Opportunity in **Private Sector Hospitals** in India

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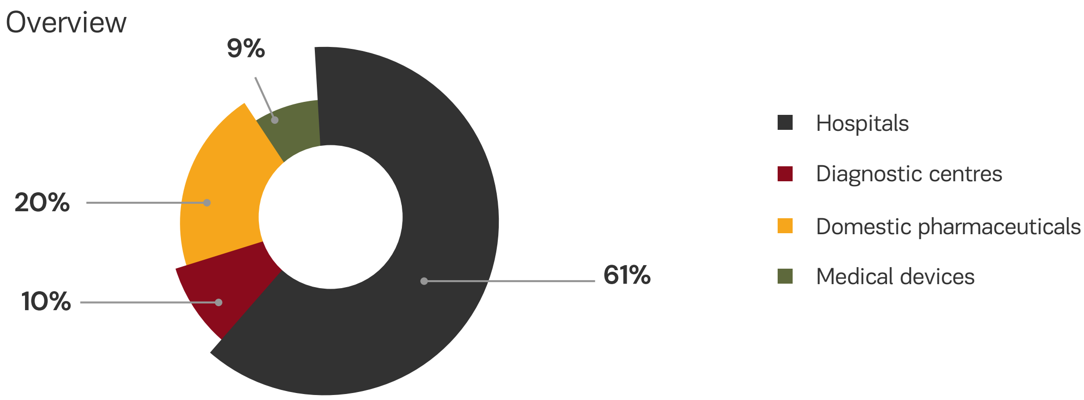
Shrikant Tiwari (name changed), a leading marketing consultant, working with an MNC (multi-national company) in NCR (National Capital Region) had his roots ingrained in Lucknow in Uttar Pradesh. His parents toiled to see to it that Shrikant was given the best possible education and got gainful employment. And today he wants to provide them with a comfortable lifestyle and the best of medical care. Till a decade back, any kind of medical complication would require them to travel to NCR due to the lack of medical infra in the city. Today, Lucknow boasts of one of the best private medical setups capable of serving patients for all their medical requirements, including cardiac and cancer screening and treatments.

For decades, Hospitals in India have been an under-appreciated cog of the healthcare system. Due to perennial low investments, India has only 14-15 beds per 10000 people vs the world average of 29.

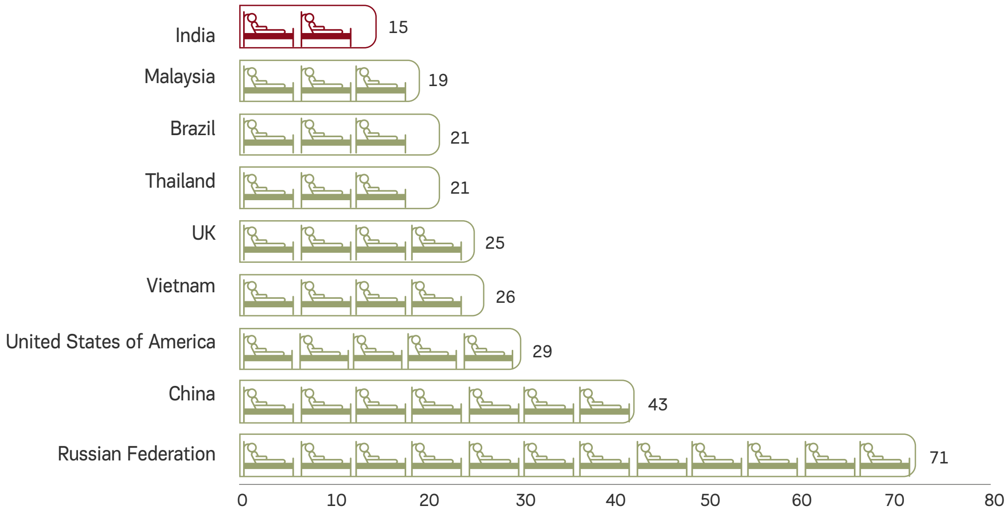
Structure of the healthcare delivery industry in India



Source: Medanta RHP (Data by CRISIL Research)

Put differently, India with a population of 140 crore people has 19 lac hospital beds – nearly one-third of the beds vs China with a similar population size. It was precisely this lacuna which came to the forefront during COVID times and government, and many private players doubled up their efforts to keep up with bed requirements.

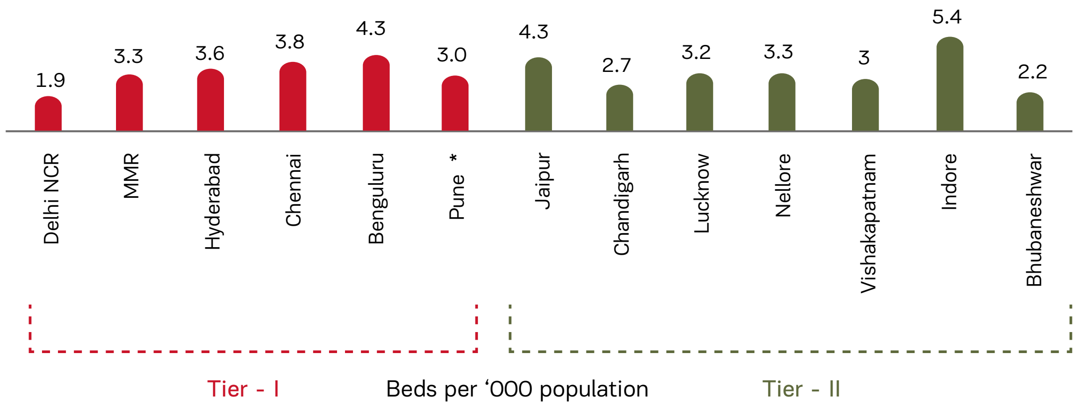
Bed Densities across Countries - Hospital Beds (per 10,000 population)



Source: Medanta RHP (Data by World Health Organization, CRISIL Research)
Note: India bed density estimated by CRISIL Research for 2020.
All countries data as of 2018 as per WHO records.

India requires additional 20 lac beds to meet the world average requirements. In India healthcare is largely an out-of-pocket expense and the private sector accounts for 62% of all beds in the country. But interestingly the largest private sector hospital in the country has only 10,000 beds - less than 1% of the market share and does not have a pan India footprint.

Estimated bed density across key tier – I and II cities in India



Based on city category classification followed by 7th Pay Commission, Tier I – X cities top 8 cities), tier II – Y cities (next 88 cities)
*Pune metropolitan region
Source: Medanta RHP (CRISIL Research)

This depicts that a large portion of hospital beds are nursing home setups which can provide primary and secondary care, but we lack high-quality tertiary care infra which can take care of complex surgeries and procedures. Most of the listed hospitals cater to this opportunity, wherein as per our internal estimates, private players can grow at 15-17% CAGR over the coming decade providing a good opportunity for any investor wanting to participate in this growth hypothesis.

A Long Runway for Growth

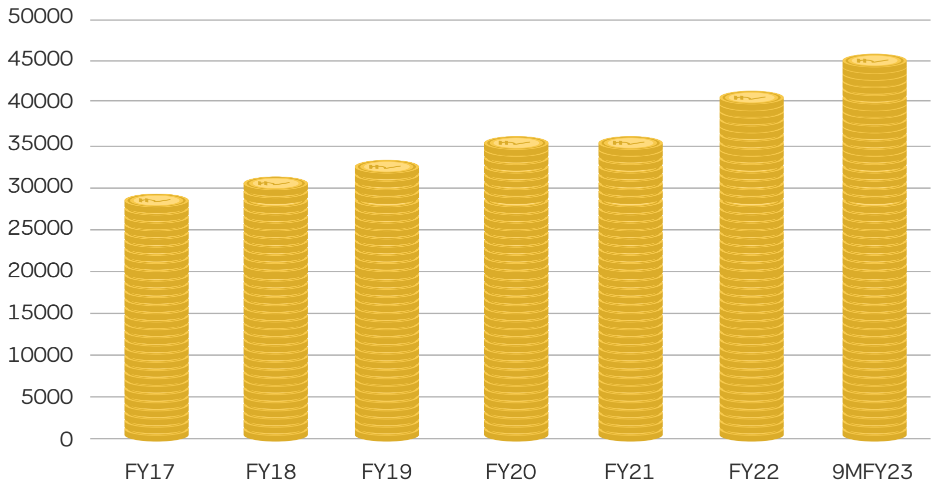
Let's first understand the overall size and scale of the opportunity. The total annual hospital spending in the country is USD 70 billion (over Rs 5.7 lac crores). Compare that to the pharmaceuticals sector with revenues of USD 40 billion per annum (including exports), and diagnostics which account for USD 10 billion. Interestingly, the largest pharma company in the country is making profits of USD 1 billion vs the largest hospital company in the country making profits of less than USD 150 million. While comparing both businesses is like comparing chalk and cheese, the profitability of the largest players vs the scale of business opportunity highlights the long runway for growth that hospitals can have.

It is pertinent to ask what does it take to have a successful business operation in hospitals and how difficult it is to replicate the same for scale. To our assessment, players in the sector need a) large investments in the best of the diagnostics, screening, and operating equipment b) clinical excellence across therapy areas especially cardiac, oncology, and transplants c) a sharp focus on costs as it is a high fixed costs business and d) most of all is to build a trustworthy, credible brand for patient care. Since hospitals are a regional business with a reach of 200 kms radius, it is extremely difficult to replicate many of these parameters as you look to scale the franchise unless you have established systems and processes in place for the same.

Many informed investors ask us what one should monitor to assess the health of the sector and a business in particular. A typical tertiary care private hospital providing complex surgery and patient care requires investment upwards of Rs 1 crore per bed and a hospital in a metro would require approximately 500 beds and in a tier 1 town around 250-300 beds. Hospitals make losses in the first year and break even on an average in 12-18 months and the average payback is 6-7 years. Key points to monitor are a) OC - occupancy of hospital network b) average revenue per occupied bed (ARBOP) c) costs structure in terms of doctor payouts as a percentage of revenues and other staff payouts d) attrition of senior talent and e) ability to build a centre of excellence on key therapy areas. During covid, occupancies dipped from 65-70% levels to below 50% which led to huge losses.

This was compensated by an increase in ARBOP partly due to changes in case mix, payor mix, and a decrease in average length of stay and partly due to price increase. Today, hospitals are back to earlier occupancies with 45-50% higher ARBOP which has led to high profitability and ROCEs above 20% for most mature assets. Most hospitals are reinvesting these gains on capex creating a virtuous cycle of growth.

Average revenue per occupied bed (Rs/day)



Source: ABSLAMC Research

We assess the sector would also witness a high level of mergers and acquisitions as most large players have low leverage and a couple of private equity investors would look to cash out as their fund lifecycle comes to an end.

Positive Outlook Supported by Strong Growth Levers

Another key lever for the sector is to improve traction on medical tourism in India. At peak, India had nearly 7 lac medical tourists spending nearly USD 3 billion - a large part of which is captured by hospitals. Medical tourist revenues to total revenues have declined to mid-single digits from low-digit levels in 2019 and we expect the same to normalise in the coming 12-18 months. The government is also creating an enabling environment to push medical tourism by 4x in the next 4-5 years by providing special approval for medical visas, financial assistance for facilities for medical tourism and one-stop information on medical facilities in the country among others. A case in point is Thailand wherein the right push and infra have led to an annual inflow of 25 lac medical tourists in the country. India too has the potential to scale given the deep domain expertise of doctors across therapy areas, costs which are a fraction of developed markets' costs for varied surgeries and procedures.

Early investors in the sector have been well rewarded as valuations have got re-rated from 15x to 20x 2-year forward EV/EBITDA multiples. This has happened on the back of improving return on capital ratios and the fact that most businesses in the sector are over the hump in terms of their ability to fund incremental growth from internal accruals rather than debt.

Key risks to watch out from here is a) any cap in prices by the government on the back of high medical inflation, especially before elections b) aggressive multiples paid by players in M&As transactions as players look to expand geographically and c) high attrition of doctors and nursing staff which can jeopardise the network. We reckon most large players have the expertise and wherewithal to manage these risks over the medium term.

Lastly, digital is also upending the service efficacy of the sector. Right from digital platforms which provide an integrated framework for managing patient records, to delivery of service at the doorstep, to increasing AI usage in surgeries and procedures, players are exploring and adopting new technologies that can improve patient outcomes and service levels. We reckon players who are open to adapting to many of these changes are well placed to capture patient mind share which would eventually lead to high market share and profitability for the business.