December 22, 2022

Shalby Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based CC/OD/Others	33.52	33.52	[ICRA]A+(Stable); Reaffirmed
Fund-based Term Loan	39.48	39.48	[ICRA]A+(Stable); Reaffirmed
Non-fund-based Stand by Letter of Credit	124.00	124.00	[ICRA]A+(Stable); Reaffirmed
Unallocated Limits	31.02	31.02	[ICRA]A+(Stable); Reaffirmed
Total	**228.02**	**228.02**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation in rating continues to factor in the extensive experience of Shalby Limited's (Shalby's) founder-promoter, Dr. Vikram Shah, who along with the management team, has a demonstrated 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 Rajasthan, Maharashtra and Punjab. Further, the rating is supported by Shalby's leadership position in arthroplasty speciality segment as well as its diversification into cardiology, oncology, bariatrics and other non-arthroplasty segments. ICRA also continues to take comfort from Shalby's comfortable financial risk profile, characterised by healthy profitability, comfortable capital structure and healthy coverage indicators and positive long-term demand outlook for healthcare services in India on the back of better affordability by virtue of increasing per capita income, widening medical insurance coverage and under-penetration of healthcare services.

The rating also favorably factors in the expected improvement in the operating income and earnings of Shalby Limited (Shalby or the company) over the medium term, driven by higher revenues across specialties arthroplasty—critical care and general medicine, which is also reflected by strong revenue (consolidated) growth of ~62.2% in FY2022 on Y-O-Y basis and ~16% in H1FY2023 (annualised over FY2022) while the hospital revenues (standalone) grew by 54.6% and 9.7% respectively in the aforesaid period. The revenue at the consolidated level is also expected to scale up in the medium term supported by its implant and joint manufacturing business housed under its step-down subsidiary, Shalby Advance Technologies, USA (SAT), in Q1FY2022. The same is expected to provide diversification to the revenue stream as well as better control over its cost structure in the long run from in-house manufacturing of implants. The hospital's earnings profile is strong, supported by improving the scale of operations, and better cost management.

The rating, however, remains constrained by the growing, though moderate occupancy levels (~46% in FY2022, 45% in Q1 FY2023, 49% in Q2 FY2023) of Shalby's hospitals, which puts pressure on the overall operational performance of the company and limits the scale expansion to an extent. Nevertheless, the occupancy levels have picked up in the recent quarters as people have started opting for elective surgeries as the impact of covid has subsided. The rating is also constrained by the low return on capital employed (RoCE) (~9% in FY2022 at consolidated level) on account of expansion of hospitals as well as impact of acquisition of new business of SAT, which is yet to break even and reach a meaningful size and scale. The RoCE is only likely to improve gradually over the next few years, post successful ramp-up of the overall occupancy levels and returns from SAT starts to flow-in. The risk of attrition of doctors also remains, through the risk is partly mitigated by Shalby's strong brand pull and long-term contracts with doctors. Further, the rating also considers the high reliance on its flagship hospital, SG Highway, for revenue and operating profitability, although the contribution of other hospitals has been increasing gradually. The company's expansion strategy has been aggressive, with six new hospitals becoming operational since FY2015 and two hospitals are under construction. ICRA also notes that Shalby, through its step-down subsidiary, SAT, backward integrated into implants and joint manufacturing business by acquiring assets of Consensus Orthopedics, the USA in Q1FY2022. Though the same is expected to provide diversification to revenues and supplement its in house sourcing of implants in the long run, given that the acquisition was largely debt funded and its operations are yet to break even, Shalby's ability to meaningfully turn around and profitably scale up the new business, remains critical credit monitorable.

Key rating drivers and their description

Credit strengths

Experienced management team with strong execution track record - Shalby is a publicly listed entity, promoted by renowned joint replacement specialist, Dr. Vikram Shah, who has over 28 years of medical experience in the UK, the US and India. Its overall operations are also supported by its senior management, with an average experience of more than 12 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. The company's brand equity is also boosted by numerous amount of doctors who get trained at Shalby on a regular basis.

Dominance in Indian arthroplasty segment - Shalby remains one of the largest specialist joint replacement provider in India and the world, with a total of over 1,41,000+ joint replacement surgeries till date and an average of 10,000–12,000 surgeries per year. The company enjoys a strong market position in the healthcare services industry in western and central India. 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. The company has a market share of ~15% in the arthroplasty segment in India.

Increase in diversification into non-arthroplasty segments - Over the past few years, the share of non-arthroplasty segments in Shalby's total revenue has been increasing steadily, contributing 71% to the total revenue in FY2022. Among the non-arthroplasty segments, oncology surgery has been the largest revenue contributor, followed by cardiology/cardiac.

Comfortable capital structure and healthy coverage indicators– Shalby's capital structure remains comfortable on a consolidated basis, despite the debt funded acquisition of the implant business in FY2022. The acquisition was funded through a debt of USD 12 million and an equity of USD 3.5 million. On the back of this the total debt at consolidated level, increased to Rs. 155.0 crore in FY2022 from Rs. 44.0 crore in FY2021. Given the debt funded nature of asset acquisition the profitability and in turn coverage numbers moderated to some extent in FY2022. However, with the scale up of operations and the business turning margin accretive, the metrics are expected to improve in the near term and will remain a key rating monitorable. Nevertheless, the capital structure has remained comfortable, given the improvement in net worth base and lower reliance on working capital debt on a standalone basis. The gearing remained healthy at 0.2 times as on March 31, 2022 (0.1x as on March 31, 2021). The Debt/OPBITDA metric remains comfortable despite moderating to 1.3x as on March 31, 2022 from 0.5x as on March 31, 2021. The interest coverage indicators also remained comfortable at 20.3x in FY2022 and 21.4x in H1 FY2023 (23.9x in FY2021) on the back of healthy operating profitability. Also, given the free cash balance of Rs. 85.8 crore, as on September 30, 2022 the company's net-debt position remains strong.

Credit challenges

Moderate overall occupancy levels, limiting scale expansion – The overall occupancy levels for Shalby remained moderate at 46% in FY2022 and has remained moderate in the past. The occupancy levels have gradually picked up in the current fiscal improving to 49% in Q2 FY2023 as elective surgeries picked up which were initially deferred due to the pandemic. Moreover, the occupancy at some of the other mature hospitals like Jabalpur and Vapi remains low. ICRA notes that at the relatively new hospitals in Jaipur, Naroda and Surat, Shalby has been able to rapidly ramp-up the occupancy to 47% in FY2022. Nonetheless, despite the low overall occupancy levels the company's operating income is supported by healthy ARPOB (Average Revenue Per Operating Bed) levels which improved to Rs. 31,347 in FY2022 from Rs. 27,400 in FY2021. The ARPOBs further improved to Rs. 33,439 in Q2 FY2023. The large equity base post the IPO, as well as the ongoing expansion in hospitals and the implants business have constrained the RoCE, which remained low at 9% in FY2022 (6.9% In FY2021).

High dependence on flagship hospital, SG Highway, for revenue and profitability; however, contribution from other hospitals has been increasing gradually – Historically, Shalby has derived a significant percentage of its total revenue from its flagship hospital, SG Highway. It derived 25.7% of the total revenue and 43.1% of the total operating profit in FY2022, albeit improving from 33% and 57% respectively in FY2020. Going forward the contribution of other hospitals to revenues and operating profit is expected to improve as they gradually ramp up.

Ability to profitably scale up the new implant manufacturing business as well as manage aggressive expansion of hospitals remain critical for improvement in return metrics— Shalby expanded its capacity aggressively by commencing operations of new hospitals at Jabalpur (Madhya Pradesh), 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, Shalby has two new hospitals in Mumbai and Nashik (Maharashtra) under construction the same is expected to become operational over FY2026 and FY2024 respectively. Such rapid expansion has led to a significant proportion of low maturity hospitals in the company's portfolio as on March 31, 2022, constraining the return indicators to some extent.

The return metrics were further tempered, by the debt funded acquisition of the implant business, which was loss making both at operating and net level in FY2022, given first year of operations. Comfort however is taken from the significant uptick in the operational profile of SAT, which has resulted in increase in scale of operations to Rs. 50.0 crore in H1 FY2023 as against a modest Rs. 31.1 crore reported for the whole of FY2022 and is expected to break even in the current fiscal. The margins however, remains subdued as the operations are yet to scale up to the optimum level. Thus, Shalby's ability to turn around the operations and profitably scale up the new venture so as to generate a commensurate return remains critical from a credit perspective on a consolidated basis.

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. Shalby faced the same in FY2016. To some extent the moderate occupancy levels seen in some of the hospitals was also due to the management churn the company has witnessed. 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.

Environment and Social Risks

Environmental considerations – The hospital sector does not face any major physical climate risk. However, they need to comply with environmental laws and regulations pertaining to handling and disposal of bio-medical specimens, wastewater, infectious and hazardous waste. The company ensures that waste disposal for its hospitals to be in line with the accordance of government guidelines, thereby ensuring that minimum generation of radiation or infection happens. E-waste disposal is conducted through an authorized agent. With respect to sanitation and water conservation the company has undertaken various measures to recycle the same and make efficient use of water. The company has taken adequate measures to meet all the government regulations with respect to solid waste, medical waste and water conservation so as to minimize any business disruption.

Social considerations – Exposure to social risks is moderate for the hospital sector. Social risks for industry players include litigation exposure and compliance of standard requirements given the importance of the service being provided. Further, regulatory interventions such as price control measures, imposition of restrictions, if any, specifically levied could impact the earnings of industry players. The company has had no major litigations with respect to the above.

Liquidity position: Strong

Shalby's liquidity position remains strong, with healthy cash flow from operations and surplus cash, bank balance and liquid investment of Rs. 202.6 crore as on March 31, 2022, out of which Rs. 146.0 remains encumbered as security against the outstanding term loan, bank facilities of subsidiary SAT and working capital facilities. The company had unutilized fund-based working capital facility of ~Rs. 33.5 crore as on September 30, 2022 and the average utilisation remained almost nil in the past 12 months. Moreover, going forward, the company is expected to generate sufficient cash flows from operations to meet its scheduled repayments over the next few years.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if sustained increases in occupancy improves revenue and profitability, which in turn improves debt coverage indicators and strengthens the overall liquidity profile.

Negative factors – Negative pressure on the company's ratings could arise if the debt/ OPBDITA metrics increases above 1.5 times on a sustained basis or if there is any significant time or cost overruns in the under-construction hospitals, or delay in turnaround of newer ventures, which overall impacts the financial profile. Further, any higher-than-expected debt-funded capex, which materially weakens the coverage indicators, will also be a negative rating trigger.

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, 2022, the company had eight direct subsidiaries, and two step subsidiaries, the details of which are enlisted in Annexure-2.

About the company

Shalby is promoted by the 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 multi-speciality healthcare facilities with ~2,012 bed capacity. 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 50+ OPD centres across India and five clinics in Africa. Operations initially focused on arthroplasty procedures (knee and hip replacements), following which the company expanded into other specialities such as oncology, bariatrics, cardiology, neurosurgery, etc, over last few years.

Key financial indicators (Consolidated - audited)

Consolidated	FY2021	FY2022
Operating Income (Rs. crore)	430.9	698.9
PAT (Rs. crore)	42.4	54.0
OPBDIT/OI (%)	20.1%	17.2%
PAT/OI (%)	9.8%	7.7%
Total Outside Liabilities/Tangible Net Worth (times)	0.2	0.4
Total Debt/OPBDITA (times)	0.5	1.3
Interest Coverage (times)	23.9	20.3

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore) as on Nov 30, 2022	Date & Rating in	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					Dec 22, 2022	Sep 16, 2021 Oct 28, 2021	July 10, 2020	Oct 18, 2019
1	Fund Based - CC/OD/others	Long Term	33.52	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A(Stable)	[ICRA]A (Positive)
2	Fund Based - Term Loan	Long Term	39.48	29.99	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A (Positive)
3	Non-fund Based – Stand by Letter of Credit	Long Term	124.00	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-	-
4	Unallocated Limit	Long Term	31.02	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-	-

Source: company

Complexity level of the rated instruments

Instrument	Complexity Indicator
CC/OD/Others	Simple
Term Loan	Simple
Stand by Letter of Credit	Very Simple
Unallocated Limit	NA

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: Click Here .

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Fund Based – CC/OD/others	NA	NA	NA	25.00	[ICRA]A+(Stable)
NA	Fund Based – CC/OD/others	NA	NA	NA	1.62	[ICRA]A+(Stable)
NA	Fund Based – CC/OD/others	NA	NA	NA	5.85	[ICRA]A+(Stable)
NA	Fund Based – CC/OD/others	NA	NA	NA	1.00	[ICRA]A+(Stable)
NA	Fund Based – CC/OD/others	NA	NA	NA	0.05	[ICRA]A+(Stable)
NA	Fund Based – Term Loan 1	FY2018	NA	FY2025	25.58	[ICRA]A+(Stable)
NA	Fund Based – Term Loan 2	FY2018	NA	FY2026	13.90	[ICRA]A+(Stable)
NA	Non – Fund based – Stand by Letter of Credit	NA	NA	NA	124.00	[ICRA]A+(Stable)
NA	Unallocated Limit	NA	NA	NA	31.02	[ICRA]A+(Stable)

Source: *Company*

Please click here to view details of lender-wise facilities rated by ICRA

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
Mars Medical Devices Limited (MMDL)	100.00%	Full Consolidation
Shalby Advance Technologies Inc. – Step down subsidiary of Shalby; Subsidiary of MMDL	100.00%	Full Consolidation
Shalby Global Technologies Pte Ltd - Step down subsidiary of Shalby; Subsidiary of MMDL	98.76%	Full Consolidation
Shalby Hospital Mumbai Private Limited	100.00%	Full Consolidation
Slaney Healthcare Private Limited	100.00%	Full Consolidation
Yogeshwar Healthcare Limited	94.68%	Full Consolidation
Griffin Mediquip LLP	95.00%	Full Consolidation

Source: *Shalby Limited audited report FY2022*

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