Narayana Hrudayalaya

IPO Note

Narayana Hrudayalaya (NHL) is one of the leading private healthcare service providers in India with a strong presence in Karnataka and the Eastern region with while it is growing its presence is other parts of India as well. The company has a relatively light asset model with it owning just 1,613 out of its 5,442 operational beds. It has a strong brand name and is known for its clinical excellence and being an affordable healthcare service provider. It currently has 23 hospitals.

Potential improvement in profitability: Generally, hospital businesses have a long gestation period before they mature (in terms of occupancy rates) and it may operate at a loss for a period of time before achieving profitability. Currently, NHL is in an investment phase where the company has increased its bed count at a higher rate in comparison to its peer Apollo Hospitals (Apollo). As a result, its top-line has grown at a faster rate but its occupancy and profitability levels are not as high as that of Apollo. Going forward, with NHL's pace of expansion being slightly slower than in the past, we expect it to gradually increase its occupancy rates and enhance its profitability.

Upcoming projects under light asset model to complement growing need for healthcare delivery in India: Unlike its peers, which have higher number of owned hospitals, NHL has fewer owned hospitals while the rest are on either lease & operate, revenue sharing, or managed basis. Going forward, the company plans to expand its bed-count following the asset light route, which would include PPP or on operation and management basis, to grow its presence in other parts of the country. Moreover, India lags behind other developing and developed countries in terms of overall bed density, total expenditure on healthcare, and consumers here incur a higher out-of-pocket expenditure on healthcare. We believe that the company can gradually build its presence with efficient use of capital and by leveraging on its brand name to capitalize on the available opportunity in the under-penetrated healthcare delivery market in India.

Outlook and Valuation: Currently, NHL's operating margin is lower than its close peer Apollo Hospitals on account of lower realizations (focus on affordable healthcare) and has lower occupancy rates. Since the hospital business has longer gestation period, we expect the occupancy and overall profitability to improve over a longer period of time. On the valuation front, at the upper end of the price band, FY2016E annualized EV/Sales multiple works out to 3.4x for NHL which is not at a significant discount to Apollo (which trades at 3.6x). **Hence we have a Neutral view on the IPO from a short term perspective. However, investors with a longer term investment horizon can subscribe to the issue considering that the company's performance is expected to be more favorable in the longer run as the hospital business entails a longer gestation period and takes time to perform at optimum levels.**

Key Financial Consolidated

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015
Net Sales	**658**	**839**	**1,095**	**1,364**
% chg	*37.7*	*27.6*	*30.5*	*24.5*
Net Profit	**26**	**25**	**32**	**(11)**
% chg	*88.8*	*(3.7)*	*27.9*	*(134.3)*
OPM (%)	12.5	9.7	11.0	9.5
EPS (₹)	**1.3**	**1.2**	**1.6**	**(0.5)**
P/E (x)	198.4	206.0	161.1	-
P/BV (x)	9.9	9.3	8.8	6.7
RoE (%)	5.0	4.5	5.5	-
RoCE (%)	7.1	4.6	7.3	5.8
EV/Sales (x)	7.9	6.3	4.8	3.9
EV/EBITDA (x)	63.3	65.2	44.2	41.3

Source: Company, Angel Research, valuation ratios calculated at upper end of price band

NEUTRAL

Issue Open: December 17, 2015
Issue Close: December 21, 2015

Face Value: ₹10	
Present Eq. Paid up Capital: ₹200cr	
Offer Size: 2.5cr Shares	
Post Eq. Paid up Capital: ₹200cr	
Issue size (amount)**: ₹600cr - ₹613cr	
Price Band**: ₹245-250	
Post-issue implied mcap**: ₹5,007cr-5,109cr	
Promoters holding Pre-Issue: 64.0%	
Promoters holding Post-Issue: 62.0%	

*Note:**at Lower and Upper price band respectively*

Book Building	
QIBs	At least 50%
Non-Institutional	At least 15%
Retail	At least 35%

Post Issue Shareholding Pattern (%	
Promoters Group	62.0
MF/Banks/Indian FIs/FIIs/Public & Others	38.0

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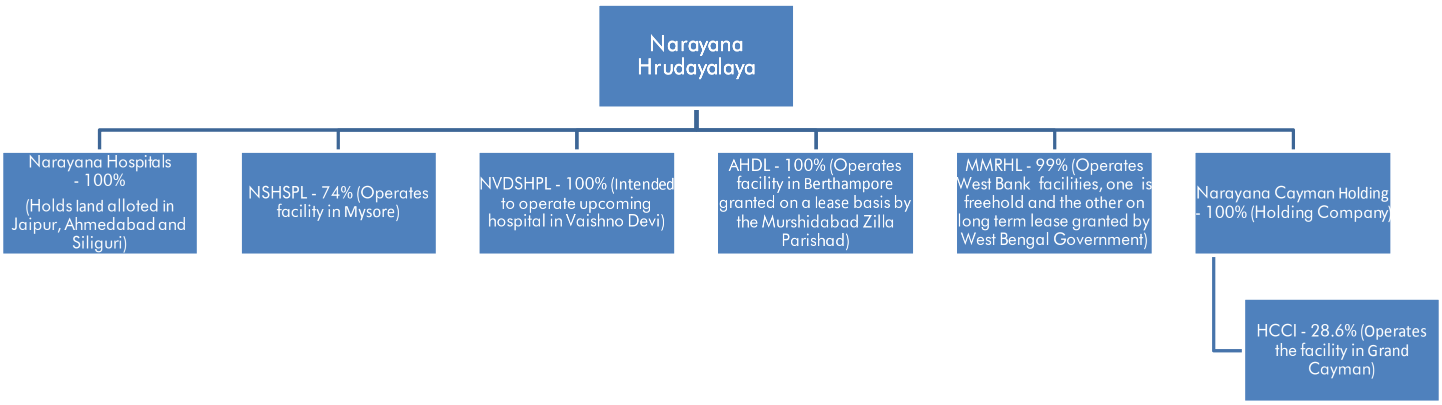
Company Background

Founded in 2000 by Dr. Devi Prasad Shetty (Promoter), NHL is one of the leading private healthcare service providers in India, operating a chain of multispecialty, tertiary and primary healthcare facilities. Currently, NHL has a network of 23 hospitals (multispecialty and super specialty healthcare facilities which provide tertiary care), 8 heart centers (super specialty units which are set up in a third party hospital) and 24 primary care facilities (including clinics and information centers), across a total of 31 cities, towns and villages in India. The network comprises of 5,442 operational beds while the capacity at the existing hospitals could be augmented to 6,602 beds. Apart from this, NHL is also expected to commence operations at 3 new facilities (Vaishno Devi, Mumbai and Lucknow) over the next 24 months, thereby increasing the number of beds by 864. It has a strong presence in the southern state of Karnataka and Eastern India, as well as an emerging presence in Western and Central India. Dr. Devi Prasad Shetty, is a cardiac surgeon with over 30 years of medical experience.

Its centres provide advanced levels of care in over 30 specialties, including cardiology and cardiac surgery, cancer care, neurology and neurosurgery, orthopaedics, nephrology and urology, and gastroenterology.

As of FY2015, NHL generated 90.7% of its revenue from its 19 hospitals offering multispecialty and super specialty services, 7.3% of its revenue from heart centers and the balance from the management fee received from four managed hospitals, ancillary businesses and other standalone clinics and primary care facilities.

Exhibit 1: Corporate Structure



Source: RHP, Angel Research

Issue details

The issue is an offer for sale by promoters and non-promoters of 2.45cr equity shares aggregating to ₹613cr at the upper end of the price band. The issue constitutes 12.0% of the paid-up equity share capital of the company. There is no fresh capital being raised by the company.

Exhibit 2: Share holding pattern

Pre-Issue			Post-Issue		
	No. of Share (cr.)	(%)		No. of Share (cr.)	(%)
Promoters	13.1	64.0	Promoters	12.7	62.0
Dr. Devi Prasad Shetty	6.7		Dr. Devi Prasad Shetty	6.5	
Shakuntala Shetty	6.4		Shakuntala Shetty	6.2	
Investors	4.4	21.7	Investors	2.4	11.7
Ashoka Investment Holdings Limited	1.7		Ashoka Investment Holdings Limited	1.1	
Ambadevi Mauritius Holding Limited	0.5		Ambadevi Mauritius Holding Limited	0.3	
JPMorgan Mauritius	2.2		JPMorgan Mauritius	1.0	
Others	2.9	14.3	Others	5.4	26.3
Total	20.4	100.0	Total	20.4	100.0

Source: Company, Angel Research

Objects of the Issue

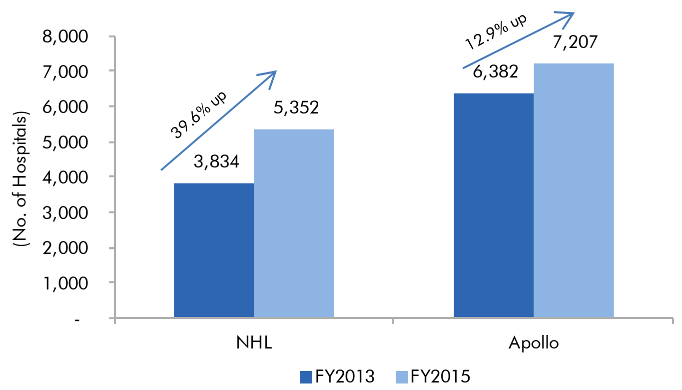
The issue comprises of sale of shares by existing investors (10%) and promoters (2%) and as a result, the company will not be receiving any proceeds of this offer. However, the company will reap the benefits from being listed as it will enhance its image. Besides, the issue will provide liquidity to the company's existing shareholders.

Investment Arguments

Potential of improvement in operating margin

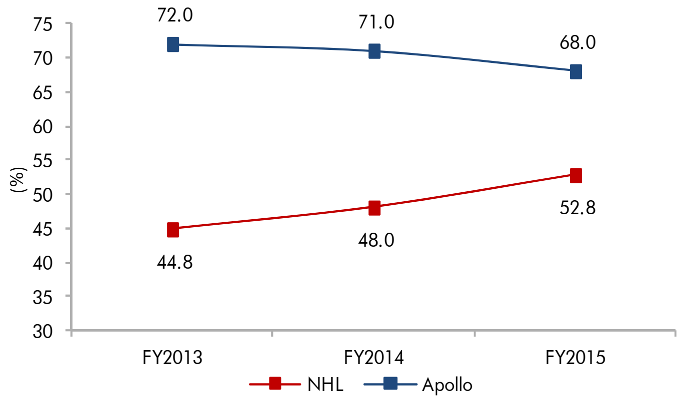
Currently the company is in an investment phase and over the last few years it has increased its bed count significantly. During FY2013-15, the company has increased its bed count from 3,834 to 5,352 (a growth of ~40%) and on the other hand, its peer Apollo has increased its bed capacity from 6,382 to 7207 representing a growth of 13%. This led to higher revenue growth but lower occupancy and lower profitability for NHL. At the same time, Apollo has not added beds aggressively which has resulted into higher occupancy rate and better margin profile in comparison to NHL.

Exhibit 3: No. of bed additions during FY13-15



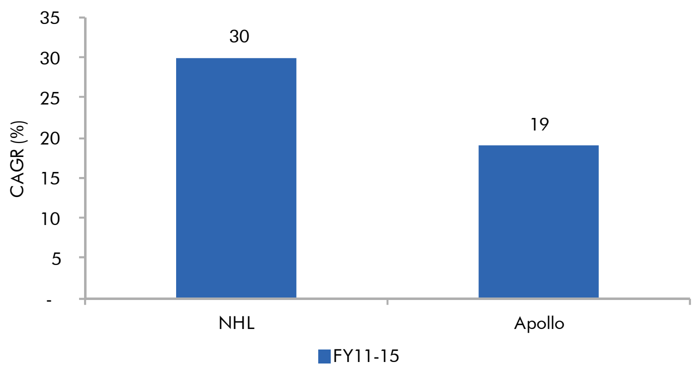
Source: Company, Angel Research, Apollo PPT

Exhibit 4: Occupancy rate during the same period



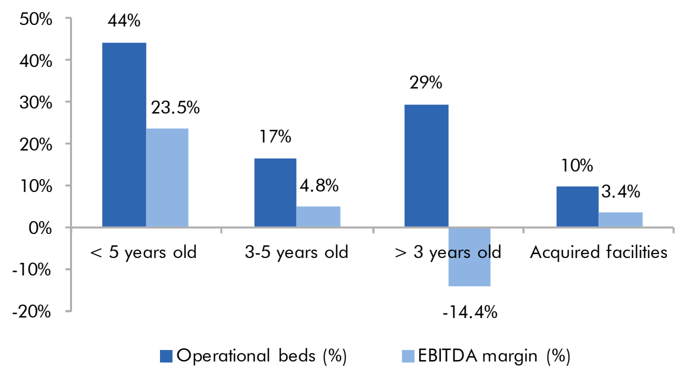
Source: RHP, Angel Research

Exhibit 5: Higher bed addition resulted in stronger top-line growth (CAGR) for NHL



Source: RHP, Angel Research

Exhibit 6: Operational beds and margin profile for NHL



Source: RHP, Angel Research

Generally, hospital businesses have long gestation periods before they mature (particularly with respect to occupancy rates) and they may operate at a loss for a period of time before achieving profitability. As per the RHP, at end of FY2015, NHL had 44% of its operational beds in the mature stage (at more than 5-year old hospitals) having ~23.5% EBITDA margin and the balance at below 5-year old hospitals were having lower profitability/loss at the EBITDA level.

Hence, going forward, the company will increase its capacity by 800-1,000 beds over the next two years, following a relatively asset-light model, which is slower than the current pace. Thus, we believe that the company will gradually be able to increase its occupancy rates with assist from its strong brand value.

Upcoming projects following the asset light model

Unlike its peers, NHL has fewer hospitals on an ownership basis. The company has 4 owned hospitals totaling to 1,613 beds which account for ~45% of revenues. The remaining beds are on lease and operate, managed, or on a revenue sharing model.

Exhibit 7: Various Operating Models

Model	Number of Operational Beds
Owned and Managed	1,613
Revenue Share	1,326
Lease and Operated	1,250
Managed	737
Clinics and Cayman Island	516
Total	**5,442**

Source: RHP, Angel Research

Currently, the company has a strong presence in Karnataka and the Eastern region and it plans to grow its presence in other parts of the country. This bed addition will be via the asset light route, which would include PPP or on operation and management basis. As a result, the company will be incurring lower capex and would thus enable it in delivering better return ratios.

Exhibit 8: Upcoming project for NHL

Location	Executed on the basis	Period	Types	No of capacity beds to be added
Vaishno Devi	Public-private basis	Within the next 12 months	Multispeciality	241
Lucknow	Operation and Management basis	Within the next 24 months	Multispeciality	326
Mumbai	Operation and Management basis	Within the next 24 months	Multispeciality, Paediatric	297
Bhubaneshwar			Tertiary Care	
			Total	864

Source: RHP, Angel Research

Pan India Presence

NHL is a well recognized brand with a reputation for clinical excellence and is known for providing affordable healthcare services. It has a pan-India network with a strong presence in Karnataka and Eastern India. Apart from this, the company is also increasing its presence in the Western and the Central region. We believe that the company can successfully leverage upon its brand name and sound business model to scale up its presence in other parts of India.

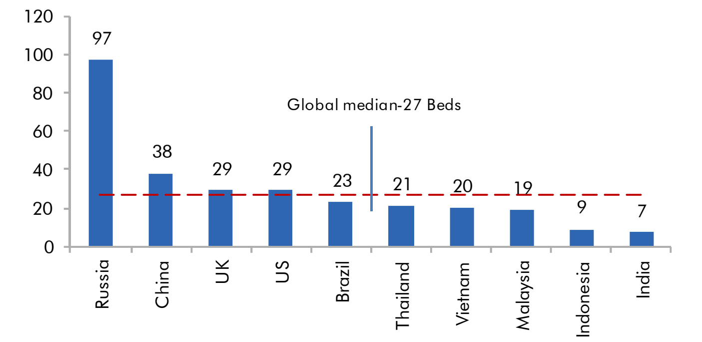
Exhibit 9: Network with a strong presence in Karnataka and eastern India

Source: RHP, Angel Research

Potential to increase bed capacities; lower out-of-pocket spend to benefit hospital industry

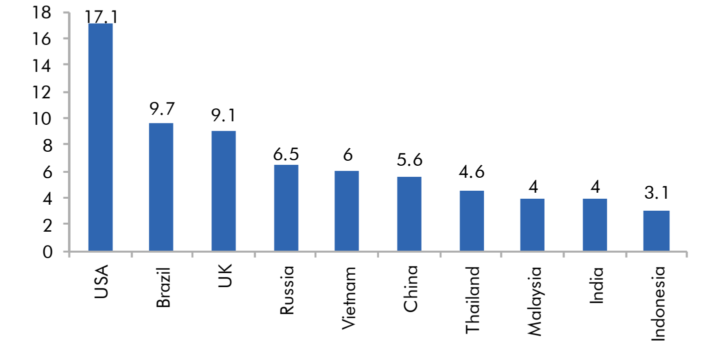
As per a report by Crisil, India has an overall bed density of ~7 per 10,000 population, which is significantly lower than that of other developing nations like Brazil, Malaysia, Vietnam, and Indonesia and the global median of 27. One of the reasons behind lower bed density in India could be lower total expenditure on healthcare, which at 4.0% of GDP is one of the lowest among the developing and developed nations. Of the total expenditure on healthcare in India, the government's contribution stands at ~32.2%, which too happens to be the lowest among countries. Such lower spend has resulted in poor affordability of healthcare services by a vast majority of India's population.

Exhibit 10: Hospital bed density- India vs others (2012)



Source: RHP, Angel Research

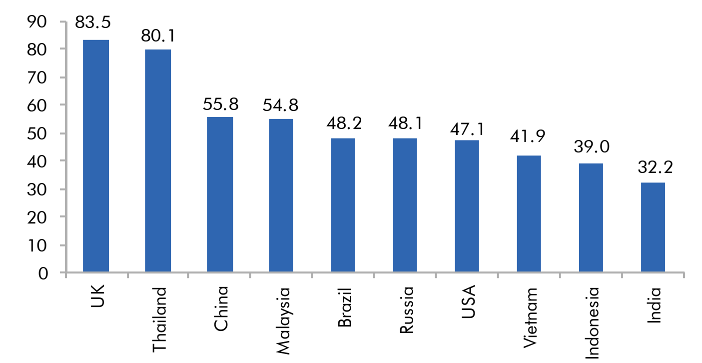
Exhibit 11: Total healthcare exp. as a % of GDP (2013)



Source: RHP, Angel Research

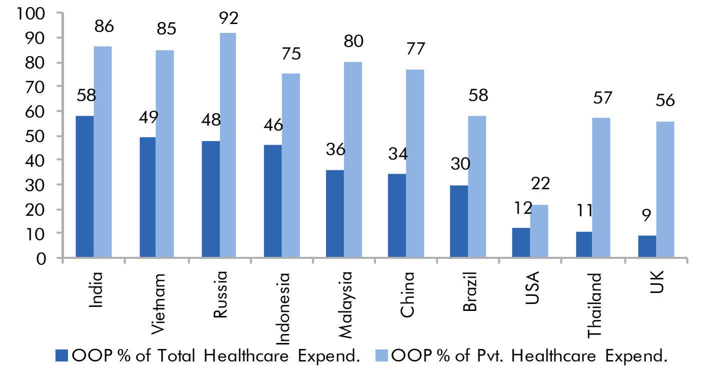
As per the WHO, of the total healthcare expense in India, 58% is borne by consumers directly (without insurance coverage or reimbursements). This proportion is relatively higher at 86% in case of private healthcare services. Higher out-of-pocket spend in terms of private healthcare services can be attributed to lower penetration of health insurance. Growing affordability on account of higher insurance penetration, growing overall population, improvement in income levels, and growing working population coupled with changing lifestyles which are leading to higher lifestyle related chronic diseases, are expected to be the key drivers for the hospital industry in the country.

Exhibit 12: Government's contribution on healthcare as % of total healthcare spend



Source: RHP, Angel Research

Exhibit 13: Proportion of out-of-pocket spending on healthcare (2013)



Source: RHP, Angel Research

Outlook and Valuation

The company has registered a CAGR of 30% in revenues over FY2011-15 to ₹1,364cr and its EBITDA has grown at a CAGR of 23.0% to ₹1,29cr over the same period. For FY2015, the company has reported a net loss of ~₹11cr on account of loss posted in its subsidiary (HCCI Cayman island associate).

Currently, NHL's operating margin is lower than its close peer Apollo Hospitals on account of lower realizations (with focus on affordable healthcare) and has lower occupancy rates. Since the hospital business has a longer gestation period, we expect the occupancy and overall profitability to improve over a longer period of time. On the valuation front, at the upper end of the price band, FY2016E annualized EV/Sales multiple works out to 3.4x for NHL which is not at a significant discount to Apollo (which trades at 3.6x). **Hence we have a Neutral view on the IPO from a short term perspective. However, investors with a longer term investment horizon can subscribe to the issue considering that hospital businesses take longer to perform at optimum levels.**

Exhibit 14: Valuations

		Sales	OPM	PAT	EV/Operational Bed	EV/Sales
NHL	FY2016E*	1,567	11.1	25	1.0	3.4
Apollo Hospitals	FY2016E*	5,945	13.8	378	2.4	3.6

*Source: Company, Angel Research; Note: *Mcap based on post IPO O/s Shares at upper price band and based on annualized numbers*

Key risks/concerns

Lower capacity utilization can impact profitability: The company has laid out plans to increase its presence in Eastern India while also growing its presence in Western and Central Indian markets. The company expects to commence 3 hospitals in a span of 2 years which will add 864 beds. Since hospitals take ~5 years to reach the matured state, lower than expected utilization levels at newer hospitals can impact profitability. Although the Vaishno Devi hospital will be EBITDA neutral, the impact on profitability is not expected to be severe.

Retention and shortage of skilled doctors: Attrition of reputed doctors can have an impact on the financials. Of the 2,563 doctors, 1,750 were engaged on a consultancy basis. The company has not entered into employment contracts with these doctors and there is no assurance that these doctors will continue to provide their services. Failure to seek their services on a long term basis may impact the revenue and profitability of the company.

Consolidated Profit & Loss Statement

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	1HFY16
Total operating income	**658**	**839**	**1,095**	**1,364**	**783**
% chg	*37.7*	*27.6*	*30.5*	*24.5*	
Total Expenditure	**576**	**758**	**975**	**1,235**	**696**
Purchase of Consumables	196	233	281	341	190
Personnel Expenses	113	157	198	277	160
Others Expenses	267	369	495	617	346
EBITDA	**82**	**81**	**120**	**129**	**87**
% chg	*47.7*	*(1.2)*	*47.8*	*7.6*	*(32.5)*
(% of Net Sales)	*12.5*	*9.7*	*11.0*	*9.5*	*11.1*
Depreciation& Amortisation	37	46	57	67	35
EBIT	**45**	**35**	**63**	**63**	**52**
% chg	*91.2*	*(21.6)*	*77.7*	*(0.2)*	
(% of Net Sales)	*6.8*	*4.2*	*5.7*	*4.6*	*6.6*
Interest & other Charges	9	17	28	41	17
Other Income	3	15	22	8	5
(% of PBT)	*7.5*	*44.8*	*39.5*	*26.4*	*13.0*
Recurring PBT	**39**	**34**	**57**	**29**	**40**
% chg	*85.6*	*(12.6)*	*67.7*	*(48.2)*	*36.5*
Extraordinary Items	-	-	-	-	-
PBT (reported)	**39**	**34**	**57**	**29**	**40**
Tax	13	10	21	18	15
(% of PBT)	*33.5*	*29.5*	*37.7*	*59.7*	*37.1*
PAT (reported)	**26**	**24**	**35**	**12**	**25**
Minority Interest	0	1	2	2	0
Share in profit of Associates	-	0	(6)	(25)	(13)
PAT after MI (reported)	**26**	**25**	**32**	**(11)**	**12**
Extraordinary Items	-	-	-	-	-
ADJ. PAT	**26**	**25**	**32**	**(11)**	**12**
% chg	*88.8*	*(3.7)*	*27.9*	-	
(% of Net Sales)	*3.9*	*3.0*	*2.9*	*(0.8)*	*1.6*
Basic EPS (₹)	**1.3**	**1.2**	**1.6**	**(0.5)**	**0.6**
Fully Diluted EPS (₹)	**1.3**	**1.2**	**1.6**	**(0.5)**	**0.6**
% chg	*88.8*	*(3.7)*	*27.9*	-	

Consolidated Balance Sheet

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	1HFY16
SOURCES OF FUNDS					
Equity Share Capital	0	0	0	200	200
Reserves& Surplus	515	547	580	565	581
Shareholders Funds	**515**	**547**	**580**	**765**	**781**
Minority Interest	2	5	3	1	0
Total Loans	116	219	279	305	201
Deferred Tax Liability	18	19	25	29	26
Other LT Liabilities	1	2	2	5	2
Long-term provisions	5	6	6	11	10
Total Liabilities	**657**	**797**	**896**	**1,115**	**1,021**
APPLICATION OF FUNDS					
Gross Block	616	791	962	1,156	1,213
Less: Acc. Depreciation	125	171	225	312	346
Net Block	**491**	**620**	**737**	**843**	**867**
Capital Work-in-Progress	87	44	20	20	15
Goodwill	-	-	1	59	59
Investments	**-**	**7**	**51**	**52**	**70**
Current Assets	129	176	239	261	298
Inventories	28	38	49	51	54
Sundry Debtors	67	91	134	143	157
Cash	19	25	28	30	44
Loans & Advances	10	13	14	26	31
Other Assets	4	7	13	11	13
Current liabilities	126	166	260	245	411
Net Current Assets	**3**	**10**	**(21)**	**16**	**(113)**
LT loans and advances	76	114	106	123	121
Other non-current assets	-	1	1	1	2
Deferred Tax Asset	**-**	**-**	**-**	**-**	**-**
Mis. Exp. not written off	-	-	-	-	-
Total Assets	**657**	**797**	**896**	**1,115**	**1,021**

Consolidated Cash flow statement

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	1HFY16
Profit before tax	39	34	57	29	40
Depreciation	37	46	57	67	35
Change in Working Capital	(19)	(22)	7	(39)	47
Interest / Dividend (Net)	9	16	28	40	16
Direct taxes paid	(13)	(17)	(20)	(22)	(16)
Others	0	(12)	(19)	2	1
Cash Flow from Operations	**53**	**45**	**110**	**77**	**125**
(Inc.)/ Dec. in Fixed Assets	(121)	(140)	(124)	(221)	(65)
(Inc.)/ Dec. in Investments	(30)	(7)	(45)	(1)	(18)
Cash Flow from Investing	**(91)**	**(147)**	**(168)**	**(222)**	**(83)**
Issue of Equity	10	10	-	194	-
Inc./(Dec.) in loans	37	-	-	-	-
Dividend Paid (Incl. Tax)	-	-	-	-	-
Interest / Dividend (Net)	(12)	108	61	146	(28)
Cash Flow from Financing	**35**	**108**	**61**	**146**	**(28)**
Inc./(Dec.) in Cash	(3)	6	3	1	14
Opening Cash balances	**22**	**19**	**25**	**28**	**30**
Closing Cash balances	**19**	**25**	**28**	**30**	**44**

Key Ratios

Y/E March	FY2012	FY2013	FY2014	FY2015
Valuation Ratio (x)				
P/E (on FDEPS)	198.4	206.0	161.1	-
P/CEPS	81.2	73.2	55.1	65.1
P/BV	9.9	9.3	8.8	6.7
Dividend yield (%)	0.0	0.0	0.0	0.0
EV/Sales	7.9	6.3	4.8	3.9
EV/EBITDA	63.3	65.2	44.2	41.3
EV / Total Assets	6.6	5.5	4.6	3.9
Per Share Data (₹)				
EPS (Basic)	1.3	1.2	1.6	(0.5)
EPS (fully diluted)	1.3	1.2	1.6	(0.5)
Cash EPS	3.1	3.4	4.5	3.8
DPS	0.0	0.0	0.0	0.0
Book Value	25.2	26.8	28.4	37.4
Returns (%)				
ROCE	7.1	4.6	7.3	5.8
Angel ROIC (Pre-tax)	7.3	4.8	8.0	6.3
ROE	5.0	4.5	5.5	(1.4)
Turnover ratios (x)				
Asset Turnover (Gross Block)	1.1	1.2	1.2	1.3
Inventory / Sales (days)	16	17	16	14
Receivables (days)	37	40	45	38
Payables (days)	39	34	51	37
Working capital cycle (ex-cash) (days)	14	23	10	15

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