Zydus Foundation

March 19, 2020

Rating

Instrument	Amount (Rs. Crore)	Rating[1]	Rating Action
Long-term Non-Convertible Debenture Issue (Proposed)	200.00	**CARE BBB+; Stable [Triple B Plus; Outlook: Stable]**	**Assigned**
Total Instruments	**200.00 [Rupees Two Hundred Crore Only]**		

Details of Instrument in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to the proposed long-term Non-Convertible Debenture (NCD) issue of Zydus Foundation (ZF) primarily derives 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 would like to foray in to the field of medical college. The rating also favourably factors in the high enrolment ratio of the medical college in its first year of operation, 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 is, however, principally constrained on account of its high leverage and envisaged insufficient operating cash flows for the foreseeable future in servicing its large 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 size on-going entirely debt funded capex for building a new 750-bed super specialty hospital-cum-medical college facility, 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.

<u>Rating Sensitivities</u>

Positive Factors

- 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 capital structure.

Negative Factors

- Material reduction in enrolment of students with sharp decline in income on a sustained basis.
- Any 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

<u>Key Rating Strengths</u>

Strong parentage of CHL providing financial flexibility

ZF is a 100% subsidiary of CHL, the flagship company of the Zydus Cadila group. CHL is the 4th largest pharmaceutical company in India and the 7th biggest pharmaceutical company in the United States of America (USA) based on prescription (source: Company). CHL is among the top 3 players in pain management, Oncology, Respiratory and Gynaecology therapeutic segments. Further, 11 of CHL's brands rank amongst the top 300 pharmaceutical brands in India. Moreover, CHL reported GCA of around Rs.2,420 crore during FY19 with modest overall gearing and strong debt coverage indicators as on March 31, 2019. Zydus Cadila group, on an average, spends nearly Rs.25-30 crore annually towards Corporate Social Responsibility (CSR) primarily in the education and healthcare sectors. During FY19, CHL provided funds of Rs.21.55 crore in the form of CSR contribution to ZF. Due to its strong financial profile, CHL is capable of providing any

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

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 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 (ZWL; rated CARE AA+; Stable), acts 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, 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.

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 (1) Assistance of Rs.7.5 lakh per seat per year in 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). These benefits support the meager operating cash flows of the company and to that extent reduces its reliance on external funding.

High enrolment ratio in light of limited availability of medical seats in the state with overall favorable growth prospect for education sector as well as healthcare sector
Despite 2019 being its first year of operation, ZF was able to achieve an enrolment level of 100% and it continued to remain at 100% in the academic year 2020 due to the limited seats available for medical education. Total seats available for M.B.B.S. course in Gujarat is 5,500 (Source: Medical Council of India) as against around ~78,000 students who registered for National Eligibility cum Entrance Test (NEET). Moreover, the outlook of 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, increasing variety of courses offered by colleges and universities, etc. However, challenges relating to access to and participation in 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. Indian government has remained very active through its various initiatives such as Ayushman Bharat and other schemes.

Key Rating Weaknesses
Limited track record of operation with the 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 operation of the medical college at Dahod. By virtue of 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 risk associated with the on-going large sized entirely debt funded capex apart from challenges of attracting and retaining quality doctors and medical professionals
ZF is currently building a new 750-bed multi-specialty hospital and additional college facility/infrastructure. The total cost of the project is Rs.400 crore which is proposed to be majorly funded through NCDs of Rs.400 crore. Currently the project is being funded through advances and CSR contributions received from the Zydus Cadila group companies. NCDs proceeds would be utilized to finance existing as well as ongoing capex. ZF has awarded construction of its medical hospital and college infrastructure project to PSP Projects Limited (PSP; rated CARE A+; Stable/ CARE A1+) which have strong execution capability thereby reducing execution risk to a certain extent. Further, with the commencement of this hospital, the total capacity of the hospital will increase to 1,113 beds from the existing 363 beds. However, 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. Undertaking new project and expanding existing facilities requires trained doctors and medical personnel. Due to scarcity of trained medical persons including doctors owing to heavy competition in the state of Gujarat, it becomes relatively difficult to attract and retain skilled pool of medical personnel especially in the tribal area of Dahod.

High leverage and envisaged insufficient operating cash flows for the foreseeable future
Due to its ongoing large size entirely debt funded capex, the leverage and debt coverage indicators of ZF are expected to remain weak in the medium term till the time the complete benefits of project accrue to it. Against a net worth of around Rs.8 crore as of end-FY19 its total debt is envisaged at around Rs.400 crore by end-FY21. Also, its 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 proposed NCD of Rs.200 crore each in two tranches at the end of 5 years from the date of allotment, 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 UGC (University Grants Commission), MCI (Medical Council of India) and AICTE (All India Council for Technical Education). 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 Gujarat High Court for operating the hospital
The Honourable Gujarat High Court has asked CHL not to charge any fees from patients who come to its hospital (erstwhile Dahod’s General Civil hospital) for treatment. The decision comes after a PIL 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.

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 proposed to be charged on the NCD. 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.

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:
Criteria on assigning outlook and credit watch to Credit Ratings
CARE’s Policy on Default Recognition
CARE’s methodology for Hospital Industry
CARE’s methodology for Education Sector
Financial ratios – Non-Financial Sector
CARE's Methodology for Consolidation and Factoring Linkages in Ratings

About the company
ZF is a 100% subsidiary of CHL, 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 Medical Council of India (MCI) to commence Medical College at Dahod. This initiative is under the Public Private Partnership (PPP) 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.

ZF is currently building a 750 bed multi-specialty hospital and medical college infrastructure/ facilities under the said policy. The total cost of the project is around Rs.400 crore which is proposed to be majorly funded by debt.

(Rs. Crore)

Brief Financials of ZF	FY19 (A) @
Total Operating Income	3.78
SBILDT	(19.38)
Net Surplus	(19.45)
Overall Gearing (times)	Very High
Interest Coverage (times)	NM

A: Audited; NM: Not Meaningful; @ 3 months of operation

As per the provisional results for H1FY20, ZF earned total operating income of Rs.37.80 crore with SBILDT of Rs.6.12 crore; albeit it is expected to end the year FY20 with a net deficit.

Covenants of rated instrument: Detailed explanation of covenants of rated instruments is given in Annexure-3

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History (Last three years): Please refer Annexure-2

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
Proposed Non-Convertible Debentures	NA*	NA*	0.10%	#	200.00	CARE BBB+; Stable

**Not available as it is proposed non-convertible debentures; as it is not yet placed its ISIN is not available*
#Maturity Date would be five years from the date of allotment.

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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Debentures-Non Convertible Debentures	LT	200.00	CARE BBB+; Stable	-	-	-	-

Annexure-3: Covenants of rated instrument

Particulars	Covenants
Financial and non-financial covenants	1) In case of delay in listing beyond 20 days from the deemed date of allotment, the company will pay penal interest of 1% p.a. over the coupon rate from the expiry of 30 days from the deemed date of allotment till the listing. 2) In case of default in payment of interest and/or principal redemption on the due dates, additional interest @ 2% p.a. over the Coupon Rate will be payable by the company for the defaulting period.

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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