September 16, 2021

Shalby Limited: Rating upgraded to [ICRA]A+(Stable)

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based CC/OD/Others	25.00	25.00	[ICRA]A+(Stable); upgraded from [ICRA]A(Stable)
Fund-based Term Loan	78.02	78.02	[ICRA]A+(Stable); upgraded from [ICRA]A(Stable)
Total	**103.02**	**103.02**	

**Instrument details are provided in Annexure-1*

Rationale

The upgrade in the rating factors in the expected improvement in the operating income and earnings of Shalby Limited (Shalby or the company) over the medium term, driven by higher revenue from non-arthroplasty—critical care and general medicine, which is also reflected by strong revenue growth of ~400% % in Q1 FY2022 on Y-O-Y basis and ~33% sequentially. The revenue at the consolidated level is also expected to get a boost by business acquisition of implant and joint manufacturing under its step-down subsidiary, Shalby Advance Technologies, USA (SAT), in Q1FY2022. The same is expected to provide diversification to the revenue stream as well as better control over its cost structure in the long run from in-house manufacturing of implants. The hospital's earnings profile is strong, supported by improving the scale of operations, and better cost management.

The rating continues to factor in the extensive experience of Shalby Limited's (Shalby's) founder-promoter, Dr. Vikram Shah, who along with the management team, has a demonstrated track record of more than two decades in the healthcare industry. The rating also derives comfort from the strong brand equity of Shalby in Gujarat and Madhya Pradesh, with a growing presence in Rajasthan, Maharashtra and Punjab. Further, the rating is supported by Shalby's leadership position in arthroplasty speciality segment as well as its diversification into cardiology, oncology, bariatrics and other non-arthroplasty segments. ICRA also continues to take comfort from Shalby's healthy financial risk profile, characterised by improvement in profitability, comfortable capital structure and healthy coverage indicators and positive long-term demand outlook for healthcare services in India on the back of better affordability by virtue of increasing per capita income, widening medical insurance coverage and under-penetration of healthcare services.

The rating, however, remains constrained by the growing, though moderate occupancy levels (~36% in FY2021) of Shalby's hospitals, which puts pressure on the overall operational performance of the company. The rating is constrained by the low return on capital employed (RoCE) levels (at 6.9% in FY2021) and is only likely to improve gradually over the next few years, post successful ramp-up of the overall occupancy level, risks of competition and attrition of doctors. Nevertheless, the risk is partly mitigated by Shalby's strong brand pull and long-term contracts with doctors. Further, the rating also considers the high reliance on its flagship hospital, SG Highway, for revenue and operating profitability, although the contribution of other hospitals has been increasing gradually. The company's expansion strategy has been aggressive, with six new hospitals becoming operational since FY2015 and two hospitals are under construction. ICRA also notes that Shalby, through its step-down subsidiary, SAT, backward integrated into implants and joint manufacturing business by acquiring assets of Consensus Orthopedics, the USA in Q1FY2022. Though the same is expected to provide diversification to revenues and supplement its in house sourcing of implants in the long run, given that the acquisition was largely debt funded and its operations are yet to break even, Shalby's ability to meaningfully turn around and profitably scale up the new business, remains critical credit monitorable.

Key rating drivers and their description

Credit strengths

Experienced management team with strong execution track record - Shalby is promoted by renowned joint replacement specialist, Dr. Vikram Shah, who has over 25 years of medical experience in the UK, the US and India. Its overall operations are also supported by its senior management, with an average experience of more than 10 years in healthcare services in India and abroad. Shalby enjoys strong goodwill among patients and healthcare professionals, which has helped it to grow over the years.

Dominance in Indian arthroplasty segment - Shalby remains one of the largest specialist joint replacement provider in India and the world, with a total of over 1,25,000 joint replacement surgeries till date and an average of 8,000–10,000 surgeries per year. The company enjoys a strong market position in the healthcare services industry. underpinned by its established brand equity, especially in the arthroplasty segment. The arthroplasty segment has remained the key revenue and profit generator for Shalby over the years.

Increase in diversification into non-arthroplasty segments - Over the past few years, the share of non-arthroplasty segments in Shalby's total revenue has been increasing steadily, contributing 77% to the total revenue in FY2021. Among the non-arthroplasty segments, oncology surgery has been the largest revenue contributor, followed by cardiology/cardiac.

Improvement witnessed in profitability in FY2021, capital structure and coverage indicators continues to be healthy – Shalby's profitability improved in FY2021 as reflected by operating margin of 20.1% in FY2021 (16.8% in FY2020 and 17.8% in FY2019) because of better cost management, which also led to rise in net margin to 9.8% (5.7% in FY2020 and 6.8% in FY2019) on a consolidated basis. Further, scheduled repayments over FY2021 and nil utilisation of working capital facilities as on March 31, 2021 resulted in lower debt levels as compared to March 31, 2020. Given the improvement in net worth base and low debt levels, the gearing remained healthy at 0.1 times as on March 31, 2021. The Debt/OPBITDA metrics also improved to 0.5 times in FY2021 from 0.8 times in FY2020. Also, given the large cash balance of Rs. 134.09 crore, as of FY2021, the liquidity also remains strong. Given the debt funded nature of asset acquisition in Q1FY2022, the profitability and in turn coverage numbers are expected to undergo some moderation in FY2022. However, with returns from the asset flowing and expected turnaround thereafter, improvement is expected from FY2023 onwards, and will remain a key rating monitorable.

Credit challenges

Low overall occupancy levels in FY2021 constrained scale of operations and return metrics – The overall occupancy levels for Shalby remained moderate at 36% in FY2021 over 38% in FY2020. The SG Highway hospital occupancy declined to 34% in FY2021 as against the occupancy of ~50% in FY2020 because patients opted to defer elective surgeries due to the pandemic. Moreover, the occupancy at some of the other mature hospitals like Jabalpur and Vapi remains low. ICRA notes that at the relatively new hospitals in Jaipur, Naroda and Surat, Shalby has been able to rapidly ramp-up the occupancy to 49% in FY2021. Nonetheless, given the low overall occupancy and the decline in elective surgeries, the company's operating income declined to Rs. 430.9 crore in FY2021 (Rs. 486.9 crore in FY2020). The large equity base posts the IPO, as well as the ongoing expansion in hospitals have constrained the RoCE, which remained low at 6.9% in FY2021 (7.6% In FY2020).

High dependence on flagship hospital, SG Highway, for revenue and profitability - Historically, Shalby has derived a significant percentage of its total revenue from its flagship hospital, SG Highway. It drove 24% of the total revenue and 36% of the total operating profit in FY2021. Though its share has been gradually decreasing over the past three years due to increased contribution of the newly commissioned hospitals, it still continues to be significant.

Aggressive expansion of hospitals - Shalby expanded its capacity aggressively by commencing operations of new hospitals at Jabalpur (Madhya Pradesh), Indore (Madhya Pradesh) and Mohali (Punjab) in FY2015–FY2016, while new hospitals were set up at Naroda (outskirts of Ahmedabad, Gujarat), Surat (Gujarat) and Jaipur in FY2017, which became operational in FY2018. Additionally, Shalby has two new hospitals in Mumbai and Nashik (Maharashtra) under construction. ICRA notes that the company faced certain delays in getting the regulatory approvals for these hospitals and the same are now expected to become operational over FY2023-FY2024. Such rapid expansion has led to a significant proportion of low maturity hospitals in the company's portfolio as on March 31, 2021, constraining its margins and return indicators to some extent.

Risk of attrition of key doctors - Loss of key doctors can lead to a loss of patients, which impacts the overall revenue and profitability of a hospital. Shalby faced the same in FY2016. While the risk of losing patients and successful doctors to competing hospitals still remains, Shalby mitigates it to some extent by entering into long-term consultancy contracts with a few key doctors.

Ability to profitably scale up and turn around new business acquired under step down subsidiary will remain critical for credit perspective at a consolidated level –Shalby ventured into implant and joint manufacturing by acquiring assets of Consensus Orthopedics, USA, through its step-down subsidiary, SAT, in May 2021. The funding of the same was largely debt funded. Though the acquisition is synergistic from the perspective of revenue diversification as well as long-term sourcing strategy, the debt metrics in the near term are expected to undergo some moderation, given the debt-funded capex and the current loss-making operations. Thus, Shalby's ability to turn around the operations and profitably scale up the new venture so as to generate a commensurate return remains critical from a credit perspective on a consolidated basis.

Liquidity position: Strong

Shalby's liquidity position remains strong, with healthy annual fund flow from operations of Rs. 75 crore in FY2021 and surplus cash, bank balance and liquid investment of Rs. 134.9 crore as on March 31, 2021, out of which Rs. 112.9 remains encumbered as security against its outstanding term loan and working capital facilities. The company also had sanctioned fund-based working capital facility of Rs. 31 crore as on June 30, 2021, the average utilisation of which remained almost nil in the past 12 months. Moreover, going forward, the company is expected to generate sufficient cash flows from operations to meet its scheduled repayments over the next few years.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if sustained increases in occupancy improves revenue and profitability, which in turn improves debt coverage indicators and strengthens the overall liquidity profile.

Negative factors – Negative pressure on the company's ratings could arise if the debt/ OPBDITA metrics increases above 1.5 times on a sustained basis or if there is any significant time or cost overruns in the under-construction hospitals, or delay in turnaround of newer ventures, which overall impacts the financial profile. Further, any higher-than-expected debt-funded capex, which materially weakens the coverage indicators, will also be a negative rating trigger.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Hospitals
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of Shalby Limited. As on March 31, 2021, the company had six direct subsidiaries, the details of which are enlisted in Annexure-2.

About the company

Shalby is promoted by the arthroplasty specialist, Dr. Vikram Shah, who commenced hospital operations under the company with a six-bed facility at Ahmedabad in 1994. Shalby currently operates a chain of multi-speciality healthcare facilities with ~2,012 bed capacity and a potential to reach ~2,400 beds in the coming 2-3 years. Shalby has a strong presence in western and central India with 11 operational hospitals in Ahmedabad, Vapi (Gujarat), Surat (Gujarat), Jaipur, Indore (Madhya Pradesh), Jabalpur (Madhya Pradesh), Mohali (Punjab) and Mumbai. Shalby also operates 37 OPD centres across India and seven clinics in Africa (Kenya and Tanzania). Operations initially focused on arthroplasty procedures (knee and hip replacements), following which the company expanded into other specialities such as oncology, bariatrics, cardiology, neurosurgery, etc, over last few years.

Key financial indicators (Consolidated - audited)

Consolidated	FY2020	FY2021
Operating Income (Rs. crore)	486.9	430.9
PAT (Rs. crore)	27.6	42.4
OPBDIT/OI (%)	16.8%	20.1%
PAT/OI (%)	5.7%	9.8%
Total Outside Liabilities/Tangible Net Worth (times)	0.2	0.2
Total Debt/OPBDIT (times)	0.8	0.5
Interest Coverage (times)	12.9	23.9

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Sep 16, 2021	July 10, 2020	Oct 18, 2019	Sep 14, 2018
1	Fund Based - CC/OD/others	Long Term	25.00	-	[ICRA]A+ (Stable)	[ICRA]A(Stable)	[ICRA]A (Positive)	[ICRA]A (Positive)
2	Fund Based - Term Loan	Long Term	78.02	44.03	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A (Positive)	[ICRA]A (Positive)

Complexity level of the rated instruments

Instrument	Complexity Indicator
CC/OD/Others	Simple
Term Loan	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Fund Based – CC/OD/others	NA	NA	NA	25.00	[ICRA]A+(Stable)
NA	Fund Based – Term Loan 1	FY2017	NA	FY2025	16.59	[ICRA]A+(Stable)
NA	Fund Based – Term Loan 2	FY2018	NA	FY2025	41.54	[ICRA]A+(Stable)
NA	Fund Based – Term Loan 3	FY2018	NA	FY2026	19.89	[ICRA]A+(Stable)

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Shalby Kenya Limited	100.00%	Full Consolidation
Shalby International Limited	100.00%	Full Consolidation
Vrundavan Shalby Hospitals Limited	100.00%	Full Consolidation
Mars Medical Devices Limited	100.00%	Full Consolidation
Shalby Hospital Mumbai Private Limited	100.00%	Full Consolidation
Shalby Healthcare Private Limited	100.00%	Full Consolidation
Shalby Advance Technologies Inc.	100.00%	Full Consolidation
Slanely Healthcare Private Limited	100.00%	Full Consolidation
Yogeshwar Healthcare Limited	94.68%	Full Consolidation
Griffin Mediquip LLP	95.00%	Full Consolidation

Source: *Shalby Limited audited report FY2021*

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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