Company Focus

7 March 2008 | 7 pages

Apollo Hospitals (APLH.BO)

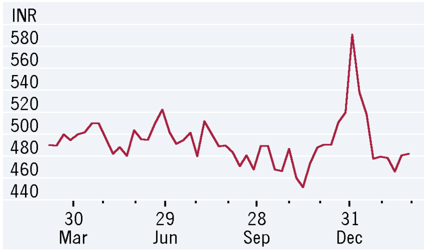
Estimate change

Buy: Best Play on Indian Healthcare

- **Best play on Indian Healthcare** — given its integrated business model, scale, national footprint & presence across multiple disease & delivery segments. Besides, the hidden value in its exposure to retail pharmacies, healthcare BPO services & land on its books would act as a support to valuations.
- **Well positioned** — AHL is a leading player in a growth sector with high entry barriers. Robust profitability despite aggressive rollout of pharmacies indicates the buoyancy in the core hospitals business. Besides, project specific tie-ups with financial partners (such as Eleanor for a Mumbai hospital) & focus on building an optimum mix of specialty hospitals & less capital intensive primary/ secondary care facilities augur well for capital efficiency in the medium term.
- **Expansion plans** — Apollo is on course with its 2-pronged strategy to expand bed capacity & sweat existing assets (lower ALOS, improve occupancies, increase focus on high-end services) in a bid to grow and maintain capital efficiency. It has ambitious expansion plans in CVS, day care services and super specialty segments and also intends to expand its pharmacy network.
- **Hidden value** — We see significant hidden value in AHL's presence in retail pharmacies (negative at EBIDTA level; to turn around in FY09), 46% stake in Apollo Healthstreet (medical BPO company; sales: US$130m; EBIDTA margins: c19-20%) & ownership of all land on which its hospitals are built. We expect the management to look at unlocking value on these fronts over next 1-3 years.
- **Incorporating recent fund raising** — We incorporate the recent fund raising (through private placement to Apax Partners & warrants to promoters) into our estimates. Overall, we forecast a 26% CAGR in EBIDTA over FY07-10E

Buy/Medium Risk	**1M**
Price (05 Mar 08)	Rs485.10
Target price	Rs610.00
Expected share price return	25.7%
Expected dividend yield	1.8%
Expected total return	**27.5%**
Market Cap	Rs28,468M
	US$708M

Price Performance (RIC: APLH.BO, BB: APHS IN)



Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	612	12.10	7.3	40.1	4.0	13.4	0.9
2007A	644	12.47	3.0	38.9	3.3	9.4	1.0
2008E	964	16.00	28.4	30.3	2.2	9.3	1.3
2009E	1,291	21.44	34.0	22.6	2.1	9.6	1.8
2010E	1,567	26.02	21.4	18.6	2.0	11.0	2.1

Source: Powered by dataCentral

Prashant Nair, CFA[1]
+91-22-6631-9855
prashant.nair@citi.com

Chirag Dagli[1]
+91-22-6631-9874
chirag.dagli@citi.com

Akshay Rai[1]
akshay.rai@citi.com

See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	40.1	38.9	30.3	22.6	18.6
EV/EBITDA adjusted (x)	23.9	20.0	15.4	11.7	9.7
P/BV (x)	4.0	3.3	2.2	2.1	2.0
Dividend yield (%)	0.9	1.0	1.3	1.8	2.1
Per Share Data (Rs)					
EPS adjusted	12.10	12.47	16.00	21.44	26.02
EPS reported	10.28	18.47	16.00	21.44	26.02
BVPS	121.79	145.88	217.43	229.20	243.48
DPS	4.50	5.00	6.40	8.58	10.41
Profit & Loss (RsM)					
Net sales	7,597	9,495	11,607	14,287	17,198
Operating expenses	-6,682	-8,381	-10,161	-12,450	-14,788
EBIT	**914**	**1,113**	**1,445**	**1,836**	**2,410**
Net interest expense	-244	-270	-242	-256	-434
Non-operating/exceptionals	41	436	211	313	324
Pre-tax profit	**712**	**1,279**	**1,414**	**1,893**	**2,300**
Tax	-238	-326	-450	-602	-732
Extraord./Min.Int./Pref.div.	46	0	0	0	0
Reported net income	**520**	**954**	**964**	**1,291**	**1,567**
Adjusted earnings	612	644	964	1,291	1,567
Adjusted EBITDA	1,293	1,521	1,862	2,392	3,060
Growth Rates (%)					
Sales	15.0	25.0	22.2	23.1	20.4
EBIT adjusted	8.7	21.7	29.9	27.1	31.2
EBITDA adjusted	12.1	17.6	22.4	28.5	27.9
EPS adjusted	7.3	3.0	28.4	34.0	21.4
Cash Flow (RsM)					
Operating cash flow	**326**	**1,148**	**1,216**	**1,642**	**1,514**
Depreciation/amortization	378	408	417	556	650
Net working capital	-385	-142	-3	37	-460
Investing cash flow	**-3,046**	**-2,133**	**-6,098**	**-2,302**	**-2,550**
Capital expenditure	-1,940	-1,566	-2,350	-2,550	-2,550
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**1,728**	**980**	**4,407**	**835**	**1,586**
Borrowings	-271	751	121	1,000	1,500
Dividends paid	-260	-298	-435	-583	-707
Change in cash	**-992**	**-5**	**-475**	**174**	**550**
Balance Sheet (RsM)					
Total assets	**12,013**	**14,450**	**20,429**	**22,867**	**25,953**
Cash & cash equivalent	539	706	386	158	326
Accounts receivable	903	1,089	1,272	1,566	1,885
Net fixed assets	6,593	7,816	9,749	11,743	13,643
Total liabilities	**5,409**	**6,575**	**6,991**	**8,720**	**10,945**
Accounts payable	1,187	1,556	1,908	2,349	2,827
Total Debt	2,828	3,579	3,700	4,700	6,200
Shareholders' funds	**6,603**	**7,875**	**13,439**	**14,148**	**15,008**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	17.0	16.0	16.0	16.7	17.8
ROE adjusted	13.4	9.4	9.3	9.6	11.0
ROIC adjusted	8.9	8.5	9.0	9.2	10.6
Net debt to equity	34.7	36.5	24.7	32.1	39.1
Total debt to capital	30.0	31.2	21.6	24.9	29.2

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Best Play on Indian Healthcare

Apollo Hospitals provides the best play on the Indian Healthcare sector given its integrated business model, scale, national footprint & presence across multiple disease & delivery segments. Besides, the hidden value in its exposure to retail pharmacies, healthcare BPO services & land on its books would act as a support to valuations. We revise our estimates to incorporate the recent equity infusion as well as greater traction in average occupancies and pricing increases. Our target price remains unchanged at Rs610/share.

Raising Estimates

Figure 1. Earnings Revision

YE March	2008E	2009E
Revenues		
New	11,607	14,287
Old	11,547	13,972
% Change	*0.5*	*2.3*
EBITDA		
New	1,862	2,392
Old	1,849	2,259
% Change	*0.7*	*5.9*
Net Profit		
New	964	1,291
Old	847	1,023
% Change	*13.8*	*26.2*
EPS		
New	16.0	21.4
Old	16.4	19.8
% Change	*(2.4)*	*8.2*

Source: Citi Investment Research estimates

We revise our estimates for FY08-10E to factor in the following developments:

- **Equity infusion by Apax Partners & promoters**: Apollo Hospitals recently issued c7m shares to Apax for cUS$104m at Rs.605.07/share. The board also approved issue of 1.5m warrants to the promoters at Rs.497.69/share. We incorporate these into our estimates leading to the total share count (fully diluted) increasing from 51m shares to 60m shares

- **Strong trend in revenues & profitability**: Apollo has witnessed a strong trend in revenues & profitability over the first nine months of FY08 – clocking growth rates of 25% & 51% YoY in sales & recurring net profit respectively. EBIDTA margins remained steady YoY despite upfront spend on new retail pharmacies, implying higher profitability in hospitals. Despite very few new beds being added in the current fiscal, hospital revenues grew 25% YoY with Chennai, Madurai (up 20%) & Hyderabad (up 18%) in particular being the key drivers. Better occupancy (up 100bps to c79%), ALOS (4.9 v/s 5.2) & tariffs (up c6% YoY) along with aggressive ramp up in retail pharmacies (557 v/s 347 at end FY07) aided revenue growth. While retail pharmacies had negative EBIT margins (-3.4%), this was due to upfront expansion cost. These numbers were ahead of our expectations and we make appropriate adjustments to our estimates over the next two years.

- **Aggressive expansion plans**: With the funds from the recent equity infusion, Apollo has an aggressive plan of adding 1700 beds over the next three years. We expect this to drive revenue CAGR of 22% over FY07-10E, while improving occupancies and pricing in existing hospitals and turnaround in the retail pharmacy business at the EBIDTA level would lead to a smart 177bps improvement in margins over the same period.

Consequently, we raise our net profit estimates by 13-26% over FY08-09E. Although our EPS estimate for FY08 is lower by 2.4% to account for the higher share count, the higher than expected momentum in the business translates into an 8.2% increase in our EPS estimate for FY09. Overall, we forecast CAGRs of 22%, 26% & 34% in revenues, EBIDTA & recurring net profit over FY07-10E. Our target price, which is based of 15xFY09 EBIDTA remains unchanged at Rs610/share because the increase in EBIDTA offsets the impact of the higher share count.

Apollo Hospitals

Company description

Apollo Hospitals is an integrated healthcare company in the private sector, with the largest hospital network in Asia. The group and its subsidiaries own 16 hospitals, and it operates 24 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 5,000 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 557 outlets.

Investment strategy

We rate Apollo Hospitals Buy/Medium Risk (1M) with a target price of Rs610/share. 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 presence in secondary- and tertiary-care markets. This should expand its reach to smaller towns, and its primary-care facilities could act as referral points for tertiary hospitals. This strategy should also bode well from a return perspective. We estimate that secondary hospitals can offer 25-30% higher returns than tertiary hospitals. Apollo is also enhancing its presence in the cardiology segment, a key driver of the in-patient market over the next 10 years. We expect Apollo's new hospitals and improvements in asset utilization to drive a 21% revenue CAGR and 26% in EBIDTA over FY07-10E.

Valuation

Apollo lacks too many listed comparables in the domestic market, but 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. P/E and EV/EBITDA in relation to earnings growth seem ideal tools to value Apollo, given the high predictability and stable earnings stream for companies operating in the healthcare services industry. We believe that this method may not be optimal - since the high interest and depreciation charges incurred upfront would lead to earnings not fully reflecting its operating performance. We therefore shift to EV/EBIDTA v/s EBIDTA CAGR as our primary methodology to value Apollo Hospitals. Our target price is based on 15x FY09E EBIDTA, which is within the stock's EV/EBIDTA trading band of 12-20x over the past two years. At 15x FY09E EBIDTA, we value the stock at Rs610/share.

Risks

We rate Apollo Hospitals Medium Risk based on our quantitative risk-rating system. Main downside risks to our target price and estimates are : 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 investment 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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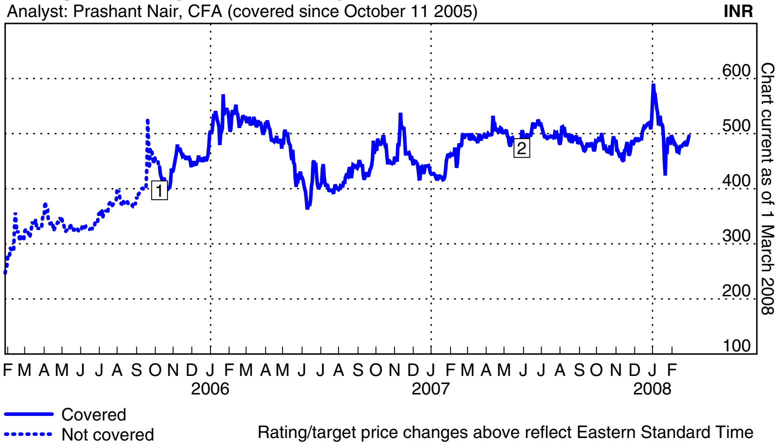
Apollo Hospitals (APLH.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Prashant Nair, CFA (covered since October 11 2005)



#	Date	Rating	Target Price	Closing Price
1:	10 Oct 05	3M	444.00	439.70
2:	30 May 07	*1M	*610.00	503.55

*Indicates change.

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