

Narayana Hrudayalaya Ltd.



We interacted with the Senior Management of Narayana Hrudayalaya represented by Mr. Viren Shetty, COO along with Mr. Debangshu Sarkar, Head of IR and his colleague, Mr. Ashish Sukhija to get more insights on Narayana's business.

Narayana sounded very optimistic on the near term growth prospects. India revenue has recovered to pre-Covid levels and the situation can only improve from here onwards unless of course there is a severe impact of a possible third wave. Cayman should also continue its growth trajectory although some softness can happen during Q3FY22 as insurance benefits are generally extinguished during Q3, Q4FY22 should be devoid of this and thus better than Q3FY22. From a long term perspective, the Management is confident about the growth in India and Cayman given the demographic situation in India as well as in Cayman, where a recent trend of locals getting treated at Narayana's facilities rather than in the US has been observed. The proposed investment in Cayman's new facility at Camana Bay should further bolster the confidence of locals getting treated in this facility as the facility would be equipped with state of the art equipment with a focus on oncology, while all other speciality departments would also be present. Besides, inflow of patients from the US should also increase going forward with the commissioning of the new facility.

Refurbishment of hospitals in India

- Narayana has elaborate plans of refurbishing its hospitals in India with a reduction in number of beds in general wards, the freed up capacity being used for ICU, Critical Care and Day Care beds. More number of private and semi private beds would also be added. Narayana feels that the situation is not as dire as it was 15 years earlier with respect to affordable healthcare as during that time Narayana was probably the only player in the private space catering to low income patients. Many new hospitals have come up across the country since then, which provide affordable healthcare. Besides, the paying capacity of patients has also improved over the years with further inroads being made in terms of insurance penetration. Thus, the refurbishment of the hospital network in India would take care of the changing dynamics effectively without hampering the basic ethos of Narayana as an affordable healthcare provider. The total cost of refurbishment would be around Rs 10,000 mln over 5 years.

Preparation for a possible third wave

- Narayana is adequately prepared to face a possible third wave. All the beds across all facilities would be ICU convertible if necessary with high flow oxygen and ventilators. Narayana expects the third wave to be much milder compared to the second wave, however, if children get affected out of proportion then the available beds in the country across all hospitals will not be able to cope up as it totals to just 2000.

Case mix and payor mix

- Narayana is continually focusing on improving the case mix across its hospitals, particularly in the ones located in Tier 1 cities. For example, it brings on board highly specialised surgeons who have trained in the US and UK to treat complicated diseases. While the number of complicated cases may not be high in number in a Tier 1 facility, the realisations are far superior leading to higher margins. Having said that, the cost of treatment of a highly complicated case would still be lower than other multispeciality hospitals. In terms of payor mix, Narayana expects the proportion of cash patients to fall to 40% from the current level of 50% in the long run. The decrease would be balanced by an equivalent increase in insurance patients while scheme patients would continue to be 20%.

Over supply situation in Cayman

- Cayman's current population is around 60,000 plus there are around 10-15,000 migrant workers. Even before Narayana entered Cayman there was an oversupply situation as the number of beds available per 1000 patients was above the WHO recommended guideline. However, Narayana was able to make inroads by providing superior tertiary and quaternary care. Narayana is thus confident that given its goodwill, its new facility would be able to attract a sizeable number of local and international patients. As of now, there are 3 hospitals in Cayman, HAS Hospital owned by the Government, Doctors Hospital and Narayana's Health City. It must be noted that Aster DM has announced a big project with investment of around USD 350 million in Cayman.

Outlook and Valuation:

We are positive about the growth prospects connected with Narayana. Both Cayman and India operations should continue to do well in the future unless there is an adverse impact of the third wave of Covid-19. The Company's plans of refurbishing and reorganising its Indian hospitals in the next five years is also commendable. **We value the stock at 15x EV/EBITDA with respect to FY23e EBITDA to arrive at a target price of Rs 586 and recommend an "Accumulate" rating on the stock.**

Rating: **Accumulate** Upside/(Downside): **11%**
Current Price: **526** Target Price: **586**

Earlier recommendation

Previous Rating: Buy
Previous Target Price: 577

Market data

Bloomberg:	NARH IN
52-week H/L (Rs):	566/293
Mcap (Rs bn/USD mn):	107.7/1,450
Shares outstanding (mn):	202.9
Free float:	33.0%
Avg. daily vol. 3mth (3M Avg – in '000):	37.3
Face Value (Rs):	10
Group:	S&P BSE 500

Source: Bloomberg, SMIFS research

Shareholding pattern (%)

	Jun-21	Mar-21	Dec-20	Sep-20
Promoter	63.9%	63.9%	63.9%	63.9%
Institutions	30.2%	30.6%	30.1%	29.6%
Non Insti	5.9%	5.5%	6.0%	6.5%
Total	100.0%	100.0%	100.0%	100.0%

Source: BSE

Price performance (%)*

	1M	3M	12M	36M
BSE Sensex	7.4	11.9	51.9	52.4
NARH	-2.6	6.4	64.7	109.4

*as on 6th September 2021; Source: AceEquity, SMIFS research

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Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	PAT (Adj)	YoY (%)	EPS (Adj)	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY19	28,609	25%	2,878	10.1%	592	16%	2.9	5.5%	7.1%	180.4	40.6
FY20	31,278	9%	4,229	13.5%	1,269	115%	6.3	11.2%	10.4%	84.1	27.6
FY21	25,823	-17%	1,821	7.1%	-143	-111%	-0.7	-1.3%	-0.1%	NA	64.2
FY22e	40,548	57%	6,429	15.9%	2,991	NA	14.7	21.1%	18.3%	35.7	18.2
FY23e	53,785	33%	8,588	16.0%	4,562	53%	22.5	24.7%	23.2%	23.4	13.6

Source: AceEquity, SMIFS research

Key takeaways from the management call

Case mix and payor mix

- Narayana is continually focusing on improving the case mix across its hospitals, particularly in the ones located in Tier 1 cities. For example, it brings on board highly specialised surgeons who have trained in the US and UK to treat complicated diseases. While the number of complicated cases may not be high in number in a Tier 1 facility, the realisations are far superior leading to higher margins. Having said that, the cost of treatment of highly complicated case would still be lower than other multispeciality hospitals. In terms of payor mix, Narayana expects the proportion of cash patients to fall to 40% from the current level of 50% in the long run. The decrease would be balanced by an equivalent increase in insurance patients while scheme patients would continue to be 20%.

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Focus on Oncology in Dharmshila and Gurgaon

- The hospitals in Dharmshila and Gurgaon have more significant contribution from oncology compared to the national average. The Dharmshila hospital had 70% of revenue from oncology in FY20 while the Gurgaon hospital had a contribution of 15% from oncology. The proportion is expected to remain the same for these two hospitals while on a national level Narayana aims to increase the oncology contribution to up to 20% of the total revenue in the long run. This will definitely aid in the improvement of margin profile as oncology commands higher realisations.

Oversupply situation in Cayman

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Fate of independent nursing homes and small hospitals in india

- Consolidation is a long term secular trend, which Narayana believes will hold true for independent nursing homes and small hospitals in India as more and more people would prefer to get themselves treated in big hospital chains. Having said that, in the near term nursing homes would continue to thrive. It is interesting to note that while in the first wave many nursing homes shut down due to lack of patients, during the second wave these entities minted money in many cases by overcharging patients. These smaller entities are also not able to invest in digital offerings and technology, which are in vogue and thus this would also be factor of changing consumer preference of hospital chains vis-à-vis independent nursing homes.

Preparation for a possible third wave

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Research and Academics

- The Research department of Narayana has not been active since its inception and the number of publications from Narayana doctors are miniscule. This is expected to change as Narayana has tied up with various foreign universities along with Onco and Cardiac centres to carry out more research.

Tier 2 hospitals vis-à-vis Tier 1 hospitals

- Narayana believes that the recent trend of patients preferring to get themselves treated in a local Narayana hospital versus a hospital located in a Tier 1 city has more to do with travel restrictions because of Covid. As the situation normalises, a section of these patients who can afford to bear the expenses will go to the nearest Tier 1 city hospital in search of better quality treatment because of availability of superior technology and renowned doctors. That is not to say that the hospitals in Tier 2 cities will not grow, but their growth rate would be lower than what has been observed during Covid.

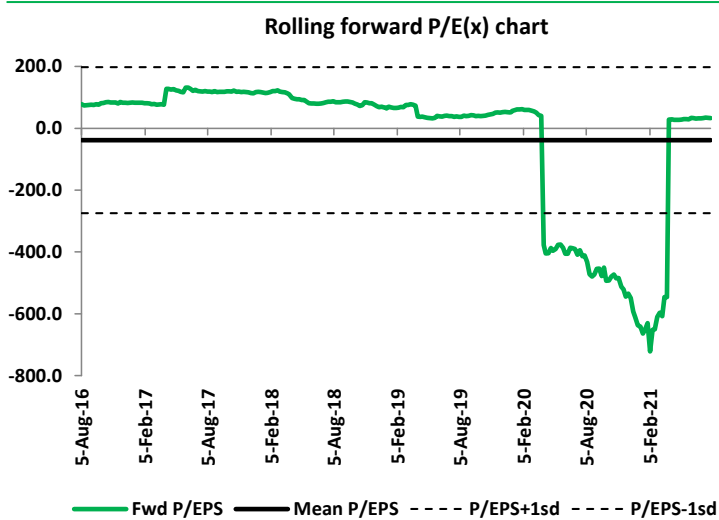
Foray into Africa

- It was Dr. Devi Shetty's vision to foray into Africa and provide the continent affordable healthcare, however, no concrete steps have been taken as yet because of complexities in that market. Narayana is happy with its investments in Cayman and wants to focus more on the Caribbean region, though it has long term aspirations of entering into Africa. In fact discussions have been going on for the past 3 years with a hospital in Kenya and another in Ethiopia.

Outlook and Valuation

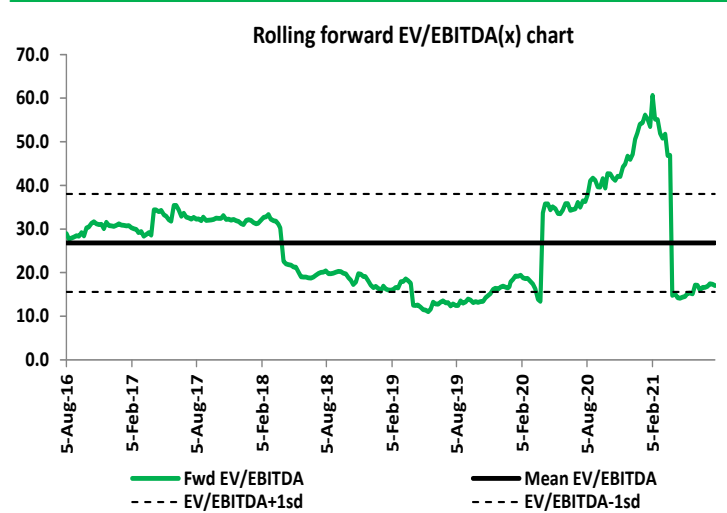
We are positive about the growth prospects connected with Narayana. Both Cayman and India operations should continue to do well in the future unless there is an adverse impact of the third wave of Covid-19. The Company's plans of refurbishing and reorganising its Indian hospitals in the next five years is also commendable. **We value the stock at 15x EV/EBITDA with respect to FY23e EBITDA to arrive at a target price of Rs 586 and recommend an "Accumulate" rating on the stock.**

Fig 1: 1-year forward P/E



Source: AceEquity, SMIFS research

Fig 2: 1-year forward EV/EBITDA



Source: AceEquity, SMIFS research

Quarterly financials

Fig 3: Quarterly Financials

Y/E March (Rs mn)	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22
Net Sales	8,223	7,852	7,429	3,935	6,007	7,504	8,378	8,598
COGS	1,915	1,848	1,788	1,105	1,616	1,988	2,069	2,154
Employee Costs	3,365	3,305	3,200	2,564	2,643	2,934	3,258	3,398
Other Expenditure	1,726	1,672	1,484	1,175	1,480	1,532	1,636	1,709
EBITDA	1,217	1,027	957	(910)	268	1,049	1,414	1,337
Depreciation	429	464	551	464	462	465	445	447
Interest	217	206	208	197	194	186	182	171
Other Income	64	55	70	47	104	46	85	67
Reported PBT	622	403	156	(1,534)	(295)	416	853	771
Tax	168	88	36	(337)	(261)	8	172	9
Tax rate (%)	27.0%	22.0%	23.1%	22.0%	88.4%	1.9%	20.2%	1.1%
Reported PAT	453	314	120	(1,197)	(34)	408	680	762
YoY Growth (%)								
Revenue	15.6%	7.3%	-2.9%	-49.4%	-26.9%	-4.4%	12.8%	118.5%
EBITDA	66.7%	31.8%	7.0%	-188.5%	-78.0%	2.2%	47.7%	NA
PAT	233.9%	147.8%	-67.8%	-495.7%	-107.5%	30.1%	468.7%	NA
QoQ Growth (%)								
Revenue	5.8%	-4.5%	-5.4%	-47.0%	52.7%	24.9%	11.6%	2.6%
EBITDA	18.3%	-15.6%	-6.8%	-195.0%	-129.4%	292.1%	34.8%	-5.5%
PAT	49.8%	-30.8%	-61.9%	-1101.0%	-97.1%	-1292.6%	66.6%	12.0%
Margin (%)								
RMC/revenue (%)	23.3%	23.5%	24.1%	28.1%	26.9%	26.5%	24.7%	25.1%
Gross margin (%)	76.7%	76.5%	75.9%	71.9%	73.1%	73.5%	75.3%	74.9%
Employee cost/revenue (%)	40.9%	42.1%	43.1%	65.2%	44.0%	39.1%	38.9%	39.5%
Other expenses/revenue (%)	21.0%	21.3%	20.0%	29.9%	24.6%	20.4%	19.5%	19.9%
EBITDA margin (%)	14.8%	13.1%	12.9%	-23.1%	4.5%	14.0%	16.9%	15.5%
PAT margin (%)	5.5%	4.0%	1.6%	-30.4%	-0.6%	5.4%	8.1%	8.9%

Source: AceEquity, SMIFS research

Financial Statements

Income Statement					
YE March (Rs mn)	FY19	FY20	FY21	FY22e	FY23e
Net Sales	28,609	31,278	25,823	40,548	53,785
COGS	6,875	7,453	6,779	10,471	12,954
% of sales	24.0%	23.8%	26.2%	25.8%	24.1%
Personnel	12139	13027	11400	16229	22353
% of sales	42.4%	41.6%	44.1%	40.0%	41.6%
Other Exp.	6717	6569	5824	7420	9890
% of sales	23.5%	21.0%	22.6%	18.3%	18.4%
EBITDA	2,878	4,229	1,821	6,429	8,588
EBITDA Margin (%)	10.1%	13.5%	7.1%	15.9%	16.0%
Depreciation & Amortisation	1374	1858	1835	1799	1785
EBIT	1,505	2,371	-14	4,629	6,803
Interest Expenses	714	853	760	823	910
EBT	791	1,518	-774	3,807	5,893
Other Income	167	238	282	210	217
Reported PBT	934	1,613	-561	3,997	6,090
Tax-Total	341	423	-418	999	1,522
Effective tax rate (%)	36.5%	26.2%	74.5%	25.0%	25.0%
Extraord. items - Adj.	-	-109	-	-	-
Reported PAT	592	1189	-143	2991	4562

Balance Sheet					
YE March (Rs mn)	FY19	FY20	FY21	FY22e	FY23e
Sources of funds					
Capital	2,044	2,044	2,044	2,044	2,044
Reserves & Surplus	8,768	9,316	9,159	12,151	16,409
Shareholders' Funds	10,811	11,360	11,203	14,194	18,452
Minority Interest	4	5	5	11	16
Total Debt	7,368	8,637	7,332	9,141	9,611
Deferred Tax Liabilities	479	544	130	130	130
Other Non Current Liabilities	2,720	2,804	2,595	2,719	2,658
Total Liabilities	21,382	23,350	21,265	26,195	30,867
Application of funds					
Net Block	17,921	20,337	19,044	20,018	19,958
Capital WIP	362	118	183	3,513	6,843
Non-current Asset	1,980	1,840	1,137	2,096	2,512
Net Non Current Assets	20,262	22,295	20,364	25,627	29,313
Investments	174	863	1,203	1,227	1,200
Goodwill	660	581	581	581	581
Inventories	832	602	478	739	914
Sundry Debtors	2,664	2,622	2,785	4,373	5,801
Other Current Assets	770	798	967	862	888
Cash & Bank Balances	1,007	1,148	1,321	154	195
Total Current Assets	5,274	5,171	5,551	6,128	7,799
Creditors	3,335	3,616	4,103	5,353	6,623
Other Current Liabilities	1,387	1,467	2,027	1,626	1,057
Current Provisions	266	477	305	391	348
Total Current Liabilities	4,988	5,561	6,435	7,370	8,027
Net Current Assets	286	-390	-884	-1,242	-229
Total Assets	21,382	23,350	21,265	26,194	30,866

Key Ratios					
YE March	FY19	FY20	FY21	FY22e	FY23e
Growth ratios (%)					
Net sales	25.4%	9.3%	-17.4%	57.0%	32.6%
EBITDA	35.6%	46.9%	-56.9%	253.0%	33.6%
Adjusted PAT	16.0%	114.5%	-111.3%	-2191.4%	52.5%
Margin Ratio (%)					
EBITDA Margin	10.1%	13.5%	7.1%	15.9%	16.0%
EBIT Margin	5.3%	7.6%	-0.1%	11.4%	12.6%
PBT (Adjusted) Margin	3.3%	5.5%	-2.2%	9.9%	11.3%
PAT (Adjusted) Margin	2.1%	4.1%	-0.6%	7.4%	8.5%
Return Ratio (%)					
ROE	5.5%	11.2%	-1.3%	21.1%	24.7%
ROCE	7.1%	10.4%	-0.1%	18.3%	23.2%
Turnover Ratio days (days)					
Inventory Period	44	30	26	26	26
Debtors Period	34	31	39	39	39
Creditors	177	177	221	187	187
Cash Conversion Cycle	-99	-117	-156	-121	-121
Solvency Ratio (%)					
Debt-equity (x)	0.8	0.9	0.8	0.7	0.5
Net Debt-equity (x)	0.7	0.8	0.6	0.7	0.5
Liquidity ratio (x)	1.0	1.0	0.9	0.9	0.9
Interest coverage ratio (x)	2.1	2.8	-0.0	5.6	7.5
Per share (Rs)					
Adjusted EPS	2.92	6.26	-0.70	14.74	22.48
CEPS	9.68	15.41	8.34	23.61	31.28
Book value	53.28	55.98	55.21	69.95	90.93
Dividend per share	1.00	-	-	1.50	1.50
Dividend Payout (%)	34%	0%	0%	10%	7%
Dividend Yield (%)	0.2%	0.0%	0.0%	0.3%	0.3%
Valuation					
P/E	180.4	84.1	-746.2	35.7	23.4
P/BV	9.9	9.4	9.5	7.5	5.8
P/S	3.7	3.4	4.1	2.6	2.0
EV/EBITDA	40.6	27.6	64.2	18.2	13.6

Cash Flow					
YE March (Rs mn)	FY19	FY20	FY21	FY22e	FY23e
Operating profit before WC changes					
Net change in working capital	-456	-172	1,099	-2,595	-2,352
Cash flow from operating activities (a)	2,786	4,433	3,091	4,043	6,452
Capital expenditure (organic)	-1,495	-1,325	-539	-6,105	-5,055
FCF	1,291	3,108	2,552	-2,062	1,397
Cash flow from investing activities (b)	-1,613	-1,885	-1,130	-6,017	-5,083
Cash flow from financing activities (c)	-273	-2,469	-1,984	895	-1,355
Net change in cash (a+b+c)	901	79	-24	-1,079	14
Opening cash balance	-50	965	1,026	1,106	27
Forex fluctuations	114	-17	104		
Ending cash balance	965	1,026	1,106	27	41
Other bank balances	42	121	213	125	153
Cash and Bank on balance sheet	1,007	1,147	1,320	153	195

Source: AceEquity, SMIFS research

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