Shalby Limited

September 14, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based - CC/OD/others	50.00	25.00	Upgraded to [ICRA]A from [ICRA]A-; Outlook revised to ‘Positive’ from ‘Stable’
Fund Based - Term Loan	322.00	78.02	Upgraded to [ICRA]A from [ICRA]A-; Outlook revised to ‘Positive’ from ‘Stable’
Total	**372.00**	**103.02**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has upgraded the long-term rating to [ICRA]A (pronounced ICRA A) from [ICRA]A- (pronounced ICRA A minus) on the Rs. 78.02-crore[1] (reduced from Rs. 322.00 crore) term loans and the Rs. 25.00-crore (reduced from Rs. 50.00 crore) fund based facilities of Shalby Limited (Shalby or the company). The outlook on the long-term rating has been revised to ‘Positive’ from ‘Stable’[2].

Rationale

The rating upgrade takes into account the improvement in the liquidity position, capital structure and coverage indicators of the company on account of funds raised through issuance of equity. The rating continues to factor in the expertise and extensive experience of its founder-promoter, Dr. Vikram Shah who, along with the management team, has demonstrated a strong operational 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 states like Rajasthan and Punjab. Further, the rating is supported by Shalby’s leadership position in the arthroplasty speciality (joint replacement) segment as well as the increased diversification into cardiology, oncology, bariatrics and other non-arthoplasty segments. The rating also positively factors in the asset light model of capital deployment employed by the company to achieve growth resulting in a low capital cost per bed as well as 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. ICRA also takes comfort from Shalby’s ability to turn the recently commissioned hospitals at Jaipur and Surat operationally profitable in a relatively short span of time.

The rating is, however, constrained by the high reliance on its flagship hospital Shalby - S.G Highway for revenue and operating profitability, although contribution of other hospitals has been increasing gradually. The rating also factors in the company’s aggressive expansion strategy with three new hospitals operationalised in FY2018. Further, the higher proportion of lower maturity hospitals has resulted in the overall occupancy levels of the company being low at ~36% in FY2018, which is likely to constrain the return indicators of the company in the short 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

[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*

into long term contracts with doctors. Given the surplus cash reserves and the management's stated intent towards growth from the funds raised through initial public offering (IPO), ICRA believes, the company could take up expansions/acquisitions in the short to medium term, however, ICRA would be considering the impact of such events on the rating as and when such events take place.

Outlook: Positive

ICRA believes that going forward, Shalby's revenues and cash accruals will show healthy growth supported by the ramp-up in occupancy levels at the relatively less-matured hospitals as well as the improved contribution of the non-arthoplasty segments. Sustained growth in scale as anticipated and improvement in occupancy levels would result in an upgrade in the rating. The outlook may be revised to 'Stable' if there is a weakening of the financial risk profile due to any debt-funded expansion or any significant adverse changes in the operational parameters of the company.

Key rating drivers

Credit strengths

Experienced management team with a 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 United Kingdom, USA and India. Its overall operations are also supported by its senior management with an average experience of more than ten years in the healthcare services industry in India and abroad. Shalby enjoys strong goodwill among patients and healthcare professionals which has helped it to grow over the years.

Dominance in the arthroplasty segment in India - Shalby remains one of the largest joint replacement specialists in India and the world with a total of about 80,000 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 joint replacement and orthopedic segments. Arthoplasty segment has been the key revenue and profit generator for Shalby over the years.

Increased diversification into non-arthoplasty segments - Though arthroplasty segment has been dominant, over the past few years, the share of non-arthoplasty segments in the company's total revenue has been increasing steadily and it contributed over 45% of the total revenue of the company in FY2018. Among the non-arthoplasty segments, cardiac surgeries/cardiology has been the largest revenue contributor followed by the oncology segment.

Comfortable capital structure and healthy coverage indicators - Shalby raised Rs. 480 crore through its initial public offering in December 2017 and used Rs. 300 crore of the proceeds to repay/prepay the outstanding term loans. Given this, the capital structure of Shalby has shown stark improvement with the gearing ratio improving to 0.1 times in FY2018 as opposed to 1.3 times in FY2017. The Debt/OPBITDA metrics also improved to 1.4 times in FY2018 as opposed to 4.6 times in FY2017. Also, given the large cash balance of ~Rs 117 crore, the net debt of the company was nil as of March 2018.

Stable operating margins and ability to break even early at new hospitals- The operating margin of Shalby has remained at healthy levels in the range of 19-22% over the past few years. This is in spite the addition of three new hospitals in FY2018. Typically, new hospitals take a few years to turn EBITDA positive; however, Shalby has been able to turn its new hospitals at Jaipur and Surat operationally profitable in less than a year.

Credit challenges

Low overall occupancy levels on the back of rapid increase in bed capacity affects overall returns - Overall occupancy levels for Shalby moderated from 41% in FY2015 to 36% in FY2018. The moderation in occupancy levels is attributable to addition of new hospitals in rapid succession over the last few years as well as the marginal drop in occupancy levels at Shalby's flagship hospital at S.G. Highway in FY2018 due to partial cannibalization of the patient inflow due to opening of the new hospitals. Given the low utilisation levels and the large equity base, return on capital employed (RoCE) remains moderate at 11.9% in FY2018.

High dependence on flagship hospital 'S.G Highway' for revenue and profitability - Historically, Shalby has derived a significant percentage of its total revenue from its flagship hospital - S.G Highway. It contributed about 40% of total revenue and 55% of total operating profits in FY2018. Though its share has been gradually decreasing over the past two years due to increased contribution of the newly commissioned hospitals, it still continues to remain moderately high.

Aggressive expansion of hospitals - Shalby expanded its capacity aggressively by commencing operations of new hospitals at Jabalpur, Indore and Mohali in FY2015-FY2016, while new hospitals were set up at Naroda (outskirts of Ahmedabad), Surat and Jaipur in FY2017 which got operational in FY2018. This has led to a significant proportion of low-maturity hospitals in the company's portfolio constraining the 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 patient and successful doctors to competing hospitals in cities like Ahmedabad, Indore & Jaipur remains, Shalby mitigates this risk, to some extent, by entering into lifetime service contracts with few key doctors as well as issuance of ESOPs.

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

Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology for Hospitals

About the company:

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 ~2,000 operational beds and a potential to reach ~2,500 beds in the coming 2-3 years. Shalby has a strong presence in Western and Central India with 11 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, bariatrics, cardiology, neurosurgery etc over the last few years. In FY2018, Shalby catered to 2.56 lakh patients against 1.87 lakh patients in previous year.

In FY2018, the company reported a net profit of Rs. 42.7 crore on an operating income of Rs. 383.2 crore, as compared to a net profit of Rs. 28.7 crore on an operating income of Rs. 323.8 crore in the previous year.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	323.8	383.2
PAT (Rs. crore)	28.7	42.7
OPBDIT/OI (%)	21.9%	21.8%
RoCE (%)	17.1%	11.9%
Total Debt/TNW (times)	1.3	0.1
Total Debt/OPBDIT (times)	4.6	1.4
Interest coverage (times)	6.7	6.7

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

S.No	Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
					September 2018	July 2017	-	-
1	Fund Based - CC/OD/others	Long Term	25.00	-	[ICRA]A (Positive)	[ICRA]A- (Stable)	-	-
2	Fund Based - Term Loan	Long Term	78.02	78.02	[ICRA]A (Positive)	[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

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

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.

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.

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