

Company Flash

12 March 2008 | 6 pages

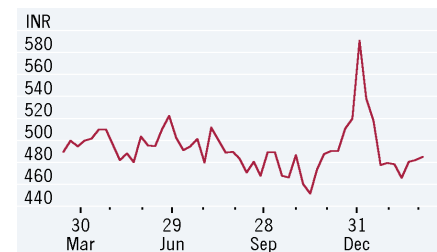
Apollo Hospitals (APLH.BO)

Citi India Conference 2008: Day 2 Takeaways

- Aggressive expansion in hospitals...** — AHEL plans to set up 3,235 (c2,164 wholly/partly owned) beds over the next 3-4 years to add to its current base of 7,461 (4146 wholly/partly owned) beds - at a total project cost of cRs1.2-1.3bn to be funded via a mix of debt, cash from recent equity infusion & operating cash flow.
- ...and in pharmacies** — AHEL currently has a base of 586 retail pharmacies, which it intends to expand to c1,500 over the next 3-4 years, at which stage it believes it will have the critical scale to look at value unlocking options. We highlight that it is this aggressive roll-out of pharmacies that is currently depressing margins & return ratios, thus masking the improving profitability of the hospitals business.
- Value unlocking options** — AHEL holds c46% stake in a medical BPO company (Apollo Health Street), for which it intends to explore the option of an IPO in the near to medium term. Also, it is in the process of setting up a REIT structure for its new projects, which should get ready over the next 6 months. While AHEL indicated that there is significant value in its land bank for existing facilities, unlocking this would need changes in rules related to stamp duty, capital gains etc.
- Strong growth ahead** — AHEL expects to grow revenues at c24-25% CAGR over next 2 years and retail pharmacy operations should break even at an aggregate level in FY09. This should translate into healthy improvement in margins & bottomline growth.

Buy/Medium Risk	1M
Price (12 Mar 08)	Rs483.55
Target price	Rs610.00
Expected share price return	26.2%
Expected dividend yield	1.8%
Expected total return	27.9%
Market Cap	Rs28,377M US\$703M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	612	12.10	7.3	40.0	4.0	13.4	0.9
2007A	644	12.47	3.0	38.8	3.3	9.4	1.0
2008E	964	16.00	28.4	30.2	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	2.2

Source: Powered by dataCentral

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

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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 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. 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 a 21% revenue CAGR and 26% in EBIDTA over FY07-10E.

Valuation

Our target price for Apollo is Rs610/share. 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 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.

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 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

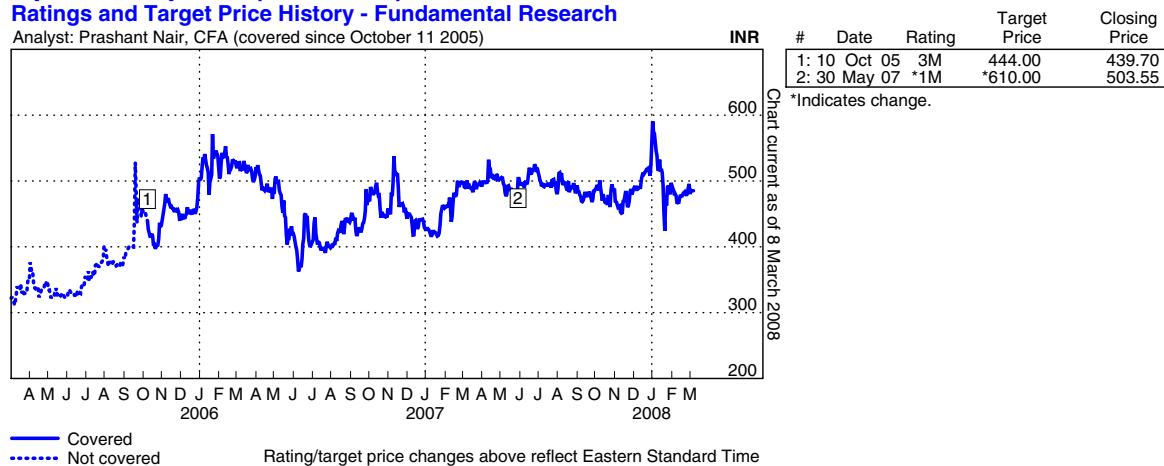
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Apollo Hospitals (APLH.BO) Ratings and Target Price History - Fundamental Research

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



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