MONTHLY MAG

September 2019

- ✓ Sector of the month
- ✓ Picks of the month

Sector of the Month (Healthcare):

The Phrase, "*What goes up, must come down*," isn't likely to apply to the global health care sector in going ahead. Aging and growing populations, greater prevalence of chronic diseases, exponential advances in innovative, but costly, digital technologies—these and other developments continue to increase health care demand and expenditures.

Healthcare industry in India comprises of hospitals, medical devices, clinical trials, outsourcing, telemedicine, medical tourism, health insurance and medical equipment. The industry is growing at a tremendous pace owing to its strengthening coverage, services and increasing expenditure by public as well private players.

Healthcare has become one of India's largest sectors - both in terms of revenue and employment. Healthcare comprises hospitals, medical devices, clinical trials, outsourcing, telemedicine, medical tourism, health insurance and medical equipment. The Indian healthcare sector is growing at a brisk pace due to its strengthening coverage, services and increasing expenditure by public as well private players.

Indian healthcare delivery system is categorised into two major components - public and private. The Government, i.e. public healthcare system comprises limited secondary and tertiary care institutions in key cities and focuses on providing basic healthcare facilities in the form of primary healthcare centres (PHCs) in rural areas. The private sector provides majority of secondary, tertiary and quaternary care institutions with a major concentration in metros, tier I and tier II cities.

India's competitive advantage lies in its large pool of well-trained medical professionals. India is also cost competitive compared to its peers in Asia and Western countries. The cost of surgery in India is about one-tenth of that in the US or Western Europe.

The healthcare market can increase three fold to Rs 8.6 trillion (US$ 133.44 billion) by 2022. India is experiencing 22-25 per cent growth in medical tourism and the industry is expected to reach US$ 9 billion by 2020.

There is a significant scope for enhancing healthcare services considering that healthcare spending as a percentage of Gross Domestic Product (GDP) is rising. The government's expenditure on the health sector has grown to 1.4 per cent in FY18E from 1.2 per cent in FY14. The Government of India is planning to increase public health spending to 2.5 per cent of the country's GDP by 2025.

Source: Ace equity, IBEF

Whats Working in the Favour

The hospital industry in India, accounting for 80% of the total healthcare market, is witnessing a huge investor demand from both global as well as domestic investors. The hospital industry is expected to reach $ 132 bn by 2023 from $ 61.8 bn in 2017; growing at a CAGR of 16-17%.

Investment in healthcare infrastructure is set to rise, benefiting both 'hard' (hospitals) and 'soft' (R&D, education) infrastructure.

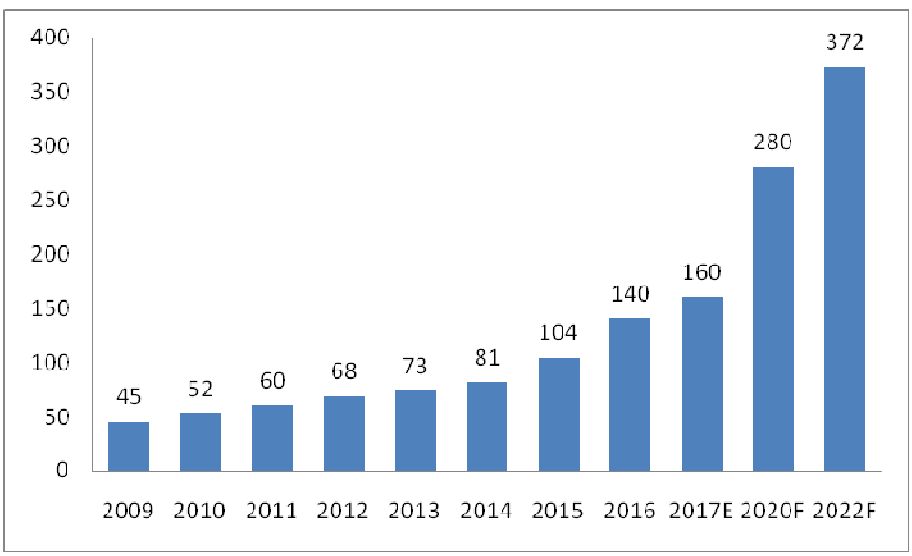
The hospital industry in India is expected to grow CAGR of 16-17 per cent to reach Rs8.6 trillion (US$ 132.84 billion) by FY22 from Rs4 trillion (US$ 61.79 billion) in FY17.

The Government of India aims to increase healthcare spending to three percent of the Gross Domestic Product (GDP) by 2022.

Availability of a large pool of well-trained medical professionals in the country. The number of doctors possessing recognised medical qualifications (Under I.M.C Act) registered with state medical councils/medical council of India increased to 841,104 in 2017 from 827,006 in 2010.

The government aims to develop India as a global healthcare hub. Creation of new drug testing laboratories and further strengthening of the 31 existing state laboratories. The world's largest government funded healthcare scheme, Ayushman Bharat was launched on September 23, 2018.

Healthcare Sector Growth Trend (US$ Billion)

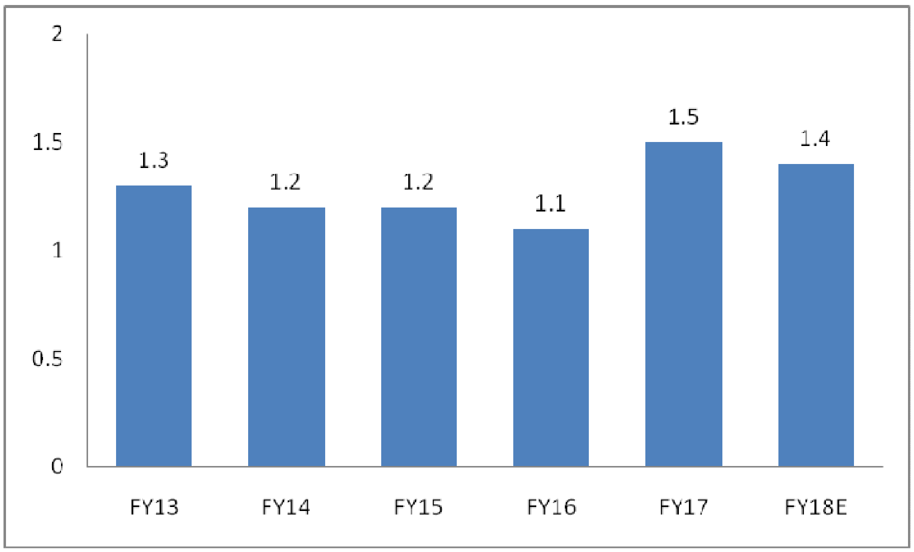


Source: Ace equity, IBEF

Healtcare expenditure per capita is rising at a fast pace. This is due to rising incomes, easier access to high-quality healthcare facilities and greater awareness of personal health and hygiene. Greater penetration of health insurance aided the rise in healthcare spending, a trend likely to intensify in the coming decade.

Economic prosperity is driving the improvement in affordability for generic drugs in the market. The government's expenditure on the health sectorh as grown to 1.4 percent of GDP in FY18E from 1.2 percent of GDP in FY14. The Government of India is planning to increase public health spending to 2.5 percent of the country's GDP by 20.

Government Healthcare Expenditure as a percentage of GDP



Demand Drivers

Rising income levels which in turn aids in steady spend in healcare facilities to be utilised and a change in demographics will also contribute to greater healthcare spending, this is likely to continue with the size of the elderly population set to rise from the current 98.9 million to about 168 million by 2026.

Medical tourism is the new growth area for the healtcare market in India. Presence of world-class hospitals and skilled medical professionals has strengthened India's position as a preferred destinationfor medical tourism. Superior quality healthcare, coupled with low treatment costs in comparison to other countries, is benefiting Indian medical tourism which has, in turn, enhanced the prospects of the Indian healthcare market. The number of Foreign Tourist Arrivals (FTAs) in India on medical visa grew 15.9 per cent year-on-year to an estimated 495,056 in 2017 from 427,014 in 2016. Yoga, meditation, ayurveda, allopathy and other traditional methods of treatment are major service offerings that attract medical tourists from European nations and the Middle East to India.

Source: Ace equity, IBEF

Government of India has been implementing various initiatives to promote ayurveda, yoga and other AYUSH systems of medicine on an international level and was allocated Rs92.31 crore (US$ 12.79 million) in 2019-20 budget for this purpose.

The Government of India liberalised its policy by providing 100 per cent FDI in the AYUSH sector for wellness and medical tourism segment. In February 2019, the Government of India established new All India Institute of Medical Sciences (AIIMS) at Manethi, District Rewari, Haryana at a cost of Rs. 1,299 crore (US$180.04 million).

Government Initiatives

Pradhan MantriJan ArogyaYojana(PMJAY): As of January 2019, around 900,000 patients received benefits of worth Rs 1,210 crore (US $167.71 million), under Pradhan Mantri Jan Arogya Yojana(PMJAY).

Tax incentives: All healthcare education and training services are exempted from service tax. Increase in tax holiday under section 80-IB for private healthcare providers in non metros for minimum of 50 bedded hospitals. 250 percent deduction for approved expenditure incurred on operating technology enables healthcare services such as telemedicine, remote radiology. Artificial heart is exempted from basic custom duty of 5 percent. Income tax exemption for 15 years for domestically manufactured medical technology products. The benefit of section 80-IB has been extended to new hospitals with 100 beds or more that are setup in rural areas; such hospitals are entitled to 100 percent deduction on profits for 5 years.

Incentives in the medical travel industry: Incentives and tax holidays are being offered to hospitals and dispensaries providing health travel facilities. Senior citizens above 80 years of age will be allowed deduction of US $491 towards medical expenditure if they are not covered under health insurance.

National Nutrition Mission: The Union Cabinet approved settingup of National Nutrition Mission (NNM) with a three year budget of Rs 85,217 crore (US$ 13.16 billion) to monitor, supervise, fix targets and guide the nutrition related interventions across ministries.

Union Budget 2019-20: Under the Union Budget 2019-20, the allocation to the Ministry of Health and Family Welfare has increased by 16.28 percent year-on-year to Rs 61,398.12 crore (US$ 8.51billion). The Government of India allocated Rs 31,745 crore (US$ 4.40 billion) under the National Health Mission.

Pradhan Mantri Surakshit Matritva Abhiyan (PMSMA): As of January 2018, Pradhan Mantri Surakshit Matritva Abhiyan (PMSMA), a programme launched in 2016 to ensure comprehensive and quality antenatal check-ups to pregnant women across India, has crossed the 10 million mark.

Ayushman Bharat: The Government of India may provide more funds for Ayushman Bharat, the world's biggest healthcare scheme, in 2019-20. As of December 2018, about 3,000,000 beneficiaries had generated e-cards and 685,000 poor patients were provided with free hospital treatment in the first 100 days since its launch.

Source: Ace equity, IBEF

Outlook

Indian healthcare is experiencing a new wave of opportunity. Providers are reinventing existing delivery models to bring healthcare closer to the patient. The following emerging trends are changing the course of the industry.

The change in the government's role from provider to payer has expanded the financial risk protection coverage to the marginalised. Private sector partnerships through health PPPs are gradually gaining acceptance, thereby improving access to care. The significant demand-supply mismatch has led healthcare to emerge as an attractive sector.

Source: Ace equity, IBEF

Pick of the Month (Apollo Hospital Ltd.): CMP: 1500 Target: 1665

AHEL today, is the leading private sector healthcare provider in Asia and owns and manages a network of speciality hospitals and clinics, a chain of Pharmacy retail outlets across the country, and provides Consultancy Services for commissioning and managing the Speciality Hospitals. Apollo Hospitals started as a 150 bed hospital in Chennai. And it has to be said, amidst much scepticism. India in the early 80's was not the easiest place for private enterprise.

As Apollo Hospitals has made colossal strides to reach where it is, more and more facets of the founding vision have turned to reality. Today Apollo Hospitals is not just one of the country's premier healthcare providers but has also played a pioneering role in helping India become a center-of-excellence in global healthcare. Apollo has succeeded in being more than just a quality healthcare provider. It has been a major player in scripting the medical landscape of the nation. This is primarily because the group has continuously been at the helm of several game-changing innovations in Indian healthcare.

Better prospects amidst improved margins: Apollo Hospitals Enterprise Ltd operates the largest hospital network and pharmacy chain in India. The hospital owns around 70 Hospitals and operates about 3,496 pharmacy outlets in India. Topline expanded to Rs. 2,229cr in Q1FY20 (up 16.7% YoY) driven by strong growth in both Healthcare and standalone pharmacy (SAP) segments which grew by 15.1% YoY and 18.5% YoY, respectively. EBITDA margin was up by 273bps YoY to 14.6% mainly due to the implementation of Ind AS 116 accounting standard. Excluding this effect, EBITDA margin rose by 43bps YoY to 12.3%. Mature hospitals showed a strong EBITDA margin, adjusted for Ind AS 116 adoption, at 22.1% (up 50bps YoY) to Rs. 202cr • Q1FY20 PAT rose 31.8% YoY to Rs. 79cr.

Management Commentary: The company has guided for debt reduction by Rs 700 crore in FY20, aided by cash generation from restructuring the pharmacy business and liquidation of an asset. The management has also guided to reduce the promoter pledge by 40-50 per cent over next six months, from the current 71 per cent, via the proceeds received from Munich stale sale monetisation.

Valuations: The stock is trading at a valuations of 64.82x P/E FY19. We recommend ***buy*** *on* ***Apollo Hospital Limited*** with a price target of ***Rs. 1665***.

NSE / BSE Code	APOLLOHOSP/ 508869
Sector	Healthcare
Industry	Hospital & Healthcare Services
Face value / Book Value (` per share)	5 / 284.8
Dividend yield (%)	0.4
52 H/L (Rs.)	1541 / 998
Market Cap. (Rs. Cr)	208,688
Shares Outstanding (Cr)	139.1
NSE / BSE Code	360,686

(In Rs.Cr)	Q1FY20	Q4FY19	Q3FY19	Q2FY19
Net Sales	2,229	2,167	2,169	2,090
EBITDA	331	268	276	258
PAT	79	77	87	79
EBITDA %	14.8%	12.4%	12.7%	12.3%
PAT %	3.6%	3.5%	4.0%	3.8%

(In Rs.Cr)	FY16	FY17	FY18	FY19
Net Sales	62,147	72,557	82,435	96,174
Sales Growth	20.0%	16.8%	13.6%	16.7%
EBITDA	6,803	7,068	7,932	10,637
EBITDA Margin	10.9%	9.7%	9.6%	11.1%
PAT	2,080	887	593	1,992
NPM%	3.3%	1.2%	0.7%	2.1%
Adj. EPS (Rs.`)	17.0	15.9	8.4	17.0

	FY16	FY17	FY18	FY19
P/E (x)	100.3	235.2	351.7	104.8
P/B (x)	6.3	6.3	6.4	6.3
EV/Sales(x)	3.6	3.0	2.7	2.3
EV/EBITDA(x)	32.5	31.2	27.8	20.8
ROCE(x)	10.5%	6.9%	7.1%	10.2%
ROE(x)	10.3%	2.7%	1.8%	6.1%

Source: Ace equity, CARE, IBEF

Pick of the Month (Dr Lal PathLabs Ltd.): CMP: 1265 Target: 1500

Dr Lal PathLabs focuses on providing patients quality diagnostic and related healthcare tests and services. The company's focus on the patient as a customer is a critical differentiator in the diagnostic and healthcare industries and, together with what its brand's recognition for quality diagnostic services, results in individuals and healthcare providers choosing it as their diagnostic healthcare service provider. This is because (i) in India, patients generally choose their diagnostic healthcare service provider and (ii) patients and healthcare providers seek quality healthcare service providers due to what range in quality and reliability of diagnostic healthcare services in India.

The company has built a national, 'hub and spoke' network that includes its National Reference Laboratory in New Delhi. The company's 'hub and spoke' model, whereby specimens are collected across multiple locations within a region for delivery to a predesignated clinical laboratory for centralized diagnostic testing, provides greater economies of scale and offers a scalable platform for the continued growth of its business.

Bundle offer, product mix, lower costs drive Margin: Revenue growth was aided by a) increase in volumes by 17% and b) product mix that drove higher contribution of bundle-test package. Its margin improved due to rationalisation on the number of clinical labs and re-routing many tests (at regional labs) to central lab in Delhi and Kolkata. Increase in patient volumes was driven by aggressive contribution from bundle-offer package and commencement of KRL.

Future growth driven by franchisee model: Alongwith focus on rationalising prices in bulk tests, DLPL has also increased the channel margins as, 35% (earlier 30%) of revenues are contributed by the franchisees. With focus on expanding franchise business, DLPL guided that incremental growth of 50-60% would be contributed by franchisees going forward.

Q1 in line: Dr Lal pathlab's revenue, adj. EBITDA and PAT grew 15%, 21% and 19% YoY. The expansion of bundle-test offer and gradual ramp up of central lab in Kolkata (KRL) to improve further volume addition in FY20E and FY21E. Management expects competitive intensity to remain strong with price war, regulatory interference and expected price ceiling of government.

Valuations: The stock is trading at a valuations of 52.2x P/E FY19. We recommend **buy** on **Dr. Lal Pathlabs Limited** with a price target of **Rs. 1500**.

NSE / BSE Code	LALPATHLAB
Sector	Healthcare
Industry	Hospital & Healthcare Services
Face value / Book Value (` per share)	10 / 115.2
Dividend yield (%)	0.5
52 H/L (Rs.)	1274 / 817
Market Cap. (Rs. Cr)	105,427
Shares Outstanding (Cr)	83.3
NSE / BSE Code	360,686

(In Rs.Cr)	Q1FY20	Q4FY19	Q3FY19	Q2FY19
Net Sales	335	301	293	318
EBITDA	110	80	78	98
PAT	59	47	46	57
EBITDA %	32.7%	26.5%	26.6%	30.8%
PAT %	17.6%	15.7%	15.8%	18.1%

(In Rs.Cr)	FY16	FY17	FY18	FY19
Net Sales	7,913	9,124	10,569	12,034
Sales Growth	20.0%	15.3%	15.8%	13.9%
EBITDA	2,077	2,375	2,640	2,937
EBITDA Margin	26.2%	26.0%	25.0%	24.4%
PAT	1,332	1,556	1,718	2,005
NPM%	16.8%	17.1%	16.3%	16.7%
Adj. EPS (Rs.`)	16.0	18.6	20.5	23.9

	FY16	FY17	FY18	FY19
P/E (x)	79.1	67.8	61.4	52.6
P/B (x)	22.0	17.7	13.4	11.2
EV/Sales(x)	13.0	11.2	9.7	8.5
EV/EBITDA(x)	49.4	43.2	38.9	34.9
ROCE(x)	48.2%	43.1%	37.9%	34.8%
ROE(x)	32.6%	28.5%	25.3%	23.8%

Source: Ace equity, CARE, IBEF

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