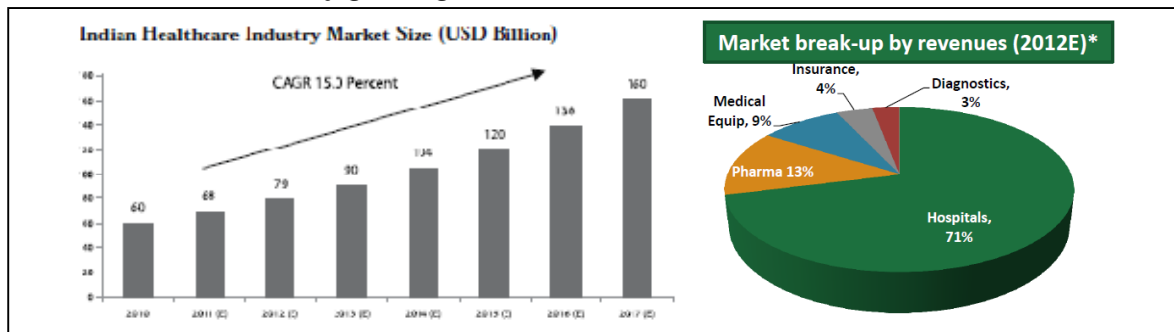


## Indian Healthcare Industry – Hospitals Sector

### Sector Update

Indian Healthcare industry contributes ~4% to the Gross Domestic Product (GDP) and is estimated to be at US \$104 bn in FY14 (Fortis Healthcare Annual Report). It is expected to continue to grow at a CAGR of 15% to reach US \$160 bn by FY17. The Indian healthcare sector consists of Hospitals, Pharmaceuticals, Medical equipment and supplies, Medical insurance and Diagnostics. Within the industry, Hospitals is the largest segment contributing ~70% of the industry revenue followed by Pharmaceutical at 13% of the total revenue and others contributing 17%. The Hospital segment is highly fragmented with ~90% of the hospitals being established and operated by doctors & trusts and the balance are being managed by corporate hospitals chains (Apollo Hospital, Fortis Healthcare, etc).

### Indian Healthcare industry growing at consistent CAGR of 15%



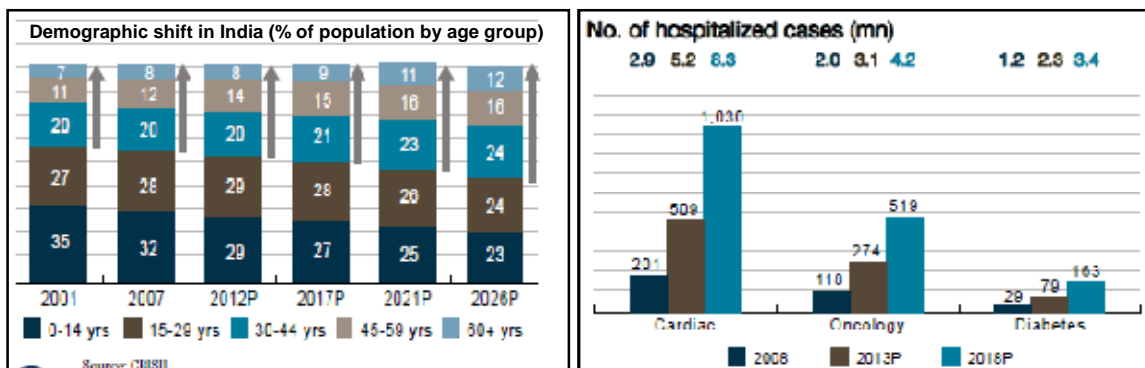
Sources: Fortis Healthcare's Annual Report and Investor Presentation

### Key drivers for the sector

In India, corporate hospital chains have been playing a key role in driving the growth and expansion in the healthcare industry. Revenue of the top three major hospitals chains (Apollo Hosp., Fortis Health. and Kovai Medical) in India have grown at a CAGR of over 20% over a period of FY10-14 mainly due to their brand equity and quality of service offerings. We believe that going forward the growth in sector will be mainly driven by the factors like 1) Fast growing population with increasing lifestyle related disease, 2) Improvement in poor healthcare infrastructure, 3) Low healthcare spending, 4) Improvement in medical insurance penetration and 5) Rising medical tourism.

- Fast growing population with increasing lifestyle related disease**

India is the second most populated country with over 1.2 bn population and according to few industry reports it is expected to surpass China over the next 10-15 years in terms of population. Along with this India's working population is also increasing which will help Indian economy to grow at a much faster rate than the other emerging economies. The working population in India was at ~58% (age group of 15-60 years) in 2001 and expected to be close to 64% in 2026. However, with the increase in young working population and change in lifestyle of this young population, there has

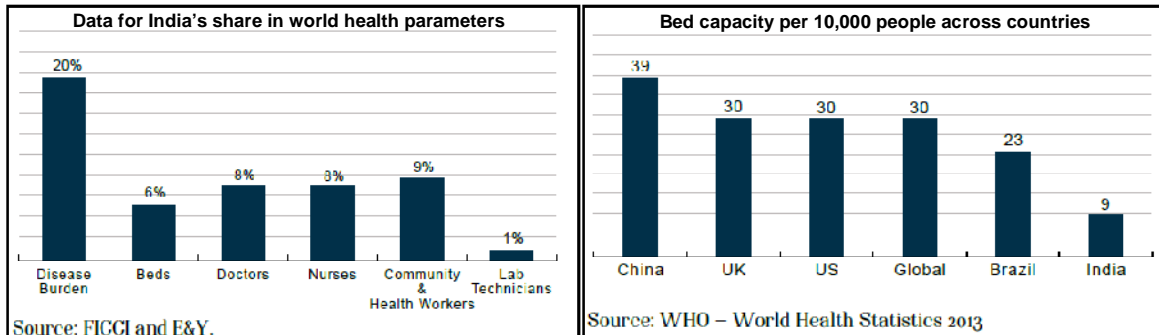


Sources: Apollo Hospitals' Investor Presentation

been an increase in lifestyle related diseases like obesity, cancer and cardiovascular illness. The current generation, which is used to deskbound work, alcohol consumption and smoking, are more prone to such lifestyle related diseases. We believe that with growing population and rising lifestyle diseases, the healthcare sector may see further uptick in revenue growth going forward.

- **Improvement in poor healthcare infrastructure**

India, despite being the second most populated country and sharing close to 20% of the global disease burden, lacks in proper healthcare infrastructure. India holds just 6% of the global beds and 8% share of doctors and nursing staff. Further, India has just 9 beds per 10,000 people which is significantly lower than the global median average of 30 beds per 10,000 people. We believe that with rising population, the need to improve healthcare infrastructure may come into the forefront in the government agenda. This indicates a huge opportunity for hospital chains which is in the process capacity expansion not only in urban areas but in the Tier-II and Tier-III cities as well.



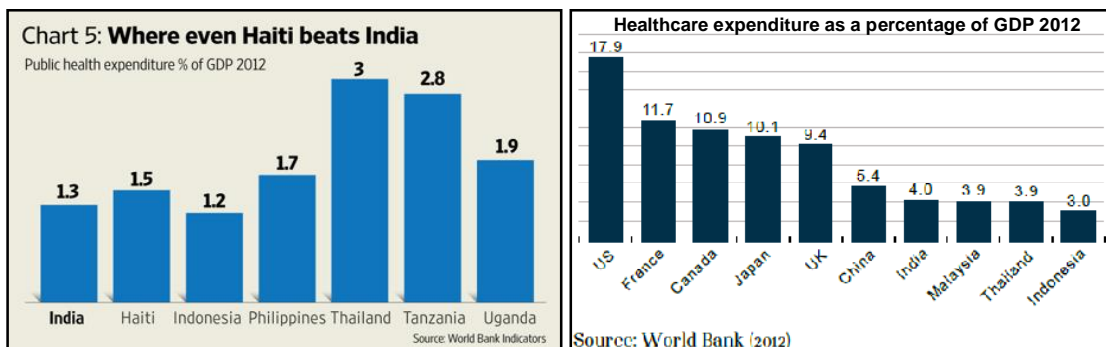
Sources: Apollo Hospitals' Investor Presentation

- **Expected improvement in healthcare spending**

One of the major reasons for poor healthcare infrastructure in India is the low level of government spending on healthcare. India's public spending is about 1.3% of the GDP on healthcare and total spending is close to ~4% of GDP which is well below from some of the emerging countries. India has proposed Rs 1.93 lakh crore (\$31 bn) over the 12th Plan (2012-2017). However, industry experts believe that considering the current poor state of healthcare infrastructure, the government needs to boost public spending on the sector.

*"The government allocation for health should increase to at least 3 per cent of GDP in the short term and 5 per cent in the medium and long term. It is currently at 1.2 per cent, which is abysmally low"... Glenmark Pharmaceuticals CMD, Source: Business Today*

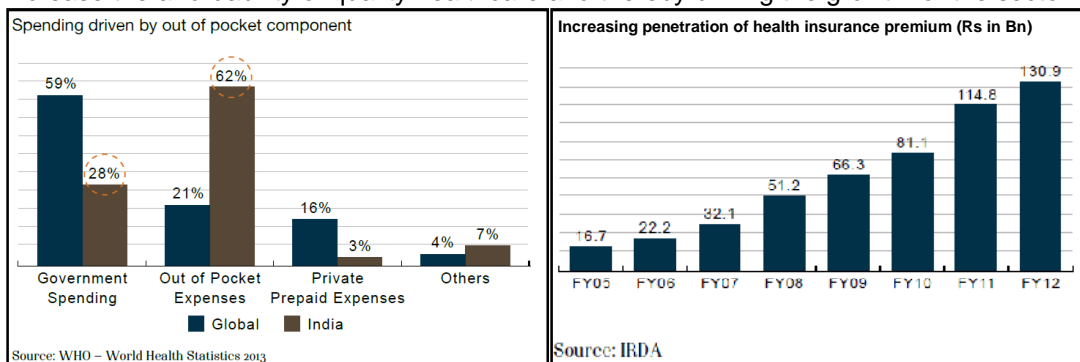
We believe that considering the government's thrust to improve quality healthcare infrastructure and services, the government may increase public spending on healthcare going forward. This may open up huge growth opportunity for the private players which are focusing on rapid capacity expansion across the country.



Source: Media Article, Apollo Hospitals' Investor Presentation

- **Improvement in health insurance penetration**

Of the total healthcare spending by an individual, ~62% of the spending is from out of pocket whereas globally an individual spends about only 21% from his pocket. In India, high out of pocket expenditure is mainly due to low public spending and low penetration of health insurance. However, off late due to rise in income levels and increase in awareness level about the health insurance benefits, health insurance premium have grown at a CAGR of 34% over a period of FY05-12 to Rs 131 bn. We believe that the rising awareness about the health insurance will increase the affordability of quality healthcare and thereby driving the growth for the sector.



Sources: Apollo Hospitals' Investor Presentation

- **Rising medical tourism**

India is emerging as one of the favorite destination for some of the optional and critical treatment for foreign citizen, given the quality treatment at a lower cost than in the developed nations. Further, the increase in qualified doctors and nurses with the improvement in sophisticated medical technology has allowed India to serve foreign patient without long waiting period. According to media reports, India is one of the top three medical tourism destinations in Asia, mainly due to the low cost of treatment, quality healthcare infrastructure and availability of highly-skilled doctors.

"Within Asia, India, Thailand and Singapore are the three countries that receive maximum medical tourists owing to low cost of treatment, quality healthcare infrastructure, and availability of highly-skilled doctors. These three countries together accounted for about 60 per cent of the total Asian revenue in 2012," the report *Medical Value Travel in India* by KPMG and Ficci said. Source: *The Economic Times*

#### cost of key treatment procedures

Ailments (US\$)	US	UK	Thailand	Singapore	India
Heart Surgery	100,000	41,726	14,250	15,312	4,500
Bone Marrow Transplant	250,000	292,470	62,500	150,000	30,000
Liver Transplant	300,000	200,000	75,000	140,000	45,000
Knee Replacement	48,000	50,109	8,000	25,000	6,000

Sources: Apollo Hospitals' Investor Presentation

## Key challenges for the sector

- **Inadequate Healthcare workforce**

One of the major shortcomings for Indian healthcare sector is inadequate workforce. According to World Health Organization (WHO) (Source: Apollo Hospital Investor Presentation), India has a ratio of 7 doctors, 10 nurses and 9 beds per 10,000 people as compared to country like China which has ratio of 14 doctors, 15 nurses and 39 beds per 10,000 people. Many Indians, especially those living in rural and semi urban areas, are still receiving services from unqualified providers. According to Industry reports, the Industry needs an additional 1.54 mn doctors and 2.4 mn nurses to match the global averages. The government is taking steps towards improving these ratios and has announced setting up of New All India Institute of Medical Science (AIIMS) in Jammu & Kashmir,

Punjab, Tamil Nadu, Himachal Pradesh and Assam and another AIIMS like institutions in Bihar. Although this is a very small step in order to reach the global average but it is positive step in right direction.

comparison of India vs. other countries in healthcare infrastructure parameters								
Per 10,000 population	China	India	Indonesia	Malaysia	Singapore	Thailand	Australia	USA
<b>Health Workforce Density</b>								
Physicians	14.6	6.5	2.0	12.0	19.2	3.0	38.5	24.2
Nurses and midwives	15.1	10.0	13.8	32.8	63.9	15.2	95.9	98.2
Dental	0.4	0.8	0.4	1.4	3.3	0.7	6.9	16.3
<b>Infrastructure</b>								
Hospital beds	39	9	6	18	27	21	39	30

Source: WHO – World Health Statistics 2013

Sources: Apollo Hospitals' Investor Presentation

- **Capital intensive nature of the sector**

Another major challenge for healthcare industry to deal with is the high level of capital intensity and long payback periods for new projects. For setting up a new hospital nearly 60-70% of the capital expenditure is required for acquiring land and developing infrastructure. Further, the hospital business also requires capital for upgradation/ maintenance / replacement of equipment and expansion. The sector also faces problems due to low level of public private partnership (PPP) ventures and therefore, availability of capital at a reasonable cost remains a key challenge for the sector. However, opening up of foreign direct investment in Medical Devices may provide some relief for the sector as it will reduce the cost of equipment and thereby reduce the maintenance and upgradation cost.

**View:**

We have a long term positive outlook on the Hospital segment in Indian Healthcare industry considering the robust growth opportunity due to increasing lifestyle related diseases, demographic changes and rising awareness levels. Further, private players like Apollo Hospitals may play a larger role in bridging the demand supply gap in the industry due to lack of adequate healthcare infrastructure and low level of PPP models. Therefore within the Hospital segment, we believe Apollo Hospital is better placed due to its strong brand equity and quality service offerings. Currently, we have a HOLD rating on the stock with 12-18 months perspective as the stock has seen strong run up. However, we do believe that the stock could offer good opportunities from a three to five years perspective.

**Background**

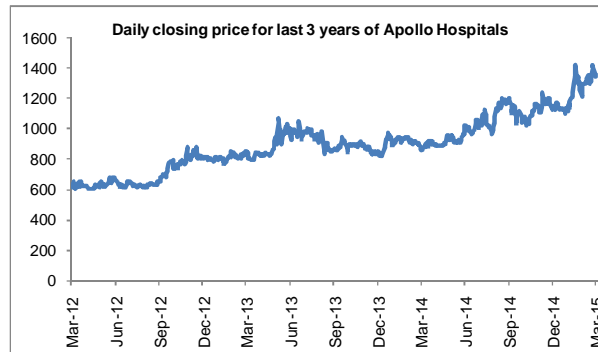
Apollo Hospitals Enterprise, Ltd. is an India-based company, which operates a private hospital group. The Company owns and manages 54 hospitals (including JV and managed Hospitals) in and around India. It also has presence in nursing and hospital management colleges, pharmacies, diagnostic clinics, medical transcription services, third-party administration and telemedicine. In September 2014, the Company acquired Hyderabad-based pharmacy chain Hetero Med Solutions Ltd.

Key Details	
52 week H/L(Rs)	1453/852
Book Value (Rs) YTD	225.6
FV (Rs)	5.0
PE (TTM)	63.8
Dividend Yield (%)	0.4

Shareholding Pattern (%) on 31 December 2014	
Promoter	34.35
FII	42.97
DII	2.91
Others	19.77
Total	100.00

**Valuations and Chart**

PE		
FY14	FY15E	FY16E
61.4	47.8	39.1



Source: Bloomberg

**View:** Apollo Hospitals has continued its focus on new bed addition and will now be focusing on operationalizing the same to bring volume growth. This may put pressure on EBITDA margin in near term as new hospitals take time to become EBITDA positive. However, going forward monetizing of loss making Pharmacy stores and price hike in Hospital business will support the margins. In the long term we remain positive on strong brand equity, robust business model with low leverage (~0.4x debt equity ratio in FY14) and focus on increasing the owned hospitals and improving penetration in Tier-II & Tier-III cities. At CMP the stock is trading at rich valuations of 39.1x FY16E earnings. Thus, we maintain our HOLD recommendation on the stock with the target price of Rs 1033 at 30x FY16E EPS of Rs 34.4. Any earning/target price revision would depend on the performance of new hospitals, improvement in margins, rollover of earning estimates and changes in general business momentum.

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