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Revenue growth of hospitals seen up 300-400 bps to 14-15%

Ayushman Bharat lends traction; firms realign to regulatory amendments

Revenue and profitability of India's hospitals sector should continue to improve between fiscals 2020 and 2021, sustaining the recovery witnessed last fiscal.

The improvement in demand will be driven by enhanced coverage under Ayushman Bharat, deeper penetration of hospitals into Tier-II cities, as well as alterations made to healthcare delivery models by hospital chains to align with regulatory changes. Other structural factors like increasing lifestyle diseases and medical tourism will continue to aid demand.

With insurance coverage of Rs 5 lakh under the Ayushman Bharat scheme (up from ~Rs 1-3 lakh under various government schemes), preference for private hospitals (account for 70% of sector's revenues by value) is rising. Since the launch of the scheme in September 2018, high-value claims, i.e., Rs 30,000 and above, have accounted for 8% of total claims, and 75-80% of these treatments were undertaken by private hospitals. That said, increase in treatment package rates under Ayushman Bharath scheme can ensure better participation by even larger private hospitals who have not enrolled in the scheme, further aiding revenue growth.

Further, CRISL's study covering 41 leading domestic hospital firms (revenues ~Rs.32000 crore) reveals that the bed additions in Tier II cities will be higher in future, resulting in better materialisation of latent demand and adoption of Ayushman Bharat schemes. **"CRISIL expects 60-70% of bed additions to come up in Tier II locations in the next 2-3 fiscals. Currently, healthcare facilities are clustered around Tier I cities such as Chennai, New Delhi, Bengaluru, Kolkata, and Mumbai, adds, Mr Anuj Sethi, Senior Director, CRISIL Ratings."**

Even as revenue growth is set to increase by 300-400 basis points (bps) to 14-15% over fiscals 2020 and 2021, operating profitability of hospital firms is also expected to improve to ~16% over this period. This will be supported by a rise in bed occupancy rates to ~75% from 60-65%, automation and optimisation of clinical procedures, efficient sourcing, and continuing recalibration of pricing of services.

A series of regulatory events in fiscals 2017 and 2018 had impacted revenue growth and profitability of private hospitals. While demonetisation and the ban on large cash transactions impacted occupancy, implementation of the Goods and Services Tax, price cap on medical implants, and increase in minimum wages for nurses and staff moderated profitability.

CRISIL's analysis of its sample set reveals these regulations tempered revenue growth to ~11% in fiscals 2017 and 2018 from ~15% in fiscal 2015 and 2016. Operating profitability dipped by ~100 basis points (bps) to 14.8%, from 15.8%.

To mitigate the impact of regulations on performance, hospital firms reworked package rates and rationalised costs. That enabled a recovery in revenue growth and operating profitability to ~13% and 15.3%, respectively, last fiscal. Further, curtailment of capacity additions allowed for better asset turnaround and aided improvement in credit metrics - for instance, debt to EBITDA (earnings before interest, tax, depreciation, and amortisation) improved to 3.4 times in fiscal 2019 from 3.8 times in fiscal 2017.

With occupancy and cash generation improving, hospital firms are expected to expand capacities. **"We expect the CRISIL sample set to incur capex of Rs 4,800 crore in fiscals 2020 and 2021," said Rajeswari Karthigeyan, Associate Director, CRISIL Ratings. "Notwithstanding the capex, better cash flows, aided also by the recent reduction in corporate tax rate, will support improvement in credit metrics – debt to EBITDA is likely to be below 3 times by fiscal 2021."**

Further regulatory changes are a possibility given the government's intent to increase accessibility and affordability of healthcare. Therefore, the impact of regulatory changes and the players' ability to respond to these would be a monitorable.

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