October 18, 2019

Shalby Limited: Rating reaffirmed at [ICRA]A(Positive)

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(Positive) Reaffirmed
Fund Based - Term Loan	78.02	78.02	[ICRA]A(Positive) Reaffirmed
Total	**103.02**	**103.02**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation continues to factor in the expertise and extensive experience of Shalby Limited's (Shalby's) 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, Maharashtra 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. ICRA also takes comfort from the healthy financial risk profile of the company characterised by comfortable capital structure and healthy coverage indicators. The rating takes into consideration 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 notes Shalby's ability to turn the recently commissioned hospitals at Jaipur (Rajasthan), Naroda (Gujarat) and Surat (Gujarat) operationally profitable in a relatively short span of time.

The rating is, however, constrained by the high proportion of the less-matured (less than two years of operations as on March 31, 2019) hospitals in the hospital mix, which results in relatively low overall occupancy level. Coupled with increased doctor payouts, this has adversely affected the profitability and return indicators of the company in FY2019. As a result, Shalby's return on capital employed (RoCE) remained at sub-optimal levels in FY2019 (for this rating category) and is only likely to improve over the next few years post successful ramp-up of overall occupancy levels. Typically, hospitals at new locations with medium to large bed capacity (over 100 beds) are expected to take a few years to achieve optimal occupancy levels. 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 the loss of successful doctors; although, the risk is partly mitigated by Shalby's policy of entering into long-term contracts with doctors. Further, the rating also takes into consideration the high reliance on its flagship hospital, SG Highway, for revenue and operating profitability, although contribution of other hospitals has been increasing gradually. 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. The rating also factors in the company's aggressive expansion strategy with six new hospitals operationalised since FY2015.

In spite of the significantly weaker than expected profitability and RoCE reported by the company during H2 FY2019, the maintenance of Positive outlook reflects the expected improvement in the operating margin and RoCE of Shalby, going forward, on the back of ramp up in occupancy at the newer hospitals. While this improvement in profitability was witnessed in Q1 FY2020, ICRA would continue to monitor the performance for a few more quarters to establish the sustainability of the higher margins and improvement in RoCE to consider a rating upgrade.

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, USA 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 the arthroplasty segment in India - Shalby remains one of the largest joint replacement specialists in India and the world with a total of over 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 arthroplasty segment. The arthroplasty segment has remained the key revenue and profit generator for Shalby over the years.

Increased diversification into non-arthoplasty segments - Over the past few years, the share of non-arthroplasty segments in Shalby's total revenue has been increasing steadily, contributing 56% to the total revenue in FY2019 and 49% in Q1 FY2020. Among the non-arthoplasty segments, cardiology/cardiac surgeries 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 (IPO) in December 2017 and used the proceeds to repay/prepay the outstanding term loans. Additionally, the utilisation of working capital facilities remained nil as on March 31, 2019 as against Rs. 15.7 crore as on March 31, 2018. Given the improved net worth and lower debt, the gearing improved to 0.1 time as on March 31, 2019 as against 0.2 time as on March 31, 2018. The Debt/OPBITDA metrics also improved to 0.9 time in FY2019 as against 1.5 times in FY2018. Also, given the large cash balance of Rs. 74.5 crore, the net debt of the company was negative as on March 31, 2019.

Credit challenges

Low overall occupancy levels constrained the profitability and return metrics - Overall occupancy levels for Shalby has remained low at 37% in FY2019 and 38% in Q1 FY2020 as against 41% in FY2015. The moderation in occupancy levels is attributable to the addition of new hospitals in rapid succession over the last few years. Given the low occupancy and higher doctor payouts, the operating margin for the company deteriorated to 17.6% in FY2019 as against 20.7% in FY2018. Coupled with a large equity base post the IPO, the RoCE also moderated to 7.1% in FY2019 as against 11.4% in FY2018.

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 ~36% of the total revenue and ~55% of the total operating profit in FY2019. 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 remain significant.

Aggressive expansion of hospitals - Shalby expanded its capacity aggressively by commencing operations of new hospitals at Jabalpur (Rajasthan), 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, going forward, two new under-construction hospitals at Mumbai and Nashik (Maharashtra) are expected to be operationalised over the next two years. Such rapid expansion has led to a significant proportion of low maturity hospitals in the company's portfolio, 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; and 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.

Liquidity position: Strong

Shalby's liquidity position remains strong with healthy annual fund flow from operations of Rs. 61.1 crore in FY2019 and surplus cash and bank balance of Rs. 78.3 crore as on June 30, 2019, including the balance IPO fund of Rs. 69.0 crore. The company also had a sanctioned fund-based working capital facility of Rs. 45.0 crore as on June 30, 2019, the average utilisation of which remained low at 20% over the past 12 months. The liquidity position is affected to some extent by the moderate scheduled repayments over the next two years.

Rating sensitivities

Positive triggers: Shalby's rating could be upgraded if the RoCE increases and sustains over 13% on the back of improvement in occupancy and operating margin and if the company's scale of operations grows to the extent that its competitive position is enhanced.

Negative triggers: Negative pressure on Shalby's rating could arise if the operating margin falls and remains below 17% on a sustained basis or if there is any significant time or cost overrun in the operationalisation of the under-construction hospitals. Any higher than expected debt-funded acquisition or capex would also exert a negative rating pressure.

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, 2019, the company had five direct subsidiaries, the details of which are enlisted in Annexure-2.

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 multispeciality healthcare facilities with ~2,000 operational beds 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 68 OPD centres across India and 13 clinics in Africa (Kenya and 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 FY2019, Shalby treated 3.53 lakh patients against 2.56 lakh patients in the previous year.

During FY2019, Shalby reported an operating income (OI) of Rs. 461.0 crore and profit after tax (PAT) of Rs. 31.7 crore. During FY2018, Shalby had reported an OI of Rs. 378.0 crore and PAT of Rs. 39.2 crore.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	378.0	461.0
PAT (Rs. crore)	39.2	31.7
OPBDIT/OI (%)	20.7%	17.6%
RoCE (%)	11.4%	7.1%
Total Debt/TNW (times)	0.2	0.1
Total Debt/OPBDIT (times)	1.5	0.9
Interest coverage (times)	6.8	11.3
DSCR (times)	2.8	2.6

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

S.No	Instrument	Current Rating (FY2020)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017
					18-October 2019	14-September 2018	07-July 2017	-
1	Fund Based - CC/OD/others	Long Term	25.00	0.00	[ICRA]A (Positive)	[ICRA]A (Positive)	[ICRA]A- (Stable)	-
2	Fund Based - Term Loan	Long Term	78.02	70.67	[ICRA]A (Positive)	[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

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
Yogeshwar Healthcare Limited	94.68%	Full Consolidation
Griffin Mediquip LLP	95.00%	Full Consolidation

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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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