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Initiating Coverage

# Narayana Hrudayalaya Ltd.

12-July-2021

RETAIL RESEARCH

# Narayana Hrudayalaya Ltd.

| Industry | LTP | Recommendation | Base Case Fair Value | Bull Case Fair Value | Time Horizon |
|---|---|---|---|---|---|
| Healthcare Facilities | Rs. 483.5 | Buy at LTP and add on dips to Rs 425-427 band | Rs. 529 | Rs. 565 | 2 quarters |

| | |
|---|---|
| HDFC Scrip Code | NARHRUEQNR |
| BSE Code | 539551 |
| NSE Code | NH |
| Bloomberg | NARH IN |
| CMP July 09, 2021 | 483.5 |
| Equity Capital (Rs cr) | 204.4 |
| Face Value (Rs) | 10.0 |
| Equity Share O/S (cr) | 20.4 |
| Market Cap (Rs cr) | 9880.9 |
| Book Value (Rs) | 54.8 |
| Avg. 52 Wk Volumes | 347502 |
| 52 Week High | 566.7 |
| 52 Week Low | 265.6 |

| Share holding Pattern % (Mar 2021) | |
|---|---|
| Promoters | 63.9 |
| Institutions | 30.6 |
| Non Institutions | 5.5 |
| Total | 100.0 |

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## Our Take:

Narayana Hrudayalaya Ltd (NHL) is a healthcare service provider that operates a chain of multi-specialty hospitals in India and in the Cayman Islands. NHL has a network of 46 healthcare facilities with 6,725 bed capacity and 30+ specialities. The company has a strong track record of providing quality healthcare services at an affordable cost. NHL was founded by Dr Devi Shetty in 2000 and is headquartered in Bengaluru. The company has an established presence and strong brand recognition in two geographical clusters, Karnataka and eastern India (which accounts for ~73% of its revenues), with an emerging presence in western, central and northern India (especially in Tier I cities). The company has established a strong position in Cayman Island, where it is planning to set up an additional multi-speciality centre and an oncology unit. The asset light model has enabled the company to have one of the lowest average effective cost per bed among its peers. Through this capital-light model, NHL added over 500 beds in last five years while expanding RoCE from 7.4% in FY16 to 13.7% in FY20. Despite lower ARPOBs (~30-40% lower than peers), its profitability and return ratios are largely in line with peers given it has followed an asset-light expansion model with a strong focus on achieving operational efficiencies through cost optimisation measures and economies of scale.

## Valuations & Recommendation:

'Narayana Health' brand is strongly associated with its ability to deliver high-quality, affordable healthcare services by leveraging economies of scale, skilled doctors, and an efficient business model. Narayana's revenue saw a robust growth of 18.1% CAGR over FY15-20. Improvement in ARPOB (speciality mix and high contribution from Tier I cities), higher occupancy rates, ramping up of operations in Cayman Island supported healthy growth over the years. NHL's strong track record of providing affordable world-class medical care will enable the company to maintain its performance at mature centres and help in scaling up operations in new units. NHL is also well positioned to capture the growing medical tourism opportunity; international patients (higher margins) which accounts for ~10% of revenue in normal year has helped in achieving higher ARPOB. Significant traction is expected as pandemic situation eases. We expect revenue growth at CAGR of 25.5% over FY21-23E, as share of revenue from new hospitals and Cayman Island increases.

Narayana Hrudayalaya is a good bet on the structural long term growth story of Indian healthcare industry, considering its established presence across healthcare verticals, geographic presence and its blended model of affordable & high-quality services. NHL plans to incur a significant greenfield capex in the Cayman Islands with estimated spend of around US$ 100 million to be funded by debt and internal accruals. The new facility would complement the existing set up by focusing more on day care, short stay but niche categories of oncology care while the existing facility would continue to cater to tertiary (Tertiary care requires highly specialized equipment and expertise in a hospital) and quaternary care (Quaternary care is considered to be an extension of tertiary care. It is even more specialized and highly unusual). NHL plans to open up pharmacies, clinics and plans to setup a diagnostic centre in the future as a part of its overall strategic to engage more patients hooked into the whole HCCI (Health City Cayman Islands) ecosystem. Notwithstanding the strong growth in the profits from existing Cayman unit, leverage metrics and operational performance would be impacted in the near to medium term until the new facility stabilizes and starts generating incremental profits. **We believe the base case fair value of the stock is Rs 529 (36.5x FY23E EPS, 15.7x FY23E EV/EBITDA) and the bull case fair value of the stock is Rs 565 (39x FY23E EPS, 16.8x FY23E EV/EBITDA) over the next two quarters. Investors can buy the stock at LTP and add on dips to 425-427 band (29.5x FY23E EPS, 12.5x FY23E EV/EBITDA). At LTP of Rs 483.5, the stock is trading at 33.3x FY23E EPS, 14.3x FY23E EV/EBITDA.**

## Financial Summary (Consolidated)

| Particulars (Rs cr) | Q4FY21 | Q4FY20 | YoY-% | Q3FY21 | QoQ-% | FY19 | FY20 | FY21 | FY22E | FY23E |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Operating Income | 837.8 | 743.0 | 12.8 | 750.4 | 11.6 | 2,860.9 | 3,127.8 | 2,582.3 | 3,588.9 | 4,066.8 |
| EBITDA | 141.4 | 95.3 | 48.4 | 102.1 | 38.5 | 287.8 | 422.9 | 182.1 | 567.0 | 654.7 |
| Depreciation | 44.5 | 55.1 | -19.3 | 46.5 | -4.3 | 137.4 | 185.8 | 183.5 | 196.1 | 209.0 |
| Other Income | 8.5 | 7.5 | 14.0 | 7.4 | 15.3 | 16.7 | 23.8 | 28.2 | 35.9 | 40.7 |
| Interest Cost | 18.2 | 20.8 | -12.3 | 18.6 | -1.8 | 71.4 | 85.3 | 76.0 | 69.3 | 79.4 |
| Tax | 17.2 | 3.6 | 379.1 | 0.8 | 2111.0 | 34.1 | 42.3 | -41.8 | 86.4 | 104.2 |
| PAT | 70.0 | 12.4 | 463.0 | 43.7 | 60.2 | 61.6 | 133.3 | -7.5 | 251.1 | 302.8 |
| Adjusted PAT | 68.0 | 12.0 | 469.1 | 40.8 | 66.6 | 59.2 | 118.9 | -14.3 | 243.6 | 296.3 |
| EPS (Rs) | 3.3 | 0.6 | 469.1 | 2.0 | 66.6 | 2.9 | 5.9 | -0.7 | 11.9 | 14.5 |
| RoE-% | | | | | | 5.6 | 10.7 | -1.3 | 19.8 | 20.0 |
| P/E (x) | | | | | | 165.6 | 82.5 | -690.8 | 40.6 | 33.3 |
| EV/EBITDA | | | | | | 36.5 | 25.1 | 57.6 | 18.6 | 15.9 |

(Source: Company, HDFC sec)

**Q4FY21 Result Review:**

Narayana Hrudayalaya posted strong quarterly numbers across all fronts. Consolidated revenue for Q4FY21 stood at Rs 837.8cr, up 12.8% YoY as higher volume of elective surgeries boosted India revenues (up 9.5% YoY to Rs 700.2cr). Hospitals in India saw sequential improvement and continued on healthy growth trajectory. Revenues from Cayman operations grew 30.6% YoY to US$18.5 million due to lower base and higher ARPOB. EBITDA margins expanded 405bps YoY to 16.9% as elective surgeries and contribution from cardiac sciences picked up. Lower employee costs and other expenses also lifted margins to Rs 141.4cr, up 48.4% YoY. It expects moderation in Cayman Islands margins as travel restrictions ease. Adjusted PAT for the quarter was at Rs 68cr. The company has been able to achieve this record profitability on the back of all-round growth registered by hospitals across the network in India as well as its operations in Cayman Islands

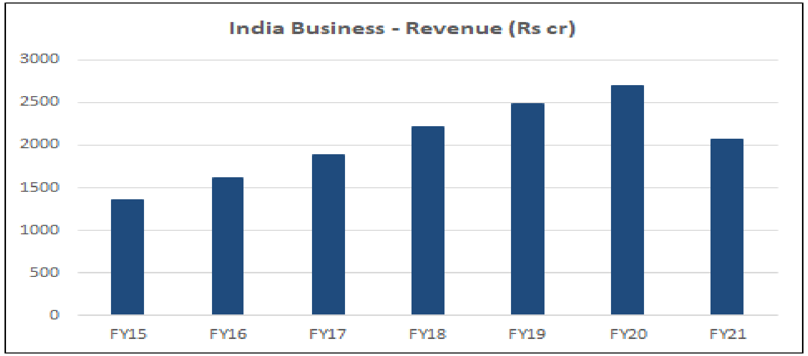
India’s in-patient volume saw a strong recovery, up 13.8% QoQ. Average revenue per occupied bed (ARPOB) improved and stood at Rs 1.1cr vs Rs 0.99cr in Q4FY20, as the patient mix was skewed towards speciality surgical procedures. Average length of stay (ALOS) continued to stay elevated at 4.8 days (as against 3.5 days in Q4FY20), despite lower covid share as pre-procedure screening time have increased. With increased covid cases, covid revenues has inched up to ~13% of India business in April and higher in May. ARPOB for Cayman came at $2 million in Q4FY21 as against $1.5 million in Q4FY20. Covid contributed ~3% of domestic revenues in Q4FY21 vs 14.2% in the previous quarter. The second wave has not impacted revenues to a greater extent, management has seen ~7-10% drop in topline in April & May compared to March 2021. The company is confident of decent recovery post June as elective surgeries pick-up. The management sees no opportunity from vaccination drive and is likely to administer it at cost. Narayana’s oncology block in Cayman Island is expected to be ready in 18 months. The company recently announced expansion of its Cayman operations with a new hospital in the city centre which would get commissioned over the next 24 months.

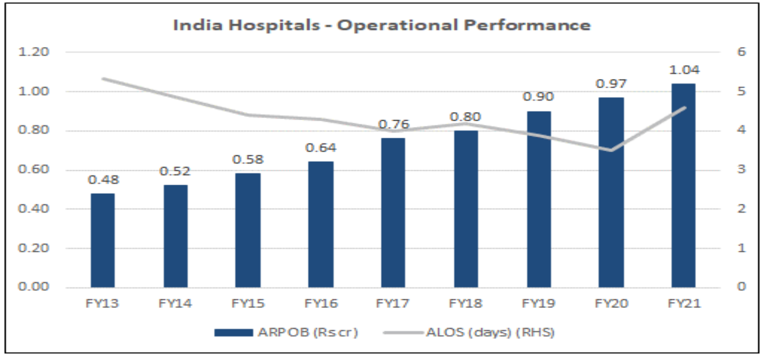
**Triggers:**

**“Asset-right” business model – Help improve return ratios:**

The key differentiator of Narayana compared to its peers is the “Asset-right” business model. In this model, Narayana does not invest in land and buildings connected with the hospitals, rather it ties up with like-minded charitable trusts, government bodies and other non-profit organizations that invest in the land and buildings in connection with the hospitals. The company invests in the medical equipments and manages running of the hospitals. The hospitals are managed either on a profit sharing or fixed rental basis. Out of the 21 hospitals managed by NH only 3 hospitals, Gurugram, NICS Health City and RTIICS Kolkata are completely owned by Narayana. The asset light model has enabled the company to have one of the lowest average effective cost per bed among its peers. Through this capital-light model, NHL added over 500 beds in last five years while expanding RoCE from 7.4% in FY16 to 13.7% in FY20 and maintaining a Debt/Equity ratio of only 0.7x in FY21. This model has enabled it to expand its network without compromising on balance sheet quality. The asset right business model would be one of the contributing factors to a substantially improved RoCE figure.

| Engagement | Particulars | No. of units | Hospitals | Operational Beds |
|---|---|---|---|---|
| Owned or long/ Perpetual lease | Owns & operates on freehold basis or long term/ perpetual lease | 9 hospitals | NICS, MSMC, Barasat, MMRHL (2 units), Ahmedabad, Jaipur, Mysore & Gurugram | 2,993 |
| Revenue Share/ Rentals | Operates and pays a revenue share/ rent to the owner | 9 hospitals | RTIICS + RTSC, Jamshedpur, Raipur, Shimoga, HSR, RNN, SRCC, Dharamshila | 1,955 |
| Public-Private Partnership (PPP) | Operates with nominal investment in partnership with public entities | 2 hospitals | Jammu, Guwahati | 365 |
| Managed Hospitals | Provides healthcare services to third parties for management fees | 1 hospital | JSW Bellary | 112 |




(Source: Company, HDFC sec)

**Focus on affordable + high quality healthcare services:**

The "Narayana Health" brand is widely recognized for providing high-quality healthcare at affordable prices. Around 60-65% beds of NHL are in general wards; which is one of the highest compared to other private hospitals; enables it to operate at lower costs. Also, charges of general wards are 10-15% lower than other private hospitals as benefit of efficient procurements, are passed on to patients. On the backdrop of lower ARPOBs (compared to its peers), the company has over the years implemented and followed unique cost control measures right from construction of hospital buildings to sourcing equipment and consumables. Extensive use of technology for cost reduction is another benefiter for the company. The company has a strong supply chain where most of the hospitals it enters into an agreement with the vendors of the diagnostic machines for testing whereby it pays for reagents rather than buying a machine outright. NHL mainly follows a fixed fee retainer model for doctors as opposed to rotational clinical model, which allows greater operating leverage. In light of covid impact, the company has adopted various cost optimisation initiatives mainly salary cuts; some of which is likely to revert back. The company having scaled up its operations in Tier I cities and premium hospitals that cater to higher-income patients, will improve its ARPOB. NHL's strong reputation for clinical excellence and ethical practice combined with competitive compensation packages helps it attract quality doctors and medical staff from both India and overseas. The access to high quality medical talent has contributed mainly to the success of company's model. 'Narayana Health' brand is strongly associated with its ability to deliver high-quality, affordable healthcare services by leveraging economies of scale, skilled doctors, and an efficient business model.

**Spread across several geographies of India with strong presence in Karnataka and eastern India:**

NHL has a network of 46 healthcare facilities, including 21 owned/operated hospitals (multi-speciality and super-speciality healthcare facilities which provide tertiary care), 1 managed hospital, 5 heart centres (super-speciality units which are set up in a third-party hospital) and 19 primary care facilities (including clinics and information centres) with 6,725 bed capacity and 30+ specialities. The company has an established presence and strong brand recognition in two geographical clusters, Karnataka and eastern India (which accounts for ~73% of its revenues), with an emerging presence in western, central and northern India (especially in Tier I cities). The company has established a strong position in Cayman Island, where it is planning to set up an additional multi-speciality centre and an oncology unit.

<u>Bangalore</u> – The company operates three hospitals in Bangalore – NICS, MSMC and HSR. These are well-established hospitals with steady track record (~7% revenue CAGR over FY18-20) and contributed ~32% to India hospital revenues in FY21. ARPOB from Bangalore has improved from Rs 1.16cr in FY20 to Rs 1.25cr in FY21. Business at these centres was impacted in FY21 as high proportion of revenues comes from international patients.

<u>Southern peripheral</u> - comprises of two hospitals with one each in Mysore and Shimoga. This cluster has seen improvement in EBITDAR (EBITDA before rental/revenue share and before allocation of any corporate expenses) over the years. EBITDAR for FY21 stood at 19% as against 15% in FY19.

Kolkata and Eastern Peripheral – Kolkata contributed to ~27% of India hospital revenue in FY21 and posted a low EBITDAR margin of 6% with ARPOB at Rs 0.91cr. It operates six hospitals in Kolkata – RTIICS, RTSC, MMRHL (2 units), Barasat and RNN and one hospital each in Jamshedpur and Guwahati in the Eastern peripheral region. The company has a strong presence and brand value in Eastern market. The recent announcement about implementation of Swasthya Sathi scheme by West Bengal Government – promising insurance coverage of Rs 5 lakhs to every family – augurs well for Narayana over the long term if the scheme is implemented in letter and spirit. Due to space constraints, Kolkata could see relatively lower growth of ~5-7%. To improve its business, the company is looking at both greenfield and brownfield expansion opportunities in Kolkata.

Western Region – Four hospitals in the Western region – Mumbai, Jaipur, Raipur, and Ahmedabad. The region contributes to ~18% of the India hospital revenues. The company reported EBITDAR of -0.2% in FY21, mainly dragged down by SRCC Mumbai operations which is likely to breakeven in latter part FY23.

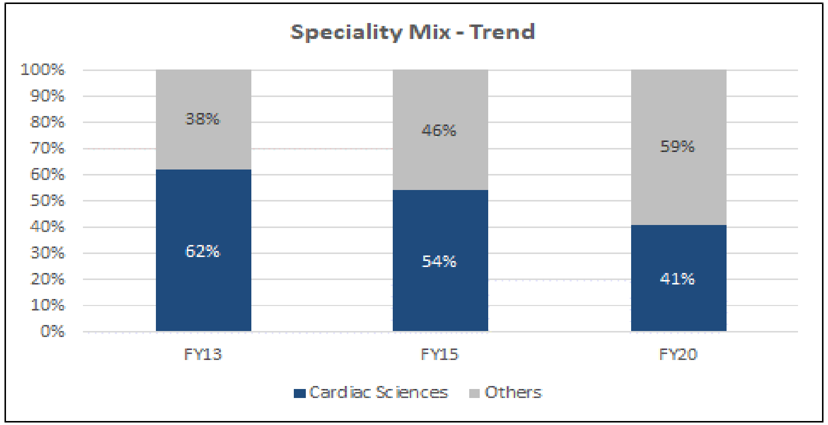
Northern region (ex-Jammu) – owns/operates two units in this region – Dharamshila (Delhi) and Gurugram facilities. These accounted for ~10% of its India hospitals revenues in FY21. This region achieves highest ARPOB among other regions given the premium nature of its facilities. Dharamshila and Gurugram have broken even on a monthly basis and we expect them to contribute positively to EBITDAR from FY22 onwards.

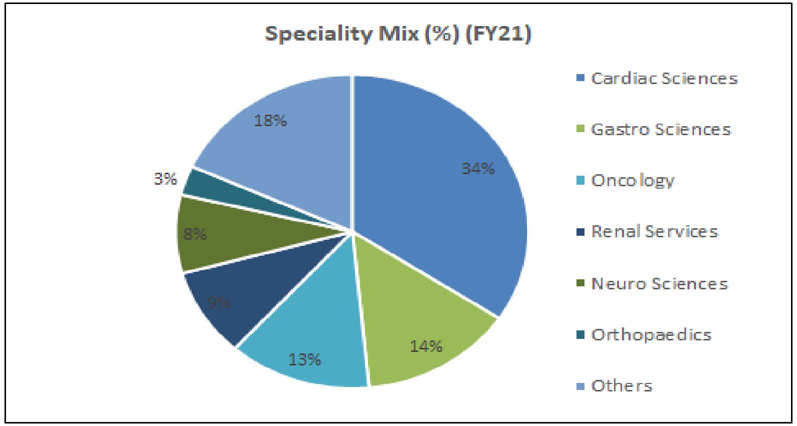
| | | Bangalore | Southern Peripheral | Kolkata | Eastern Peripheral | Western | North |
|---|---|---|---|---|---|---|---|
| No of Hospitals | | 3 | 2 | 6 | 2 | 4 | 3 |
| Hospitals | | NICS, MSMC, HSR | Mysore, Shimoga | RTIICS + RTSC, MMRHL, Barasat, RNN | Jamshedpur, Guwahati | Jaipur, Raipur, Mumbai, Ahmedabad | Dharamshila (Delhi), Gurugram, Jammu |
| % of Hospital Operational Beds | | 30% | 10% | 26% | 8% | 18% | 8% |
| % of Hospital Operational revenue | | 32% | 8% | 27% | 6% | 18% | 10% |
| ARPOB (Rs cr) | FY19 | 1.07 | 0.65 | 0.84 | 0.61 | 0.79 | 1.25 |
| | FY20 | 1.16 | 0.70 | 0.91 | 0.67 | 0.83 | 1.36 |
| | FY21 | 1.25 | 0.92 | 0.91 | 0.79 | 0.99 | 1.49 |
| EBITDAR Margin (%) | FY19 | 29.0% | 15.4% | 20.8% | 3.8% | 0.0% | -30.2% |
| | FY20 | 30.7% | 18.4% | 21.7% | 12.0% | 3.4% | -18.1% |
| | FY21 | 10.4% | 19.0% | 6.0% | 5.3% | -0.2% | -9.2% |

(Note: ARPOB & EBITDAR Margin (%) for North is excluding operations in Jammu; Source: Company, HDFC sec)

**Diversified across different specialties:**

Narayana Hrudayalaya leveraged its leadership position in Cardiac and Renal Sciences to expand services across all the fields. Specialities like Gastro Sciences, Oncology, Neurology and Orthopaedics have grown from minor departments to contribute significantly to overall revenues gradually. Diversifying away from cardiac has de-risked the business model (impacted by stents price control) and at the same time benefitted the company from the rising demand for tertiary care services in the country. The contribution of cardiac sciences to inpatient revenue has reduced from 62% in FY13 to 34% in FY21. The new upcoming radiation oncology and multi-speciality centre at Cayman Island is expected to further diversify the company's operations and provide healthy contribution to the company's revenue and profitability owing to the high value nature of the procedures targeted in the new facility.




(Source: Company, HDFC sec)

**Improving Maturity Mix & Non-Flagship Facilities - Add to Profitability:**

Anchored by the company's 3 flagship hospitals' (NICS, MSMC & RTIICS) continued impressive performance which were complemented by operations steadily ramping up at the 3 new hospitals, the category of other mature hospitals delivered a robust all-round growth. Flagship units receive high footfalls from outstation/ international patients and hence were severely impacted during covid. We expect gradual recovery at these units as travel restrictions ease. With limited visibility on international segment (high margin business), we expect revenue to growth in single digit. Out of the other mature units (14 hospitals), Raipur, Mysore, Shimoga have shown resilience and outperformed the flagship units during FY21 with higher margins. New hospitals - SRCC in Mumbai (commissioned in Apr'17), Dharamshila in Delhi (Mar'18) and Gurugram (Mar'18) - continue to see a reduction in losses due to ramp up in occupancies. Combined EBITDAR losses of Rs 70cr in FY19 was reduced to Rs 42.4cr in FY21, driven by strong performance in Gurugram and Dharamshila due to its oncology presence. Pandemic has improved the image of these new facilities given the quality services offered. The improvement in numbers in the last few quarters is also on the back of judicious case mix identification (more focus on oncology, transplants and non-invasive procedures).

| Existing Mature Units | FY19 | FY20 | FY21 |
|---|---|---|---|
| **Hospitals** | 17 | 17 | 16 |
| **% of Hospital Revenue** | 92% | 90% | 87% |
| **% of Hospital Operational Beds** | 90% | 89% | 89% |
| **ARPOB (Rs cr)** | 0.88 | 0.94 | 1.01 |
| **EBITDAR Margin (%)** | 21.5% | 23.2% | 8.9% |

| New Units | FY19 | FY20 | FY21 |
|---|---|---|---|
| **Hospitals** | 3 | 3 | 3 |
| **% of Hospital Revenue** | 8% | 10% | 13% |
| **% of Hospital Operational Beds** | 10% | 11% | 11% |
| **ARPOB (Rs cr)** | 1.09 | 1.22 | 1.39 |
| **EBITDAR Margin (%)** | -36.6% | -22.1% | -15.8% |

(Source: Company, HDFC sec)

Narayana Hrudayalaya after having aggressively expanding its domestic capacity in FY14-18, is under consolidation phase. Moreover, the company has focussed on increasing its presence in other Tier I cities by setting up premium multi-speciality hospitals in New Delhi, Gurugram and Mumbai. Besides expanding in metros (Mumbai, Delhi NCR, and Kolkata), it added capacities in several tier-2/3 towns such as Jaipur, Raipur, Jamshedpur, Guwahati, etc. Added capacities had indeed improved the company ARPOB from Rs 0.90cr in FY19 to Rs 1.04cr in FY21. ARPOB for new hospitals in FY21 came in at 1.39cr as against Rs 1.01cr for mature hospitals. Over the past two years, it has consolidated its operations by bolstering capacities at existing units (added oncology block in Jaipur and Raipur) and exited some of the non-core units such as Whitefield and Durgapur. Capacity expansion in India lately has been in the form of wing additions i.e., converting some general words into semi-private, semi-private to private and so on. These changes have helped in improving overall mix and are aimed at increasing realizations on per bed basis. Going forward, it will look to add capacities selectively in regions; prioritising Kolkata through brownfield expansion. Also, the management believes that there is a scope of expanding its reach in India through primary care services (around 10km radius of the hospitals), which will help increase its out-patients volume. The company recently announced expansion of its Cayman operations with a new hospital in the city centre which would get commissioned over the next 24 months.

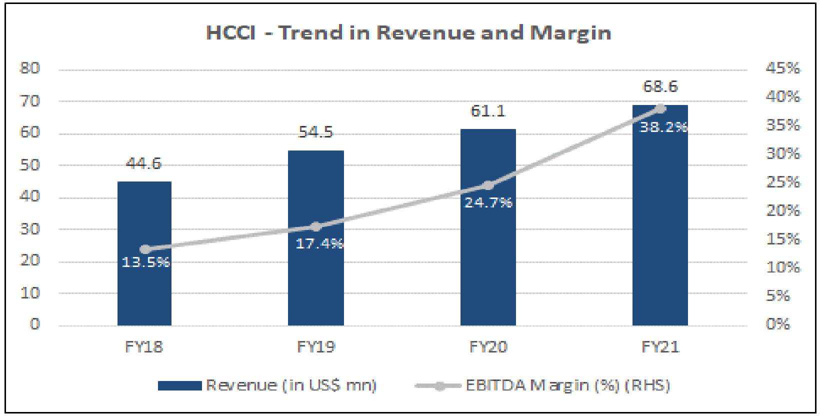
**Medical Tourism Opportunity; Normalcy to improve International Patients contribution and support margins:**

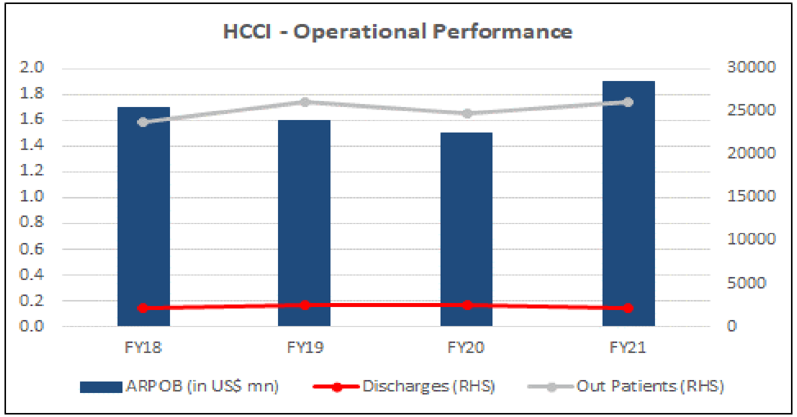
India has grown to become a top-notch destination for medical value travel because it scores high over a range of factors that determine the overall quality of care. Indian hospitals are offering standard services at comparatively low costs (~20-30% of costs compared to that in developed countries). NHL is well positioned to capture the growing medical tourism opportunity; international patients (higher margins) which accounts for ~10% of revenue in normal year has helped in achieving higher ARPOB. Some of mature units are more dependent on international patients. Although medical value travel is being allowed to foreigners intending to travel to India for treatment, significant traction is expected when international flights resume in full scale.

**Improved trajectory and Capacity Expansion at Cayman:**

Narayana owns and operates Health City Cayman Islands (HCCI), which is a 110-bed facility located in the Cayman Islands, Caribbean. The company initially acquired a minority stake of 28.6% in 2010 in partnership with Ascension Health Ventures LLC, a U.S based trust and set up the hospital in 2014. In 2018, the company acquired the remaining 71.4% stake for ~Rs 208cr. HCCI primarily targets Caymanians and North American patients (Cayman Islands is 430 miles south of Miami, near Caribbean islands) and provides high-quality, affordable tertiary health care at costs ~25-40% of U.S. prices. All the Doctors at HCCI are recruited from India and sent to the Cayman Islands. HCCI continued to deliver strong and consistent performance over the last few quarters and posted strong revenue of $68.6 million with EBITDA of $26.2 million for FY21 (EBITDA margin of 38%). Such high margins were largely on account of COVID-19, as the high-net-worth Caymanian population chose treatment at HCCI for some high-end procedures, instead of travelling abroad (U.S). Although some percentage will definitely go back to U.S as they are more comfortable of getting treated there, but the covid crisis has enhanced NHL's credibility and would retain some percentage of such HNI patients- which augurs well for medium-term growth. Also, higher outpatient/daycare work which has higher margins improved the overall profitability. NHL is making investments in primary care and oncology block which is likely to commence in 2-3 quarters. It is opening up pharmacies, clinics and plans to setup a diagnostic centre in the future as a part of its overall strategic to engage more patients hooked into the whole HCCI ecosystem.

# Narayana Hrudayalaya Ltd.




(Source: Company, HDFC sec)

The company has announced an expansion of its Cayman operations with a new hospital in the city centre which should get commissioned over the next 24 months. This is in order to expand the scope of super specialty treatment options already offered and offer medical services closer to the city centre. The new facility is planned on a 3-acre land plot, is expected to have 50 operating beds entailing a capex outlay of ~US$100 million that will be funded through a mix of internal accruals and debt. The new facility will include an advanced Cancer Center which will offer comprehensive oncology treatment including bone marrow transplant, CAR-T cell therapy, medical oncology, haemato oncology, surgical oncology and radiation oncology. The new facility shall also offer robotic surgery, a neonatal intensive care unit, emergency and critical care, as well as a fully equipped radiology department.

The new hospital at Camana Bay is likely to improve HCCI’s reach to patients both – international and local, due to close proximity to the airport (10-min drive) and several major residential complexes. This will enable NHL to cater to local residents, who usually travel abroad for high-end medical treatment. The company expects ARPOB to remain higher than the existing unit ($1.9 mn), given its focus on cancer care and outpatient services. Given the city centric-location of the facility and focus on high-end oncology & critical care, NHL expects to break-even at a rapid pace. Further, the company sees minimal cannibalization with operationalization of new unit except some outpatient and diagnostics services being shifted, given the existing unit focuses more on elective and high-end surgeries. The new facility would complement the existing set up by focusing more on day care, short stay but niche categories of oncology care while the existing facility would continue to cater to tertiary and quaternary care.

While the improvement in Cayman operations is healthy, it is not sustainable unless we see higher traction from international patients. The plan for new facility is a positive as it would attract patients (especially from U.S) who seek high end oncology treatment at cheap prices. NHL is among the three healthcare providers in the region, one being the government and two being private healthcare. HCCI market share is high in cardio/onco procedures (80-90%) while for orthopaedics/ emergency it is 30-40%. Recent announcement by Aster DM Healthcare about its entry into the region increases the competition landscape and is a key risk to the topline and margins of HCCI.

**Improving clinical outcomes and additional savings through digital initiatives:**

Narayana Hrudayalaya launched its in-house Hospital Information System (HIS) platform 'NH-Atma' to completely manage its digital infrastructure and involves doctors, nurses, administrative staff and patients. NH-Atma is cloud-based, fully scalable and can integrate with existing infrastructure in the hospital. It will enable patients to use their cellular phones to make payments for admission, discharge and consultations; which reduces the cost for manpower and administration. This application allows doctors to access detailed patient records such as medical reports, real-time data, etc from any location seamlessly thus ensuring better patient care. The company has also focussed in building inhouse Business and Clinical Intelligence platform – MEDHA. This platform provides real-time and accurate inputs on the various operational and clinical metrics, thus helping clinical and business leaders at all levels in the organisation take better informed and quicker decisions. The company have tied-up with Microsoft to develop an in-house messaging platform named Kaizala. Through Kaizala, different medical cards have been developed to manage and analyse patient information. An example of this is the e-ICU cards that enables doctors to manage an ICU patient's condition remotely using their mobile phones. The management realised that now more patients are willing to pay for being served online. There is indeed a wide digital literacy gap in India, but because of covid there seems to be behavioural shift as people are ready to availing online healthcare services, especially outpatients. Most of the post-operation follow-up, physiotherapy, wellness, chronic care management, even diabetes management could gradually witness more digital acceptance. The management believes that IT is an enabler and has been proactive in keeping their digital infrastructure updated with higher spends. The adoption of technology to manage the day-to-day operations has enabled the company to streamline costs and also provide quality medical care over the years.

**Strong Operational performance with healthy Balance Sheet:**

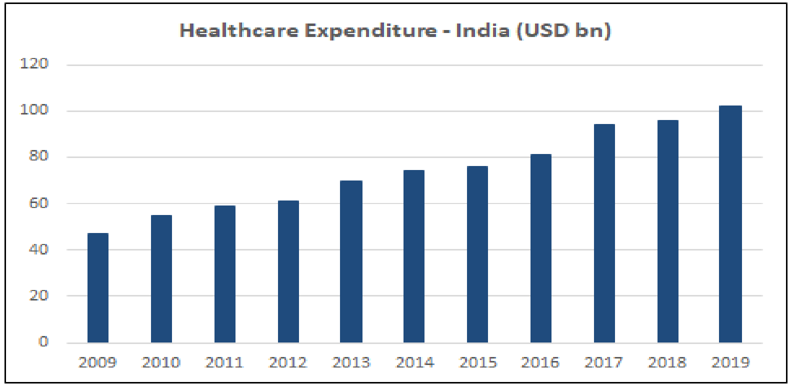
Narayana's revenue saw a robust growth of 18.1% CAGR over FY15-20. Improvement in ARPOB (speciality mix and high contribution from Tier I cities), higher occupancy rates, ramping up of operations in Cayman Island supported healthy growth over the years. In the domestic business, the company's mature hospitals at Karnataka and West Bengal have a strong brand recall among the middle and lower income population in those regions, especially in the field of cardiac services. Revenue from the new centres (Delhi, Gurugram and Mumbai) has also seen scaled up while improving margins as the company targets higher-income and international patients at those centres. Despite lower ARPOBs (~30-40% lower than peers), its profitability and return ratios are largely in line with peers given it has followed an asset-light expansion model with a strong focus on achieving operational efficiencies through cost optimization measures and economies of scale. Debt/equity was low at 0.7x as of March-end 2021. The company has been prudent in capital allocation. Recent expansion plan in Cayman Island would support profitability over medium term. NHL's EBITDA margins have improved on improving efficiencies in mature hospitals and reduced losses in new hospitals. Sharp improvement in margins was observed in Cayman in FY21 due to higher elective high-end procedures and increased out-patient volumes.

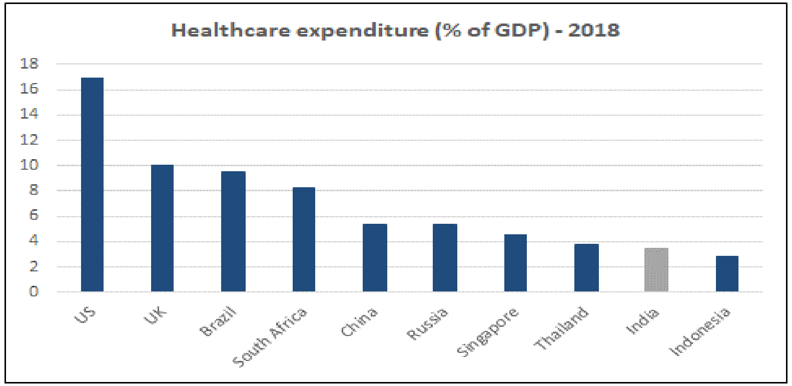
**Industry Insights & Triggers:**

Hospitals in India has long runway to growth with lower number of doctors/bed relative to total population, healthcare spends as percentage of GDP to the global averages. The hospital industry in India stood at $62 billion in 2017 and is expected to increase at a 16-17% CAGR to reach a size of $133 billion by 2023. This indicates that there is tremendous scope for enhancing healthcare services penetration in India and ample opportunity for the development of the healthcare industry as a whole. The demand outlook for healthcare services is positive in the long-run, due to growing awareness of healthcare issues, under-served nature of the sector, better affordability through increasing per capita income, and widening medical insurance coverage. India offers affordable healthcare treatment to many developing countries encouraging inbound medical tourism. Treatment for major surgeries in India costs approximately 1/5th of developed countries. A rare combination of world-class hospitals, equipped with best-in-class technology, skilled medical professionals, low treatment costs, and process improvements like e-medical visa, have made India a preferred destination for medical tourism.

India's huge demand-supply gap, rising health insurance penetration, high out-of-pocket spends, increase in medical tourism provide compelling growth prospects for the industry. The adoption of asset-light models of expansion, enhanced focus on retail formats – pharmacy, diagnostics and digital initiatives – are expanding avenues of growth while keeping the balance sheet light. Private players remain the key growth contributors, given that the government spending remains low at ~1.5% of GDP.

# Narayana Hrudayalaya Ltd.




(Source: World Bank, HDFC sec)

## Concerns:

**High competition:** The healthcare sector is competitive, as increasing healthcare providers (newer and existing hospitals, low-cost nursing homes, etc) try to establish themselves among patients. Increasing subsidies from the government and improvement in services from the government hospitals may cause attrition in patients and disrupt business sustainability. With the advancing technology and newer medical interventions, several hospitals are evolving with their services as well. Entry of Aster DM in Cayman Island could impact revenue and operating performance over medium over for the facilities located there.

**Operational Risk:** As significant capex incurred for new hospitals, delay in ramp-up will impact EBITDA and affect cashflow generation. Any delay in commissioning or expansion (reaching breakeven) of new facilities may impact overall growth, thus impacting overall financials. Lower occupancy level in hospitals could impact its profitability. New hospitals breakeven has been pushed back by a year amid the pandemic, now likely in CY22. With respect to its Cayman operations, inability to sustain patient footfalls at existing units and extended payback period for the new unit remains a key risk. Also delayed payback period for the new facility being set up at $100 mn could impact overall margins and return ratios.

**Exposed to regulatory risks inherent in the sector** - Regulatory risks pertaining to restrictive pricing regulations levied by the Central and state governments could constrain the profit margins of the company. Any adverse government policy intervention, viz. price caps would impact its margins.

**Discontinuation of leases**: The company's operations are carried on leased hospital buildings. In the event of these leased properties are not renewed or are not renewed on favourable terms to the company, its business operations would be disrupted.

**Near term pressures:** H2FY21 margins are unlikely to sustain as the Covid-induced cost reduction may not hold in future. Q1FY22 results could be impacted due to resurgence of Covid (wave 2); however on a YoY basis they could still look good.

**Company Profile:**

Narayana Hrudayalaya Ltd (NHL) is a healthcare service provider that operates a chain of multi-specialty hospitals in India and in the Cayman Islands. NHL has a network of 46 healthcare facilities, including 21 owned/operated hospitals (multi-speciality and super-speciality healthcare facilities which provide tertiary care), 1 managed hospital, 5 heart centres (super-speciality units which are set up in a third-party hospital) and 19 primary care facilities (including clinics and information centres) with 6,725 bed capacity and 30+ specialities. The company has a strong track record of providing quality healthcare services at an affordable cost. NHL was founded by Dr Devi Shetty in 2000 and is headquartered in Bengaluru. NHL has a strong presence in the southern state of Karnataka and eastern India, with an emerging presence in western, central and northern India.

NHL's 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. The business is attractively placed to create an affordable, globally-benchmarked quality-driven healthcare services model. Narayana Hrudayalaya adheres to national and international standards for healthcare; 19 hospitals are NABH accredited and 2 are JCI accredited (Narayana Institute of Cardiac Sciences, Bangalore- India and Health City Cayman Islands). "Narayana Health" brand is strongly associated with its ability to deliver high-quality, affordable healthcare services by leveraging economies of scale, skilled doctors, and an efficient business model.

Narayana Hrudayalaya owns and operates Health City Cayman Islands (HCCI), which is a 110-bed facility located in the Cayman Islands, Caribbean (contributes ~20% of the revenues in FY21). Cayman Island's close proximity to the west coast of the U.S has attracted patients from cities like Miami with the cost of procedures at HCCI at around 25-40% of U.S prices. NHL is a reputed player in the region along with two other players (one being the government). It recently announced expansion in Cayman (~$100mn) for 50 bed facility which would focus mainly on providing oncology, critical care and day care services. Despite lower ARPOBs (~30-40% lower than peers), its profitability and return ratios are largely in line with peers given it has followed an asset-light expansion model with a strong focus on achieving operational efficiencies through cost optimisation measures and economies of scale.

**Peer Comparison (Consolidated):**

| | Mcap (Rs cr) | Sales | | | | EBITDA Margin (%) | | | | PAT | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | FY20 | FY21 | FY22E | FY23E | FY20 | FY21 | FY22E | FY23E | FY20 | FY21 | FY22E | FY23E |
| Narayana Hrudayalaya | 9880.9 | 3128 | 2582 | 3589 | 4067 | 13.5 | 7.1 | 15.8 | 16.1 | 119 | -14 | 244 | 296 |
| Apollo Hospitals | 53572.7 | 11247 | 10560 | 13886 | 16342 | 14.1 | 10.8 | 14.3 | 15.2 | 455 | 150 | 694 | 993 |
| Fortis Healthcare | 17892.5 | 4632 | 4030 | 5514 | 6223 | 13.2 | 10.0 | 16.9 | 17.2 | 58 | -110 | 362 | 477 |

| | RoCE (%) | | | | EV/EBITDA | | | |
|---|---|---|---|---|---|---|---|---|
| | FY20 | FY21 | FY22E | FY23E | FY20 | FY21 | FY22E | FY23E |
| Narayana Hrudayalaya | 13.7 | 1.4 | 20.0 | 20.5 | 25.1 | 57.6 | 18.6 | 15.9 |
| Apollo Hospitals | 10.4 | 7.4 | 15.9 | 18.8 | 37.3 | 50.9 | 28.9 | 22.8 |
| Fortis Healthcare | 4.4 | 2.0 | 9.0 | 10.3 | 31.5 | 46.7 | 19.8 | 16.8 |

(Source: Company, HDFC sec)

# Narayana Hrudayalaya Ltd.

## Financials (Consolidated)

### Income Statement

| (Rs Cr) | FY19 | FY20 | FY21 | FY22E | FY23E |
|---|---|---|---|---|---|
| **Net Revenues** | **2860.9** | **3127.8** | **2582.3** | **3588.9** | **4066.8** |
| Growth (%) | 25.4 | 9.3 | -17.4 | 39.0 | 13.3 |
| Operating Expenses | 2573.1 | 2704.9 | 2400.2 | 3021.8 | 3412.0 |
| **EBITDA** | **287.8** | **422.9** | **182.1** | **567.0** | **654.7** |
| **Growth (%)** | **35.6** | **46.9** | **-56.9** | **211.4** | **15.5** |
| **EBITDA Margin (%)** | **10.1** | **13.5** | **7.1** | **15.8** | **16.1** |
| Depreciation | 137.4 | 185.8 | 183.5 | 196.1 | 209.0 |
| **EBIT** | **150.5** | **237.1** | **-1.4** | **370.9** | **445.8** |
| Other Income | 16.7 | 23.8 | 28.2 | 35.9 | 40.7 |
| Interest expenses | 71.4 | 85.3 | 76.0 | 69.3 | 79.4 |
| **PBT** | **95.7** | **175.6** | **-49.2** | **337.5** | **407.0** |
| Tax | 34.1 | 42.3 | -41.8 | 86.4 | 104.2 |
| RPAT | 61.6 | 133.3 | -7.5 | 251.1 | 302.8 |
| **APAT** | **59.2** | **118.9** | **-14.3** | **243.6** | **296.3** |
| **Growth (%)** | **15.2** | **101.0** | **-112.0** | **-1803.2** | **21.6** |
| EPS | 2.9 | 5.9 | -0.7 | 11.9 | 14.5 |

### Balance Sheet

| As at March | FY19 | FY20 | FY21 | FY22E | FY23E |
|---|---|---|---|---|---|
| **SOURCE OF FUNDS** | | | | | |
| Share Capital | 204.4 | 204.4 | 204.4 | 204.4 | 204.4 |
| Reserves | 876.8 | 931.6 | 915.9 | 1139.1 | 1415.0 |
| **Shareholders' Funds** | **1081.1** | **1136.0** | **1120.3** | **1343.5** | **1619.3** |
| **Minority's Interest** | 0.4 | 0.5 | 0.5 | 0.8 | 1.3 |
| Long Term Debt | 725.3 | 819.6 | 673.5 | 793.5 | 843.5 |
| Net Deferred Taxes | 43.8 | 52.4 | 11.2 | 11.2 | 11.2 |
| Long Term Prov & Others | 272.0 | 280.4 | 259.5 | 344.6 | 370.2 |
| **Total Source of Funds** | **2122.6** | **2288.8** | **2065.0** | **2493.6** | **2845.5** |
| **APPLICATION OF FUNDS** | | | | | |
| Net Block & Goodwill | 1858.1 | 2091.9 | 1962.6 | 2216.5 | 2407.5 |
| CWIP | 36.2 | 11.8 | 18.3 | 18.3 | 18.3 |
| Other Non-Current Assets | 211.4 | 199.0 | 122.2 | 146.7 | 162.8 |
| **Total Non Current Assets** | **2105.6** | **2302.6** | **2103.1** | **2381.4** | **2588.6** |
| Current Investments | 0.0 | 69.3 | 110.0 | 120.0 | 120.0 |
| Inventories | 83.2 | 60.2 | 47.8 | 59.0 | 66.9 |
| Trade Receivables | 266.5 | 262.3 | 278.5 | 363.8 | 412.2 |
| Cash & Equivalents | 100.7 | 114.8 | 132.1 | 214.1 | 400.7 |
| Other Current Assets | 77.0 | 79.8 | 96.7 | 108.2 | 122.6 |
| **Total Current Assets** | **527.4** | **586.4** | **665.1** | **865.1** | **1122.4** |
| Short-Term Borrowings | 11.5 | 44.2 | 59.7 | 74.7 | 74.7 |
| Trade Payables | 333.5 | 361.6 | 410.3 | 432.6 | 512.5 |
| Other Current Liab & Prov | 165.3 | 194.5 | 233.2 | 245.6 | 278.3 |
| **Total Current Liabilities** | **510.4** | **600.3** | **703.2** | **752.9** | **865.5** |
| Net Current Assets | 17.0 | -13.8 | -38.1 | 112.2 | 256.9 |
| **Total Application of Funds** | **2122.7** | **2288.8** | **2065.0** | **2493.6** | **2845.5** |

# Narayana Hrudayalaya Ltd.

**Cash Flow Statement**

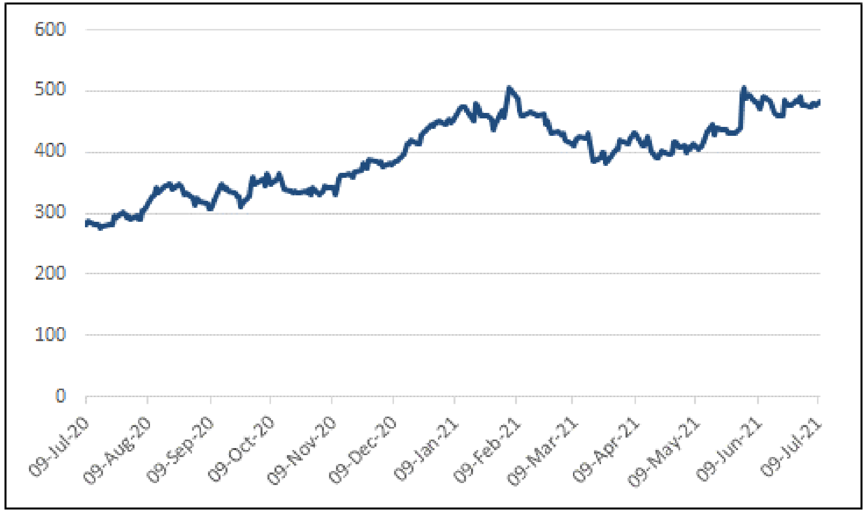
| (Rs Cr) | FY19 | FY20 | FY21P | FY22E | FY23E |
|---|---|---|---|---|---|
| Reported PBT | 95.7 | 175.6 | -49.2 | 337.5 | 407 |
| Non-operating & EO items | 59.6 | 75 | -14.5 | 38.6 | -1.9 |
| Interest Expenses | 68.1 | 80.7 | 76 | 69.3 | 79.4 |
| Depreciation | 137.4 | 185.8 | 183.5 | 196.1 | 209 |
| Working Capital Change | 8.3 | 48.8 | 71.5 | -58.3 | 47.2 |
| Tax Paid | -54 | -66 | 41.8 | -86.4 | -104.2 |
| **OPERATING CASH FLOW ( a )** | **315.1** | **499.9** | **309.1** | **496.8** | **636.4** |
| Capex | -149.5 | -114.4 | -60.7 | -450 | -400 |
| Free Cash Flow | 165.6 | 385.4 | 248.3 | 46.8 | 236.4 |
| Investments | 0.3 | -67.8 | -34 | -10 | 0 |
| Non-operating income | -12.8 | -6.7 | -18.3 | 0 | 0 |
| **INVESTING CASH FLOW ( b )** | **-162** | **-188.9** | **-113** | **-460** | **-400** |
| Debt Issuance / (Repaid) | 27.6 | -147.2 | -130.5 | 135 | 50 |
| Interest Expenses | -55.3 | -50.9 | -76 | -69.3 | -79.4 |
| FCFE | 137.9 | 187.4 | 41.8 | 112.5 | 207 |
| Share Capital Issuance | 0.4 | 0.1 | 0 | 0 | 0 |
| Dividend | 0 | -49 | 0 | -20.4 | -20.4 |
| Others | 0 | 0 | 8.1 | 0 | 0 |
| **FINANCING CASH FLOW ( c )** | **-27.3** | **-246.9** | **-198.4** | **45.2** | **-49.9** |
| **NET CASH FLOW (a+b+c)** | **125.8** | **64** | **-2.4** | **82.1** | **186.6** |

**Key Ratios**

| (Rs Cr) | FY19 | FY20 | FY21 | FY22E | FY23E |
|---|---|---|---|---|---|
| **PROFITABILITY RATIOS** | | | | | |
| EBITDA Margin | 10.1 | 13.5 | 7.1 | 15.8 | 16.1 |
| EBIT Margin | 5.8 | 8.3 | 1 | 11.3 | 12 |
| APAT Margin | 2.1 | 3.8 | -0.6 | 6.8 | 7.3 |
| RoE | 5.6 | 10.7 | -1.3 | 19.8 | 20 |
| RoCE | 9.3 | 13.7 | 1.4 | 20.0R | 20.5 |
| **SOLVENCY RATIO** | | | | | |
| Debt/EBITDA (x) | 2.6 | 2 | 4 | 1.5 | 1.4 |
| D/E | 0.7 | 0.8 | 0.7 | 0.6 | 0.6 |
| **PER SHARE DATA** | | | | | |
| EPS | 2.9 | 5.9 | -0.7 | 11.9 | 14.5 |
| CEPS | 9.6 | 14.9 | 8.3 | 21.5 | 24.7 |
| Dividend | 1 | 1 | 0 | 1 | 1 |
| BVPS | 52.9 | 55.6 | 54.8 | 65.7 | 79.2 |
| **TURNOVER RATIOS** | | | | | |
| Debtor days | 34.8 | 30.8 | 38.2 | 32.7 | 34.8 |
| Inventory days | 10.6 | 8.4 | 7.6 | 5.4 | 5.6 |
| Creditors days | 40.7 | 40.6 | 54.6 | 42.9 | 42.4 |
| **VALUATION** | | | | | |
| P/E | 165.6 | 82.5 | negative | 40.6 | 33.3 |
| P/BV | 9.1 | 8.7 | 8.8 | 7.4 | 6.1 |
| EV/EBITDA | 36.5 | 25.1 | 57.6 | 18.6 | 15.9 |
| EV/Revenues | 3.7 | 3.4 | 4.1 | 2.9 | 2.6 |
| Dividend Yield (%) | 0.2 | 0.2 | 0 | 0.2 | 0.2 |
| Dividend Payout | 34.5 | 17.2 | 0 | 8.4 | 6.9 |

# Narayana Hrudayalaya Ltd.

## One Year Price Chart




(Source: Company, HDFC sec)

**Disclosure:**

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