

Zydus Foundation

September 29, 2020

Rating

Instruments	Amount (Rs. Crore)	Rating ¹	Rating Action
Long-term Non-Convertible Debenture Issue	200.00	CARE BBB+; Stable [Triple B Plus; Outlook: Stable]	Reaffirmed
Long-term Non-Convertible Debenture Issue (Proposed)	50.00	CARE BBB+; Stable [Triple B Plus; Outlook: Stable]	Assigned
Total Instruments	250.00 [Rupees Two Hundred and Fifty Crore Only]		

Details of instruments in Annexure-1

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.

The rating of ZF, however, continues to remain 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 sized 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.

Rating Sensitivities

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

Key Rating Strengths

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 as well as the 4th biggest pharmaceutical company in the United States of America (USA) based on prescription (which is an improvement of three positions from last year) with increase in market share by 0.62% to 4.10% (source: Company). CHL is among the top 3 players in pain management, oncology, respiratory and gynaecology therapeutic segments. Further, 12 of CHL's brands rank amongst the top 300 pharmaceutical brands in India. Moreover, CHL reported Gross Cash Accruals of around Rs.1,983 crore during FY20 (FY; refers to period April 01 to March 31) with

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

modest overall gearing and strong debt coverage indicators. 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 FY20, CHL provided funds of Rs.21.99 crore in the form of CSR contribution to ZF. 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 (ZWL; rated CARE AA+; Stable), 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.

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 Yojana (PMJAY). These benefits support the meager operating cash flows of the company and to that extent reduces its reliance on external funding.

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

Despite 2019 being its first year of operation, ZF was able to achieve an enrolment level of 100% and the same has continued in the academic years 2020 and 2021 due to the limited seats available for medical education in Gujarat. 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, 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. Indian government has remained very active through its various initiatives such as Ayushman Bharat, Amrutam Yojana and other schemes.

Key Rating Weaknesses

Limited track record of operations 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 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 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 envisaged to be entirely funded by NCDs of Rs.400 crore. The company has issued NCDs of Rs.185 crore in Tranche I 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) in March 2020. The Tranche II of the NCD issue was expected to be placed in April 2020; however it has been delayed due to Covid-

19 pandemic. Further, the company is in the process to place additional NCDs worth Rs.50 crore to fund the 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 has strong execution capability thereby reducing project implementation risk to a certain extent. However, due to disruption caused by Covid-19; the project may get delayed by few months although there is urgent requirement of additional beds in this pandemic time. Further, with the commencement of this hospital, the total capacity of the hospital will increase to 1,113 beds from the existing 363 beds. 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 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. Undertaking new project and expanding existing facilities requires adequate 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.

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 the project accrue to it. The net worth base/corpus increased to Rs.38 crore as on March 31, 2020 from Rs.8 crore as on March 31, 2019 due to donation received from group companies. However, against a net worth of Rs.38 crore as of end-FY20, 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 existing and proposed NCDs 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 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.

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 and proposed 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.

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

Rating Methodology – Hospital Industry

Rating Methodology – Education Sector

Financial ratios – Non-Financial Sector

Rating Methodology: Consolidation and Factoring Linkages in Ratings

Liquidity Analysis of Non-Financial Sector Entities

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/ facility under the said policy. The total cost of the project is around Rs.400 crore which is to be majorly funded by debt.

(Rs. Crore)

Brief Financials of ZF	FY19 (A) @	FY20 (A)
Total Operating Income	3.78	36.91
SBILDT	(19.38)	(1.30)
Net Surplus	(19.45)	(2.86)
Overall Gearing (times)	Very High	4.89
Interest Coverage (times)	NM	(5.65)

A: Audited; @ 3 months of operation

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
Non-Convertible Debentures	March 24, 2020 @	INE04VY08012	0.10%	March 25, 2020 @	200.00 @	CARE BBB+; Stable
Proposed Non-Convertible Debentures	NA*	NA*	0.10%	#	50.00	CARE BBB+; Stable

@ NCDs of Rs.185 crore is placed and listed under Tranche I while Tranche II of Rs.15 crore is yet to be placed. So, the maturity date and issuance date refers to the placed Tranche I of NCDs.

*Not available as this is a proposed non-convertible debentures; as it is not yet placed its ISIN is not available

Maturity date would be at the end of 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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Debentures-Non Convertible Debentures	LT	200.00	CARE BBB+; Stable	-	1)CARE BBB+; Stable (19-Mar-20)	-	-
2.	Debentures-Non Convertible Debentures	LT	50.00	CARE BBB+; Stable	-	-	-	-

Annexure-3: Covenants of rated Instrument

NCDs	Covenants
Financial and non-financial covenants	<p>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</p> <p>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.</p> <p>(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"):</p> <p>(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;</p> <p>(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.</p>

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. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.

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