Zydus Foundation (Revised)

September 02, 2021

Ratings

Facilities/ Instruments	Amount (Rs. crore)	Ratings[1]	Rating Action
Non-Convertible Debenture	185.00 (Reduced from Rs.200 crore)	**CARE BBB+; Stable [Triple B Plus; Outlook: Stable]**	**Reaffirmed**
Non-Convertible Debenture (Proposed) #	-	-	**Withdrawn**
Total Instruments	**185.00 [Rupees One Hundred and Eighty-Five Crore Only]**		

Details of facilities/instruments in Annexure-1

 # The company issued NCDs of Rs.50 crore and received the subscription from the issue during FY21. However, the company was unable to get these NCDs listed on stock exchanges as per the regulatory requirement. Hence, subsequently it paid-back the amount so raised to investors within the stipulated time frame. As on date, there is no outstanding against the proposed rated NCDs. Taking cognizance of this, CARE has withdrawn the rating assigned to the proposed NCD of the company.

Detailed Rationale & Key Rating Drivers

The rating assigned to the long-term Non-Convertible Debenture (NCD) issue of Zydus Foundation (ZF) continues to primarily derive strength from its strong parentage of Cadila Healthcare Limited (CHL) by virtue of being its wholly-owned subsidiary. Majority of CHL's corporate social responsibility (CSR) spend is being done through ZF and the same is expected to continue. The rating also suitably factors in CHL's need-based support to ZF as a parent, since it is strategically important to the Zydus Cadila group which already has vast experience in the pharmaceutical and healthcare sectors; and through ZF the group has forayed in to the field of medical college. The rating also favourably factors in the high enrolment ratio of the medical college, benefits available from the state government under various schemes for its medical college and hospital along with good growth prospects for the education sector. There was healthy receipt of CSR funds from various Zydus Cadila group companies during FY21 (FY; refers to period April 1 to March 31) leading to strengthening of ZF's net-worth base coupled with lower than envisaged reliance on debt for its on-going capex.

The rating of ZF, however, continues to remain constrained on account of its loss-incurring operations resulting into weak debt coverage indicators and envisaged insufficient operating cash flows for the foreseeable future in servicing its project debt; thereby necessitating continued reliance on Zydus Cadila group for its servicing. The rating is further constrained on account of inherent execution and stabilization risk associated with its large sized on-going partly debt funded capex for building a new super-speciality hospital-cum-medical college which has encountered time and cost overrun, limited track record of operation of the existing medical college and susceptibility to regulatory changes in the higher education and healthcare sectors. CARE also takes cognizance of the on-going Public Interest Litigation (PIL) filed against CHL in the Honourable Gujarat High Court wherein the Court has asked CHL not to charge any fees from patients for medical treatment until the case is disposed-off. Further, CARE takes note of ZF's formation under Section 8 of the Companies Act, 2013 with the objective of promotion of education, research or charity; and profit, if any, is to be utilized for promoting these objectives thereby limiting net surplus and cash flow.

Rating Sensitivities

Positive Factors (Factors that could lead to positive rating action / upgrade)

- Demonstration of successful track record of ramp-up of its medical college operation through high enrolment ratio and healthy fees along with successful stabilization of the hospital operation with receipt of income from the hospital, thereby leading to self-sustainable generation of cash flows for meeting ZF's debt servicing requirements for the entire tenor of the debt without any reliance on group support.
- Significant improvement in its debt coverage indicators.

Negative Factors (Factors that could lead to negative rating action / downgrade)

- Material reduction in enrolment of students with sharp decline in income on a sustained basis.
- Any further time-overrun or cost-overrun in the on-going capex leading to significantly lower than previously envisaged performance.
- Any change in the extent of shareholding of the parent (CHL) or deterioration in the credit profile of CHL or lower than envisaged support from CHL/ Zydus Cadila group.

Detailed description of the key rating drivers

Key Rating Strengths

Strong parentage of CHL providing financial flexibility

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

ZF is a 100% subsidiary of CHL, the flagship company of the Zydus Cadila group. CHL is the 4th largest pharmaceutical company in India as well as the 5th biggest generic-pharmaceutical company in the United States of America (USA) based on prescription (Source: Company). According to the management, CHL is the market leader in dermatology and gynaecology in the domestic market, ranked 2nd in pain management and respiratory, 4th in cardiac and gastro-intestinal and 5th in anti-infective therapeutic segment. Further, 14 of CHL's brands rank amongst the top 300 pharmaceutical brands in India with nine brands having sales of more than Rs.100 crore (Source: Company). Moreover, CHL reported net profit of around Rs.2,185 crore during FY21 with comfortable gearing and strong debt coverage indicators. CHL, on an average, spends nearly Rs.25-30 crore annually towards CSR primarily in the education and healthcare sectors. During FY21, CHL provided funds of Rs.78.54 crore (P.Y.: Rs.21.99 crore) in the form of CSR contribution (significantly higher than required obligation) to ZF. The additional CSR spend by CHL would be available to set-off against future CSR obligation. Due to its strong financial profile, CHL is capable of providing any need-based assistance to ZF. Further, the management of CHL has also indicated their willingness to extend any need-based support to ZF.

Managerial linkages with the resourceful promoter group Zydus Cadila which has wide experience in pharmaceutical and healthcare sectors

ZF is a part of the Zydus Cadila group promoted by Ahmedabad-based Mr Pankaj Patel and his family. Mr. Pankaj Patel, the Chairman of CHL and Mr. Sharvil Patel, Managing Director of CHL and Chairman of Zydus Wellness Limited, act as Directors in ZF thereby demonstrating strong managerial linkages with the Zydus Cadila group. Further, the promoter group has significant experience of more than six decades in the pharmaceutical and healthcare industry. The major group companies are Zydus Healthcare Limited (ZHL), ZWL, Zydus Hospira Oncology Private Limited, Zydus Technologies Limited, etc.

Zydus Cadila group currently manages and operates four hospitals in Gujarat including two in Ahmedabad, one in Anand and one in the Suzuki Motor Gujarat Township at Becharji Village. Over the period of last three years ended FY21, Zydus Cadila group has demonstrated strong financial support to ZF by infusing fund to support its operations as well to fund the on-going capex requirement.

Benefits available from state government

Under the Health Policy 2016, introduced by the Government of Gujarat (GoG), ZF is eligible for receiving various incentives such as (i) Assistance of Rs.7.5 lakh per seat per year in M.B.B.S. course for a maximum period of five years, (ii) Reimbursement of electricity duty in the electricity bill of medical college and attached hospital for five years, (iii) Annual grant from the government which was received by the Civil hospital before the transfer of operations to ZF, (iv) Other government grant related to construction of hospital building, purchase of equipment, under Health Policy 2016 and under Pradhan Mantri Jan Arogya Yojana (PMJAY). These benefits support the meager operating cash flows of the company and to that extent reduces its reliance on external funding. ZF has received total government grant of Rs.58.25 crore till March 31, 2021 and is expected to receive grant of Rs.23.50 crore (Rs.15 crore against student fee and Rs.8.50 crore for hospital building construction) each in FY22 and FY23 from the government.

Continued high enrolment ratio in light of limited availability of medical seats in the state with overall favorable growth prospects for the education as well as healthcare sectors

Since its first year of operation in 2019, ZF was able to maintain the enrolment level at 100% due to the limited seats available for medical education in Gujarat. Generally, the academic year starts in month of August. However, due to Covid-19, there is a delay in entrance exam hence, the academic year is expected to start from October 2021 (2021-2022 batch). Total seats available for M.B.B.S. course in Gujarat is nearly 5,400-5,600 as against around 78,000-80,000 students who registered for National Eligibility cum Entrance Test (NEET). Hence, it is expected that ZF would continue to receive 100% enrolment in 2021-22 and going forward. Moreover, the outlook for overall education sector remains favourable in light of growing middle class population with rising income levels, increasing enrolment of students in colleges and universities, emphasis on girls' education, increasing private spend on education, wider variety of courses offered by colleges and universities, etc. However, challenges relating to access to education, quality of education imparted, governance and management, and financial commitment to education development continue to persist.

At present, the rising incidences of lifestyle diseases, the rising demand for affordable healthcare, the emergence of technologies like telemedicine, and the increased role of government in healthcare investment space are the major driving factors in Indian healthcare industry. The Indian government has remained very active through its various initiatives such as Ayushman Bharat, Amrutam Yojana and other schemes.

Strengthening of net worth base on the back of healthy receipt of corpus fund

During FY21, ZF received donation for special purpose amounting to Rs.141 crore (out of which Rs.109 crore was from group companies) which was directly credited to the corpus fund of its balance sheet leading to strengthening of net-worth base of the company as on March 31, 2021. Consequently, the overall gearing ratio of the company improved significantly from 4.89 times as on March 31, 2020 to 1.10 times as on March 31, 2021. Moreover, with higher than envisaged receipt of corpus fund, the debt of the company remained lower at Rs.185 crore as on March 31, 2021 as compared to envisaged level of Rs.400 crore as on even date. As informed by the management, ZF does not have plan to raise any debt in the medium term which will lead to gradual improvement in overall gearing over a period of FY22-FY24.

Liquidity: Adequate

Liquidity of ZF over next one year is expected to remain adequate in the absence of any long-term debt repayment obligation during this period as well as due to nominal interest rate charged on the existing NCDs. The liquidity of ZF is largely underpinned from the expectation of its access to timely need-based support from its parent (CHL) and Zydus Cadila group. ZF being part of large size Zydus Cadila group enjoys strong financial flexibility.

Key Rating Weaknesses

Limited track record of operations with the medical college being first venture of the promoter group in the higher education sector

ZF has a very short track record of operation as it had taken over the operation of the medical college at Dahod (Gujarat) in January 2019. Although Zydus Cadila group has vast experience in the healthcare and pharmaceutical industries, the promoter group has ventured into the higher education sector by taking over the operations of the medical college at Dahod. By virtue of being the group's first venture in higher education sector, the operations may be impacted if not managed successfully. Moreover, the revenue profile of the college is concentrated due to offering of only one undergraduate course i.e. M.B.B.S. Maintaining healthy enrolment ratio and generating sufficient cash flows by way of charging of adequate tuition fees over a long period of time and thereby becoming self-sufficient would be crucial for its prospects.

Execution and stabilization risks associated with the on-going large sized capex

ZF is currently building a new 750-bed multi-specialty hospital and additional medical college facility/ infrastructure. ZF has awarded construction of its medical hospital and college infrastructure project to PSP Projects Limited (PSP; rated CARE A+; Stable/ CARE A1+) which has strong execution capability which reduces the project implementation risk to an extent. Earlier, ZF had envisaged the project cost at around Rs.400 crore which was expected to get completed by end of FY21. However, due to adverse impact of Covid-19 pandemic, the project got delayed. Further, with significant rise in input cost mainly steel and cement apart from some change in scope of work, the cost of project is now revised to around Rs.550 crore. ZF has plans to build an additional infrastructure for Post Graduate course which was not envisaged earlier. The entire project is now expected to be complete by end of FY24. Despite higher than envisaged cost of project, the debt level is not envisaged to increase. On the contrary, earlier, the company had planned to raise NCD Rs.400 crore which is now reduced to Rs.185 crore. ZF has incurred capex of Rs.395 crore as on March 31, 2021 which was partly funded through NCDs of Rs.185 crore and remaining through donation fund. Company expects the remaining cost of project to be funded through donation fund. ZF had issued NCDs of Rs.185 crore with negligible rate of interest of 0.10% p.a. on private placement basis to one of its group companies i.e. M/s. Recon Pharmaceuticals and Investments (a partnership firm and wholly owned subsidiary of CHL, held through ZHL).

Currently, the company has total 410 bed capacity and plans to commence the 750 bed multi-specialty hospital within next 12-18 months. The hospital already operates above its capacity thereby reducing stabilizing risk to a certain extent; albeit non-charging of fees from the patients for such a larger capacity will entail higher cost of operation without commensurate revenue until it is allowed to charge fees from patients by the Court. However, as the hospital is working under Public Private Partnership (PPP) model, the government is expected to reimburse patient fees by way of grant as well as under various medical schemes like Ma Amrutam scheme, etc.

Challenges of attracting and retaining quality doctors and medical professionals

Undertaking new project and expanding existing facilities require trained doctors and medical personnel. Due to scarcity of trained medical persons (including doctors) owing to better alternatives available with them, it becomes relatively difficult to attract and retain skilled pool of medical personnel, especially in the tribal area of Dahod.

Envisaged limited operating cash flows for the foreseeable future

Due to its loss-incurring operations, the debt coverage indicators of the company remained weak in FY21; and it is expected to remain weak in the medium term till the time the complete benefits of the project accrue. Further, ZF has schedule bullet repayment obligation of existing NCD on March 25, 2025. ZF's cash accruals are envisaged to be meager during the tenor of the NCD, thereby necessitating need-based support from CHL/ Zydus Cadila group for its timely servicing (including through refinancing). Considering bullet repayment of the existing NCDs in FY25, there exists refinancing risk. However, ZF being part of the Zydus Cadila group and a 100% subsidiary of CHL, it is envisaged that ZF should be able to service/refinance its debt in a timely manner.

Presence in a regulated higher education sector

Higher education sector is one of the regulated sectors with both state and central governments regulating the industry directly and/or indirectly through various bodies including University Grants Commission (UGC), Medical Council of India

(MCI) and All India Council for Technical Education (AICTE). The scope of government regulations is wide, starting from establishment of course/institute, seat sharing, fee fixation and periodical review of the standards followed by the institute. These factors have significant impact on the revenues and profitability of the institutions. Also, risk related to non-renewal of courses along with any adverse changes in regulatory guideline persists as the university needs to follow the same from time to time.

On-going PIL in Honourable Gujarat High Court for operating the hospital
The Honourable Gujarat High Court has directed CHL not to charge any fees from patients who come to its hospital (erstwhile Dahod General Civil hospital) for treatment. The decision came after a PIL was filed by four residents of Dahod stating that the hospital management had started charging the poor patients for medical services which were given free till 2017 and urged the court to put a break on the practice. Presently, ZF is not charging any fees for medical treatment in its existing hospital. The matter is sub-judice and its outcome and impact on ZF will be closely monitored by CARE.

Analytical Approach: Standalone along with factoring managerial and financial linkages with its parent, CHL. CHL, having a strong credit risk profile, is capable of providing need-based support to ZF in a timely manner. Further, management of CHL has also strongly articulated their willingness to extend any need-based support to ZF.

Applicable Criteria:
Policy on Withdrawal of ratings
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology – Hospital Industry
Rating Methodology – Education Sector
Financial ratios – Non-Financial Sector
Rating Methodology: Notching by factoring linkages in Ratings
Liquidity Analysis of Non-Financial Sector Entities

About the Company
ZF, a 100% subsidiary of CHL, was incorporated in January 2019, under Section 8 of the Companies Act, 2013. ZF is headed by Mr. Pankaj Patel and family who also own and run CHL, ZWL and various other companies. ZF had taken over the running operations of 363-bed Civil Hospital Dahod from Government of Gujarat (GoG) under Brown Field (Scheme for establishment of new self-financed medical college at government hospitals) Scheme of Health Policy, 2016 and obtained permission from GoG and MCI to commence Medical College at Dahod. This initiative is under the PPP model initiated by GoG. ZF now manages the Zydus Medical College and Hospital (ZMCH) at Dahod and the college is affiliated to Shri Govind Guru University, Godhra. ZMCH is providing tertiary health care services to tribal population of eastern Gujarat and adjacent districts of Madhya Pradesh and Rajasthan states and runs the college offering M.B.B.S. course.

Brief Financials of ZF (Rs. Crore)	FY20 (Aud.)	FY21 (Aud.)
Total Operating Income	36.67	44.53
SBILDT	(1.54)	(2.06)
Net Surplus	(2.86)	(9.64)
Overall Gearing (times)	4.89	1.10
SBILDT Interest Coverage (times)	-ve	-ve

Status of non-cooperation with previous CRA: Not Applicable
Any other information: Not Applicable
Rating History (Last three years): Please refer Annexure-2
Covenants of rated instrument: Detailed explanation of covenants of rated instruments is given in Annexure-3.
Complexity level of various instruments rated for this company: Annexure 4

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	ISIN No.	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Debentures-Non Convertible Debentures	March 24, 2020	INE04VY08012	0.10%	March 25, 2025	185.00	CARE BBB+; Stable
Debentures-Non Convertible Debentures (Proposed)	-	-	-	-	0.00	Withdrawn

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Debentures-Non Convertible Debentures	LT	185.00	CARE BBB+; Stable	-	1)CARE BBB+; Stable (29-Sep-20)	1)CARE BBB+; Stable (19-Mar-20)	-
2.	Debentures-Non Convertible Debentures (Proposed)	LT	-	Withdrawn	-	1)CARE BBB+; Stable (29-Sep-20)	-	-

Annexure-3: Covenants of rated Instrument

NCDs	Covenants
Financial and non-financial covenants	1) In the event there is a downgrade in the Credit Rating of the Debentures or the Issuer below ‘BBB+’ by the Rating Agency having an outstanding rating on the Debentures or the Issuer, the Coupon for the Debentures shall be revised upwards by 0.05% for each notch of such downgrade, from the date of such downgrade and shall be payable on the immediately next Coupon Payment Date 2) In case of default in payment of any monies accruing due on the respective due dates or in creation of Security Interest within the stipulated timelines, the entire outstanding amount thereof shall carry default interest, which shall be a rate of 2% p. a. over and above the applicable Coupon Rate in respect of all outstanding amounts for the period of default or delay until (and incl.) date on which such failure is rectified or waived off, as the case may be, by the Debenture Trustee. (3) The Debenture holders shall have a right to call upon the Issuer to mandatorily redeem the Debentures, upon the occurrence of any of the following events (each a “Mandatory Redemption Event” and collectively “Mandatory Redemption Events”): (a) In the event, the Credit Rating of the Debentures or Issuer is downgraded to or below ‘B-’ by the Rating Agency having an outstanding rating of the Debentures or Issuer or a new rating of B- or lower is assigned; (b) In the event the Debentures are not listed on the wholesale debt market segment of the Stock Exchange within 15 (fifteen) days from the Deemed Date of Allotment or within such period as permitted under Applicable Law.

Annexure-4: Complexity level of the rated instruments

Sr. No.	Name of the Instrument	Complexity Level
1.	Debentures-Non Convertible Debentures	Complex

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:

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