# Zydus Foundation

August 30, 2022

## Rating

| Facilities/Instruments | Amount (₹ crore) | Rating[1] | Rating Action |
|---|---|---|---|
| Non-Convertible Debentures | 160 (Reduced from Rs.185 crore) | CARE BBB+; Stable (Triple B Plus; Outlook: Stable) | Reaffirmed |
| **Total Long-Term Instruments** | **160 (₹ One Hundred Sixty Crore Only)** | | |

Details of instruments/facilities in Annexure-1.

## Detailed rationale and key rating drivers

The rating assigned to the long-term Non-Convertible Debenture (NCD) issue of Zydus Foundation (ZF) continues to derive strength from its strong parentage of Zydus Lifesciences Limited (ZLL; previously known as Cadila Healthcare Limited) by virtue of being its wholly owned subsidiary. Majority of ZLL's corporate social responsibility (CSR) spend is being done through ZF and the same is expected to continue. The rating also suitably factors in ZLL'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 into 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.

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 stabilization risk associated with its large sized on-going partly debt funded capex for building a new super-speciality hospital-cum-medical college, 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 ZLL in the Honourable Gujarat High Court wherein the Court has asked ZLL 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 change in the extent of shareholding of the parent (ZLL) or deterioration in the credit profile of ZLL or lower than envisaged support from ZLL/ Zydus Cadila group.

## Detailed description of the key rating drivers

**<u>Key rating strengths</u>**

**Strong parentage of ZLL providing financial flexibility**

ZF is a 100% subsidiary of ZLL, the flagship company of the Zydus Cadila group. ZLL is the 4$^{th}$ largest pharmaceutical company in India as well as the 5$^{th}$ biggest generic-pharmaceutical company in the United States of America (USA) based on prescription (Source: Company). According to the management, ZLL is the market leader in gynaecology and nephrology in the domestic market. Further, 12 of ZLL's brands rank amongst the top 300 pharmaceutical brands in India with 8 brands having sales of more than Rs.100 crore (Source: Company). Moreover, ZLL reported net profit of around Rs.4,487 crore including profit on sale of assets of Rs.2,581 crore during FY22 with comfortable gearing and strong debt coverage indicators. ZLL, on an average, spends nearly Rs.25-30 crore annually towards CSR primarily in the education and healthcare sectors. During FY22, ZLL provided funds of Rs.17.00 crore (P.Y.: Rs.78.54 crore) in the form of CSR contribution to ZF. Due to its strong financial profile, ZLL is capable of providing any need-based assistance to ZF. Further, the management of ZLL 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 ZLL and Mr. Sharvil Patel, Managing Director of ZLL and Chairman of Zydus Wellness Limited (ZWL), act as

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

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, ZWL, Cliantha Research Ltd, 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 FY22, 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 GoG, "Zydus Medical College and Hospital" is eligible for receiving various incentives such as 1) Assistance of Rs.7.5 lakh per seat for M.B.B.S. course for a maximum period of five years. 2) Reimbursement of electricity duty in the electricity bill of medical college and attached hospital for five years. 3) Annual grant from the government which was received by the Civil hospital before the transfer of operations to ZF. 4) Other government incentives related to construction of hospital building, purchase of equipment, under Health Policy 2016 and under Pradhan Mantri Jan Arogya Yjana (PMJAY). ZF has received total government grant of Rs.81.75 crore up to March 31, 2022 and is expected to receive grant of Rs.23.50 crore (Rs.15 crore student grant & Rs.8.50 crore hospital grant) in FY23 from the government.

**Continued high enrolment ratio in light of limited availability of medical seats in the state with overall favourable 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. Total seats available for M.B.B.S. course in Gujarat is nearly 5,400-5,600 as against more than 90,000 students who registered for National Eligibility cum Entrance Test (NEET) annually. Hence, it is expected that ZF would continue to receive 100% enrolment 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.

**Healthy net-worth base on the back of continued receipt of corpus fund**
During FY22, ZF received donation for special purpose amounting to Rs.27.39 crore which was directly credited to the corpus fund under balance sheet leading to further strengthening of net worth base of an entity as on March 31, 2022. The overall gearing ratio of the company improved remained moderate at 0.97 times as on March 31, 2022. The debt of the company comprises of NCD of Rs.185 crore as on March 31, 2022. As informed by the management, ZF does not have plan to raise any debt in the medium term which will lead to improvement in overall gearing over a period of FY23-FY25. Moreover, it has to be noted that ZF has prepaid part NCD of Rs.25 crore during FY23 leading to reduction in debt level to Rs.160 crore as on July 31, 2022.
The entity reported a positive surplus at operating level during FY22, first time since inception. Furthermore, it is expected to earn positive surplus at operating level in foreseeable future backed by increasing student strength and absorption of fixed cost. While it had incurred a deficit at net level in FY22 due to increased depreciation charge.

## 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 (ZLL) 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 limited 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 although there are plans to introduce a post graduate course. 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.

**Stabilization risks associated with the on-going large sized capex**
The entity has completed the project to build additional bed capacity along with college facility/ infrastructure and incurred an aggregate cost of around Rs.400 crore as on March 31, 2022, of the total envisaged cost of around Rs.550 crore. As on March 31, 2022, the entity has achieved total beds capacity of 650 of the total planned bed capacity of 750. The balance 100 bed capacity is expected to commence over FY23 and FY24. Further, the entity has plan to build additional infrastructure for Post Graduate course over a period of FY23 and FY24. The entire capex of around Rs.550 crore is being funded through NCD of Rs.185 crore (of which the entity has prepaid Rs.25 crore) and balance through CSR contribution received from Zydus group entities. Company expects the remaining cost of project to be funded through donation fund only and there would not be any reliance on debt for funding of capex.
Currently, the company has total 650 bed capacity at current multi-specialty hospital which is expected to reach to 750 beds over next 2 years. The hospital already operates at optimum 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 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; 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 ZLL/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 ZLL, 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 ZLL 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, ZLL. ZLL, having a strong credit risk profile, is capable of providing need-based support to ZF in a timely manner. Further, management of ZLL has also strongly articulated their willingness to extend any need-based support to ZF.
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## Applicable criteria

Factoring Linkages Parent Sub JV Group
Financial Ratios – Non-financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Rating Methodology - Education
Rating Methodology – Hospital Sector
Policy on default recognition
Policy on Withdrawal of Ratings

## About the company

ZF, a 100% subsidiary of ZLL, 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 ZLL, 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 (₹ crore) | FY21 (A) | FY22 (A) | Q1FY23 (UA) |
|---|---|---|---|
| Total operating income | 44.53 | 64.47 | 23.25 |
| SBILDT | (2.060 | 6.26 | 6.59 |
| SAT | (9.63) | (4.82) | 2.57 |
| Overall gearing (times) | 1.10 | 0.97 | - |
| SBILDT Interest coverage (times) | (4.29) | Very High | - |

A= Audited; UA = Un-audited

**Status of non-cooperation with previous CRA:** Not Applicable

**Any other information:** Not Applicable

**Rating history for the last three years:** Please refer Annexure-2

**Covenants of the rated instruments/facilities:** Detailed explanation of covenants of the rated instruments/facilities 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 | ISIN | Date of Issuance | Coupon Rate | Maturity Date | Size of the Issue (₹ crore) | Rating Assigned along with Rating Outlook |
|---|---|---|---|---|---|---|
| Debentures-Non-Convertible Debentures | INE04VY08012 | March 24, 2020 | 0.10% | March 25, 2025 | 160.00 | CARE BBB+; Stable |

## Annexure-2: Rating history for the last three years

| Sr. No. | Name of the Instrument/Bank Facilities | Current Ratings | | | Rating History | | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Outstanding (₹ crore) | Rating | Date(s) and Rating(s) assigned in 2022-2023 | Date(s) and Rating(s) assigned in 2021-2022 | Date(s) and Rating(s) assigned in 2020-2021 | Date(s) and Rating(s) assigned in 2019-2020 |
| 1 | Debentures-Non-Convertible Debentures | LT | 160.00 | CARE BBB+; Stable | - | 1)CARE BBB+; Stable (02-Sep-21) | 1)CARE BBB+; Stable (29-Sep-20) | 1)CARE BBB+; Stable (19-Mar-20) |
| 2 | Debentures-Non-Convertible Debentures | LT | - | - | - | 1)Withdrawn (02-Sep-21) | 1)CARE BBB+; Stable (29-Sep-20) | - |

*Long term/Short term.

**Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities**

| NCDs | Covenants |
|---|---|
| **Financial covenants 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<br>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.<br>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"):<br>(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.<br>(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 various instruments rated for this company**

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

**Annexure-5: Bank lender details for this company –** Not Applicable

**Note on complexity levels of the rated instruments:** CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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