CARE Ratings
Professional Risk Opinion

CARE/ARO/RL/2019-20/2929

Mr. Pankaj R. Patel
Director
Zydus Foundation
Zydus Corporate Park, Scheme No.63,
Survey Number 536, Near Vaishnodevi Circle,
Sarkhej-Gandhinagar Highway, Ahmedabad - 380015

March 18, 2020

Confidential

Dear Sir,

Credit rating for proposed Non-Convertible Debenture Issue

Please refer to your request for rating of proposed long-term non-convertible debenture (NCD) issue aggregating to Rs.200.00 crore of Zydus Foundation. The proposed NCDs would have tenure of five years with bullet repayment at the end of fifth year from the date of allotment.

The following rating has been assigned by our Rating Committee:

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

2. Please arrange to get the rating revalidated, in case the proposed issue is not made within a period of **six months** from the date of our initial communication of rating to you (that is March 16, 2020).
3. In case there is any change in the size or terms of the proposed issue, please get the rating revalidated.
4. Please inform us the below-mentioned details of issue immediately, but not later than 7 days from the date of placing the instrument:

Instrument type	ISIN	Issue Size (Rs crore)	Coupon Rate	Coupon Payment Dates	Terms of Redemption	Redemption date	Name and contact details of Debenture Trustee	Details of top 10 investors

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

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5. Kindly arrange to submit to us a copy of each of the documents pertaining to the NCD issue, including the offer document and the trust deed.
6. The rationale for the rating will be communicated to you separately. A write-up (press release) on the above rating is proposed to be issued to the press shortly, a draft of which is enclosed for your perusal as Annexure. We request you to peruse the annexed document and offer your comments if any. We are doing this as a matter of courtesy to our clients and with a view to ensure that no factual inaccuracies have inadvertently crept in. Kindly revert as early as possible. In any case, if we do not hear from you by March 19, 2020, we will proceed on the basis that you have no any comments to offer.
7. CARE reserves the right to undertake a surveillance/review of the rating from time to time, based on circumstances warranting such review, subject to at least one such review/surveillance every year.
8. CARE reserves the right to revise/reaffirm/withdraw the rating assigned as also revise the outlook, as a result of periodic review/surveillance, based on any event or information which in the opinion of CARE warrants such an action. In the event of failure on the part of the entity to furnish such information, material or clarifications as may be required by CARE so as to enable it to carry out continuous monitoring of the rating of the bank facilities, CARE shall carry out the review on the basis of best available information throughout the life time of such bank facilities. In such cases the credit rating symbol shall be accompanied by "ISSUER NOT COOPERATING". CARE shall also be entitled to publicize/disseminate all the afore-mentioned rating actions in any manner considered appropriate by it, without reference to you.
9. Our ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.
10. Users of this rating may kindly refer our website www.careratings.com for latest update on the outstanding rating.
11. CARE ratings are not recommendations to buy, sell or hold any securities.

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If you need any clarification, you are welcome to approach us in this regard. We are indeed, grateful to you for entrusting this assignment to CARE.

Thanking you,
Yours faithfully,

[Jeel Dalal]
Analyst
jeel.dalal@careratings.com

Encl.: As above

[Krunal Modi]
Senior Manager
krunal.modi@careratings.com

Disclaimer

CARE's ratings are opinions on the likelihood of timely payment of the obligations under the rated instrument and are not recommendations to sanction, renew, disburse or recall the concerned bank facilities or to buy, sell or hold any security. CARE's ratings do not convey suitability or price for the investor. CARE's ratings do not constitute an audit on the rated entity. CARE has based its ratings/outlooks on information obtained from sources believed by it to be accurate and reliable. CARE does not, however, guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CARE have paid a credit rating fee, based on the amount and type of bank facilities/instruments. CARE or its subsidiaries/associates may also have other commercial transactions with the entity. In case of partnership/proprietary concerns, the rating /outlook assigned by CARE is, inter-alia, based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors. CARE is not responsible for any errors and states that it has no financial liability whatsoever to the users of CARE's rating.
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Annexure 1

Details of Rated Instruments

Brief tentative terms of Instrument

Particulars	Instrument
Type of Instrument	Proposed Unsecured Redeemable Non-Convertible Debentures (NCDs) to be listed on Stock exchange
Size of the issue	Up to Rs.200 crore
Coupon	Fixed coupon rate of 0.10% p.a. to be paid annually
Repayment terms and Maturity	5 years from date of allotment (bullet repayment)
Debenture Trustee	IDBI Trusteeship Services Limited
Purpose	Capex, Repayment/Prepayment of existing loans and general corporate purpose.
Mode of Issue	Private Placement
ISIN	Not Applicable
Financial and non-financial covenants	1) In case of delay in listing beyond 20 days from the deemed date of allotment, the company will pay penal interest of 1% p.a. over the coupon rate from the expiry of 30 days from the deemed date of allotment till the listing. 2) In case of default in payment of interest and/or principal redemption on the due dates, additional interest @ 2% p.a. over the Coupon Rate will be payable by the company for the defaulting period.

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Annexure
Brief Rationale
Zydus Foundation

Ratings

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

Details of Instrument in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to the proposed long-term Non-Convertible Debenture (NCD) issue of Zydus Foundation (ZF) primarily derives 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 would like to foray in to the field of medical college. The rating also favourably factors in the high enrolment ratio of the medical college in its first year of operation, 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 is, however, principally 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 size 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

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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 and the 7th biggest pharmaceutical company in the United States of America (USA) based on prescription (source: Company). CHL is among the top 3 players in pain management, Oncology, Respiratory and Gynaecology therapeutic segments. Further, 11 of CHL's brands rank amongst the top 300 pharmaceutical brands in India. Moreover, CHL reported GCA of around Rs.2,420 crore during FY19 with modest overall gearing and strong debt coverage indicators as on March 31, 2019. 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 FY19, CHL provided funds of Rs.21.55 crore in the form of CSR contribution to ZF.

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

High enrolment ratio in light of limited availability of medical seats in the state with overall favorable growth prospect for education sector as well as healthcare sector

Despite 2019 being its first year of operation, ZF was able to achieve an enrolment level of 100% and it continued to remain at 100% in the academic year 2020 due to the limited seats available for medical education. 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

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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, increasing variety of courses offered by colleges and universities, etc. However, challenges relating to access to and participation in 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 and other schemes.

Key Rating Weaknesses

Limited track record of operation 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 operation of the medical college at Dahod. By virtue of 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 risk 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 proposed to be majorly funded through NCDs of Rs.400 crore. Currently the project is being funded through advances and CSR contributions received from the Zydus Cadila group companies. NCDs proceeds would be

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utilized to finance existing as well as 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 have strong execution capability thereby reducing execution risk to a certain extent. Further, with the commencement of this hospital, the total capacity of the hospital will increase to 1,113 beds from the existing 363 beds. However, 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. Undertaking new project and expanding existing facilities requires trained doctors and medical personnel. Due to scarcity of trained medical persons including doctors owing to heavy competition in the state of Gujarat, 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 project accrue to it. Against a net worth of around Rs.8 crore as of end-FY19 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 proposed NCD of Rs.200 crore each in two tranches 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

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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's General Civil hospital) for treatment. The decision comes after a PIL 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 proposed to be charged on the NCD. 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
CARE's methodology for Hospital Industry
CARE's methodology for Education Sector
Financial ratios – Non-Financial Sector
CARE's Methodology for Consolidation and Factoring Linkages in Ratings

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

(Rs. Crore)

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

A: Audited; @ 3 months of operation

As per the provisional results for H1FY20, ZF earned total operating income of Rs.37.80 crore with SBILDT of Rs.6.12 crore; albeit it is expected to end the year FY20 with a net deficit.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History (Last three years): Please refer Annexure-2

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:

CARE Ratings commenced operations in April 1993 and over nearly two decades; it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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
Proposed Non-Convertible Debentures	NA*	NA*	0.10%	#	200.00	CARE BBB+; Stable

**Not available as it is proposed non-convertible debentures; as it is not yet placed its ISIN is not available*
#Maturity Date would be 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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Debentures-Non Convertible Debentures	LT	200.00	CARE BBB+; Stable	-	-	-	-

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Annexure-3: Covenants of rated instrument

Particulars	Covenants
Financial and non-financial covenants	1) In case of delay in listing beyond 20 days from the deemed date of allotment, the company will pay penal interest of 1% p.a. over the coupon rate from the expiry of 30 days from the deemed date of allotment till the listing. 2) In case of default in payment of interest and/or principal redemption on the due dates, additional interest @ 2% p.a. over the Coupon Rate will be payable by the company for the defaulting period.

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