

December 29, 2020

SRL Limited: Long-term rating upgraded to [ICRA]A; ratings continue to be on watch with developing implications

Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|----------------------------|-----------------------------------|----------------------------------|--|
| Fund-based Limits | 24.00 | 24.00 | [ICRA]A&; Upgraded from [ICRA]A-& and rating continues to be on watch with developing implications |
| Short-term interchangeable | (24.00) | (24.00) | [ICRA]A1&; Rating continue to be on watch with developing implications |
| Non-fund Based Limits | 4.50 | 4.50 | [ICRA]A&/A1&; Long term rating upgraded from [ICRA]A-&; ratings continue to be on watch with developing implications |
| Total | 28.50 | 28.50 | |

*Instrument details are provided in Annexure-1; &: on watch with developing implications

Rationale

ICRA has taken a consolidated view of SRL Limited and its subsidiaries because of operational and functional linkages between the entities.

The upgrade in the long-term rating of SRL Limited (SRL) factors in an overall stabilisation of credit profile of its parent company – Fortis Healthcare Limited, marked by improvement in its operating metrics and debt coverage indicators as well as SRL’s healthy financial risk profile, characterised by negligible debt and healthy liquidity profile.

Aided by adequate Cash flow generation and limited capital expenditure requirements, SRL has been able to limit its dependence on external borrowings to a large extent and maintain a healthy financial risk profile over the years. Despite the decline in earnings in the first half of the fiscal on account of the pandemic, it continued to maintain a debt-free profile with healthy cash balances (i.e. Rs. 210.0 crore as on September 30, 2020).

Additionally, SRL’s cash flow generation has improved sequentially, after the temporary moderation in Q1 FY2021 as patients deferred routine checkups and elective surgeries. The company’s revenues have ramped-up steadily over the past five to six months, aided by incremental revenues from Covid-19 related testing requirement, recovery in non-Covid business and increase in average revenue per test driven by Covid-19 RT-PCR tests. Accordingly, its revenues exceeded the pre-pandemic levels by September 2020. With gradual increase in test volumes and cost containment measures, the company’s operating profit margin recovered to 22.5% in Q2 FY2021 from a loss (at OPBDIT level) in Q1 FY2021. With earnings on a recovery trend, ICRA expects SRL to continue to maintain its comfortable financial risk profile, with healthy operating margins, negligible debt and strong liquidity going forward.

The upgrade in the ratings also factors in the improved operational performance of the parent company- Fortis, which coupled with the elimination of hospital service fees being paid earlier to RHT Health Trust (RHT)¹ led to improvement in its operating profit margins to ~13% in FY2020 from ~5% in FY2019. Furthermore, the consolidated debt coverage indicators and credit metrics of Fortis reported significant improvement in FY2020, primarily aided by equity infusion from IHH Healthcare Bhd in Q3 FY2019 and increased profitability on the back of elimination of fees to RHT and cost control initiatives by the new management. Although Fortis' operational and financial performance was impacted in Q1 FY2021 by the Covid-19 pandemic, the performance recovered substantially in Q2 FY2021 with the occupancy levels recovering to 66% from 29% in April 2020. The net debt to equity ratio remained comfortable at 0.16 times as on September 30, 2020.

The ratings continue to factor in SRL's position as one of the leading diagnostic service companies in the organised segment, its well-diversified presence across different delivery channels including walk-ins, corporate/hospital tie-ups, government/PPP business and international clients. The company's business position is supported by its well-established network of both reference laboratories as well as collections centres, coupled with its ability to offer a comprehensive range of pathology services, especially in the domain of complex diagnosis/tests.

The ratings factor in the improvement in SRL's receivable cycle post the change in Fortis' management. SRL's debtor days had increased significantly during FY2018-FY2019 because of high quantum of receivables outstanding from Group companies. However, with the improvement in Fortis' liquidity position, following the change in ownership, the dues are being realised in a timely manner. Consequently, the company's overall debtor days reduced to 53 days (as on March 31, 2020) from 124 days (as on March 31, 2019), leading to an improvement in the liquidity profile.

Despite strong business position and healthy credit metrics, SRL's ratings continue to remain on watch with developing implications because of the event risk related to the ongoing regulatory investigations at the Group level. Besides providing an exit to P.E. players in SRL Limited, the Group at present is exposed to multiple investigations at SRL's parent company level and erstwhile promoters by the Securities and Exchange Board of India (SEBI), Serious Fraud Investigations Office (SFIO) and significant outstanding litigations, especially the petition filed by Daiichi Sankyo Company Limited in court. ICRA notes that an application under the Insolvency Act has been filed against SRL but the same is sub-judice before the NCLT, Chandigarh. Any adverse outcome of these investigations or litigations may impair the parent company's ability to maintain its operational and financial risk profile, consequently impacting SRL as well. Accordingly, ICRA would continue to monitor the impact of these developments and litigations on the Group's credit profile.

Key rating drivers and their description

Credit strengths

Healthy financial profile with stable profit margins, no long-term borrowings and significant cash accruals – The company has reported strong coverage and capitalisation indicators over the past few years, aided by steady cash

¹ Fortis, in Q4 FY2019, acquired the Indian assets of Singapore Stock Exchange listed RHT Health Trust (RHT); the same was primarily funded through ~Rs. 4,000-crore equity infusion by IHH Healthcare Bhd (IHH) into Fortis.

accruals. Improvement in debtor position from the Fortis Group hospitals led to increased liquidity and improved working capital cycle for SRL. Going forward, it is expected to have sufficient cash flow from operations to fund its capex requirements.

Leading diagnostics service provider backed by strong brand and widespread network of laboratories and collection centres– SRL is positioned as the leading diagnostics services company within the organised segment in India, backed by a well-known brand and a widespread network of 422 laboratories, which are supported by an extensive network of 1,685 collection centres and 7,505 direct client pick-up points spread across the country.

Comprehensive range of diagnostic tests including speciality tests labs supports business position – The company has one of the most comprehensive range of diagnostic tests in India with four service verticals – pathology, radiology, wellness and clinical trials. It offers a broad range of pathology and radiology tests that are used by doctors in routine testing, patient diagnosis, and in the monitoring as well as treatment of disease. In addition, it has developed speciality testing services such as oncology testing, HIV testing and diagnostic genetics.

Credit challenges

Ongoing litigations and investigations at group level by SEBI and SFIO – The Fortis Group and its erstwhile promoters are at present facing multiple investigations and litigations and any adverse ruling may impact the Group's operations.

Subdued growth compared to peers – SRL's revenue growth (on a consolidated basis) has lagged its peers during the past few years because of a confluence of factors including Group-related issues, closure of some of its under-performing imaging labs and loss of market share in the South Indian market. Additionally, it faced a decline in revenues from labs located within Fortis hospitals and phasing out of the diagnostic services offered at various healthcare centres in Uttar Pradesh (under the PPP model) from FY2018. Going forward, the company is expected to focus on improving footfalls while maintaining the operational profitability.

Increasing competition from new diagnostic chains (including online aggregators) and regional players offering significant price discounts – The competition in the diagnostics industry has increased substantially with significant investments from private equity players. In addition, the entry of online aggregators that offer discounts to attract customers has put significant pressure on pricing. This is likely to put pressure on earnings of incumbent players going forward. Additionally, price caps set by regulators could lower the pricing power in the sector, which will have a negative impact on the sector's profit margins.

Profitability indicators lower than peers – The company's operating profit margins lag its peers because of lower share of walk-in customers and relatively lower utilisation of existing network of laboratories. In order to improve its asset utilisation, it is working on various measures such as enhancing efficiency of its network by centralising its processes.

Liquidity position: Strong

SRL's liquidity profile is **strong** supported by expectation of healthy cash flow generation, sizeable cash reserves (Rs. 210.0 crore as on September 30, 2020 at the consolidated level) and available credit facilities of Rs. 24 crore. Furthermore, the company's retained cash flows are likely to improve, supported by expectation of steady reduction in receivables pending from its parent company – Fortis Healthcare Limited, which had increased over

the past few years owing to liquidity constraints in the hospital business. ICRA believes that it is adequately positioned to fund its capex plans (Rs. 40-45 crore in FY2021) over the near term through internal cash flows. Accordingly, the reliance on long-term borrowings is likely to remain minimal in the near term.

Rating sensitivities

Positive triggers – The ratings may be upgraded if there is a favourable development at the Group level, which may allay some of the concerns related to regulatory developments, besides overall improvement in the credit profile of the parent company. Further, improvement in the scale of operations of the company, while maintaining healthy profitability and credit metrics, would be considered favourably for an upward rating action.

Negative triggers – The ratings may be downgraded in case of any outcome emanating from the ongoing regulatory investigations at the Group level, which might have an adverse impact on the Group’s business or financial profile or if there is a decline in profitability indicators due to pricing pressure in the industry or deterioration in the company’s debtor days.

Analytical approach

| Analytical Approach | Comments |
|---------------------------------|---|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology Rating Methodology for Healthcare Diagnostic Service Providers |
| Parent/Group Considerations | Parent/Group Company: Fortis Healthcare Limited; 57.7% stake in SRL Limited. |
| Consolidation / Standalone | The ratings are based on the consolidated financial statements of the issuer. |

About the company

Incorporated in 1995, SRL Limited (SRL) is one of the leading pan-India diagnostic services company with its presence across India and pathology and imaging services. The company is part of the Fortis Group with 57.7% of its equity being held by Fortis Healthcare Limited. With the acquisition of SRL Diagnostics Private Limited (SRLD; erstwhile Piramal Diagnostics Services Private Limited) in August 2010, SRL had expanded its presence, especially in western and eastern parts of the India. It has a widespread network of 422 labs, 1,685 collection centres, four international labs and 7,505 direct client pick-up points spread across India as of September 2020. Apart from India, SRL has presence outside India primarily in the UAE and Nepal.

SRL’s business is classified in seven main divisions – retail/walk-in (21% of revenues in FY2020), hospitals (22%), direct client (25%), collection centres (17%), international (4%), corporate (4%) and radiology (7%). The company offers a broad range of pathology and radiology tests that are used by doctors in routine testing, patient diagnosis, along with monitoring and treatment of disease. In addition, it has developed specialty testing services such as oncology testing, HIV testing, diagnostic genetics and clinical trials.

In FY2020, the company reported consolidated turnover of Rs. 1,010.3 crore with profit after tax (PAT) of Rs. 78.9 crore. FHL is the major shareholder of SRL with 57.7% equity stake, followed by three Private Equity investors – namely, NYLIM Jacob Ballas (15.9%), Resurgence PE (8.1%) and International Finance Corporation (IFC, 7.6%).

Key financial indicators (audited)

| | Standalone | | Consolidated | |
|--|------------|--------|--------------|---------|
| | FY2019 | FY2020 | FY2019 | FY2020 |
| Operating Income (Rs. crore) | 699.1 | 709.7 | 1,003.7 | 1,010.3 |
| PAT (Rs. crore) | 55.9 | 57.7 | 85.9 | 78.9 |
| OPBDIT/OI (%) | 13.5% | 14.8% | 17.3% | 16.9% |
| PAT/OI (%) | 8.0% | 8.1% | 8.6% | 7.8% |
| Total outside liabilities / Tangible Net Worth (times) | 0.1 | 0.1 | 0.1 | 0.2 |
| Total Debt/OPBDIT (times) | 0.0 | 0.4 | 0.0 | 0.4 |
| Interest Coverage (times) | 29.2 | 13.0 | 30.0 | 13.4 |

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

| | Instrument | Current Rating (FY2021) | | | | Rating History for the Past 3 Years | | | | | | | | | | | |
|---|---------------------------------------|-------------------------|--------------|--------------------|----------------|-------------------------------------|------------------------|------------------------|--------------------------|-----------------|-----------------|----------------|----------------|----------------|----------------|-----------------------|--|
| | | Type | Amount Rated | Amount Outstanding | Current Rating | Earlier Rating | FY2020 | | | FY2019 | | | FY2018 | | | | |
| | | | | | 29-Dec-2020 | 24-Apr-2020 | 20-Dec-2019 | 1-Feb-2019 | 12-Apr-2018 | 4-Apr-2018 | 9-Mar-2018 | 13-Feb-2018 | 7-Feb-2018 | 28-Dec-2017 | 17-Jul-2017 | 4-Jul-2017 | |
| 1 | Fund-based facilities | Long Term | 24.0 | NA | [ICRA]A& | [ICRA]A-& | [ICRA]BBB+ (Stable) | [ICRA]BBB- (Stable) | [ICRA]BBB- (Negative) | [ICRA]BBB+@ | [ICRA]BBB+@ | [ICRA]A-@ | [ICRA]A+@ | [ICRA]A+& | [ICRA]A+& | [ICRA]A+ (Stable) | |
| 2 | Short-term fund-based interchangeable | Short Term | (24.0) | NA | [ICRA]A1& | [ICRA]A1& | [ICRA]A2 | [ICRA]A3 | [ICRA]A3 | [ICRA]A2@ | [ICRA]A2@ | [ICRA]A2+@ | [ICRA]A1+@ | [ICRA]A1+& | [ICRA]A1+& | [ICRA]A1+ | |
| 3 | Non-fund based facilities | Long and Short Term | 4.50 | NA | [ICRA]A&/A1& | [ICRA]A-&/A1& | [ICRA]BBB+ (Stable)/A2 | [ICRA]BBB- (Stable)/A3 | [ICRA]BBB- (Negative)/A3 | [ICRA]BBB+@/A2@ | [ICRA]BBB+@/A2@ | [ICRA]A-@/A2+@ | [ICRA]A+@/A1+@ | [ICRA]A+&/A1+& | [ICRA]A+&/A1+& | [ICRA]A+ (Stable)/A1+ | |

&: on watch with developing implications

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 facilities | NA | NA | NA | 24.00 | [ICRA]A& |
| NA | Short term fund based interchangeable | NA | NA | NA | (24.00) | [ICRA]A1& |
| NA | Non-fund based facilities | NA | NA | NA | 4.50 | [ICRA]A&/ A1& |

Source: SRL; &: on watch with developing implications

Annexure-2: List of entities considered for consolidated analysis

| Company Name | Ownership | Consolidation Approach |
|---|-----------|------------------------|
| SRL Diagnostics Private Limited | 100.00% | Full Consolidation |
| SRL Diagnostics FZ-LLC | 100.00% | Full Consolidation |
| SRL Diagnostics (Nepal) Private Limited | 50.00% | Equity Method |
| DDRC SRL Diagnostics Private Limited | 50.00% | Equity Method |
| SRL Reach Limited | 100.00% | Full Consolidation |

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