~17%. In 9MFY17, APHS has seen 8% growth in inpatient volume, 5% ARPOB growth with shorter ALOS (4 days). While bed occupancy declined to 64% (vs. 66% in 9MFY16), Apollo is seeing demand picking up. Apollo is on track to add 500 beds in FY19
- **Pharmacy division** (40% of FY16 revenue): Matured pharmacies (opened prior to FY10) are posting 7% EBITDA margin, while those opened prior to FY12have EBITDA margin of5.4%. In Q3, the division reported 29% YoY increase in revenue to Rs 7.9 bn, while EBITDA margin improved96 bps to ~5%. RoCE in Q3FY17 at 18% vs. 12% in Q3FY16. 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 and higher in-house brands in the sales mix. Apollo, which has the largest pan-India network with 2,506 pharmacies, plans to add 200 pharmacies annually over next couple of years

Capex plans: Total capex estimated for FY16-19 is ~Rs 9 bn. Of this, Rs 3 bn has already been spent.

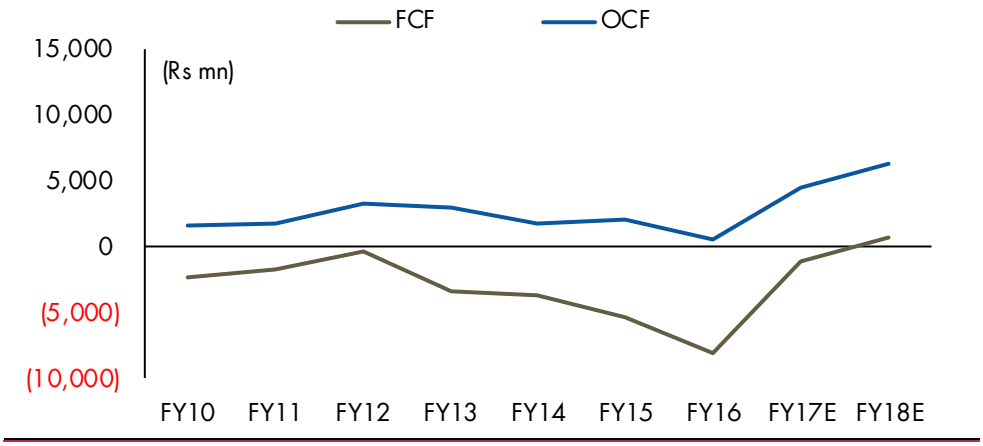
Exhibit 2: Hospital expansion plan

	No. of beds	Total Est. cost (Rs mn)	Capex/ bed (Rs mn)
Addition in FY17			
Indore (Expansion)	65	280	4.3
	65	**280**	**4.3**
Addition in FY19			
South Chennai (Incl Proton)	200	7,500	37.5
Byculla, Mumbai	300	1,400	4.67
	500	**8,900**	
Total	**565**	**9,180**	**16.2**

Source: Company

Over the past 3 years, APHS has added ~2,400 beds and is further adding 500 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 18% revenue CAGR coupled with gradual improvement in EBIDTA margin as beds and pharmacies mature.

Exhibit 3: Free cash generation



Source: Company, Axis Capital

Exhibit 4: Segmental analysis

(Rs mn)	FY15	FY16	FY17E	FY18E	FY19E	FY20E	FY21E
Old Hospitals							
Revenue	26,000	32,000	34,240	36,637	39,201	41,945	44,882
EBITDA	6,280	7,590	7,961	8,610	9,408	10,277	11,220
EBITDA margin (%)	24%	24%	23%	24%	24%	25%	25%
New Hospitals							
Revenue	1,770	3,510	7,300	8,760	10,512	12,614	15,137
EBITDA	(80)	(200)	(146)	(88)	841	1,766	2,573
EBITDA margin (%)	-5%	-6%	-2%	-1%	8%	14%	17%
Pharmacy							
Revenue	17,726	23,230	27,876	33,451	40,141	48,170	57,804
EBITDA	640	830	1,115	1,438	1,806	2,312	2,948
EBITDA margin (%)	4%	4%	4%	4%	5%	5%	5%
AHLL / Others							
Revenue		1,240	2,108	2,424	2,788	3,206	3,687
EBITDA		(420)	(949)	(485)	14	160	221
EBITDA margin (%)		-34%	-45%	-20%	1%	5%	6%
Consolidated Revenue	**45,496**	**59,980**	**71,524**	**81,272**	**92,643**	**105,936**	**121,510**
Consolidated EBITDA	**6,840**	**7,800**	**7,981**	**9,476**	**12,070**	**14,515**	**16,963**
EBITDA margin (%)	*15%*	*13%*	*11%*	*12%*	*13%*	*14%*	*14%*

Source: Company, Axis Capital

Over the past 3 years, PAT of Apollo hospitals has remained flat on account of higher investments in setting up new hospitals and clinics. However, over FY16-19, Apollo is adding a mere 1,000 beds and we expect the beds which were commissioned over the past 3 years to breakeven by FY18-19, leading to margin expansion.

Exhibit 5: Peer comparison

Company name	Apollo Hospitals Enterprise	Fortis Healthcare Ltd	Raffles Medical Group	Bumrungrad Hospital PCL	Bangkok Dusit Medical	IHH Healthcare Bhd	NarayanaHrudayalaya Ltd
Price (USD)	18	2	1	5	1	1	5
Mcap (USDm)	2,442	1,105	1,775	3,819	9,629	12,038	994
EV (USDm)	2,798	1,768	1,730	3,741	10,503	13,709	1,030
Sales (USDm)							
CY14/FY15	847	649	296	481	1,717	2,244	223
CY15/FY16	930	643	299	516	1,836	2,174	246
CY16/FY17e	1,052	719	340	515	1,865	2,276	291
CY17/FY18e	1,235	795	381	552	2,068	2,661	343
EBITDA (USDm)							
CY14/FY15	137	27	71	138	383	590	22
CY15/FY16	132	41	68	155	443	547	27
CY16/FY17e	129	65	71	158	411	569	38
CY17/FY18e	159	90	81	173	459	656	47
PE (x)							
CY14/FY15	44	(47)	32	45	42	52	na
CY15/FY16	48	(289)	34	38	42	50	335
CY16/FY17e	47	72	35	39	39	54	85
CY17/FY18e	34	33	31	36	35	43	59
EV/Ebitda (x)							
CY14/FY15	20	47	23	27	27	21	48
CY15/FY16	21	29	26	24	23	24	38
CY16/FY17e	22	21	25	24	25	23	na
CY17/FY18e	18	15	22	22	23	20	na
ROE (%)							
CY14/FY15	11	(3)	13	27	17	4	(2)
CY15/FY16	10	2	12	26	15	4	8
CY16/FY17e	12	5	12	25	16	5	11
CY17/FY18e	15	6	13	24	17	6	14

Source: Bloomberg

Financial summary (Consolidated)

Profit &loss (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Net sales	51,785	60,856	71,417	81,981
Other operating income	-	-	-	-
Total operating income	**51,785**	**60,856**	**71,417**	**81,981**
Cost of goods sold	(27,904)	(33,060)	(37,315)	(42,630)
Gross profit	23,881	27,796	34,101	39,351
Gross margin (%)	*46.1*	*45.7*	*47.8*	*48.0*
Total operating expenses	(16,534)	(19,973)	(26,120)	(29,875)
EBITDA	**7,347**	**7,823**	**7,981**	**9,476**
EBITDA margin (%)	*14.2*	*12.9*	*11.2*	*11.6*
Depreciation	(2,117)	(2,533)	(2,761)	(3,036)
EBIT	**5,230**	**5,290**	**5,220**	**6,439**
Net interest	(1,179)	(1,685)	(1,934)	(2,203)
Other income	368	267	250	250
Profit before tax	**4,419**	**3,872**	**3,535**	**4,486**
Total taxation	(1,300)	(1,002)	(742)	(942)
Tax rate (%)	*29.4*	*25.9*	*21.0*	*21.0*
Profit after tax	3,119	2,870	2,793	3,544
Minorities	145	149	150	158
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	3,264	3,019	2,943	3,702
Adj. PAT margin (%)	*6.3*	*5.0*	*4.1*	*4.5*
Net non-recurring items	135	292	-	-
Reported net profit	3,399	3,310	2,943	3,702

Balance sheet (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Paid-up capital	696	696	696	696
Reserves & surplus	31,017	33,841	35,746	38,471
Net worth	31,713	34,537	36,442	39,167
Borrowing	19,923	26,867	26,867	26,867
Other non-current liabilities	4,020	4,843	4,843	4,843
Total liabilities	**56,386**	**67,549**	**69,605**	**72,487**
Gross fixed assets	41,202	49,227	55,227	60,727
Less: Depreciation	(10,413)	(13,101)	(15,862)	(18,898)
Net fixed assets	30,789	36,126	39,365	41,829
Add: Capital WIP	5,326	5,956	5,500	5,500
Total fixed assets	36,115	42,082	44,865	47,329
Total Investment	3,106	2,697	2,697	2,697
Inventory	3,503	4,433	4,949	5,681
Debtors	6,093	7,020	8,927	10,248
Cash & bank	3,773	3,976	2,065	2,033
Loans & advances	10,349	14,409	14,283	13,937
Current liabilities	8,206	9,188	10,302	11,558
Net current assets	15,512	20,650	19,922	20,341
Other non-current assets	1,652	2,120	2,120	2,120
Total assets	**56,386**	**67,549**	**69,605**	**72,487**

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY15	FY16	FY17E	FY18E
Profit before tax	4,419	3,872	3,535	4,486
Depreciation & Amortisation	2,117	2,533	2,761	3,036
Chg in working capital	*(1,608)*	*(2,340)*	*(1,433)*	*(700)*
Cash flow from operations	**4,699**	**4,232**	**6,055**	**8,084**
Capital expenditure	*(8,681)*	*(8,311)*	*(5,544)*	*(5,500)*
Cash flow from investing	**(7,591)**	**(6,840)**	**(5,294)**	**(5,250)**
Equity raised/ (repaid)	*417*	*206*	*(61)*	-
Debt raised/ (repaid)	*5,481*	*5,820*	-	-
Dividend paid	*(800)*	*(1,616)*	*(835)*	*(835)*
Cash flow from financing	**3,923**	**2,725**	**(2,972)**	**(3,180)**
Net chg in cash	1,032	116	(2,211)	(346)

Key ratios

Y/E March	FY15	FY16	FY17E	FY18E
OPERATIONAL				
FDEPS (Rs)	23.5	21.7	21.2	26.6
CEPS (Rs)	39.6	42.0	41.0	48.4
DPS (Rs)	5.8	6.0	6.0	6.0
Dividend payout ratio (%)	23.5	25.2	28.4	22.6
GROWTH				
Net sales (%)	18.1	17.5	17.4	14.8
EBITDA (%)	9.3	6.5	2.0	18.7
Adj net profit (%)	3.0	(7.5)	(2.5)	25.8
FDEPS (%)	3.0	(7.5)	(2.5)	25.8
PERFORMANCE				
RoE (%)	10.6	9.1	8.3	9.8
RoCE (%)	8.4	7.0	6.2	7.2
EFFICIENCY				
Asset turnover (x)	1.2	1.2	1.2	1.3
Sales/ total assets (x)	0.9	0.9	0.9	1.0
Working capital/ sales (x)	0.2	0.2	0.2	0.2
Receivable days	42.9	42.1	45.6	45.6
Inventory days	28.8	30.5	28.5	28.6
Payable days	56.3	58.8	55.1	54.4
FINANCIAL STABILITY				
Total debt/ equity (x)	0.6	0.8	0.7	0.7
Net debt/ equity (x)	0.5	0.6	0.6	0.6
Current ratio (x)	2.9	3.2	2.9	2.8
Interest cover (x)	4.4	3.1	2.7	2.9
VALUATION				
PE (x)	52.6	56.9	58.3	46.4
EV/ EBITDA (x)	25.5	25.0	24.7	20.8
EV/ Net sales (x)	3.6	3.2	2.8	2.4
PB (x)	5.4	5.0	4.7	4.4
Dividend yield (%)	0.5	0.5	0.5	0.5
Free cash flow yield (%)	-	-	-	-

Source: Company, Axis Capital

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