

ICRA Lanka reaffirms [SL]A- ratings for Nawaloka Hospitals PLC; Revises outlook to Negative from Stable

May 17, 2017

Instrument	Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	[SL]A- reaffirmed; outlook revised to Negative from Stable
Senior Unsecured Redeemable Debenture	1,500	[SL]A- reaffirmed; outlook revised to Negative from Stable

ICRA Lanka Limited, subsidiary of ICRA Limited, a Group Company of Moody's Investors Service, has reaffirmed the Issuer rating of [SL] A- (pronounced SL A minus) for Nawaloka Hospitals PLC's ("NHL"/"the Company"), while revising the outlook on the rating to Negative from stable. ICRA Lanka has also reaffirmed the issue rating of [SL]A- for the Company's LKR 1,500 Mn Senior Unsecured Redeemable Debenture Programme, currently listed on the Colombo Stock Exchange. The outlook on the rating has also been revised to Negative from Stable.

The revision of the outlooks for the ratings from stable to negative is on account of deterioration in capital structure and coverage indicators of the company on account of higher than expected debt funded capital expenditure, which has resulted in increase in gearing from 1.34(x) as on FYE March 2015 to ~2.06(x) and 2.60(x) as on FYE March 2016 and 9M ending FYE March 2017 respectively. The cost of ongoing multi story building and car parking project has witnessed increase from LKR 2.5 Bn to LKR 3.5 Bn due to certain changes in scope of the project and is expected to be completed by mid of FYE March 2018. Apart from this project, the company had also incurred capex for other equipment and machineries during FYE March 2016, which was also partly funded by debts. While, the capex is expected to help the company in de bottlenecking its operations and addressing infrastructure issues, which had resulted in low occupancy levels for the flagship hospital; the timely completion of the project without additional cost overruns, rate of improvement in occupancy levels and translation of other benefits from the project into improvement in revenue and profit margins remains a sensitivity factor.

The rating reaffirmation factors in the strong brand name and operational track record of the Company, witnessed by the healthy market share enjoyed by NHL in Sri Lanka's private sector healthcare industry. Over the years, the Company has been able to leverage its location advantage to attract leading healthcare consultants which has aided in consistent expansion of service offerings, leading to healthy revenue growth (consolidated revenue excluding Nawaloka Medicare Pvt Ltd)~19.4% YOY growth during FYE March 2016 and 4.60 % annualized growth during 9M FYE March 2017.

NHL is also one of the few private sector groups to expand its services into the lab diagnostics business and also expand its bed capacities to locations outside of Colombo. These have enabled the Company to offset the increasing pricing pressures on account of rising competitive intensity in the market and the consolidated entity has witnessed margin improvement and growth in operating cash flows during FYE March 2016 and 9M FYE March 2017. With high repayment obligations in the medium term compared to current cash accrual levels, the company may face some liquidity pressure and need refinancing if the growth in cash accruals are inadequate, however some comfort is drawn from the liquid investments of ~LKR 1 Bn, which includes the receipt of ~ 50% of LKR 973Mn advances made to a group entity in the past, during Q4 FYE March 2017 and the balance is expected in next fiscal.

ICRA Lanka also positively factors the favorable demand outlook for the healthcare industry, which is expected to witness a sharp increase in demand driven by increasing medical insurance penetration, lifestyle related disorders; given the physical limitations of the public healthcare system, incumbent

private players (especially those who are expanding operations) are expected to benefit immensely from the same.

These positives are partially offset by the rising competitive intensity in the industry, which has exerted margin pressure on incumbents and NHL's reliance on government sector consultants to drive operations (an issue faced by the private sector in general). Any adverse regulations restricting employment of such consultants or inability to add more consultants owing to competitive pressures could adversely impact operations. Inability to match pricing actions in line with rising wages for employee and consultants could also exert pressure on margins. ICRA Lanka also notes that the company has acquired the stake of partner in the JV laboratory business and going forward will operate the same as wholly owned subsidiary under technical collaboration with a foreign player-Green Cross Group, South Korea. The ability of the company to attract and retain quality manpower while realizing the targeted revenue growth from new ventures, would be critical to augment overall cash flows and the same will be a key rating sensitivity factor.

Company Profile

Incorporated in the year 1982 by the late Mr. Deshamanya H K Dharmadasa, Nawaloka Hospitals PLC ("Nawaloka"/"the Company") is a leading private sector hospital chain in Sri Lanka. The business commenced operations in September 1985 and currently has 455 operational beds, being operated under four separate entities. Nawaloka is listed in the Colombo stock Exchange with the next generation of the promoter holding a majority share (~65%). All of the hospitals are operated by wholly owned subsidiaries of the Company. During FYE March 2018, Nawaloka has also started a standalone fully functional referral based laboratory through a technical partnership with Green Cross Group-South Korea.

On a consolidated basis, for the nine month ended FYE March 2017, NHL reported a net profit of LKR 168.7 Mn on an operating income of LKR 4,709.0 Mn. For FYE March 2016, NHL reported a net profit of LKR 206.0 Mn on an operating income of LKR 5,560.2 Mn.

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