

## Strong Hospital, Implant business outlook lowering discount to bigger peers

**About the stock:** Started by renowned orthopaedic surgeon Dr Vikram Shah, Shalby is a multi-specialty hospitals chain with expertise in joint replacement.

- Revenue-wise breakup Q4FY23: Arthroplasty: 41%, Critical care & General medicine: 10%, Cardiac science: 10%, Orthopaedic: 7%, Oncology: 10%, Neurology: 4%, Nephrology: 5%, Others: 13%
- Shalby registered a blended ARPOB of ₹ 34,865 and ALOS of 4.01 days (without day care procedures) in Q4FY23
- Acquisition of US based Consensus to diversify into related implant business besides supporting arthroplasty and orthopaedic segments

### Key Investment Thesis:

- Shalby is a market leader in arthroplasty procedure with ~15% market share of all joint replacement surgeries by organised private corporate hospitals.
- Diversification of arthroplasty and orthopaedics with cardiac science, oncology and neuro-science with availability of additional bed capacity to support growth
- Strong growth outlook on implant business in core-markets post achieving EBITDA breakeven in Q4FY23
- Set on an inspirational target to clock US\$100 million in Implant business in next 5 years (from ~US\$11 million in FY23) and focus remains on expansion to 50 franchises in the next few years
- Net Debt free balance sheet with FY25 RoIC approaching 15%

### Rating and Target Price

- We assign BUY rating on the back of 1) strong arthroplasty legacy and diversification into other super-specialties 2) asset light model via franchisee drive, 3) expansion of implant business into newer geographies besides stronger India and US traction
- We value Shalby at ₹ 220 based on SOTP valuation.



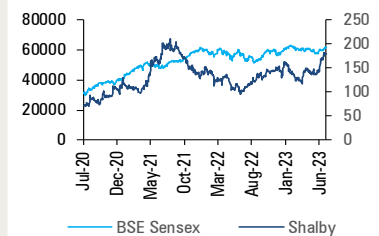
### Particulars

Particular	Amount
Market Capitalisation	₹ 1954 crore
Debt (FY23)	₹ 142 crore
Cash (FY23)	₹ 12 crore
EV	₹ 2084 crore
52 week H/L	192/107
Equity capital	₹ 108.0 crore
Face value	₹ 10

### Shareholding pattern

Particular	Jun-22	Sep-22	Dec-22	Mar-23
Promoter	74.0	74.0	74.0	74.0
Others	26.0	26.0	26.0	26.0

### Price Chart



### Recent event & key risks

- Launch of TUKS in US and India
- Key Risk:** (i) slower ramp up in elective surgeries (ii) Lower than guided traction from implants.

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### Key Financial Summary

Key Financials (₹ Crore)	FY20	FY21	FY22	FY23	5 year CAGR (FY17-22)	FY24E	FY25E	2 year CAGR (FY23-25E)
Revenues	486.9	430.9	698.9	804.9	16.6	918.3	1049.0	9.2%
EBITDA	81.7	86.4	119.9	137.4	10.9	167.6	192.7	11.9%
EBITDA margins (%)	16.8	20.1	17.2	17.1		18.2	18.4	
Net Profit	27.6	42.4	54.0	68.3	13.5	88.9	111.3	17.6%
EPS (₹)	2.6	3.9	5.4	6.3		8.2	10.3	
PE (x)	54.8	35.7	27.9	22.1		17.0	13.6	
EV to EBITDA (x)	18.4	16.9	12.8	10.9		8.1	6.7	
RoCE (%)	7.2	6.5	8.4	9.9		11.8	13.9	
ROE (%)	3.5	5.1	6.7	7.4		8.9	10.2	

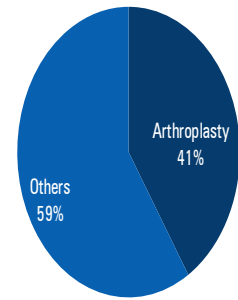
## Company Background

Healthcare services under the brand 'Shalby' commenced in 1994 while actual incorporation happened in 2004. Led by Dr Vikram Shah, an orthopaedic surgeon with more than 25 years of professional experience, the company has grown from a single hospital to a chain of multi-specialty hospitals. Its first hospital, Vijay Shalby was established by Shalby Orthopaedic Hospital and Research Centre, one of the group entities, in 1994. Subsequently, SG Shalby and Vrundavan Shalby commenced operations in 2007 and 2011, respectively. From four hospitals in April 2012, the company has grown to 14 hospitals IN FY23

The company also has a network of 59 outpatient clinics across 16 states in India and abroad, which act as a separate medium to tap new patients. Internationally also, it has established a strong presence in Africa, Bangladesh and Cambodia with multiple out-patient clinics extending expert healthcare and wellness services to these countries.

The existing revenue mix between Arthroplasty and other specialties is at ~41:59 (FY23). The total bed capacity was at 2222 with operational beds at 1260. The company employs over 3800+ employees including more than 500 doctors. Shalby registered a blended ARPOB of ₹ 34842 and ALOS of 3.92 days (with day care procedures) in FY23.

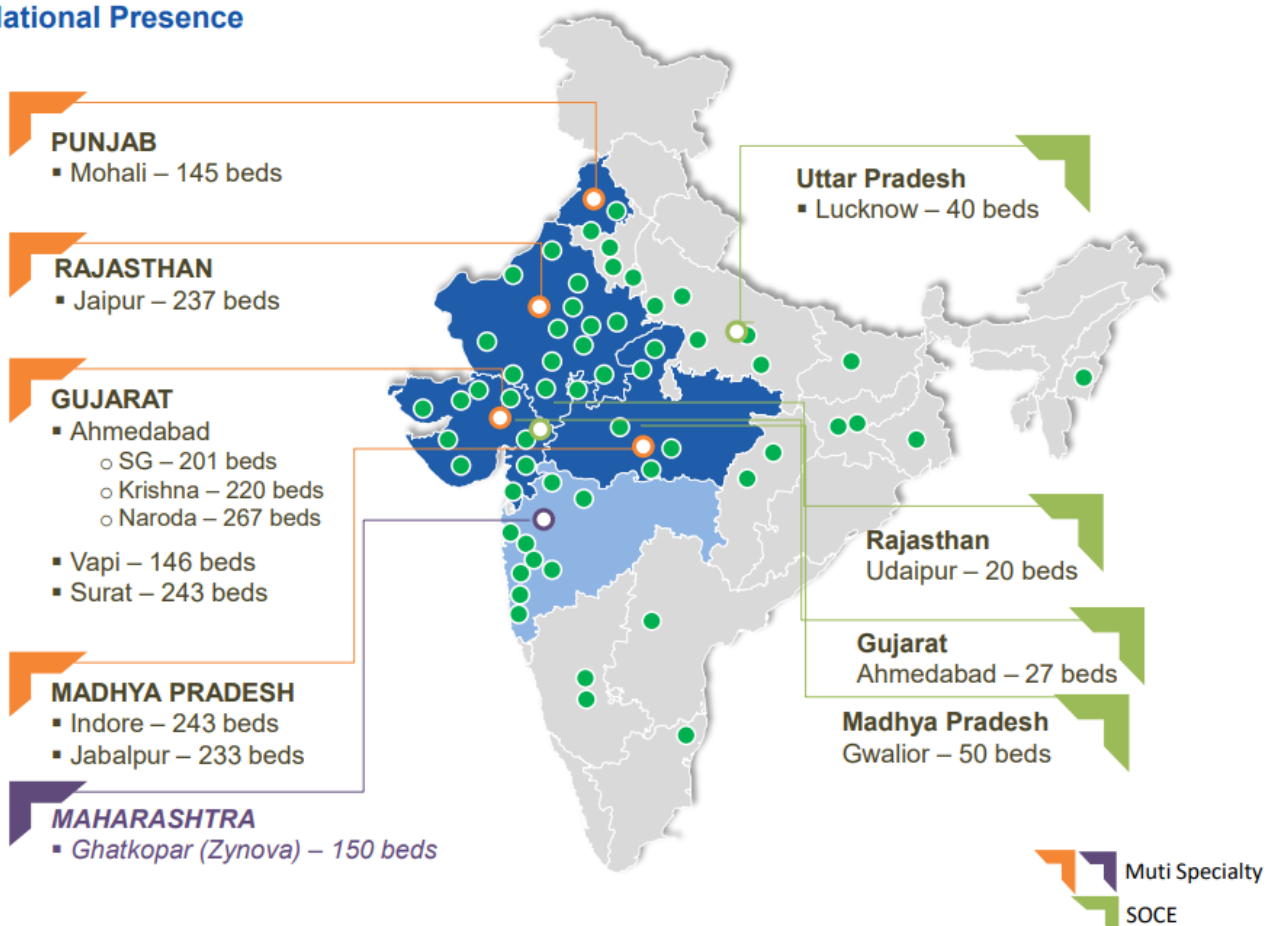
### Arthroplasty - ~41% of revenues



Source: ICICI Direct Research; Company

Exhibit 1: Network of hospitals in India with bed capacity

### National Presence



Source: ICICI Direct Research; Company



## Investment Rationale

### Market leader in fast growing joint replacement surgeries

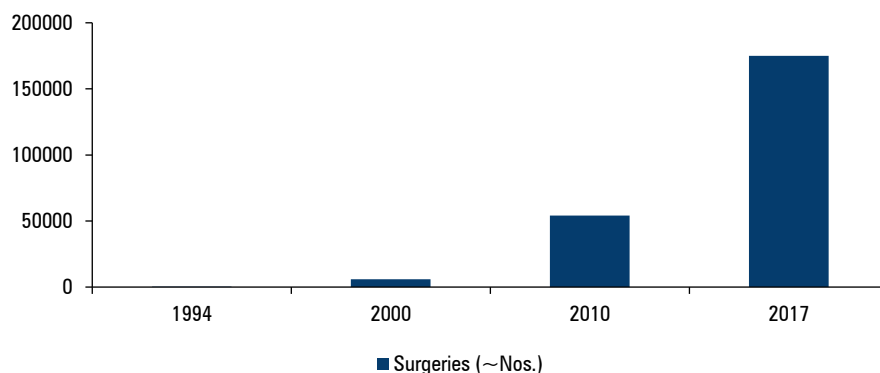
Rapid ageing, greater life expectancy, lack of exercise as well as altered lifestyles are driving the incidence of osteoarthritis among Indians. Osteoarthritis is the most frequent joint disease with a prevalence of ~30% in India. Knee replacement surgeries in India grew at ~30% CAGR since inception of the company till 2017. They are expected to emerge as the fourth most common cause of physical disability in India in the next decade. Having performed 148000+ joint replacements since 2007, the company has been a market leader in the area of joint replacement surgeries with ~15% market share among organised private corporate hospitals in India.

Led by renowned orthopaedic surgeon Dr Shah, the company has achieved strong brand recall in Gujarat, especially in joint replacement surgeries. Among other unique aspects associated with the company, the most prominent could be the '0 technique' procedure, which reduced surgical time from 150 minutes to 25 minutes and a patient's hospital stay from 15 to three days. Through 59 outpatient clinics (FY22), it offers orthopaedic consultation services to patients.

*Rapid ageing, greater life expectancy, lack of exercise as well as altered lifestyles are driving the incidence of osteoarthritis among Indians*

*Led by renowned orthopaedic surgeon Dr Shah, the company has achieved strong brand recall in Gujarat, especially in joint replacement surgeries*

**Exhibit 2: Knee replacement surgeries grow at ~30% CAGR over past three decades**



Source: ICICI Direct Research, Company Annual Report FY19

### Expanding in other specialities to de-risk

After achieving critical mass in arthroplasty, the company has been rapidly expanding in other specialties, especially in new hospitals. In the last few years, Shalby has forayed into tertiary and quaternary specialties like cardiology, neurology, oncology, bariatric, liver & renal transplants, etc. A case in point is Jabalpur hospital, which commenced operations in 2014 with a primary focus on cardiology. Similarly, Shalby Indore provides advanced radiation therapy for cancer treatment. The company has engaged the services of 75 doctors with specialisation in the area of orthopaedics and 244 doctors with specialisations in other specialties (FY19). Further, in line with its strategy to further strengthen its capabilities in non-orthopaedic specialties, it offers advance post-graduate diplomas in a range of disciplines including non-invasive cardiology, dialysis management, oncology and sports medicine through Shalby Academy. Share of arthroplasty has come down from 97% in FY08 to 41% in FY23.

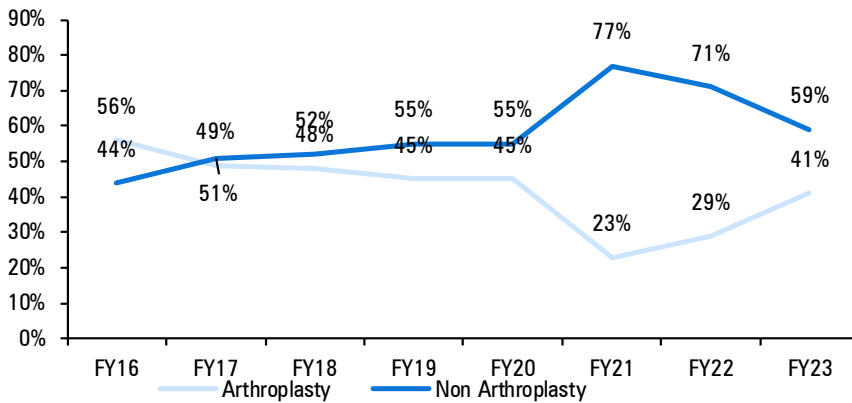
*In the last few years, the company has forayed into tertiary and quaternary specialties like cardiology, neurology, oncology, bariatric, liver and renal transplants, etc*

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The shift is visible, especially in <6 years hospitals where the non-arthroplasty pie is higher than the arthroplasty pie. Thus, hospitals in Indore, Jabalpur, Jaipur, Naroda, Surat and Mohali are running on a multi-specialty model.

While arthroplasty will continue to remain the cash cow for the company, it can utilise the significant cash flows for expansion in other specialties without additional leverage on the balance sheet.

**Exhibit 3: Post Covid Arthroplasty normalised at 41%**



Source: ICICI Direct Research, Company

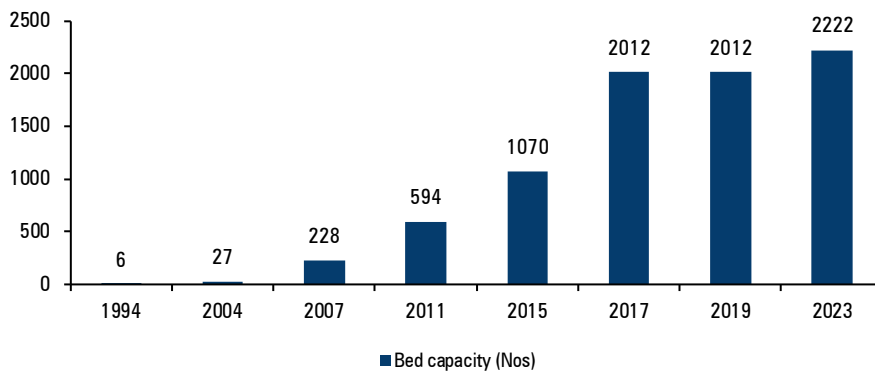
### Leverage free balance sheet despite continuous expansion

Shalby is one of the rare hospital chains, which has a debt free balance sheet. Despite aggressive expansion in the past decade, the company remained debt free owing to its assets light model approach and continuous strong free cash flow generation from legacy hospitals in Ahmedabad owing to its strong brand recall. As per the management, the company’s per bed cost is ₹ 40-50 lakh against capex of ₹ 75+ lakh at other corporate hospitals while operational cost is 10-15% lower than industry standard. The company has utilised ₹ 388 crore (out of ₹ 480 crore) from IPO proceed for repayment of loans and purchase of equipment. As a matter of policy, the company has confined itself to mid-tier hospitals (~200 beds), which are relatively easy to manage.

*Shalby is one of the rare hospital chains, which has a debt free balance sheet despite aggressive expansion in the past decade*

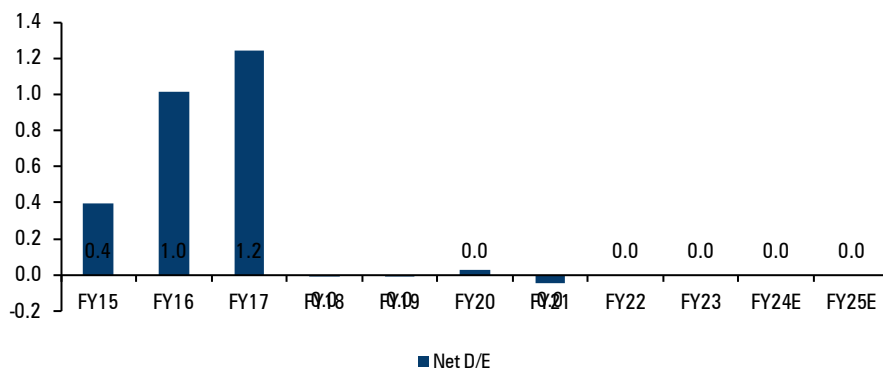
Another peculiar aspect is the design and arrangement of the hospital structure that accommodates 30%+ higher beds on every floor. Similarly, against the industry average of four operation theatres (OTs) for 200 beds, the company’s hospital design accommodates eight OTs for 200 beds, which allows Shalby to perform more surgeries per day.

Exhibit 4: Shalby adds ten hospitals in past decade



Source: ICICI Direct Research, Company

Exhibit 5: Shalby’s debt free balance sheet



Source: ICICI Direct Research, Company

## Key risks and Concerns

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### Changing healthcare regulations in India

According to the order dated August 16, 2017, by the National Pharmaceuticals Pricing Authority (NPPA) a cap has been introduced in the pricing of orthopaedic surgical procedures using knee implants performed by hospitals and clinics, among others. As a result, the charges in relation to knee replacement surgeries may have to be reduced in line with the requirements set out in the abovementioned order. This may, in turn, adversely impact the company's margins and profitability. Furthermore, any such passing of a regulation could have an adverse impact on the company's business and financial performance.

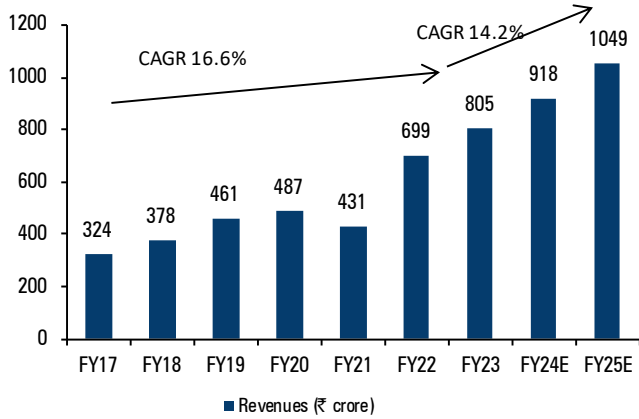
### High operational profit concentration from four hospitals

Four hospitals, with a presence above six years, contributed 86% to FY19 EBITDA. This includes flagship hospitals SG Shalby and Krishna Shalby. Thus, the company is still exposed to concentration risk. Any adverse impact in any of these legacy hospitals, especially the two flagship assets, could drag down the overall company performance.

### Significant dependence on key man to run business

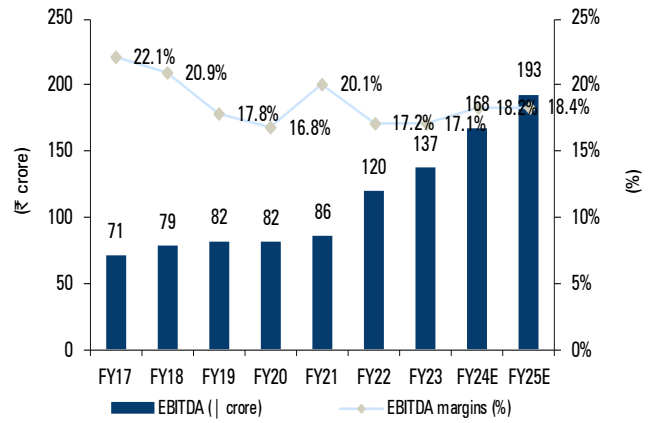
Dr Vikram Shah's reputation has been the single most driving force in the company's success. Apart from his dexterity in the field of arthroplasty surgeries, the company is also significantly dependent on him for strategic directions and managing business affairs. Hence, there remains a key man focus risk.

Exhibit 6: Revenue to grow at CAGR of 14.2% over FY23-25E



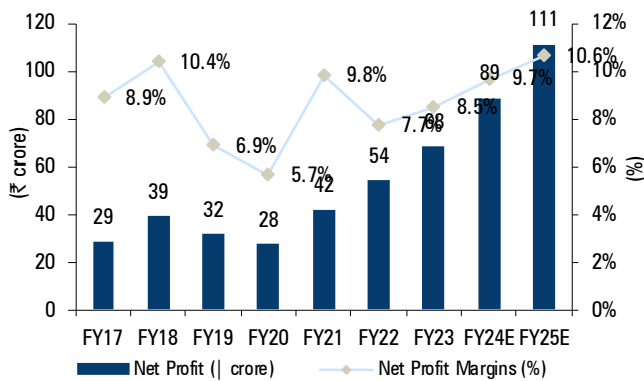
Source: Company, ICICI Direct Research

Exhibit 7: EBITDA & EBITDA margins trend



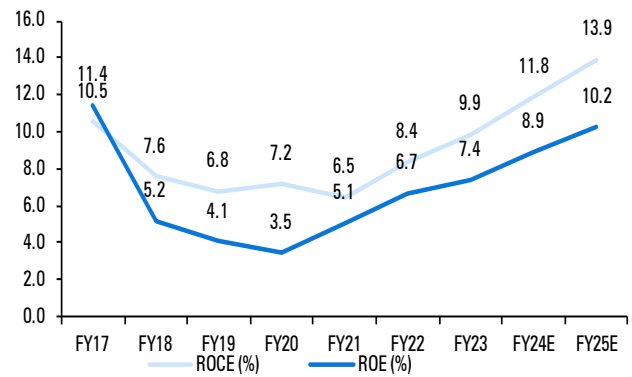
Source: Company, ICICI Direct Research

Exhibit 8: PAT & PAT margins trend



Source: Company, ICICI Direct Research

Exhibit 9: RoE & RoCE trend



Source: Company, ICICI Direct Research

Exhibit 10: Valuation

Particulars	FY25E (₹ cr)	Valuation Matrix	Multiple (x)	EV (₹ cr)
Hospital	199.3	EV/EBITDA	11.5	2,292
Shalby Consensus	159.1	EV/Sales	1.0	159
EV				2,451
Net Debt FY25E (₹ cr)				84.3
Minority Interest				1.0
Targeted MCap (₹ cr)				2,366
No of shares (cr)				10.8
<b>Per Share Value (₹)</b>				<b>220</b>

## Financial Summary

Exhibit 11: Profit and loss statement					₹ crore
Year-end March	FY22	FY23	FY24E	FY25E	
Total Operating Income	698.9	804.9	918.3	1,049.0	
Growth (%)	62.2	15.2	14.1	14.2	
Raw Material Expenses	41.6	59.4	54.7	62.5	
Gross Profit	657.4	745.5	863.6	986.5	
Gross Profit Margins (%)	94.0	92.6	94.0	94.0	
Employee Expenses	118.4	143.6	163.9	187.2	
Other Expenditure	419.0	464.5	532.2	606.7	
Total Operating Expenditure	579.0	667.5	750.8	856.4	
<b>EBITDA</b>	<b>119.9</b>	<b>137.4</b>	<b>167.6</b>	<b>192.7</b>	
Growth (%)	38.8	14.6	21.9	15.0	
Interest	5.9	9.1	6.4	2.9	
Depreciation	42.9	48.1	49.1	47.6	
Other Income	12.4	22.5	18.4	21.0	
<b>PBT before Exceptional Items</b>	<b>83.6</b>	<b>102.7</b>	<b>130.4</b>	<b>163.2</b>	
Less: Exceptional Items	4.4	0.0	0.0	0.0	
PBT after Exceptional Items	79.1	102.7	130.4	163.2	
Total Tax	25.2	34.4	41.5	51.9	
PAT before MI	54.0	68.3	88.9	111.3	
<b>PAT</b>	<b>54.0</b>	<b>68.3</b>	<b>88.9</b>	<b>111.3</b>	
Growth (%)	27.4	26.6	30.1	25.1	
<b>EPS (Adjusted)</b>	<b>5.4</b>	<b>6.3</b>	<b>8.2</b>	<b>10.3</b>	

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement					₹ crore
Year-end March	FY22	FY23	FY24E	FY25E	
Profit/(Loss) after taxation	56.2	73.6	84.2	101.2	
Add: Depreciation & Amortization	42.9	38.8	49.1	50.2	
Net Increase in Current Assets	-118.6	-63.4	-42.5	-48.8	
Net Increase in Current Liabilities	27.8	17.6	15.6	17.8	
Others	10.6	1.1	13.4	15.2	
<b>CF from Operating activities</b>	<b>18.9</b>	<b>67.7</b>	<b>119.9</b>	<b>135.6</b>	
Investments	-8.8	-119.2	0.0	0.0	
(Purchase)/Sale of Fixed Assets	-48.3	-17.7	-100.0	-100.0	
Others	-3.2	75.8	-5.0	-5.7	
<b>CF from Investing activities</b>	<b>-60.3</b>	<b>-61.1</b>	<b>-105.0</b>	<b>-105.7</b>	
Inc / (Dec) in Equity Capital	0.0	-7.5	0.0	0.0	
Dividend & Dividend tax	-10.8	-10.8	-16.8	-20.2	
Other	101.3	-31.7	36.6	9.8	
<b>CF from Financing activities</b>	<b>90.5</b>	<b>-50.1</b>	<b>19.7</b>	<b>-10.4</b>	
<b>Net Cash Flow</b>	<b>49.1</b>	<b>-43.4</b>	<b>34.6</b>	<b>19.5</b>	
Cash and Cash Equivalent	6.5	55.6	12.1	46.7	
<b>Cash</b>	<b>55.6</b>	<b>12.2</b>	<b>46.7</b>	<b>66.3</b>	
<b>Free Cash Flow</b>	<b>-29.4</b>	<b>50.0</b>	<b>19.9</b>	<b>35.6</b>	

Source: Company, ICICI Direct Research

Exhibit 13: Balance Sheet					₹ crore
Year-end March	FY22	FY23	FY24E	FY25E	
Equity Capital	108.0	107.3	107.3	107.3	
Reserve and Surplus	768.3	820.4	891.6	980.6	
Total Shareholders funds	876.3	927.7	998.9	1,088.0	
Total Debt	155.0	141.7	91.7	41.7	
Deferred Tax Liability	30.6	43.4	44.3	45.2	
Minority Interest	-0.1	-0.1	-0.1	-0.1	
Other Non Current Liabilities	26.9	48.5	49.5	50.5	
<b>Source of Funds</b>	<b>1,088.7</b>	<b>1,161.2</b>	<b>1,184.3</b>	<b>1,225.2</b>	
Gross Block - Fixed Assets	852.7	910.6	930.6	900.6	
Accumulated Depreciation	187.5	235.6	284.7	332.3	
Net Block	665.2	675.0	645.9	568.3	
Capital WIP	5.8	10.5	90.5	170.5	
Goodwill	10.2	10.2	10.2	10.2	
Fixed Assets	681.2	695.7	746.6	749.0	
Investments	24.7	145.7	145.7	145.7	
Other non-Current Assets	41.5	41.7	45.8	50.4	
Deferred Tax Assets	20.0	26.7	29.4	32.4	
Inventory	121.1	185.4	45.0	51.4	
Debtors	101.0	106.4	132.7	151.6	
Loans and Advances	0.0	0.0	0.0	0.0	
Other Current Assets	93.6	67.5	68.8	70.2	
Cash	110.6	12.1	98.5	119.6	
Total Current Assets	426.3	371.3	345.0	392.7	
Creditors	70.7	87.9	93.0	106.3	
Provisions	1.1	1.5	1.6	1.8	
Other Current Liabilities	33.0	30.6	33.6	37.0	
Total Current Liabilities	104.8	119.9	128.3	145.0	
Net Current Assets	321.4	251.4	216.7	247.7	
<b>Application of Funds</b>	<b>1,088.7</b>	<b>1,161.2</b>	<b>1,184.3</b>	<b>1,225.2</b>	

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios				
Year-end March	FY22	FY23	FY24E	FY25E
<b>Per share data (₹)</b>				
Reported EPS	5.0	6.3	7.8	9.4
Cash EPS	8.4	9.5	10.8	12.1
BV per share	81.1	85.9	92.1	99.6
Cash per Share	10.2	1.1	4.3	6.1
Dividend per share	1.0	1.3	1.6	1.9
<b>Operating Ratios (%)</b>				
Gross Profit Margins	94.0	92.6	94.0	94.0
EBITDA margins	17.2	17.1	18.2	18.4
PAT Margins	8.4	8.5	9.2	9.6
Cash Conversion Cycle	495.0	647.4	790.0	790.0
Asset Turnover	0.8	0.9	1.0	1.1
EBITDA conversion Rate	15.8	49.3	71.6	70.4
<b>Return Ratios (%)</b>				
RoE	6.7	7.4	8.5	9.4
RoCE	8.4	9.9	10.9	12.1
RoIC	8.3	9.2	12.2	14.6
<b>Valuation Ratios (x)</b>				
P/E	35.9	28.4	23.1	19.2
EV / EBITDA	16.4	14.0	11.6	10.1
EV / Net Sales	2.8	2.4	2.1	1.9
Market Cap / Sales	2.8	2.4	2.1	1.9
Price to Book Value	2.2	2.1	2.0	1.8
<b>Solvency Ratios</b>				
Debt / EBITDA	1.3	1.0	1.1	1.1
Debt / Equity	0.2	0.2	0.2	0.2
Current Ratio	3.0	3.0	3.0	2.9
<b>Quick Ratio</b>	<b>1.9</b>	<b>1.4</b>	<b>1.4</b>	<b>1.4</b>

Source: Company, ICICI Direct Research



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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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