Initiating Coverage Report

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Table of Contents

Apollo Hospitals Enterprise Ltd.

Sector: Healthcare facilities

Brief Overview

CMP (INR) (As on 3rd Jan 2020)	1486
Target (INR)	1755
Upside(%)	18
Recommendation	**Buy**

BSE Code	508869
NSE Code	APOLLOHOSP
Reuters Ticker	ALPH.NS
Bloomberg Ticker	APHS IN

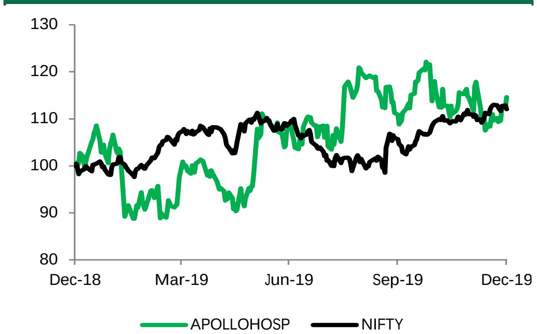
Stock Scan

Market cap (INR Cr.)	20,680
Outstanding Shares (Cr.)	13.9
Face Value (INR)	5
Dividend Yield(%)	0.4
P/E (x)	62.0
P/B (x)	5.6
Debt/Equity (x)	1.5
Beta vs. Sensex	0.8
52 Week High/ Low (INR)	1575/1083
Avg. Daily Volume (NSE)/1yr	730330

Shareholding Pattern (%)

	Sep-2019	Jun 2019	Mar 2019
Promoters	30.80	34.40	34.40
Institutions	61.83	57.31	57.40
Non-Institution	7.37	8.29	8.20

Stock vs. Nifty (Relative Returns)



Source: NSE

Apollo Hospitals Enterprise Ltd.: On the cusp of transformation

We initiate coverage on Apollo Hospitals (Apollo) with a Buy rating. Apollo Hospitals has emerged as Asia's foremost integrated healthcare services provider and has a robust presence across the healthcare ecosystem, including ***Hospitals, Pharmacies, Primary Care & Diagnostic Clinics and several Retail Health models***. As the nation's first corporate hospital, Apollo Hospitals is acclaimed for pioneering the private healthcare revolution in the country. The key aspects which draw attention to Apollo's business are:

- **Capex cycle is behind:** The Company is expected to incur only maintenance capex of around Rs 200 crores each in FY21E and FY22E compared to the cumulative capex of Rs 3,452 crores incurred from FY15 to FY19. This will enable Apollo to generate free cash flow to the tune of Rs 850 crores plus each in FY21E and FY22E leading to significant debt reduction and impacting RoCE favourably.
- **Increase in capacity utilization:** There is enough room to increase the bed occupancy rate leading to increased operating leverage in both mature and new hospitals. We expect average bed occupancy rate to increase to 70% in FY22E from 67% in FY19 leading to an improvement in RoCE.
- **Reduction in promoter pledge:** Post the conclusion of Apollo Munich transaction promoter pledge is expected to reduce substantially from the present 66% to 25%. Further, the cash accruing to Apollo Hospitals would help in reduction of debt.
- **Pharmacy Restructuring:** Stand alone pharmacies, post the restructuring would be focused on the backend of procurement and supply of medicines. The cash accruing to Apollo Hospitals as a result of the restructuring would help in reduction of debt.

We have valued the stock at 15x FY22E EV/EBITDA to arrive at a **Target Price of Rs 1755**, which provides an upside of 18% based on current market price. We thus recommend a "**Buy**" rating on the stock.

Financial Performance at a glance (Consolidated)

Particulars (INR Cr)	FY18	FY19	FY20E	FY21E	FY22E
Net Sales from ops.	8243	9617	10631	11860	13372
Growth %	14%	17%	11%	12%	13%
EBITDA	793	1064	1389	1614	1855
EBITDA Margin (%)	9.6%	11.1%	13.1%	13.6%	13.9%
Net Profit (Adjusted)	117	236	261	466	705
Net Profit Margin (%)	1.4%	2.5%	2.5%	3.9%	5.3%
EPS (Adjusted)	8.44	16.97	18.76	33.47	50.66
BVPS	233.71	239.60	251.45	277.70	320.54
EV/EBITDA (x)	30.4	22.7	17.3	14.9	13.0
P /E (x)	176.1	87.6	79.2	44.4	29.3
ROE (%)	3.6%	7.1%	7.5%	12.1%	15.8%
ROCE(%)	6.2%	9.2%	9.4%	12.8%	16.4%

Source: Company Data, SMIFS Research

Investment Rationales

Apollo Hospitals is credited for bringing many firsts to India such as First MRI, First PET CT, First Proton Therapy, etc.

Strong brand position with extensive reach

Apollo Hospitals has maintained a strong brand position for over thirty five years. ***It is India's foremost integrated healthcare provider and has always made efforts to ensure that it is at the cutting edge of clinical protocols and technology.*** It is also credited for bringing many firsts to India such as First MRI, First PET CT, First Proton Therapy, etc. The reputation and trust built by the group are strong assets, and continue to help the group attract large numbers of patients, as well as the most talented clinicians and staff.

As of FY19, Apollo Hospitals had 10,167 beds (9233 owned and 934 managed) across 65 owned and 5 managed hospitals, 3,428 pharmacies, and 765 retail healthcare centres. The network is well spread across India and provides services for 55 specialities. Apollo Hospitals has been playing a crucial role in enhancing the nation's overall healthcare standards by providing comprehensive healthcare services in multiple delivery formats at different patient touchpoints to fulfil healthcare requirements across the spectrum – from primary care at neighbourhood clinics, and short stay surgeries, to complex quaternary care at the flagship hospitals. The Company has also established newer delivery models such as homecare, to complete the continuum of care value proposition.

Key figures for FY19

Bed capacity	10,167
Pharmacies	3,428
Retail healthcare centres	765
Specialities served	55

Source: Company Data

Robust business model with increase in capacity utilization

Apollo's diversified business portfolio and widespread geographical presence insulates it from localised and sporadic events.

The diversified business portfolio and widespread geographical presence insulates the Company's performance from localised and sporadic events. The size and scale of the Company also give it strength to transition over periods of regulatory headwinds. With the advent of technology, new business areas such as telehealth and homecare are gaining traction.

Telehealth/Telemedicine or Virtual Healthcare allows patients and doctors to touch base remotely using technology such as video conferencing or mobile apps. Many people are also becoming comfortable using wearable technology to monitor any changes in their health – and sharing that data with their doctors. Convenience, ease of use, and travel times to their closest doctor are main reasons why patients choose virtual care.

Internet of Things (IoT) uses sensors, apps and remote monitoring to provide continuous clinical information. Ambulatory monitoring devices and cloud-based solutions are enabling doctors to access the information they need to care for patients from their home or surroundings they are comfortable in.

There is enough room to increase the bed occupancy rate leading to increased operating leverage and reduce the average length of stay (ALOS) in the mature and new hospitals. ***We expect average bed occupancy rate to increase to 70% in FY22E from 67% in FY19 . This would have a positive impact on RoCE***.

The Company expects mature hospitals' EBITDA margin to expand by 200-300 bps over the next three years and 13 new hospitals with 2700+ beds added in the last few years with over Rs 2,200 crores of capital employed to contribute meaningfully to EBITDA over the next 3-4 years.

- **Capex cycle is behind**

The Company is expected to incur only maintenance capex of around Rs 200 crores each in FY21E and FY22E compared to the cumulative capex of Rs 3,452 crores incurred between FY15 and FY19. ***This will enable Apollo to generate free cash flow to the tune of Rs 850 crores plus each in FY21E and FY22E leading to significant debt reduction*** (Net Debt to Equity ratio is expected to drop to 0.7 in FY22E, post IND AS 116 adjustment from pre IND AS 116 level of 1 in FY19) ***and impacting RoCE favourably***.

Apollo Hospitals is expected to incur only maintenance capex of around Rs 200 crores each for FY21E and FY22E compared to the cumulative capex of Rs 3,452 crores incurred between FY15 and FY19.

Apollo Hospitals has facilities located in large urban centers such as Chennai, Hyderabad, Kolkata, Bengaluru, New Delhi, Ahmedabad, Mumbai, Bhubaneshwar, Madurai and Mysore among others. The Group has also invested in other centres in Tier II and Tier III cities, that are largely under-served with respect to healthcare services, with attractive demographic indicators such as growing population, disposable income potential, etc. All these markets will continue to demonstrate high demand for high quality tertiary services including transplants, robotics and complex procedures under cardiac, oncology and orthopaedic specialties. Given the existing capacity and operational beds already created, there is significant headroom for growth in these centres.

Apollo Hospitals will nurture and grow national Centres of Excellence in focus specialities.

With a strong focus on asset turns, asset utilisation, clinical differentiation and outcomes, these units are expected to deliver significant top-line growth, as well as expanded margins (given that fixed costs have largely been absorbed).

Focus on Centres of Excellence

Apollo Hospitals will nurture and grow national Centres of Excellence (COEs) in ***focus specialities*** – ***cardiac sciences, neuro sciences, orthopaedics, oncology, transplants, emergency, critical care and preventive health***. Each of these COEs will be comprehensively developed across clinical differentiations, protocols, outcomes and benchmarks, market share, talent, academics and research, under the supervision of dedicated Service Line Managers. The focus on CoEs will lead to enhanced case mix, and thereby a superior margin profile. As occupancy levels improve to optimal levels, such case mix changes and improvements will ensure that topline growth and quality of revenue are fully protected.

Proton

Apollo Hospitals commissioned the first proton therapy centre in South Asia in January 2019 in Chennai.

In proton therapy, doctors use a particle accelerator to target a tumor with a beam of protons.

Proton therapy is a type of external beam radiotherapy that uses ionizing radiation. In proton therapy, medical practitioners use a particle accelerator to target a tumor with a beam of protons. These charged particles damage the DNA of cells, ultimately killing them by stopping their reproduction. Cancerous cells are particularly vulnerable to attacks on DNA because of their high rate of division and their reduced abilities to repair DNA damage. Some cancers with specific defects in DNA repair may be more sensitive to proton radiation.

Apollo Hospitals commissioned the first proton therapy centre in South Asia in January 2019 in Chennai. The total cost of the project is around Rs 1000 crores. While the project is generating EBITDA losses currently because of lower intake of patients, it is expected to generate an EBITDA of close to 40% plus when it ramps up fully. Complete ramp up would happen when all the three gantries are fully operational with a capacity of treating 1000 patients. The average cost of treatment for Indian residents is Rs 28 lakhs and for foreign nationals is USD 65,000.

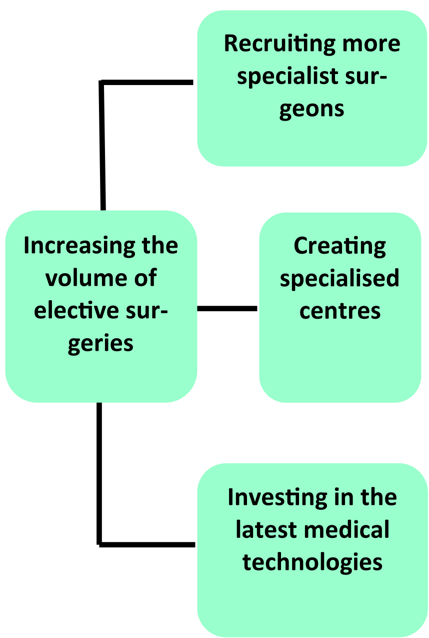
Investment Rationales

The retail health assets are housed within Apollo Health and Lifestyle Ltd. and cater to short-stay surgeries, boutique birthing and ubiquitous access to clinics and diagnostics services.

Growth of retail healthcare segment

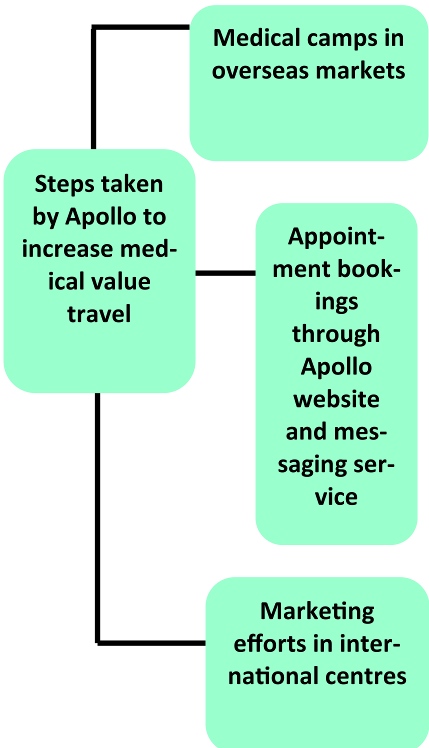
Apollo Hospitals has invested in multiple formats of retail healthcare, to maximize the number of lives touched and to provide ease of access to consumers across the care continuum. ***The retail health assets are housed within the subsidiary Apollo Health and Lifestyle Limited (AHLL)***. These formats cater to the changing profile of healthcare consumers, and hence will be growth models for the future—short-stay surgeries, boutique birthing and ubiquitous access to clinics and diagnostics services. They will strengthen Apollo's efforts to gain top-of mind recall and market share. The Group has also invested in ensuring that services across all formats are seamlessly delivered, under the One Apollo initiative. This initiative is aimed at building deep relationships with the Apollo consumer across categories—hospitals, pharmacy, clinics, and diagnostics and also unlocking potential for up-sell, cross-sell, and loyalty driven behaviour using advanced analytics.

Focus on life enhancing procedures and elective surgeries



With increasing health awareness and disposable incomes, there is a growing demand for elective or planned surgeries. Therefore, apart from focusing on 'Centres of Excellence', Apollo plans to build a strong presence in the growing market of elective and life enhancing procedures. ***The hospitals are well-equipped to offer various elective procedures like knee replacements, hip replacements, cosmetic surgeries, dental services and other similar procedures***. Going ahead, the plan is to increase the volume of such procedures performed in the hospitals by recruiting more specialist surgeons, creating specialised centres, and investing in the latest medical technologies to improve clinical outcomes in these areas.

Investment Rationales



Medical Value Travel

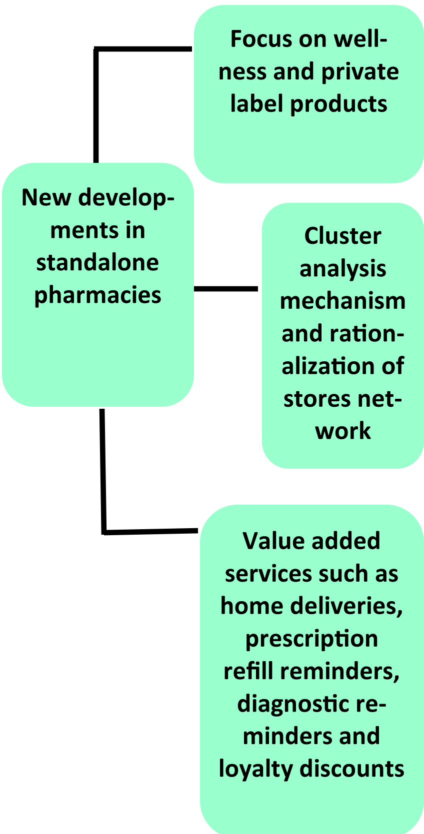
Apollo Hospitals has been able to attract a large number of patients from foreign countries over the years for treatments at its various state- of-the- art facilities. Apollo Hospitals has a well-established track record of providing clinical outcomes comparable to the best in the world at a fraction of the international costs. The Group undertakes several camps in overseas markets to build the doctor connect for patients. Further, overseas patients can now easily make appointments for personal consultations for their treatment in India through the Apollo website and dedicated messaging service. In order to gain significant market share of the growing Medical Value Travel segment in India, Apollo has stepped up marketing efforts in international centres and is driving in-person consultations with senior specialists. ***Almost 10% of the hospitals revenue is derived from international patients***.

These efforts have led to the attraction of a large number of patients from neighbouring countries, Middle East, Africa, ASEAN countries and Pacific Island countries. The Group has agreements with Ministries of Health in various countries for treatment of patients referred to by them. Having served patients from over 120 countries, ***Apollo continues to offer a wide range of high quality services including preventive health checks, organ transplantation (kidney, liver and cornea transplantation), robotic surgery, cancer treatment, joint replacement surgery, cosmetic procedures, eye procedures, brain and spine surgeries, etc.*** Apollo Hospitals is extremely well positioned to address the needs of the growing Medical Value Travel segment in the country.

Standalone pharmacies

Apollo Pharmacies is the largest organized retail pharmacy chain in India selling prescription, over the counter (OTC) and private label products. ***Revenue growth from this segment of Apollo Hospitals has been very impressive at 28% CAGR over the last ten years with presence in over 400 cities/towns spread across 20 states and 4 union territories, with a total of 3,428 stores as on 31st March, 2019***. During FY19, net additions to the network were 407 stores.

Investment Rationales



There has been an evolution in the product offering with focus shifting to wellness and private label products. The optimal product mix for each store is consciously designed. A cluster analysis mechanism has been put in place, and each cluster is managed by an independent manager. Value added services such as home deliveries, prescription refill reminders, diagnostic reminders as well as loyalty discounts are offered to customers. Steps like increasing the proportion of private label products and rationalizing the store network through the discontinuation of non-viable stores have helped to steadily improve the business profitability profile. Large organized players with superior operating scale have a high potential for significant growth in this sector; and as the undisputed market leader, Apollo Pharmacies has a distinct advantage.

Apollo's Board has recently decided to restructure the pharmacy business by segregating the front-end retail pharmacy business into a separate company, Apollo Pharmacies Ltd. Apollo Hospitals will own 25.5% of Apollo Pharmacies and the remaining stake will be held by three private investors. Post this transaction, the back-end business related to the standalone pharmacies and 85% of the business economics will continue to be with Apollo Hospitals. Cash of around Rs 490 crores would accrue to Apollo Hospitals as a result of this transaction.

The Company expects stand alone pharmacies, post the restructuring to be on the path of achieving Rs 10,000 crores revenue in 5 years. Overall RoCE target for this segment will be 30% plus in the next five years. RoCE in FY19 for this segment was 19%.

Reduction in promoter pledge

In the course of Apollo Munich transaction, where Apollo Hospitals would be selling its 10% stake to HDFC Ergo, the promoters of Apollo Hospitals would also be selling their stake of 41% to HDFC Ergo and the sale proceeds would be used to reduce the percentage of shares pledged by them.

Promoter pledge is expected to reduce substantially from the present 66% to 25% of total number of shares held by promoters. This would alleviate the overhang on the stock.

Entities within the umbrella of Apollo Hospitals (AHEL)

AHEL Standalone	Location	Description	AHEL Ownership
Chennai Main	Chennai	Hospital	100.0%
ACI - Chennai	Chennai	Hospital	
Tondiarpet - Chennai	Chennai	Hospital	
FirstMed - Chennai	Chennai	Hospital	
Apollo Children's Hospital	Chennai	Hospital	
Apollo Specialty, Vanagaram	Chennai	Hospital	
Women & Child, OMR	Chennai	Hospital	
ASH Perungudi	Chennai	Hospital	
Women & Child, Shafee Mohammed Road	Chennai	Hospital	
Apollo Proton & Cancer care	Chennai	Hospital	
Madurai	Madurai	Hospital	
Karur	Karur	Hospital	
Karaikudi	Karaikudi	Hospital	
Trichy	Trichy	Hospital	
Nellore	Nellore	Hospital	
Hyderabad	Hyderabad	Hospital	
Bilaspur	Bilaspur	Hospital	
Mysore	Mysore	Hospital	
Vizag (old & new)	Vizag	Hospital	
Karim Nagar	Karim Nagar	Hospital	
Bhubaneswar	Bhubaneswar	Hospital	
Jayanagar	Bangalore	Hospital	
Nashik	Nashik	Hospital	
Vizag New	Vizag	Hospital	
Malleswaram	Bangalore	Hospital	
Navi Mumbai	Mumbai	Hospital	

Subsidiaries	Location	Description	AHEL Ownership
Samudra Healthcare Enterprises Ltd.	Kakinada	Hospital	100.00%
Apollo Hospitals (UK) Ltd	UK	Hospital	100.00%
Imperial Hospital and Research Centre Ltd.	Bangalore	Hospital	90.00%
Pinakini Hospitals Ltd.	Nellore	Hospital	79.44%
Apollo Home Health care India Ltd	Chennai	Paramedical Services	100.00%
Apollo Health and Lifestyle Ltd.	Hyderabad	Apollo Clinics	70.25%
AB Medical Centres Limited	Chennai	Infrastructure	100.00%
Western Hospitals Corporation Pvt Ltd	Belapur	Hospital	100.00%
Sapien Bioscienses Pvt Ltd	Hyderabad	Biobanking tissues	70.00%
Apollo Rajshree Hospital	Indore	Hospital	54.63%
Apollo Lavasa Health Corporation Ltd	Maharashtra	Hospital	51.00%
Apollo Home Health care Ltd	Hyderabad	Paramedical Services	87.00%
Total Health			100.00%
Apollo Healthcare Technology Solutions ltd	Chennai	Hospital	40.00%
Assam Hospitals Ltd	Assam	Hospital	64.60%
Apollo Hospitals International Ltd.	Ahmedabad	Hospital	50.00%
Apollo Hospitals Singapore PTE Limited			100.00%
Future Parking Pvt Ltd	Chennai	Infrastructure	100.00%
Apollo Medicals Pvt Ltd	Chennai	Pharmaceutical	100.00%
Associates	**Location**	**Description**	
Indraprastha Medical Corporation Ltd.	Delhi, Noida	Hospital	22.03%
Apollo Gleneagles Hospitals Ltd.	Kolkata	Hospital	50.00%
Apollo Gleneagles PET-CT Pvt. Ltd.	Hyderabad	Hospital	50.00%
Family Health Plan Ltd.		TPA, Health Insurance	49.00%
ApoKos Rehab Pvt Ltd	Hyderabad	Rehab Centre	50.00%
Stemcyte India Therapautics Pvt Ltd	Ahmedabad	Stemcell Banking	24.50%
Apollo Medics	Lucknow	Hospital	50.00%

Source: Company Data

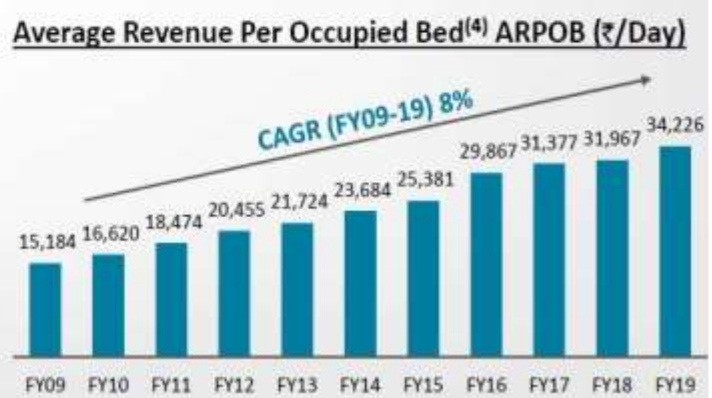
Details of Beds under Operation

Category wise	Capacity Beds	Operational Beds	No. of Hospitals
Owned Hospitals	8,683	7,246	44
Day care centres/ CRADLE	550	550	21
Managed Hospitals	934	934	5
Grand Total	**10,167**	**8,730**	**70**
Cluster wise (owned hospitals)			
Chennai	1,696	1,511	11
Hyderabad	959	839	5
Kolkata	706	700	2
Delhi	790	715	2
Bangalore	627	556	3
Mumbai	478	225	1
Ahmedabad	320	263	2
Tamilnadu (outside Chennai)	808	650	6
Bhubaneswar	290	285	1
Other India	2,009	1,604	11
Grand Total	**8,683**	**7,348**	**44**
Maturity wise (owned hospitals)			
Mature (> 10 years)	4,931	4,548	23
5 – 10 years	1,029	926	8
0 – 5 years	2,723	1,874	13
Grand Total	**8,683**	**7,348**	**44**

*Beds as on 30th Jun 2019

Source: Company Data

Key Operating Metrics

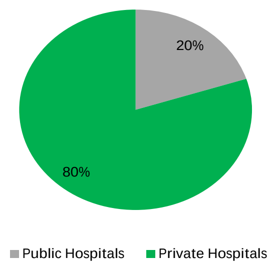


Note: All operating data for owned hospitals.
(1) Bed Occupancy Rate: Total Occupied Bed Days/Total Operating Bed Days. Represents % of available hospital beds occupied by patients.
(2) Excludes our hospitals located outside India.
(3) ALOS represents average number of days patients stay in our hospitals.
(4) ARPOB (Net of doctor fees): Total Hospital Revenue/Patient Days (Total Occupancy in Numbers (Average Daily Census) x No of days).

Source: Company Data

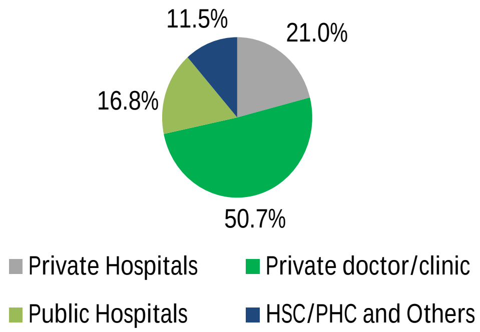
Industry Overview

Share in the Total Health Market



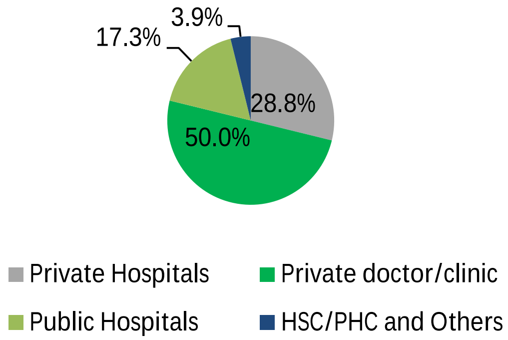
Source: Company Data

Ailments treated by different care types (Rural Areas)



Source: Company Data

Ailments treated by different care types (Urban Areas)



Source: Company Data

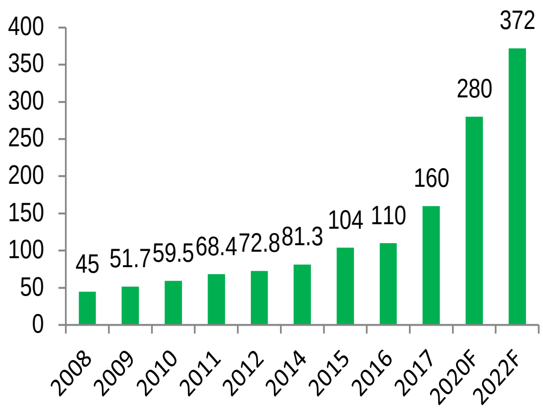
Private sector's contribution to healthcare in India

India's basic/public healthcare infrastructure is very inadequate for meeting the demands of its large population. The unmet opportunity combined with strong fundamentals in the market has led to the emergence of private healthcare service providers. Private healthcare institutions provide world class facilities, employ highly skilled and globally recognized professionals, leverage advanced technology in treatments, and maintain high standards of quality. Admittedly, this is a phenomenon in the Tier I urban areas of the country, but nevertheless, the private sector has done a commendable job in creating these pockets of excellence while simultaneously generating significant value. ***The enduring success of the early movers has encouraged the emergence of multiple players in this space and spawned industry diversification and in-depth specialization***. The Indian healthcare industry has today become a preferred sector for strategic and financial investments.

Private sector players enjoy a market share of nearly 80% of India's healthcare market. They also account for almost 74% of the country's total healthcare expenditure. Their share in number of hospitals is estimated at 74% while the share of hospital beds is estimated at 40%. Based on the success and breadth of services offered by the private sector hospitals, rural populations are increasingly seeking care from this sector. Of all the levels of care mentioned in the charts beside, treatment by a private doctor/clinic is the single most important point of contact for treatment of ailments for rural areas (50.7%) and urban areas (49.3%). This is followed by treatments at private hospitals, public hospitals and health sub centres (HSC), primary health centres (PHC) & others.

Industry Overview

Healthcare sector growth trend (USD bln)



Source: Company Data

Growing market size

The Indian healthcare sector, which stood at USD 110 billion in 2016 is expected to reach a size of over USD 372 billion by 2022, registering a CAGR of 22%. ***The hospital industry in India stood at USD 62 billion in 2017 and is expected to increase at a 16-17% CAGR to reach a size of USD 133 billion by 2023***. These statistics indicate that there is tremendous scope for enhancing healthcare services penetration in India and ample opportunity for the development of the healthcare industry as a whole. Conducive policies for encouraging FDI, tax benefits, and favourable Government policies coupled with promising growth prospects are helping the industry attract private equity, venture capital and foreign players. Today, Indian companies are entering into alliances with domestic and foreign companies to drive growth and gain new markets.

Increase in population and demographic trends

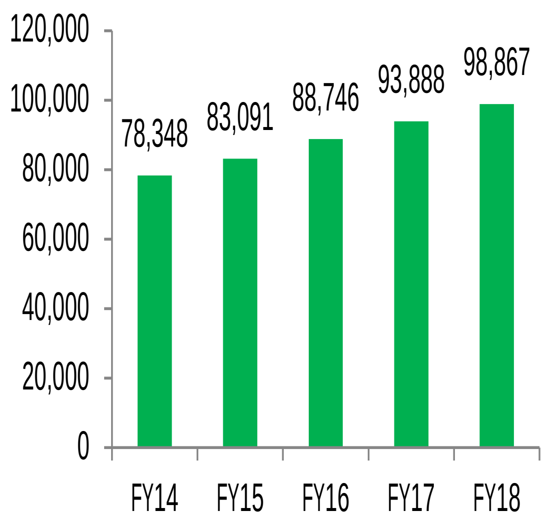
Chronic ailments such as arthritis, hypertension, diabetes, asthma and heart diseases are commonplace among the elderly.

As of 2011, nearly 8% of the Indian population was aged 60 years or more, and this is expected to surge to 12.5% by 2026. According to Report on Status of Elderly in Select States of India 2011, published by the United Nations Population Fund (UNFPA) in November 2012, chronic ailments such as arthritis, hypertension, diabetes, asthma and heart diseases were commonplace among the elderly with 66% of the respective population reporting at least one of these. In terms of gender-based tendencies, while men were more likely to suffer from heart, renal and skin diseases, women showed higher tendencies of contracting arthritis, hypertension and osteoporosis.

With the Indian population expected to grow to ~1.44 billion by 2023 and considering the above mentioned factors, the need to ensure access to healthcare services for this vast populace is an imperative. This provides an attractive opportunity to expand into a sector with huge potential for growth.

Industry Overview

India's per capita income at constant prices



Source: Company Data

Rising per capita income and widening of income inequalities

The last decade has witnessed remarkable economic development with rise in per capita income which has paved the way for increasing demand of healthcare services and access to better healthcare facilities. However, even as India continues to develop, the difference in earnings is giving rise to wide levels of inequality. The people in the various income slab categories fall into unique baskets typified by varying healthcare needs. Each of these presents a market in terms of the addressable value proposition. The growth in the affordable segment of population, on account of rising income levels, supports the need for quality medical care that comes at a relatively higher price. Growth in household incomes, and consequently, disposable incomes, is, therefore, critical to the overall growth in demand for healthcare delivery services in India. ***The share of households falling in the income bracket above Rs 2 lakhs is expected to go up to 35% in FY22 from 23% in FY17, providing a potential target segment with more paying capacity for hospitals.***

Under consumption of healthcare services

The healthcare service delivery landscape demonstrates a lag with regard to accessibility and geographical reach in meeting the requirements of the nation's 1.3 billion people, almost 70 percent of who live in rural areas. Public health care institutions—ranging from primary health centers that form the backbone of the system in rural areas to larger district-level hospitals are hampered by a lack of manpower and inadequate resources such as diagnostics, pathology services and stock-outs.

With bed availability of 1 per 1,050 persons versus a global average of 2.9 beds per 1,000 persons, the current hospital infrastructure in India is very inadequate. ***Approximately 1.7 million beds have to be added by 2025 to meet the rising demand and address the current shortage***. A combination of unaffordability and minimum access to healthcare facilities, especially for the under privileged people belonging to the lower strata of society has led to a massive under consumption of healthcare services in the country.

With bed availability of 1 per 1,050 persons versus a global average of 2.9 beds per 1,000 persons, the current hospital infrastructure in India is very inadequate.

Transition in disease profile

The contribution of NCDs to the total disease profile has risen from 30% in 1990 to 55% in 2016. NCDs accounted for nearly 62% of all deaths in India in 2016.

Lifestyle related illnesses or non-communicable diseases (NCDs) have been increasing rapidly in India over the last few years in contrast with communicable diseases. The contribution of NCDs to the total disease profile has risen from 30% in 1990 to 55% in 2016. NCDs accounted for nearly 62% of all deaths in India in 2016. ***According to The World Economic Forum, the world will lose nearly 30 trillion USD by 2030 for NCD treatments and India's share of this burden will be 5.4 trillion USD***. CRISIL Research believes that NCDs exhibit a tendency to increase in tandem with rising income levels. WHO projects an increasing trend in NCDs by 2030, following which CRISIL has forecast rising demand for healthcare services associated with lifestyle related diseases such as cardiac ailments, cancer and diabetes. Another emerging market in the country is orthopaedics, which currently comprises a very small proportion as compared with NCDs. The orthopaedics market can be classified into four different segments, viz., knee, hip, trauma and spine, of which the knee replacement market holds the biggest share, followed by trauma and spine. As opposed to other countries, hip replacement in India is still a very small segment as compared to knee replacements.

Health infrastructure is skewed towards urban areas

The current healthcare facilities in Tier II and Tier III cities still remain far behind in comparison to urban areas with many rural areas lacking even basic amenities.

Healthcare infrastructure is very asymmetric between rural and urban India. The current healthcare facilities in Tier II and Tier III cities still remain far behind in comparison to urban areas with many rural areas lacking even basic amenities. Rural infrastructure has largely been supported by public health facilities which are ill equipped to deal with the massive need for healthcare access. The concentrated healthcare facilities in urban areas are not so easily accessible for most of the people living in rural and remote areas of the country. ***Low per capita income, low expenditure on healthcare, and low number of doctors coupled with poor insurance penetration in rural areas are reasons for the vast disparity in offerings when compared with urban and semi-urban areas***. Apart from these issues, drinking water facilities, nutritional intake, sanitation facilities, awareness about diseases, etc. are also important factors that influence the health of a person. Urban areas are believed to have a better score on these parameters. Today, there exists a substantial unmet demand for high-quality and specialist healthcare services in Tier-II & Tier-III cities.

Country wise cost of ailments

Treatment	USA	Korea	Singapore	Thailand	India
	US $				
Hip Replacement	50,000	14,120	12,000	7,879	7,000
Knee Replacement	50,000	19,800	13,000	12,297	6,200
Heart Bypass	144,000	28,900	18,500	15,121	5,200
Angioplasty	57,000	15,200	13,000	3,788	3,300
Heart Valve Replacement	170,000	43,500	12,500	21,212	5,500
Dental Implant	2,800	4,200	1,500	3,636	1,000

Source: Company Data

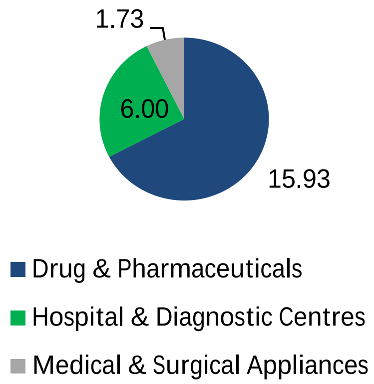
Medical Value Travel (MVT)

MVT is a burgeoning multi-billion dollar industry and likely to grow further due to the many benefits offered to patients. India has emerged as a preeminent destination for medical tourism and is one of the major hubs in the world (along with Thailand, Singapore, Malaysia and South Korea). A rare combination of world-class hospitals, equipped with best-in-class technology, skilled medical professionals, low treatment costs, and process improvements like e-medical visa, have made India a preferred destination for medical tourism. ***Treatments that are most in demand include heart surgeries, knee implants, cosmetic surgeries and dental care—all of which are largely driven by the private sector. India had 38 JCI accredited hospitals in 2018, and witnessed close to 5,00,000 medical value travellers in 2017***. Nearly 95% of the medical tourists are from countries in Africa, West Asia and South Asia. However, numbers from countries like the UK and Canada are also steadily increasing because of high costs and long waiting periods for treatment in these countries. ***The Government estimates that the size of the medical tourism market would be around 9 billion USD by 2020 amounting to 20% of the global share; up from a size of 3 billion USD in 2015***.

The Government of India has undertaken several initiatives to support medical tourism which in turn is enhancing India's image as a preferred destination for medical tourists. For e.g. the e Visa facility now covers practically all the countries of the world (166 countries). E -Medical visa facility for the attendant has also been introduced. Further process simplifications will strengthen India's position as an attractive destination for medical travellers.

Industry Overview

Cumulative FDI (Apr2000-Dec2018) USD bln



Source: Company Data

Increasing investments in the Indian Healthcare space

Over the past few years, Indian healthcare funding has witnessed a dynamic growth by venture capitalists and private equity funds. Foreign investors have been playing a significant role in the development of the healthcare sectors. These multinational players have been trying to deepen their presence through partnerships and investments. These trends indicate rising investor confidence in the Indian healthcare space and deepen the perception of India as an attractive healthcare investment destination. FDI in the health care sector has gathered momentum in recent years. ***During April 2000-December 2018, FDI inflows into the drugs and pharmaceuticals sector stood at a figure of USD 15.93 billion***. Demand growth, cost advantages and policy support have played a very important role in attracting FDI in the healthcare sector.

Key Risks

- **Slow ramp up of new hospitals, assumptions on occupancy, average length of stay (ALOS), average revenue per operating bed (ARPOB) not converging in actual terms**

  Our model has assumed steady ramp up of new hospitals, occupancy level increasing from 67% in FY19 to 70% in FY22E, ALOS decreasing from 3.84 days in FY19 to 3.59 days in FY22E, ARPOB increasing from Rs 29,103 in FY19 to Rs 34,607 in FY22E. If these assumptions made in our model do not fructify then there is a risk to our earnings estimates.

- **Price regulation**

  The intrinsic value of a service is more than just the cost of inputs. Any attempt to regulate the prices of healthcare inputs without addressing and providing for the comprehensive costs of providing quality services, will cripple the sector's finances, and compromise quality of care. While traditionally, regulations have focused on licensing and approvals, recently, the Government has also begun regulating prices of drugs and consumables. While the intent to make healthcare more affordable is laudable, it is important to ensure that healthcare providers are able to remain financially sustainable in the long-term.

- **Increase in competitive intensity**

  Competitive intensity and presence of speciality hospitals have increased, especially in key markets in the country. Over capacity has also been observed in some pockets. Every player from the organised and unorganised sectors, particularly in metros and Tier 1 cities, is striving for market leadership. This could lead to cut-throat competition and unfair practices for survival.

- **Shortage of skilled manpower**

  There is an acute shortage of skilled healthcare resources across the board. At 8 physicians and 12 nursing personnel per 10,000 people, India alarmingly trails the global median of 14 physicians and 29 nursing personnel. India also lags behind other developing nations like Brazil on these parameters. Unless immediate steps are taken to increase the number of doctors, nurses and paramedics, the shortage of manpower will lead to prohibitive costs and derail the delivery of healthcare services.

- **Incidents of vandalism**

Increasing incidents of vandalism against hospitals are being reported every now and then. While the core reason for such vandalism is negligence by doctors, other reasons include supposedly excessive billing. Proper attention is necessary to ensure that doctor negligence is reduced to 0% and billings are as per norms. Till such time these issues are redressed, vandalism by patients' relatives and mob in general would continue to be a key risk.

SWOT Analysis

Strengths

- Strong brand position.
- Resilient business model with increase in capacity utilization and reduction in ALOS.
- Top clinical talent and professional management team.

Weaknesses

- Regulatory burden.
- Shortage of experienced doctors and skilled professionals.

Opportunities

- Preventive health and wellness.
- High number of under served and poorly served markets.
- Medical Value Travel.
- Capex cycle is behind.
- Pharmacy restructuring.

Threats

- Heightened competitive intensity.
- Incidents of vandalism.

Company Overview

Apollo Hospitals has a robust presence across the healthcare ecosystem, including Hospitals, Pharmacies, Primary Care & Diagnostic Clinics and several Retail Health models.

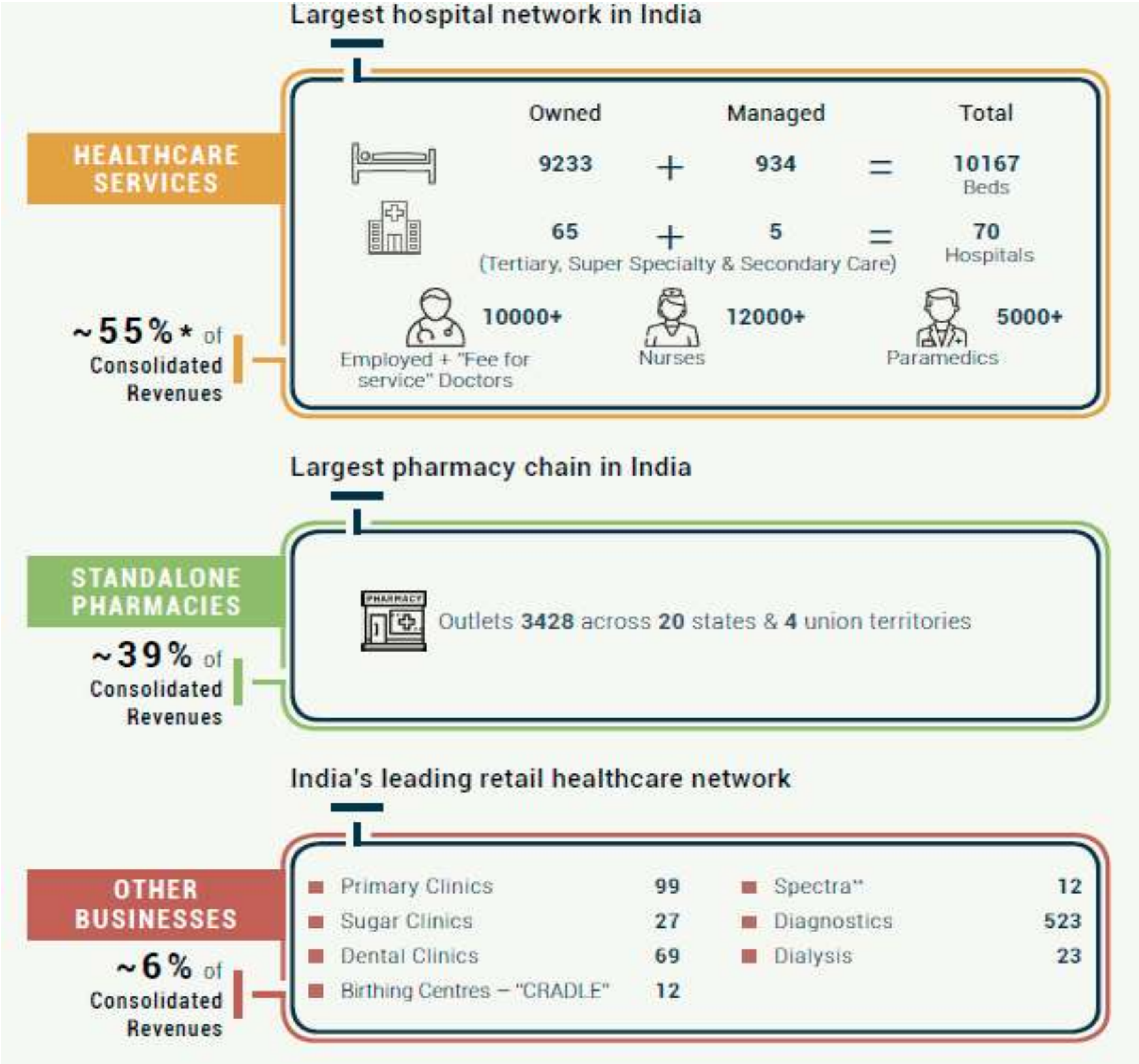
Apollo Hospitals was established in 1983 by Dr. Prathap C Reddy, renowned as the architect of modern healthcare in India. As the nation's first corporate hospital, Apollo Hospitals is acclaimed for pioneering the private healthcare revolution in the country.

Apollo Hospitals has emerged as Asia's foremost integrated healthcare services provider and has a robust presence across the healthcare ecosystem, including Hospitals, Pharmacies, Primary Care & Diagnostic Clinics and several Retail Health models. The Group also has Telemedicine units across 10 countries, Health Insurance Services, Global Projects Consultancy, Medical Colleges, Medvarsity for E-Learning, Colleges of Nursing and Hospital Management and a Research Foundation. In addition, 'ASK Apollo'—an online consultation portal and Apollo Home Health complete the care continuum. Recently, Apollo has launched South Asia's first proton cancer centre in Chennai.

As pointed out in this report, the pharmacy segment is in the process of getting restructured with the front-end retail pharmacy business getting segregated into a separate company—Apollo Pharmacies Ltd. Apollo Hospitals will own 25.5% of Apollo Pharmacies.

Further, Apollo Hospitals is also in the process of offloading its entire stake of 10% in Apollo Munich Health Insurance by selling it to HDFC Ergo for Rs 299.74 crores. The promoters of Apollo Hospitals would also be selling their stake of 41% to HDFC Ergo and the sale proceeds would be used to reduce the percentage of shares pledged by them. All necessary approvals from Competition Commission of India (CCI), Reserve Bank of India (RBI) and Insurance Regulatory and Development Authority of India (IRDAI) have been obtained as on January 1,2020.

Business Snapshot of Apollo Hospitals with reference to FY19



Source: Company Data

Key Management Team

- **Dr. Prathap C. Reddy**

  Dr. Prathap C. Reddy is the founder and executive chairman of the Company. He has spent 33 years with the Company and was conferred with Padma Bhushan in 1991 and Padma Vibhushan in 2010.

- **Dr. Preetha Reddy**

  Dr. Preetha Reddy is an executive vice chairperson of Apollo Hospitals. She has been on the Board since 1989 and has 30+ years of healthcare experience.

- **Ms. Shobana Kamineni**

  Ms. Shobana Kamineni is an executive vice chairperson of Apollo Hospitals. She has been on the Board since 2010 and has 30+ years of healthcare experience.

- **Ms. Suneeta Reddy**

  Ms. Suneeta Reddy is the managing director of Apollo Hospitals. She has been on the Board since 2000 and has 30+ years of healthcare experience.

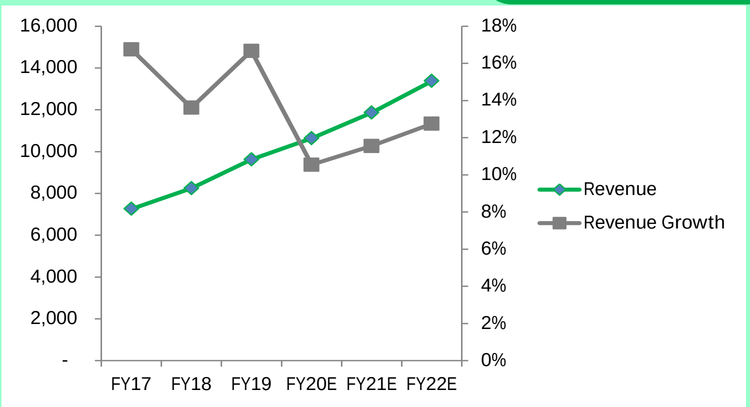
- **Ms. Sangita Reddy**

  Ms. Sangita Reddy is the joint managing director of Apollo Hospitals. She has been on the Board since 2000 and has received the "Young Manager of the year 1998" award from Hyderabad Management Association.

- **Independent Directors** include Mr. Vinayak Chatterjee, Dr. T. Rajagopal, Dr. Murali Doraiswamy, Mr. M.B.N. Rao and Ms. V. Kavitha Dutt.

Key Performance Indicators

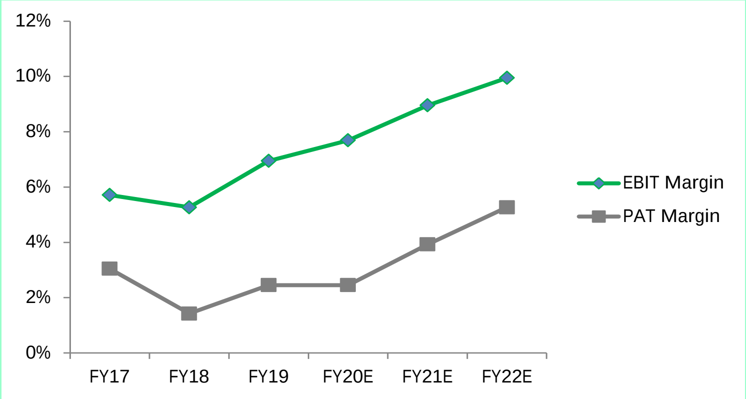
Revenue & Revenue Growth



Source: Company Data, SMIFS Research

Revenue from operations is expected to grow at a CAGR of 12% between FY19 and FY22E.

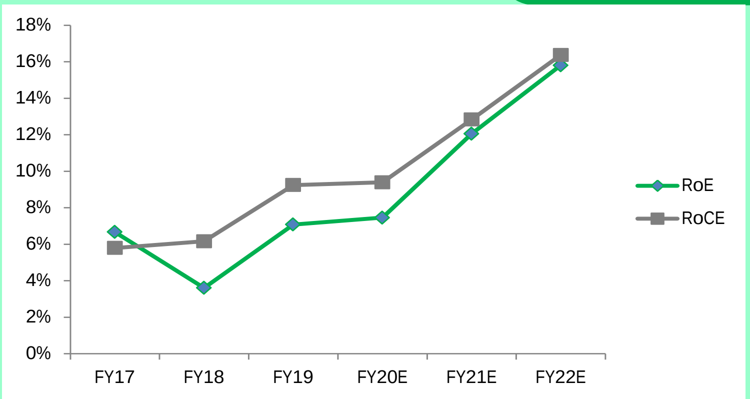
Profit Margins



Source: Company Data, SMIFS Research

EBIT Margin is expected to improve from 6.9% in FY19 to 10.0% in FY22E. PAT Margin is expected to improve from 2.5% in FY19 to 5.3% in FY22E.

RoE and RoCE

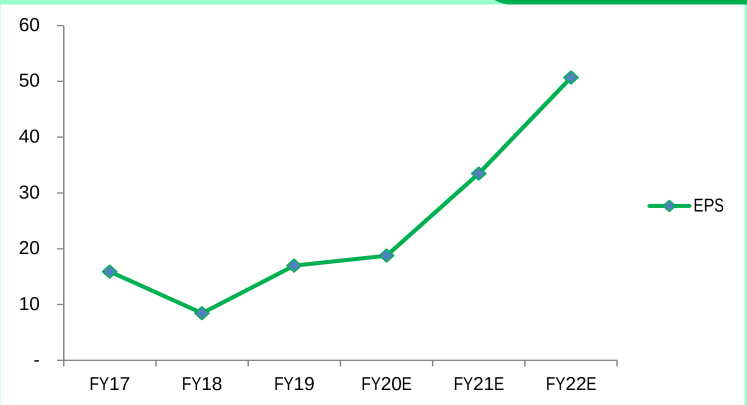


Source: Company Data, SMIFS Research

RoE and RoCE are expected to improve from 7.1% and 9.2% respectively in FY19 to 15.8% and 16.4% respectively in FY22E.

Key Performance Indicators

EPS Growth



Source: Company Data, SMIFS Research

EPS is expected to grow at a CAGR of 44% between FY19 and FY22E.

Debt/Equity Ratio

Source: Company Data, SMIFS Research

Our assumptions indicate a steady decrease in Debt/Equity ratio from 1.10 in FY19 to 0.79 in FY22E. The spike in FY20E is because of the IND AS 116 effect.

Free Cash Flow Generation

Source: Company Data, SMIFS Research

Apollo was in an expansion spree because of which, free cash flow was negative in FY17 and FY18. It turned positive in FY19.Due to minimal capex expectation in FY21E and FY22E, free cash flow will rise significantly to Rs 850 crores plus in each of these years.

Outlook and Valuation

Apollo Hospitals is India's foremost integrated healthcare provider with presence across the entire spectrum of healthcare ecosystem, including Hospitals, Pharmacies, Primary Care & Diagnostic Clinics and several Retail Health models. The immediate brand recall and resilient business model associated with Apollo shortlists it in becoming a strong investment case.

The key initiatives taken by Apollo include its focus on Centres of Excellence whereby Apollo will nurture and grow national centres of excellence in focus specialities – cardiac sciences, neuro sciences, orthopaedics, oncology, transplants, etc. The objective of these would be to enhance the case mix thereby improving the margin profile.

Growth of the retail healthcare system housed within Apollo Health and Lifestyle Ltd. (AHLL) in various parts of the country is another initiative which along with the launch of Proton Cancer Centre in Chennai will improve the revenue streams of Apollo in the long run. Apollo also has an edge on Medical Value Travel given its band of highly efficient doctors. Apollo's efforts of building a strong presence in the growing market of elective and life enhancing procedures should also keep it in good stead.

Standalone pharmacies have been growing at an impressive rate of 28% CAGR over the last 10 years. Evolution in product offering with focus shifting to wellness and private label products along with value added services like home deliveries, prescription refill reminders, etc. positions this segment well for the future. Apollo also has plans for an omni channel model including online pharmacies.

Apollo would incur only maintenance capital expenditure of around Rs 200 crores each for FY21E and FY22E. This would lead to significant free cash flow generation of Rs 850 crores plus in each of the years, which would help in reducing the debt substantially and enhancing its RoCE (Return on Capital Employed) ratio. Further, increase in bed capacity utilization to 70% in FY22E from 67% in FY19 would also boost the RoCE ratio.

Pledged shares of promoters are also expected to come down from 66% to 25%, post the sale of stake in Apollo Munich by the promoters of Apollo Hospitals. This would alleviate the overhang on the stock.

We have valued the stock at 15x FY22E EV/EBITDA to arrive at a **Target Price of Rs 1755**, which provides an upside of 18% based on current market price. We thus recommend a "**Buy**" rating on the stock.

Peer Comparison

Peers	EV/EBITDA			P/E			P/B			RoE(%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Apollo Hospitals	17.4	15.0	13.0	79.6	44.6	29.5	5.9	5.4	4.7	7.5%	12.1%	15.8%
Narayana Hrudayala	16.7	14.2	12.1	48.1	34.0	25.1	5.6	4.8	4.1	12.1%	14.7%	16.9%
Fortis Healthcare	17.0	14.1	12.0	53.7	38.4	27.0	1.5	1.5	1.4	3.0%	4.2%	5.5%
Shalby	9.9	8.4	7.2	19.5	16.1	13.2	1.2	1.2	1.1	6.3%	7.3%	8.2%
Healthcare Global	9.0	7.7	6.2	NA	NA	NA	2.1	2.3	2.4	-11.2%	-5.9%	-2.9%

Source: SMIFS Research, Bloomberg

Financial Details

Income Statement (Consolidated)					
Particulars (INR Cr.)	FY18	FY19	FY20E	FY21E	FY22E
Revenue from operations	8243	9617	10631	11860	13372
Revenue Growth	14%	17%	11%	12%	13%
Cost of goods sold	4033	4661	5178	5764	6485
Employee benefits expenses	1404	1598	1765	1969	2220
Other expenses	2013	2295	2275	2538	2862
EBITDA	793	1064	1389	1614	1855
EBITDA Margin	9.6%	11.1%	13.1%	13.6%	13.9%
EBITDA Growth	9%	34%	31%	16%	15%
Depreciation & Amortisation	359	396	571	552	525
EBIT	434	668	818	1062	1331
Interest Cost	295	327	463	400	309
Other Income	32	31	33	33	30
PBT (Adjusted)	171	374	390	710	1070
Tax expense	54	137	129	244	365
PAT (Adjusted)	117	236	261	466	705
PAT Margin	1.4%	2.5%	2.5%	3.9%	5.3%
PAT Growth (Adjusted)	-47%	101%	11%	78%	51%

Balance Sheet (Consolidated)					
Particulars (INR Cr.)	FY18	FY19	FY20E	FY21E	FY22E
Share Capital	70	70	70	70	70
Reserves & Surplus	3314	3399	3564	3939	4547
Networth	3384	3469	3634	4009	4617
Long term Borrowings	2924	2952	4263	3451	2679
Other Non-Current Liabilities	738	807	810	820	832
Short term Borrowings	379	498	735	735	735
Other Current Liabilities	1188	1457	1522	1715	1574
Total Equity & Liabilities	8613	9183	10964	10730	10437
Net Tangibile Asset	5098	5422	6762	6430	6126
Other Non Current Assets	1295	1479	1471	1449	1476
Inventories	566	585	669	741	830
Trade Receivables	825	1023	1107	1235	1392
Cash and Cash Equivalents	306	286	437	396	152
Other Current assets	523	388	518	479	462
Total Assets	8613	9183	10964	10730	10437

Source: Company Data, SMIFS Research

Financial Details

Cash Flow Statement Extract (Consolidated)					
Particulars (INR Cr.)	FY18	FY19	FY20E	FY21E	FY22E
PBT	171	374	1009	710	1070
Depreciation & Amortisation	359	396	571	552	525
Interest expense	295	327	463	400	309
(Increase)/Decrease in CA	(67)	(82)	(299)	(161)	(229)
Increase/(Decrease) in CL	604	388	302	193	(141)
Taxes Paid	(125)	(192)	(333)	(234)	(353)
Cash Flow from Operating Activities	537	905	628	1090	1069
Capital Expenditure	(620)	(672)	8	(223)	(220)
Cash Flow Investing Activities	(405)	(711)	228	(179)	(222)
Increase/(Decrease) in Borrowings	302	235	(142)	(451)	(672)
Dividend payments including tax	(101)	(84)	(100)	(100)	(109)
Cash Flow from Financing Activities	(108)	(215)	(705)	(952)	(1090)
Net Cash Flow	24	(20)	150	(41)	(243)
Closing Balance	306	286	437	396	152

Key Ratios (Consolidated)					
Particulars	FY18	FY19	FY20E	FY21E	FY22E
Margins					
Gross Margin	51.1%	51.5%	51.3%	51.4%	51.5%
EBITDA Margin	9.6%	11.1%	13.1%	13.6%	13.9%
PBT Margin (Adjusted)	2.1%	3.9%	3.7%	6.0%	8.0%
PAT Margin (Adjusted)	1.4%	2.5%	2.5%	3.9%	5.3%
DPS	5.00	6.00	6.00	6.50	7.00
Solvency Ratios					
Current Ratio	1.4	1.2	1.2	1.2	1.2
Debt/Equity	1.1	1.1	1.5	1.2	0.8
Net Debt/Equity	0.9	1.0	1.3	1.0	0.7
Interest Coverage	1.5	2.0	1.8	2.7	4.3
Profitability Ratios					
RoE	3.6%	7.1%	7.5%	12.1%	15.8%
RoCE	6.2%	9.2%	9.4%	12.8%	16.4%
Valuation Ratios(x)					
EV/EBITDA	30.4	22.7	17.3	14.9	13.0
EV/Sales	2.9	2.5	2.3	2.0	1.8
P/E	176.1	87.6	79.2	44.4	29.3
P/B	6.4	6.2	5.9	5.4	4.6

Source: Company Data, SMIFS Research

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