CARE Ratings
Professional Risk Opinion

COVID-19 Impact: Corporate Hospitals

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Even before the corporate hospital chains had fully recovered from the damage done on their financial health due to cut in the price of stents and knee implants in FY2018; they have been yet again hit by a new challenge in form of COVID-19.

India's drug price regulator National Pharmaceutical Pricing Authority (NPPA) had capped the prices of stents (February 2017) and knee implants (August 2017) by over 70% which led to a deterioration in the profitability margins of most of the corporate hospitals. Hospitals traditionally were making around two-third of profits from consumables such as drugs, stents, implants, and the services contributed only remaining one-third of profits. With the fall in the prices of stents followed by implants, the profits went downwards. The sector was also adversely impacted with GST implementation as they were not able to input credit on consumables given the fact that they were under the zero rate category. The corporate hospitals were agile enough and went for various measures to improve their profitability. Focus on cost rationalization measures, a gradual increase in the procedure price and stabilizing the operations and monetizing the existing assets rather than going for large Capex; helped the domestic players to improve their margins from Q3FY19 onwards.

With the pandemic COVID-19 now spread across, CARE Ratings believes that the corporate hospitals will once again face pressure on their income and margins for the next couple of quarters with some respite not likely before H2FY21. We may see an uptick in occupancy levels during H2FY21 once the lockdowns are lifted and the public at large starts visiting hospitals for elective treatments.

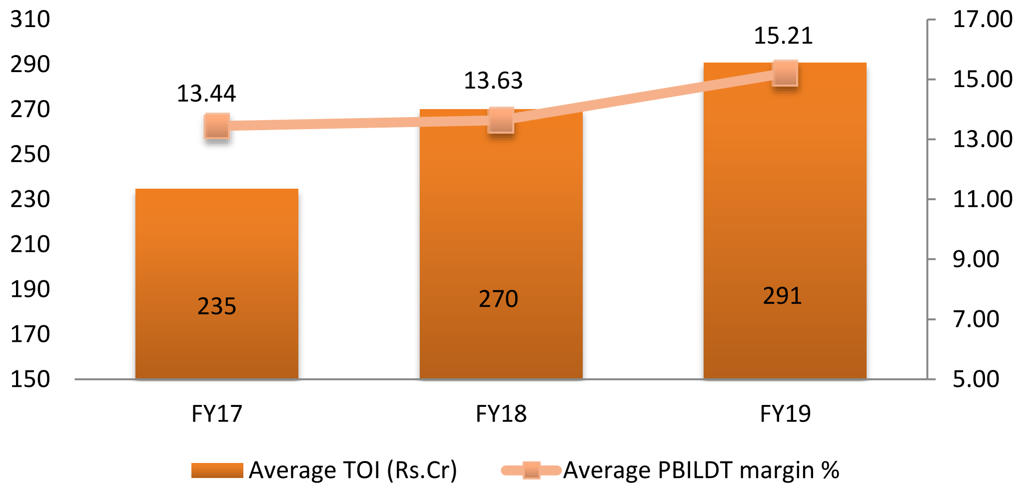
Declining occupancy resulting in a fall in income

A typical hospital earns a significant amount of its revenue from two segments – Inpatient Department (IPD) and Outpatient Department (OPD). With the outbreak of COVID-19; the number of patients in OPD has gone down significantly owing to the nationwide lockdown. The OPD volumes have also been adversely impacted due to the reluctance of people at large to visit hospitals due to fear of getting infected from other patients.

The IPD segment as well hospitals have witnessed a significant decline in the occupancy levels following government advisory. The Ministry of Health and Family Welfare (MoHFW) had issued an advisory on March 22, 2020, to postpone elective and non-essential surgeries and asked hospitals to discourage patients to visit for routine visits to OPD or utilize OPD services in primary/ secondary care facilities rather than crowding tertiary care centres. Elective surgeries are mostly an outcome of OPD visits and with almost negligible OPD patients, elective surgeries are bound to go down. Another important segment of revenue was from international patients in the form of medical tourism which has also completely dried up for hospitals with nationwide lockdown.

CARE Ratings investment grade portfolio has an average total operating income of Rs.291 crore during FY19 (a growth of ~8% over FY18) with an average PBILDT margin of 15.21% during FY19 (an increase of 158 bps over FY18).

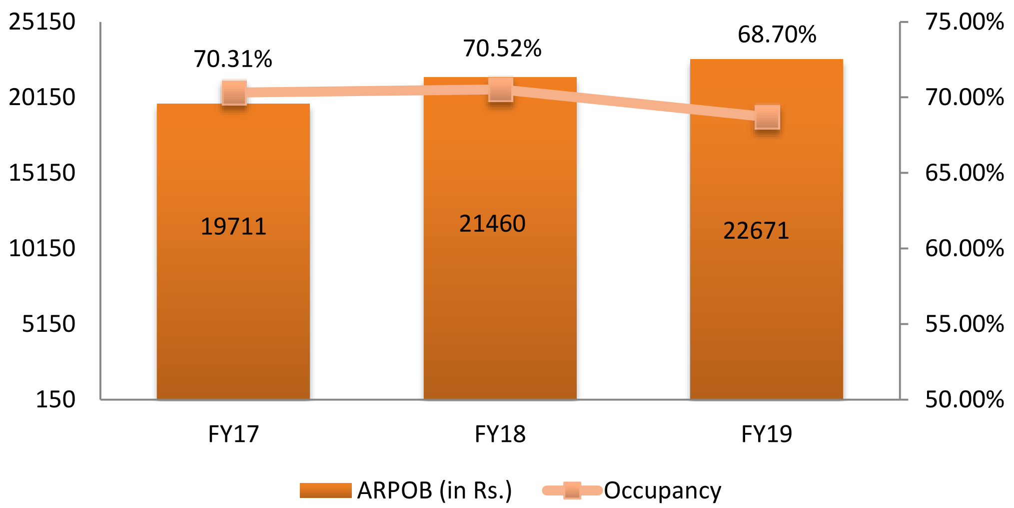
Chart 1: Average TOI and PBILDT margin % of CARE Ratings investment grade portfolio



Source: **CARE Ratings**

The average occupancy level for CARE Ratings investment-grade portfolio stood at 68.70% during FY19 (FY18: 70.52%) while Average Revenue Per Occupied Bed (ARPOB) stood at Rs.22,671 during FY19 (FY18: Rs.21,460).

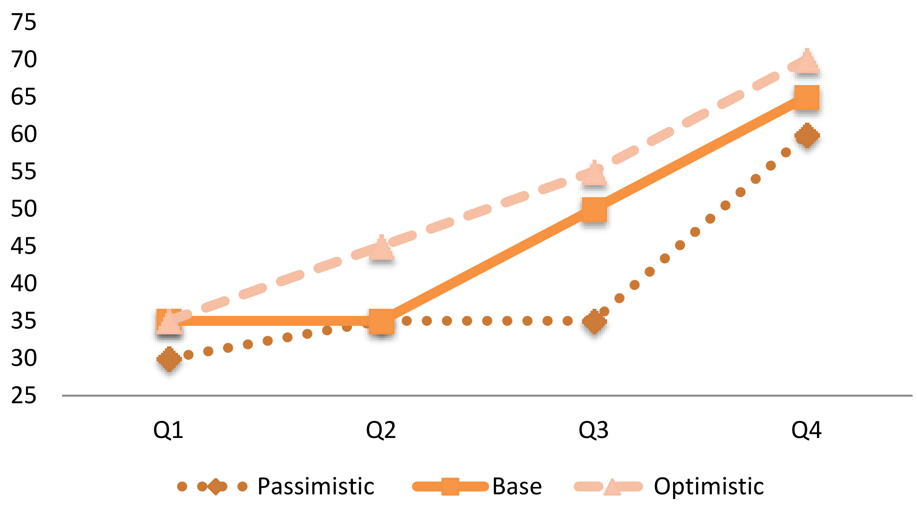
Chart 2: Average ARPOB and Occupancy levels for CARE Ratings investment grade portfolio



Source: **CARE Ratings**

CARE Ratings believes on account of factors mentioned earlier, there has been a fall in occupancy level in the range of 40-50% and the average occupancy levels for many corporate hospitals have come down to the range of 30-40%. Hospitals are expected to operate in the range of 30-40% occupancy levels for H1FY21. Nonetheless, we may witness an uptick in the occupancy levels by H2FY21, once the lockdown is lifted and the incidence of COVID-19 cases subsides. CARE Ratings believes as a base case the average occupancy level for its portfolio will be around 46.25% during FY21 while the pessimistic and optimistic levels at around 40% and 51% respectively for FY21.

Chart 3: Quarter-wise expected occupancy % movement for FY21

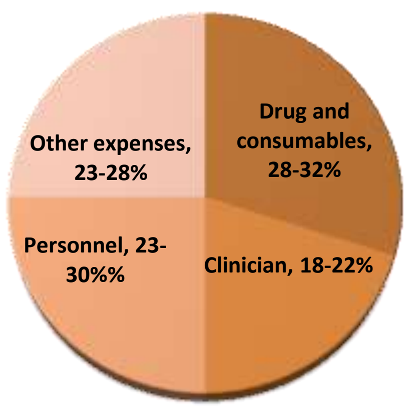


Source: **CARE Ratings**

Pressure on margins on account of high fixed expenses

With lower-income and high fixed expenses, most hospitals are expected to witness pressure on their profitability and cash accruals. Around 50-60% of hospital costs are fixed in nature which primarily includes Doctor's remuneration and salaries for allied healthcare workers including nursing staff.

Chart 4: Cost structure of hospital (%)



Source: **CARE Ratings**

Doctor's remuneration is surely a major cost for hospital and depending on the model of the hospital the same is either fixed or semi-fixed in nature. Various leading hospital chains have a significant majority of the doctors on their payroll while many others have around 50% of their empaneled doctors as visiting. With more payroll doctors, the brand equity of the hospital is stronger. However, in the current situation, players with more visiting doctors would be able to trim down their costs more efficiently and cut down on their losses compared to hospitals with a larger share of payroll doctors. Nevertheless, cost related to Doctor's remuneration and salaries related to medical staff will continue to exert pressure on the profits of hospitals even after some rationalization. Furthermore, the Ministry of Health and Family Welfare advisory expects hospitals to be prepared with isolation facilities and adequate availability of doctors, nurses and support staff in different specialties, including pre and para-clinical departments. All this will not provide a large window to the hospitals in trimming down their expenses.

Another significant cost that the companies incur is the rental expense. Corporate hospital chains must take a strategic call between the owned versus rental model. While large corporate chains own most of their hospitals, various affordable hospital groups have most of their hospitals on lease/rentals. Hospitals with large rental expenses are surely expected to feel pressure on their margins unless they can re-negotiate or defer the rental for the next couple of quarters.

Squeezed liquidity and stretched operating cycle

CARE Ratings believes that with lower total income and profitability margins, hospital entities will witness squeeze in the liquidity at least in the upcoming two quarters. Given the fact that hospital businesses are characterized by heavy Capex and long gestation periods, a lot of entities might face a challenge in their debt servicing on account of lower cash flows. It is noteworthy to mention that hospital entities attempt to establish a balanced mix of matured and new assets as matured hospitals tend to provide better profitability with stable revenue. The other important aspect related to matured and a new asset is the fact that corporate hospital chains that have recently undergone an expansion cycle are more leveraged and have higher debt repayments compared to matured hospitals or chains with a portfolio of the higher number of matured assets. With lower cash accruals and high debt repayment, a lot of entities might feel the pressure on their cash flows in FY21. We expect a significant number of the entities would defer their non-essential Capex plans for FY21 and even witness re-financing of debt to manage the cash flow mismatches if required.

Furthermore, we may witness the stretching of the collection days in the sector on account of higher revenue from Central and State Government schemes. Hospitals receive payments in various forms and channels such as Cash business, Third-Party Agencies (TPA), Institutional clients and Central Government Health Scheme (CGHS) and Ex-Servicemen Contributory Health Scheme (ECHS). In CARE Ratings view, a hospital with more cash business will have better cash flow as compared to more of CGHS business wherein the payments are realized with delay. As per an office order by MoHFW in the first week of April, 2020; various measures have been extended to increase the coverage of CGHS users on account of the current COVID-19 situation. Furthermore, to strengthen the country's response to COVID -19 pandemic, the Government of India included the testing and treatment for COVID-19 under Ayushman Bharat Pradhan Mantri Jan Arogya Yojana (AB-PM JAY) from April 2020 onwards. These factors would lead to higher debtors in form of CGHS/ECHS/AB-PMJAY and thus add to the liquidity woes of these hospital entities. As per the Association of Healthcare Providers India (AHPI), there are around 57 lakh ECHS and 37 lakh CGHS beneficiaries in the country with together of around Rs.1,500 crore of dues under these schemes as on December 2019. Timely release of these funds will be crucial for the hospital chains and will surely provide them with the needed liquidity.

Credit Perspective

CARE Ratings believes that the impact of COVID-19 on the corporate hospital sector will be negative though it may not be prolonged. We would witness fall in occupancy levels across hospitals due to negligible OPD as well as IPD operations owing to nationwide lockdown. Profitability is also expected to remain under pressure in the sector given more than half of the cost being fixed in nature. However, as medical treatments cannot be deferred for long, occupancy levels will witness a rise once the lockdown is over and the overall reluctance to visit hospitals subsides. We believe fundamentals of the sector to remain intact and continue to grow backed by an increase in demand for modern healthcare facilities, a rise in awareness about diseases, health consciousness among people, increase in per capita income, changing lifestyle, transition in disease profile etc.

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