

Company

30 May 2010 | 7 pages

Apollo Hospitals (APLH.BO)

Equity

Alert: Steady FY10

- **FY10: Steady Top Line, Margins Lower Than Expected** – Recurring PAT grew 29% YoY on the back of 26% revenue growth and 78bps margin expansion. While revenue growth was inline, the margin expansion was a tad below expectations - on commissioning of around 500 new beds. This along with lower (than expected) profit from associates led to the miss at the PAT level.
- **Hospitals: On Course** – Hospitals across clusters recorded 20%+ YoY revenue growth on the back of improved occupancy levels and improved case mix. EBITDA margins, too, remained steady except for the ex-Chennai & Hyderabad cluster which saw a slight decline in margins due to new hospitals which were commissioned during the year. Significant subsidiaries (Ahmedabad, Bangalore, Kolkata) saw margin expansion of 239 bps in FY10.
- **Pharmacies Achieve EBITDA Break Even** – Apollo's standalone pharmacies achieved break even at the EBITDA level (EBITDA margin of 0.1%) in 4QFY10. Pharmacies set up in 2007 or before, recorded impressive margins of 5.15% on the back of several initiatives to improve pharmacy profitability (sale of branded generics and consumer goods). Overall Apollo had 1,049 standalone pharmacies by end FY10 after adding 166 new stores during the course of the year.

We await more details from the company's earnings call on Monday (11:00 am, Dial in: +91 22 6629 0301/ +91 22 3065 0122)

- [Please see takeaways from Apollo's presentation at our conference here](#)

Apollo Hospitals (APLH.BO; Rs763.85; 1M)

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Apollo Hospitals

Company description

Apollo Hospitals is an integrated healthcare company in India's private sector, with the largest hospital network in Asia. The group and its subsidiaries own 26 hospitals, and it operates 20 hospitals. These hospitals are owned either by joint ventures and associated companies or operated under contracts as franchise hospitals or under consultancy contracts across the Afro-Asian region, with more than 8,000 operational beds. It has a network of more than 2,000 doctors (including more than 1,300 "fee-for-service" doctors), around 2,000 nurses and 1,000 paramedical personnel on its payroll. It also operates a network of primary-care clinics, a medical back-office operation, a health-insurance company and a healthcare staffing company that provides nurses to the UK, the US and other countries. Its retail pharmacy business is one of the largest in India, with a network of 873 outlets.

Investment strategy

We rate Apollo Hospitals shares Buy/Medium Risk (1M). We are positive on the Indian healthcare delivery market and believe that Apollo is one of the best plays on the burgeoning healthcare opportunity in India. It appears poised to benefit from healthcare opportunities in India, driven by both domestic and international patients, and is ahead of most of its competitors on scale, brand recognition and service offerings. It has an integrated business model that, in addition to hospitals, includes clinics, diagnostic services, pharmacies, telemedicine, and healthcare education and training. The company, which dominates the tertiary-care segment, is pursuing a strategy of expanding its presence in secondary- and tertiary-care markets: secondary hospitals can offer 25-30% higher returns than tertiary hospitals. We expect Apollo's new hospitals and improvements in asset utilization to drive 19% revenue CAGR and 29% in EBIDTA over FY09-12E.

Valuation

Our target price for Apollo is Rs840. While there are few listed comparables in the domestic market, the company has a reasonable and well-diversified global peer group. Some of these are much bigger than Apollo, but we see healthcare growth opportunities as greater in India than in developed markets given the country's current low expenditure and health care penetration. Notionally, P/E and EV/EBITDA relative to earnings growth would seem to be ideal tools to value Apollo, given the high predictability and stability of earnings streams in the healthcare services industry. Yet we believe that this method may not be optimal, since high interest and depreciation charges incurred upfront would lead to earnings not fully reflecting operating performance. We therefore use EV/EBIDTA vs. EBIDTA CAGR as our primary methodology to value Apollo Hospitals. We believe Indian hospitals should trade at a premium to their global counterparts given the much higher growth opportunity in the Indian market. We benchmark our target sector multiple with comparable peers in the Asia Pac region. Our current EV/EBIDTA multiple of 14x is also in the range that Apollo has traded over the last several years. At 14x Mar 11E EBIDTA we arrive at our target price of Rs840.

Risks

We rate Apollo Hospitals as Medium Risk based on our quantitative risk-rating system, which tracks historical share price volatility. Main downside risks to our

target price and estimates include: 1) Apollo Hospital has a fixed-cost-intensive business with high operating leverage. Inability to scale up occupancy and realizations could depress capital efficiency; 2) The business requires large investments in technology-intensive medical equipment that could be rendered obsolete quickly by rapid progress in technology; and 3) Slippage in service quality by Apollo's primary-care franchisees could dilute its brand equity.

Appendix A-1

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Apollo Hospitals (APLH.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Prashant Nair, CFA



Chart current as of 29 May 2010

	Date	Rating	Target Price	Closing Price
1	30-May-07	*1M	*610.00	503.55
2	21-Jul-08	1M	*582.00	479.45

	Date	Rating	Target Price	Closing Price
3	9-Dec-08	1M	*457.00	393.30
4	8-Sep-09	1M	*660.00	515.10

	Date	Rating	Target Price	Closing Price
5	29-Jan-10	1M	*840.00	684.15

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Mar 2010

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