

September 22, 2021

## SRL Diagnostics Private Limited: Ratings continue to be on watch with developing implications and withdrawn

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Limits	15.00	0.00	[ICRA]A&; Continues to be on watch with developing implications and withdrawn
Short-term interchangeable	(15.00)	0.00	[ICRA]A1&; Continues to be on watch with developing implications and withdrawn
Non-fund Based Limits	2.00	0.00	[ICRA]A&/ [ICRA]A1&; Continues to be on watch with developing implications and withdrawn
<b>Total</b>	<b>17.00</b>	<b>0.00</b>	

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

### Rationale

ICRA has withdrawn the ratings assigned to the bank facilities of SRL Diagnostics Private Limited (SRLD). The ratings have been withdrawn in accordance with ICRA's policy on withdrawal and suspension, at the request of the company and based on the no objection certificate received from the issuing banks.

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

The ratings for the entity continue to factor in SRL's position as one of the leading diagnostic service companies in the organised segment and 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 also favourably factor in the company'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.

After a subdued performance in Q1 FY2021 with patients deferring their routine check-ups and elective surgeries due the pandemic, SRL's revenues ramped-up steadily from Q2 FY2021 onwards, aided by incremental revenues from Covid-19 related testing requirement, recovery in its 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, reporting a growth of ~2% in FY2021. With gradual increase in test volumes and cost containment measures, the company's operating profit margin recovered to 16.6% in FY2021 over 16.9% in FY2020.

SRL proceeded to acquire the balance 50% stake in its existing joint venture, DDRC SRL Diagnostics Private Limited (DDRC-SRLD), for a cash consideration of ~Rs. 350 crore (inclusive of the ownership of the DDRC brand). The acquisition was completed in April 2021 and was funded entirely by internal accruals. DDRC-SRLD is in the same business sector as SRL and commands a majority market share in the organised diagnostics segment in Kerala. It derives ~70% of its revenues from the B2C segment and recorded revenues of ~Rs. 301.7 crore in FY2021 (~88% YoY growth). Aided by the consolidation of DDRC-SRLD as well as huge demand for Covid testing because of the second wave of the pandemic, SRL reported a significant growth in revenues

(214% YoY growth) and profitability (EBITDA margin of 29.9%) in Q1 FY2022. Going forward, SRL's credit risk profile is expected to continue to remain healthy aided by healthy operating margins, negligible debt and improving market share among organised diagnostic players.

SRL's parent company, Fortis Healthcare Limited (FHL), reported revenues of Rs. 4,030 crore in FY2021 (13% YoY decline) and EBITDA margin of 11.2% (14.3% in FY2020). Although FHL's operational and financial performance was impacted in Q1 FY2021 by the pandemic, the performance recovered substantially in H2 FY2021 with the occupancy levels recovering to 64% from 37% in Q1 FY2021. FHL continued to maintain a comfortable balance sheet with Net debt to EBITDA ratio of 0.9x as on March 31, 2021 vis-à-vis 1.04x as on March 31, 2020. ICRA notes that the minority shareholders of SRL, who hold a put option, have agreed to not exercise the option for a further period of 36 months. Accordingly, FHL has time to provide exit to the minority shareholders, and it is not expected to impact FHL's credit profile over the near to medium term.

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. 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 also has significant outstanding litigations, especially the petition filed by Daiichi Sankyo Company Limited in court. Moreover, there is a proposal to change the name and branding of FHL and its subsidiaries, including SRL, subject to various requisite approvals. Furthermore, pursuant to the Supreme Court order dated December 14, 2018, IHH Healthcare Bhd's (IHH) open offer to acquire additional 26% stake in FHL was put on hold. The hearings pertaining to this matter have been concluded and the order has been reserved by the Hon'ble Supreme Court. Any adverse outcome of these investigations or litigations may impact the parent company's credit profile, consequently impacting SRL as well. Accordingly, the ratings continue to remain on watch pending clarity on these matters.

## 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 one of 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 across the country.

#### **Healthy financial risk profile characterised by 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 accruals and low dependence on external borrowings. 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 continue to record sufficient cash flow from operations to fund its capex requirements, thereby limiting its dependence on external borrowings.

#### **Comprehensive range of diagnostic tests, including speciality test 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

**Exposed to 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 and credit profile. The outcome of these investigations and litigations remains a monitorable.

**Subdued growth and profitability metrics compared to peers** - SRL's revenue growth (on a consolidated basis) has lagged behind 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 within Fortis hospitals and phasing out of the diagnostic services offered at various healthcare centres in Uttar Pradesh (under the PPP model) from FY2018. Its operating profit margins have also lagged behind its peers because of lower share of walk-in customers and relatively lower utilisation of its existing network of laboratories. Nevertheless, to improve its asset utilisation, it has been working on various measures, such as enhancing efficiency of its network by centralising its processes. Additionally, the company's focus on improving footfalls and the consolidation of DDRC-SRLD is expected to support its revenue growth over the medium term.

**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 may have a negative impact on the sector's profit margins.

### Liquidity position: Strong

SRL's liquidity profile is **strong**, supported by expectation of healthy cash flow generation, sizeable cash reserves (~Rs. 270 crore as of August 2021) 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, FHL, which had increased over the past few years owing to liquidity constraints in the hospital business. ICRA believes that the company is adequately positioned to fund its capex plans 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 – Not applicable

### Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Rating Methodology for Healthcare Diagnostic Service Providers</a> <a href="#">Policy on Withdrawal of Credit Ratings</a> <a href="#">Rating approach- Consolidation</a>
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the consolidated financial statements of the issuer. As on March 31, 2021, SRL had three subsidiaries and two joint ventures which are enlisted in Annexure 2.

## About the company

SRL Diagnostics Private Limited, formerly known as Piramal Diagnostic Services Private Limited, is one of the largest chains of clinical diagnostic centres in India. It is a wholly owned subsidiary of SRL Limited, which is owned by Fortis Healthcare Limited (57.7% stake). SRLD is one of the few diagnostic centre chains offering pathology and radiology services on a pan India level. Most centres, in addition, offer echocardiography, ECG, stress tests, pulmonary function tests, audiometry and body composition tests, besides pathology and radiology tests. SRLD operates ~35 labs and ~26 collection centres. Additionally, through DDRC SRL Diagnostics Private Limited (DDRC-SRLD), it operates ~203 labs and four collection centres in Kerala.

In FY2021, the company reported a turnover of Rs. 244.6 crore with a profit after tax (PAT) of Rs. 43.6 crore. At the consolidated level, the SRL Group reported a turnover of Rs. 1,030.1 crore with PAT of Rs. 87.8 crore.

## Key financial indicators (audited)

SRL Consolidated	FY2020	FY2021
Operating Income (Rs. crore)	1,010.3	1,030.1
PAT (Rs. crore)	78.9	87.7
OPBDIT/OI (%)	16.9%	16.6%
PAT/OI (%)	7.8%	8.5%
Total Outside Liabilities/Tangible Net Worth (times)	0.2	0.2
Total Debt/OPBDIT (times)	0.4	0.3
Interest Coverage (times)	13.4	13.5

SRLD Standalone	FY2020	FY2021
Operating Income (Rs. crore)	277.2	244.6
PAT (Rs. crore)	25.4	43.6
OPBDIT/OI (%)	26.8%	21.2%
PAT/OI (%)	9.1%	17.8%
Total Outside Liabilities/Tangible Net Worth (times)	2.7	1.5
Total Debt/OPBDIT (times)	1.7	2.2
Interest Coverage (times)	3.8	3.3

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Source: Company, ICRA Research; All calculations are as per ICRA research

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Aug 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019	
						Sep 22, 2021	Feb 16, 2021 Dec 29, 2020	Apr 24, 2020	Dec 20, 2019	Feb 1, 2019
1	Fund-based facilities	Long Term	0.00	NA	[ICRA]A&; withdrawn	[ICRA]A&	[ICRA]A-&	[ICRA]BBB+ (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Negative)
2	Short-term fund-based interchangeable	Short Term	0.00	NA	[ICRA]A1&; withdrawn	[ICRA]A1&	[ICRA]A1&	[ICRA]A2	[ICRA]A3	[ICRA]A3
3	Non-fund based facilities	Long and Short Term	0.00	NA	[ICRA]A&/ [ICRA]A1&; withdrawn	[ICRA]A&/ [ICRA]A1&	[ICRA]A-&/ [ICRA]A1&	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB- (Negative)/ [ICRA]A3

&: Under watch with developing implications; @: under watch with negative implications

## Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based Limits	Simple
Short-term interchangeable	Simple
Non-fund Based Limits	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: [www.icra.in](http://www.icra.in)

**Annexure-1: Instrument details**

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund based facilities	NA	NA	NA	0.00	[ICRA]A&; withdrawn
NA	Short term fund based interchangeable	NA	NA	NA	0.00	[ICRA]A1&; withdrawn
NA	Non-fund based facilities	NA	NA	NA	0.00	[ICRA]A&/ [ICRA]A1&; withdrawn

*Source: Company*

**Annexure-2: List of entities considered for consolidated analysis**

Company Name	SRL Ownership	Consolidation Approach
SRL Limited	100.00% (parent company)	Full Consolidation
SRL Diagnostics Private Limited	100.00% (rated entity)	Full Consolidation
SRL Diagnostics FZ-LLC "SRL- Dubai"	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

*Source: SRL annual report FY2021*

*Note: ICRA has taken a consolidated view of the parent (SRL), its subsidiaries and joint ventures while assigning the ratings*

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