ICRA

November 23, 2017

Narayana Hrudayalaya Limited

Summary of rated instrument

Instrument*	Rated Amount (Rs. crore)	Rating Action
Fund-based – Working Capital	40.00 (enhanced from 0.00)	[ICRA]AA- (Stable) /[ICRA]A1+; Reaffirmed
Non-fund based – Working capital (Interchangeable with Fund-based – Working Capital)	(40.00)#	
Fund-based – Term Loan	175.00 (enhanced from 0.00)	
Non-fund based – Working capital limits	35.00 (enhanced from 0.00)	
Long-term – Unallocated limits	0.00 (reduced from 240.00)	
Short-term – Unallocated limits	0.00 (reduced from 10.00)	
Commercial Paper Programme	50.00	[ICRA]A1+; Reaffirmed
Total Limits	**300.00**	

* Instrument details are provided in Annexure-1
# Sub-limit of Fund-based – Working Capital

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA-† (pronounced ICRA double A minus) and the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) assigned on the Rs 250.00 crore bank limits of Narayana Hrudayalaya Limited (NHL). ICRA has also reaffirmed the short-term rating of [ICRA]A1+ on the Rs 50.00 crore commercial paper programme of NHL.

While assigning the ratings, ICRA has taken a consolidated view of NHL and its subsidiaries including Narayana Hrudayalaya Surgical Hospital Private Limited (NHSHPL) and Meridian Medical Research and Hospital Limited (MMRHL) given the strong operational, financial and management linkages among these entities.

Rationale

The ratings reaffirmation favourably factors in NHL's established position and significant brand equity around the 'Narayana Health' brand. The ratings also derives comfort from the geographically diversified presence of NHL across India with a strong presence in Karnataka and East India. NHL has been diversifying in operational specialities from cardiac care and renal sciences to oncology, neuro-sciences, orthopaedics and gastroenterology. ICRA also takes into account the asset right model of capital deployment employed by the company to achieve growth which results in low investment outlay. The company hence has a low capital cost per bed of Rs 0.28 crore as of September 30, 2017. The company offers affordable healthcare and competitive pricing managed through cost efficiencies and economies of scale. ICRA also positively factors in the increase in occupancy level at existing hospitals and shorter ALOS, which have been enabling improved utilization levels and higher patient turnaround rate resulting in a healthy growth in ARPOB. ICRA also notes that the positive demand outlook for healthcare services in the country due to factors such as better affordability through increasing per capita income and widening medical insurance coverage, growing awareness for healthcare and under-penetration of healthcare services, is expected to benefit the company given its scalable model.

The ratings are however constrained by the high reliance of NHL on the top three hospitals for revenue as well as profit generation. Regulatory risks in terms of restrictive pricing regulations levied by central and state government organisations could constrain the profit margins in the industry going forward. The leverage of the company has risen in H1 FY2018 as seen from the gearing level[1] which has increased from 0.23 times as on March 31, 2017 to 0.49 times as on September 30, 2017 on account of acquisition of a near completion hospital in Gurgaon. Debt funded buyback of partner's equity in Cayman associate in Q4 FY2018 will result in significant increase in the debt levels. Going forward, ability of the group to improve on its operating parameters and hence the profitability, and the extent of capex/acquisitions undertaken and funding pattern for the same would be the key rating sensitivities.

Key rating drivers

Credit strengths

- **Significant brand equity around the 'Narayana Health' brand:** The company enjoys a strong market position in the healthcare services industry and has an established brand equity (especially in the cardiac segment) and ability to provide quality healthcare at affordable prices. Strong brand equity and goodwill among patients and healthcare professionals has helped NHL in partnering with governmental bodies, not-for-profit trusts and charities, and private organisations to operate and manage their healthcare facilities.
- **Spread across several geographies of India with a strong presence in Karnataka and East:** NHL has a network of 50 healthcare facilities, including 23 hospitals, seven heart centres and 19 primary care facilities, across a total of over 30 cities, towns and villages in India, with 5,889 operational beds and capacity beds of 6,888 beds. The primary care facilities and heart centres act as feeders for the main hospitals of the group. NHL has an established presence and strong brand recognition in two geographical clusters, namely, Karnataka and eastern India, with an emerging presence in western, central and northern India. The company also has a global footprint with the establishment of Health City, Cayman Islands, North America (which is proposed to become 100% subsidiary by Q4 FY2018).
- **Strong presence in cardiac and renal sciences with continuing diversification into other specialties:** NHL has a strong reputation and clinical capabilities in cardiac and renal sciences and has been expanding its core specialty areas to include additional clinical specialties of oncology, neurology and neurosurgery, orthopaedics and gastroenterology. Cardiac and renal services, which contributed to 68% of the inpatient revenue in FY2013 reduced to 58% in FY2016 and further to 56% in FY2017. In FY2017, 48% (50% in FY2016) of inpatient revenues came from cardiac divisions and 8% was contributed by renal sciences.
- **Asset right model of capital deployment results in a low capital cost per bed of Rs 0.28 crore as of September 30, 2017:** NHL follows an asset-light model which helps maintain low capital cost per operating bed; the company generally partners with trusts, donors, and societies for land and building infrastructure and invests only in medical infrastructure. NHL uses various models of operating hospitals in order to optimise capital employed and returns generated. This approach allows it to achieve capital cost per bed of Rs 0.28 crore as of September 30, 2017. NHL has supplemented its asset light model with the acquisition of existing healthcare facilities.

[1] Debt figures for the company include financial lease obligations

- **Competitive prices managed through cost efficiencies and economies of scale:** NHL's cost efficiencies and lean cost structure enables the company to provide affordable healthcare which coupled with subsidised medical service obligations result in lower ARPOB than most of its comparable peers. NHL's cost efficiencies arise from economies of scale, supply chain efficiencies with reliance on fewer vendors and provision of basic amenities at its hospitals. Access to a cloud-based ERP system and network of telemedicine centres also help increase hospital efficiencies and lower overall costs.
- **Improvement in operational metrics in existing hospitals:** Increase in occupancy level in existing hospitals and shorter ALOS, have been enabling higher utilization levels and higher patient turnaround rate resulting in a healthy growth in ARPOB. ARPOB has also been helped with the case mix moving towards higher clinical complexity cases and higher international patient admissions.

Credit weaknesses

- **Heavily reliant on the top three hospitals for margins:** In FY2017, the three flagship hospitals contribute significantly to the group's revenues and EBITDA as several of the other hospitals are under ramp-up phase. NHL is heavily dependent on these facilities to continue to generate higher revenues and maintain a healthy financial position. This dependence has moderated over the last three years.
- **Exposed to regulatory risks:** Regulatory risks in terms of restrictive pricing regulations levied by central and state government organisations could constrain the profit margins in the industry going forward.
- **Increase in leverage levels in FY2018:** The debt levels of the company have increased from Rs 221 crore as on March 31, 2017 to Rs 483 crore as on September 30, 2017. The rise in debt levels is on account of the debt funded acquisition of under construction hospital in Gurgaon for Rs 180 crore and the accounting of financial lease obligations amounting to Rs ~115 crore post tie up with Dharamshila Cancer Foundation & Research Centre in H1 FY2018.
- **Debt funded buyback of equity of partner in Cayman associate to further increase the debt levels:** Health City Cayman Islands Limited (HCCI), operates a 105 capacity bed tertiary care facility in Cayman Islands. As on March 31, 2017, NHL holds 28.60% stake in HCCI. NHL and Ascension (partner with 71.4% stake) have entered into a definitive agreement whereby HCCI will buyback Ascensions stake for a consideration of USD 32.26 mn. Consequent to this buyback by 15th January 2018, HCCI will become a 100% step-down subsidiary of NHL. The debt funded buyback will result in significant increase the debt levels to Rs ~850 crore as on March 31, 2018. However, presence of moratorium period with step up repayment schedule is expected to result in comfortable debt service coverage ratio.
- **Commissioning of new hospitals to constrain the near term profitability:** The company has recently started a children's hospital in Q1 FY2018 in Mumbai and plans to commission a new hospital in Gurgaon in Q4 FY2018. Commissioning of these new hospitals and the initial ramp up period are expected to constrain the near term profitability for the company.

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
NH operates a chain of multispecialty, tertiary and primary healthcare facilities. Dr. Devi Shetty, who has over 30 years of medical experience, began NHL in 2000. The group, which initially focused on cardiac and renal sciences, expanded to additional areas of focus: cancer care, neurology and neurosurgery, orthopaedics, and gastroenterology and was rebranded as 'Narayana Health' in 2013 to reflect the diversified presence. The group owns and operates certain hospitals and also enters into management agreements with hospitals under which the group acquires the operating control of the hospitals. NHL has a strong presence in the southern state of Karnataka and eastern India, with an emerging presence in western, central and Northern India. The 'Narayana Health' brand is associated with the delivery of affordable healthcare services by leveraging its economies of scale.

NHL has a network of 20 owned/operated hospitals (multi-speciality and super-speciality healthcare facilities which provide tertiary care), three managed hospitals, seven heart centres (super-speciality units which are set up in a third party hospital) and 19 primary care facilities (including clinics and information centres), across a total of 31 cities, towns and villages in India, and 1 hospital in Cayman Islands with 5,889 operational beds and 6,888 capacity beds.

Key financial indicators (Consolidated)

	FY2016	FY2017
Operating Income (Rs. crore)	1,620	1,885
PAT (Rs. crore)	20.8	83.0
OPBDIT/ OI (%)	11.25%	12.82%
RoCE (%)	7.12%	13.80%
Total Debt/ TNW (times)	0.29	0.23
Total Debt/ OPBDIT (times)	1.41	0.91
Interest Coverage (times)	6.10	10.96
NWC/ OI (%)	-1%	-1%

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:
Table:

S. No.	Instrument	Current rating (FY2018)			Chronology of rating history		
		Type	Amount Rated (Rs. crore)	November 2017	FY2017	FY2016	FY2015
					September 2016	July 2015	NA
1	Fund-based – Working Capital	Long Term/Short Term	40.00	[ICRA]AA- (Stable) /[ICRA]A1+	NA	NA	NA
2	Non-fund based – Working capital (Interchangeable with Fund-based – Working Capital)	Long Term/Short Term	(40.00)#	[ICRA]AA- (Stable) /[ICRA]A1+	NA	NA	NA
3	Fund-based – Term Loan	Long Term	175.00	[ICRA]AA- (Stable)	NA	NA	NA
4	Non-fund based – Working capital limits	Short Term	35.00	[ICRA]A1+	NA	NA	NA
5	Long-term – Unallocated limits	Long Term	0.00	-	[ICRA]AA- (Stable)	NA	NA
6	Short-term – Unallocated limits	Short Term	0.00	-	[ICRA]A1+	NA	NA
7	Commercial Paper Programme	Short Term	50.00	[ICRA]A1+	[ICRA]A1+	NA	NA
8	Commercial Paper Programme	Short Term	40.00	NA	Withdrawn	[ICRA]A1+ (SO)	NA

Sub-limit of Fund-based – Working Capital

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	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund-based – Working Capital	-	-	-	40.00	[ICRA]AA- (Stable) /[ICRA]A1+
NA	Non-fund based – Working capital (Interchangeable with Fund-based – Working Capital)	-	-	-	(40.00)#	[ICRA]AA- (Stable) /[ICRA]A1+
NA	Fund-based – Term Loan	-	-	Mar-2027^	175.00	[ICRA]AA- (Stable)
NA	Non-fund based – Working capital limits	-	-	-	35.00	[ICRA]A1+
NA	Commercial Paper Programme	-	-	-	50.00	[ICRA]A1+

^ Represents the farthest maturity date among the various maturity dates for different term loans

Sub-limit of Fund-based – Working Capital

Source: NHL

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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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