ICRA

July 07, 2017

Shalby Limited

Summary of rated instruments

Instrument*	Rated Amount (in Rs. Crore)	Rating Action
Term Loans	322.00	[ICRA]A-(Stable) assigned
Working Capital	50.00	[ICRA]A-(Stable) assigned

* Instrument Details are provided in Annexure-1

Rating action

ICRA has assigned the long term rating of [ICRA]A- (pronounced ICRA A minus) to the Rs.322.00[1] crore term loan and Rs.50.00 crore working capital facilities of Shalby Limited (Shalby) [2]; the outlook on the long-term rating is Stable.

Rationale

The assigned rating factors in the expertise and extensive experience of its founder-promoter, Dr. Vikram Shah who along with his management team have demonstrated a strong operational track record of more than two decades in the healthcare industry. The rating derives comfort from the strong brand equity of Shalby in Gujarat and growing presence in states like Madhya Pradesh along the back of leadership position in the arthroplasty speciality (joint replacement) segment in the country. Further, the rating draws comfort from the asset light model of capital deployment employed by the company to achieve growth resulting in a low capital cost per bed. ICRA also positively factors in the financial risk profile characterised by healthy profitability, moderate gearing and strong interest coverage indicators. ICRA also notes that the positive demand outlook for healthcare services in India, due to factors including better affordability through increasing per capita income, widening medical insurance coverage and under-penetration of healthcare services, is expected to benefit the company.

The rating is, however, constrained by the high dependence on its flagship hospital 'Shalby-S.G Highway, and arthroplasty speciality for revenue and margins, although the risk is mitigated to some extent by the recent foray into new states and higher focus on other specialities. The rating factors in the largely debt funded nature of expansions undertaken over the last three years, which is likely to constraint coverage metrics going forward, while efforts to stabilise operations at the new hospitals has resulted in differing levels of success. Further, the higher proportion of lower maturity hospitals and the gestation period before stabilisation of overall occupancy levels at optimal level is likely to constrain the return indicators of the company in the medium term. The ramp up in occupancy levels is also exposed to the risk emanating from competing hospitals that could impact patient flow and keep the operations vulnerable to loss of successful doctors, although; the risk is partly mitigated by Shalby's policy of entering into long term contracts with doctors.

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1 100 lakh = 1 crore = 10 million

2 For complete rating scale and definitions, please refer to ICRA's website, www.icra.in, or other ICRA Rating Publications

Key rating drivers

Credit Strengths
- Promoted by renowned orthopedic surgeon Dr. Vikram Shah; experienced management team with a strong execution track record and strong brand equity of 'Shalby'
- Spread across several geographies of India with a strong presence in Gujarat & Madhya Pradesh
- Strong presence in joint replacement apart from continuing diversification into other specialities
- Asset light model of capital deployment to achieve growth; Low capital cost per bed
- Healthy profitability & strong coverage metrics, despite low to moderate occupancy levels
- Positive demand outlook for healthcare services in the country

Credit Weaknesses
- High dependency on the flagship hospital & joint replacement speciality for revenues & margins; though the revenue concentration has moderated in recent years
- Overall occupancy levels have remained low at ~30%; mature hospitals like "S.G Highway-Ahmedabad" has registered occupancy of ~45-55% over FY2015 & FY2016
- Aggressive expansion of network of hospitals and healthcare facilities; acquisition and construction of hospitals in Surat, Naroda & Japiur are debt funded projects which is likely to impact coverage metrics of the company
- Higher proportion of lower maturity hospitals with lower profitability or losses constrain the profit margins and return indicators for the group in the near to medium term
- Risk of competition from other hospitals in cities like Ahmedabad, Indore & Jaipur; company however enjoys first mover advantage in the 150-200 beds category in cities like Jabalpur, Mohali, Vapi etc
- Ability to attract and retain doctors, though risk partly mitigated by entering into long term contracts with doctors

Description of key rating drivers highlighted above:
Shaby Limited (Shalby) is promoted by renowned joint replacement specialist, Dr. Vikram Shah, who commenced operations with a six bed facility in Ahmedabad in 1994. Over the last 23 years, the company has gradually scaled up to ~2000 beds, with on-going and planned expansions expected to take the total capacity to ~2475 beds. In addition to the hospitals, the company also operates ~68 OPD clinics across several states in India and ~13 OPD clinics in African countries like Tanzania, Kenya etc. that help source domestic and international patients to its network of hospitals.

Shalby carries out one of the highest number of joint replacement surgeries in India with ~15% market share[3] of the total organized joint replacement market in India. Dr. Vikram Shah, has over 25 years of experience and carried out more than 70,000 joint replacement surgeries till date. He is credited with the innovation of the '0' technique that has helped reduce surgery time and average stay time of the patient at the hospital. Besides this he has also invented the OS needle which is used in attaching soft tissue to the bone. Since March 2007, Shalby has conducted an aggregate of 84,579 surgeries, and provided healthcare services to an aggregate of 923,441 patients, consisting 121,576 inpatients and 801,865 outpatients. The overall operations are also supported by Shalby's senior management with an average experience of more than ten years in the healthcare services industry in India and abroad.

Shalby operated largely as a Gujarat based chain of hospitals, however owing to a steady increase in patients from neighbouring states like Madhya Pradesh, Rajasthan and some parts of Maharashtra, the

[3] Source: Frost & Sullivan Report, DRHP, May 2017

company expanded operations by setting up or acquiring hospitals in Punjab, Rajasthan, Madhya Pradesh, Maharashtra and Goa.

Shalby expanded its capacity aggressively by setting up new hospitals at Jabalpur (FY2015), Indore (FY2016) and Mohali (FY2016) while new hospitals were set up at Naroda (outskirts of Ahmedabad), Surat and Jaipur in FY2017. The Gujarat cluster of hospitals is centered in Ahmedabad city comprising of four hospitals namely SG Highway, Krishna Hospital, Vijay and Naroda in addition to hospitals at Vapi and Surat. The Maharashtra & Goa cluster comprises of hospitals at Goa & Mumbai and an upcoming hospital at Nashik. The Rajasthan and Madhya Pradesh cluster comprises of hospitals at Indore and Jabalpur and a new hospital at Jaipur. Shalby also entered the north India market with the acquisition of a hospital at Mohali in Punjab.

Shalby has adopted a comparatively asset- light model of expansion with hospitals like Jabalpur and Mumbai operated on O&M basis. Further, efforts to optimize space have helped in accommodating more beds resulting in comparatively lower capital costs of ~Rs.0.30-0.35 crore per bed. Also, new hospitals planned in the near to medium term at Mumbai, Nashik and Vadodara are planned to be operated on O&M basis, thus resulting in low overall capex cost per bed.

Overall occupancy levels moderated from 64% in FY2012 to 32% in FY2016 before improving marginally to 34% during 9MFY2017. The moderation in occupancy levels is attributable to addition of new hospitals in rapid succession over the last few years. Despite low occupancy levels, operating margins remained at healthy levels, however profitability was impacted during FY2016 on account of losses from the newer hospitals, increase in corporate overheads including selling expenses and sharp increase in employee costs. However, in order to contain costs, the two promoters – Dr. Vikram Shah and Ms. Darshini Shah, renegotiated their professional fees at significantly lower rates, resulting in lower pay out to the two promoters at Rs. 4.53 crore during 9MFY2017 vis-a-vis Rs.17.41 crore in FY2015. While Shalby has been able to ramp up occupancy levels at hospitals in Indore and Jabalpur, occupancy continues to remains low for hospitals like Vapi, Goa and Mohali. Ramp up of occupancy levels at existing hospitals, particularly newly established hospitals remains to be seen, which is expected to constraint profitability and return indicators till occupancy levels improve. Further, profitability has been supported by high Average Revenue Per Occupied Bed (ARPOB), which has remained between Rs.38,000-40,000 per day over FY2013-FY2015, which moderated to Rs.34,034 per day in FY2016 and further to Rs. 31,687 per day during 9MFY2017 with addition of new hospitals. Average Length of Stay (ALOS) for patients has remained steady at ~4 days over the past few years. ARPOB and ALOS vary depending on the maturity profile and service mix of each hospital as hospitals with higher flow of international patients or higher concentration of specialties like arthroplasty and oncology that require longer patient time have higher ALOS and ARPOB. Mature hospitals like S.G Highway have higher occupancy levels as they have been operational for several years and carry out a significant percentage of the arthroplasty procedures resulting in higher ARPOB.

Among the twelve operational hospitals, Shalby derives a significant percentage of its total revenue from its flagship hospital- S.G Highway, which however moderated from ~70% of total revenue in FY2015, to 61% in FY2016 and further to 53% in 9MFY17 owing to increased contribution of other hospitals that were set up over the last two years. In terms of contribution to total profitability, the share of S.G Highway moderated marginally from 84% in FY2015 to ~74% in FY2016 before increasing to ~95% of total profitability during 9MFY2017. Share of profitability from the flagship remains high due to operating losses reported by the comparatively newer hospitals. Due to the relatively low maturity profile of the hospitals, the revenue and profitability continues to be heavily reliant on its flagship hospital. The rate of expansion of the network of healthcare facilities is one of the most important factors affecting Shalby's operational and financial parameters. Each new facility goes through an initial ramp-up period during which the operating expenses exceed revenue resulting in operating losses. Until patient volumes reach targeted levels, new facilities are expected to incur operating losses.

Further revenue & profitability also remains dependent on arthroplasty specialty which contributed 64% of the total inpatient and outpatient revenue in FY2015 and 66% of total revenue in FY2016. General medicine has been the second largest revenue contributor and its share to total revenue has witnessed similar increase from 6% in FY2015 to 8% in FY2016. The contribution of the top five specialties has more or less remained at similar levels of ~82-83% over the last two years while the remaining has been contributed by the remaining 34 specialties. Although general and laparoscopy surgery, gynaecology and paediatric departments together contribute to ~16% of the total IPD flow, their contribution to total revenue remains low at ~3-4% owing to the smaller ticket size of procedures.

During FY2015 & FY2016, loss of key doctors to competing hospitals impacted profitability due to loss of patients as well as an overall increase in employee costs from Rs.88.41 crore in FY2015 to Rs.104.7 crore in FY2016 in order to retain doctors and staff .As on December 31, 2016, Shalby engaged the services of 453 doctors (of whom 240 were engaged on a consultancy basis including visiting consultants, 47 were student doctors, 105 were patient care officers, 44 physiotherapists, 11 dentists and 6 dieticians). The risk of losing doctors is mitigated to some extent by entering into lifetime service contracts with some key doctors in the orthopedic and joint replacement specialty. Further, Shalby normally enters into employment agreements with consultant doctors, obligating them to serve a minimum period of time. While the risk of losing patient and successful doctors to competing hospitals in cities like Ahmedabad, Indore & Jaipur remains, Shalby enjoys first mover advantage in the 150-200 beds category in cities like Jabalpur, Mohali, Goa and Vapi.

Overall debt levels increased sharply from Rs. 35 crore in FY2014 to Rs. 221 crore in FY2016 on account of capex towards setting up of new hospitals at Indore, Naroda, Jaipur & Surat. In addition to this loans were also taken to fund acquisition and refurbishment of Mohali hospital and other operational hospitals in Ahmedabad. Overall debt levels increased to Rs. 274 crore as on December 31, 2016. Consequently, gearing levels increased over the past two years from 0.24 times as on March 31, 2014 to 1.05 times as on March 31, 2016 and further to 1.09 times as on December 31, 2016. In line with increase in debt levels, interest coverage metrics moderated to 5.44 times in FY2016, and is likely to moderate further in the near to medium term. Further, debt coverage metrics as indicated by Total Debt/OPBDITA increased sharply from 0.57 times as on March 31, 2014 to 3.59 times as on December 31, 2016.

Analytical approach: For arriving at the rating, ICRA has applied its rating methodologies as indicated below

Links to applicable Criteria

Rating Methodology for Hospitals
Corporate Credit Rating –A Note on Methodology

About the company:

Shalby Limited (Shalby) is promoted by 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 multispecialty healthcare facilities comprising of ~2000 operational beds and a potential to reach 2,475 beds in the coming 2-3 years. Shalby has a strong presence in Western and Central India with 12 operational hospitals in the cities of Ahmedabad, Vapi, Surat, Jaipur, Indore, Jabalpur, Mohali & Mumbai. Shalby also operates 68 OPD centres across India and 13 clinics in Africa (in Kenya & Tanzania).Operations initially focused on arthroplasty procedures (knee and hip replacements) following which the company expanded into other specialities like oncology, neurology and neurosurgery etc over the last few years.

During FY2016, Shalby reported total operating income of Rs. 291.2 crore and a profit after tax of Rs.26.5 crore against an operating income of Rs. 274.7 crore in FY2015 and a profit after tax of Rs. 34.9 crore. During 9MFY2017 (as per provisional financials), Shalby has reported an operating income of Rs. 243.1 crore and a profit before tax of Rs. 44.7 crore.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating history for last three years:

Table:

S.No	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. Crore)	Month-year & Rating	Month-year & Rating in FY2017	Month-year & Rating in FY2016	Month-year & Rating in FY2015
				July 2017			
1	Term Loan	Long Term	322.00	[ICRA]A- (Stable)			
2	Working Capital/Overdraft	Long Term	50.00	[ICRA]A- (Stable)	-	-	-

Complexity level of the rated instrument:
ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1
Instrument Details

Name of the instrument	Date of issuance/ Sanction	Coupon rate	Maturity Date	Size of the issue (Rs. Crore)	Current Rating and Outlook
Term Loan	-	-	FY2026	322.00	[ICRA]A- (Stable)
Working Capital/Overdraft	-	-	-	50.00	[ICRA]A- (Stable)

Source: Shalby Limited

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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.
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