

December 20, 2019

SRL Limited: Long-term rating upgraded to [ICRA]BBB+; short-term rating upgraded to [ICRA]A2

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Limits	24.00	24.00	Rating upgraded to [ICRA]BBB+ (Stable) from [ICRA]BBB- (Stable)
Short-term interchangeable	(24.00)	(24.00)	Rating upgraded to [ICRA]A2 from [ICRA]A3
Non-fund Based Limits	4.50	4.50	Rating upgraded to [ICRA]BBB+ (Stable)/A2 from [ICRA]BBB- (Stable)/A3
Total	28.50	28.50	

*Instrument details are provided in Annexure-1

Rationale

ICRA has upgraded the ratings of SRL Limited to [ICRA]BBB+ (Stable) and [ICRA]A2 from [ICRA]BBB- (Stable) and [ICRA]A3 following an upgrade in the ratings of its parent company viz. Fortis Healthcare Limited (Fortis) to [ICRA]BBB+&/[ICRA]A2& from [ICRA]BBB-(&)/[ICRA]A3(&) and improvement in cash flow position of the company triggered by gradual release of receivables pending from Fortis. In September 2019, ICRA had upgraded the ratings of Fortis aided by improvement in operational performance, which coupled with elimination of hospital service fees being paid earlier to RHT¹ led to improvement in company's earnings. In November 2018, IHH Healthcare Berhad Malaysia's (IHH) acquired a controlling stake of 31.1% in Fortis for a consideration of Rs. 4,000 crore. Following the change in ownership and management at Fortis, SRL has started gradually receiving pending receivables, which along with improvement in its operating margins supported by its cash flows.

The assigned ratings continue to factor in SRL's position as one of the leading diagnostics services 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 ability to offer comprehensive range of pathology services, especially in the domain complex diagnosis/tests.

While SRL had a strong dependence on northern India in the past, the acquisition of Piramal Diagnostics (later rechristened as SRL Diagnostics) in FY2011 expanded its presence in western and southern India. The company's JV, DDRC Diagnostics Private Limited is providing testing and diagnostics services in the field of pathology in Kerala. Similarly, SRL Reach Limited (100% subsidiary) is having its reach in Jharkhand. Hence, SRL is a pan-India player enjoying significant advantage in light of the stiff competition from the organised and unorganised players as well as various hospital-operated laboratories.

¹ Fortis, in Q4 FY2019, acquired Indian assets of Singapore Stock Exchange listed RHT Health Trust (RHT); the same was primarily funded through ~Rs. 4000-crore equity infusion by IHH Healthcare Bhd (IHH) into Fortis.

SRL's debtor days had increased significantly over the past two years because of increase in receivables outstanding from its Group companies. However, with the improvement in liquidity position of FHL, following the change in management and dues being realised in a timely manner. Consequently, the company's overall debtor days have reduced to 55 days (as on September 30, 2019) from 124 days (as on March 31, 2019), thereby leading to an improvement in the liquidity profile.

Despite an increase in working capital intensity over the past few years owing to higher receivable cycle, the company continued to maintain healthy financial profile aided by adequate cash flow generation and limited capital expenditure. Its credit profile continues to be marked by negligible debt and healthy cash balances (i.e. Rs. 121.69 crore as of September 2019).

Despite strong business position and healthy credit metrics, SRL's ratings are constrained by the ratings of its parent company, given its controlling stake and financial and business linkages notwithstanding the presence of independent minority shareholders. 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) and Serious Fraud Investigations Office (SFIO) and significant outstanding litigations, especially the petition filed by Daiichi Sankyo Company Limited in Supreme Court of India and the High Court of Delhi. Any adverse outcome of these investigations or litigations may impair the parent company's ability to maintain its operational and financial risk profile. Thus, ICRA would continue to monitor the impact of these developments on SRL's credit profile as well as litigations concerning the Group.

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

The outlook on SRL's long-term rating remains at Stable. ICRA believes SRL will continue to benefit from its extensive track record of operations, established brand, healthy financial risk profile and will maintain its strong credit indicators.

Key rating drivers and their description

Credit strengths

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 411 laboratories and wellness centres. The company has four regional labs covering the entire country. These are supported by an extensive network of 1,174 collection centres and 8,057 direct client pick-up points.

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 and has 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 and treatment of disease. In addition, it has developed speciality testing services such as oncology testing, HIV testing and diagnostic genetics.

Healthy financial profile with stable profit margins, no long-term borrowings and significant cash accruals – The company has strong coverage and capitalisation indicators over the past few years, aided by steady cash accruals. Improvement in debtor position from the Fortis Group hospitals led to increased liquidity and improved working capital cycle for SRL. It is expected to have sufficient cash flow from operations to fund the capex.

Credit challenges

Ongoing litigations and investigations 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 consolidated) 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, loss of market share in the South Indian market, 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. ICRA expects the company to focus on improving footfalls while maintaining 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 productivity of its network by centralising its processes and increasing the efficiency of its network.

Liquidity position: Strong

SRL's liquidity profile is strong supported by expectation of healthy cash flow generation, sizeable cash reserves (Rs. 121.69 crore as of September 2019) 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 receivable pending from its parent company – Fortis Healthcare Limited, which had increased over the past few years owing to liquidity constraints in the hospital business.

In FY2020, the company aims to spend approximately Rs. 69 crore towards expanding its network of laboratories and collection centres, besides investments in equipment. ICRA believes that it is adequately positioned to fund its capex through internal cash flows. Accordingly, the reliance on long-term borrowings is likely to remain minimal in the near-term.

Rating sensitivities

Positive triggers – Ratings may be upgraded if there is a positive event at the Group level leading to an improvement in credit profile of the parent company or improvement in scale of operations of the company, while maintaining operational profitability and sufficient liquidity.

Negative triggers – Ratings may be downgraded in case of any event, 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 debtor days of the company.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Diagnostic Service Providers
Parent/Group Considerations	Parent/Group Company: Fortis Healthcare Limited ([ICRA]BBB+&/A2&); 57.7% stake in SRL Limited.
Consolidation / Standalone	The rating is based on the consolidated financial statements of the issuer.

About the company

Incorporated in 1997, 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 a part of the Fortis Group (Fortis Healthcare Limited, rated [ICRA]BBB+&/A2&) 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. At present, it has a widespread network of 411 labs, 1,174 collection centres, four international labs and 8,057 direct client pick-up points spread across India as on September 2019. Apart from India, SRL has presence outside India primarily in UAE and Nepal with both markets contributing 3% to revenues in FY2019.

SRL's business is classified in six main divisions – retail/walk-in (31%), hospitals (23%), direct client (20%), collection centres (18%), international (4%) and others (4%). The company offers a broad range of pathology and radiology tests that are used by doctors in routine testing, patient diagnosis, and in the monitoring and treatment of disease. In addition, it has developed speciality testing services such as oncology testing, HIV testing, diagnostic genetics and clinical trials.

In FY2019, the company reported consolidated turnover of Rs. 1003.7 crore with a profit after tax (PAT) of Rs. 85.9 crore. Fortis Healthcare Limited (rated [ICRA]BBB+&/A2&) 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	
	FY2018	FY2019	FY2018	FY2019
Operating Income (Rs. crore)	677.9	699.1	982.2	1003.7
PAT (Rs. crore)	35.5	55.9	68.9	85.9
OPBDIT/OI (%)	14.4%	13.5%	15.7%	17.3%
RoCE (%)	7.4%	9.8%	12.0%	13.7%
Total outside liabilities / Tangible Net Worth	0.1	0.1	0.1	0.2
Total Debt/OPBDIT (times)	0.2	0.0	0.1	0.0
Interest Coverage (times)	35.3	29.2	25.4	30.0
DSCR	30.6	24.1	18.5	22.0

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)			Rating History for the Past 3 Years												
		Type	Amount Rated	Amount Outstanding	Rating	FY2019			FY2018						FY2017		
						20 Dec 19	01 Feb 19	12 April 18	04 April 18	09 Mar 18	13 Feb 18	07 Feb 18	28 Dec 17	17 July 17	04 July 17	07 Feb 17	09 Sep 16
1	Fund based facilities	Long Term	24	NA	[ICRA] BBB+ (Stable)	[ICRA] BBB- (Stable)	[ICRA] BBB- (Negative)	[ICRA] BBB- (Negative)	[ICRA] BBB+@	[ICRA] A-@	[ICRA] A+@	[ICRA] A+&	[ICRA] A+&	[ICRA] A+ (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	Short term fund based interchangeable	Short Term	(24)	NA	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA] A2@	[ICRA] A2+@	[ICRA] A1+@	[ICRA] A1+&	[ICRA] A1+&	[ICRA] A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Non-fund based facilities	Long and Short Term	4.5	NA	[ICRA] BBB+ (Stable)/ A3	[ICRA] BBB- (Stable)/ A3	[ICRA] BBB- (Negative) / A3	[ICRA] BBB- (Negative) / A3	[ICRA] BBB+@/ A2@	[ICRA] A-@/ A2+@	[ICRA] A+@/ A1+@	[ICRA] A+&/ A1+&	[ICRA] A+&/ A1+&	[ICRA]A+ (Stable)/ A1+	-	-	-

Amount in Rs. crore

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] BBB+ (Stable)
NA	Short term fund based interchangeable	NA	NA	NA	(24.00)	[ICRA]A2
NA	Non-fund based facilities	NA	NA	NA	4.50	[ICRA] BBB+ (Stable)/ A2

Source: SRL

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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