JSC Evex Hospitals
Georgia, Healthcare Services

SCOPE BB STABLE

Key metrics

			Scope estimates	
Scope credit ratios	2021	2022P[1]	2023E	2024E
Scope-adjusted EBITDA interest cover	3.9x	2.1x	2.7x	3.0x
Scope-adjusted debt/EBITDA	2.5x	3.7x	3.3x	2.7x
Scope-adjusted FFO/debt	29%	14%	20%	25%
Scope-adjusted FOCF/debt	12%	-4%	1%	8%

Rating rationale

The issuer rating of JSC Evex Hospitals (Evex) benefits from predictable revenue streams with high EBITDA cash conversion capacity, operational synergies and efficiency. This is reflected in comparatively high profitability and an ability to grow organically while maintaining moderate leverage. Negative rating drivers include limited diversification of revenue streams, reflected in heavy dependence on government-funded programmes, limited scale and a small addressable market. Exclusive exposure to the Georgian market with dependance on universal healthcare (UHC) spending links the issuer rating to the sovereign rating of the Republic of Georgia (rated BB/Stable).

We acknowledge that the credit quality of Georgia Healthcare Group (Evex' parent company) is bolstered by its more diversified operations and stronger financial risk profile. While we do not explicitly adjust for potential parent support in our supplementary rating drivers, we do consider it in our assessment of the financial risk profile.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation of a recovery in revenues from underperforming hospitals while the Scope-adjusted debt/EBITDA ratio consistently remains below 4.0x. The Outlook also takes into account the successful transition to the Diagnosis Related Group (DRG) model without operational difficulties, as well as the company's ability to maintain its margins.

A positive rating action is deemed remote in the foreseeable future given the company's scope and reach in the emerging market of the Republic of Georgia (rated BB/Stable). If there is a positive rating development in the sovereign, a positive rating action on Evex could be considered if the company improved its diversification while keeping its current financial risk profile.

A negative rating action could result from a deterioration in credit metrics, as indicated by free operating cash flow below 5% and a Scope-adjusted debt/EBITDA ratio of above 4x on a sustained basis or a change to a more shareholder-friendly financial policy. Weak financial performance could be triggered by an adverse change in regulations that puts operating profitability under pressure, or it could follow from higher-than-expected dividend payouts.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
8 Jun 2022	Affirmation	BB/Stable
7 Jul 2021	Affirmation	BB/Stable
16 Jul 2020	Affirmation	BB/Stable
11 Jul 2019	New	BB/Stable

[1] Preliminary results

Ratings & Outlook

Issuer	BB/Stable
Senior unsecured debt	BB

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Related Methodology and Related Research

General Corporate Rating Methodology; July 2022

Georgia's sovereign rating

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Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Market-leading position in referral hospitals in Georgian healthcare market, with primary aim of increasing service quality through operating efficiency (credit-positive ESG factor) • Underlying healthcare services market has low cyclicality and is protected • Comparatively high operating margins • Potential to generate free operating cash flow	• Low number of outpatients per capita compared to peer countries • Weak diversification, with all operations in Georgia and only in one industry • Unstable regulatory framework and heavy dependance on government-funded revenue streams (credit-negative ESG factor) • Substantial dividend payments limit room for active deleveraging

Positive rating-change drivers	Negative rating-change drivers
• Improved diversification while maintaining the current financial risk profile. However, a positive rating action is deemed unlikely in the foreseeable future given the company's scope and reach in the emerging market that is the Republic of Georgia (rated BB/Stable by Scope).	• FOCF below 5% on a sustained basis • Scope-adjusted debt/EBITDA ratio above 4x • Shareholder-friendly financial policy

Corporate profile

JSC Evex Hospitals (Evex) is a subsidiary of the Georgia Healthcare Group (GHG). The ultimate parent of GHG and its subsidiaries is investment holding company Georgia Capital PLC (GC). Evex operates 17 hospitals located in major regional cities in Georgia. GHG acquires new healthcare facilities and renovates existing ones to enlarge its network and create a wide range of high-quality medical services across its hospitals.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022P[2]**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA interest cover	2.2x	3.9x	2.1x	2.7x	3.0x	3.5x
Scope-adjusted debt/EBITDA	3.8x	2.5x	3.7x	3.3x	2.7x	2.1x
Scope-adjusted FFO/debt	15%	29%	14%	20%	25%	33%
Scope-adjusted FOCF/debt	24%	12%	-4%	1%	8%	17%
Scope-adjusted EBITDA in GEL m						
EBITDA	57	80	58	70	86	100
Disposal gains fixed assets	1	-4	0	0	0	0
Capitalised software development costs	-6	-4	-6	-6	-6	-6
Scope-adjusted EBITDA	**53**	**73**	**52**	**64**	**80**	**94**
Funds from operations in GEL m						
Scope-adjusted EBITDA	53	73	52	64	80	94
less: (net) cash interest paid	-23	-19	-24	-23	-26	-27
less: cash tax paid per cash flow statement	0	0	0	0	0	0
Funds from operations (FFO)	**29**	**54**	**27**	**41**	**54**	**67**
Free operating cash flow in GEL m						
Funds from operations	29	54	27	41	54	67
Change in working capital	40	-17	-8	-19	-17	-13
Non-operating cash flow	-7	2	-8	0	0	0
less: capital expenditure (net)	-14	-17	-19	-19	-19	-19
less: lease amortisation	0	-1	-1	-1	-1	-1
Free operating cash flow (FOCF)	**48**	**21**	**-9**	**3**	**18**	**35**
Net cash interest paid in GEL m						
Net cash interest per cash flow statement	23	19	24	23	26	27
add: interest component, operating leases	0	0	0	0	0	0
Net cash interest paid	**23**	**19**	**24**	**23**	**26**	**27**
Scope-adjusted debt in GEL m						
Reported gross financial debt	264	217	213	225	245	250
less: cash and cash equivalents	-67	-33	-20	-15	-33	-48
Scope-adjusted debt (SaD)	**198**	**184**	**193**	**210**	**212**	**202**

2 Preliminary results

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Environmental, social and governance (ESG) profile[3]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit-positive)
Red leaf (ESG factor: credit-negative)
Grey leaf (ESG factor: credit-neutral)

Clients and supply chain

Our credit-positive health and safety assessment reflects Evex' characteristics of business model such as increasing service quality through operating efficiencies (i.e. in-house developed apps). These efficiencies provide quick and easy access to the entire healthcare ecosystem, including appointments, online payments and online consultations. This innovative approach taken by Evex' hospitals promotes the well-being of society through reduced waiting times in hospitals. In the short term, product development costs led to higher capex spending, but we anticipate top-line growth to result in efficient daily operations management.

Regulatory and reputational risks

Several safety or regulatory standards have been introduced on the market, giving Evex an additional competitive advantage. However, we believe future efforts to reform healthcare reimbursement, prices, and access will be incremental rather than dramatic. In addition, we see significant risk stemming from the ongoing high dependence on government-funded revenue streams as any turbulence or potential changes to the reimbursement portfolio or prices could have a significant adverse effect on the company's business performance. We see this point as a credit-negative ESG factor for Evex' rating.

[3] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BB

Credit-supportive Industry risk

Evex's business risk profile benefits from the underlying healthcare services industry's low cyclicality, medium barriers to entry and low substitution risk.

Market dominance in Georgian healthcare industry

The business risk profile remains supported by Evex' dominant market position in the fragmented Georgian healthcare services industry, with around 17% of the market by number of clinical beds and around 20% of market shares by revenues as of YE 2022. However, its market position remains constrained by a relatively limited addressable market (less than GEL 2.8bn). The market-leading position in referral hospitals helps Evex to create scale through operating efficiency and synergies, which result in higher-quality healthcare services (credit-positive ESG factor)

Weak top-line performance in FY 2022

Although there was some offset from a rebound in demand for elective care, leading to organic growth in certain hospitals, the company's preliminary figures for 2022 show total revenues have decreased by 9.3% (to GEL 288m) compared to the previous year.

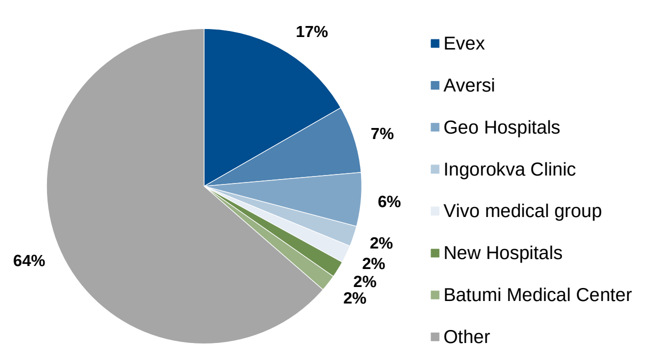
Post-Covid transition effect creates operating challenges

The abrupt shift from Covid operations[4] to regular operations presented challenges. Patients had sought alternative service providers in nearby areas, and they still associated the hospitals with Covid-related operations. Consequently, patients needed some time to re-evaluate the hospitals as providers of elective care services. These factors resulted in a decline in admission and occupancy rates at those hospitals. The post-pandemic transition had a negative impact on EBITDA estimated between GEL 6m-8m.

Closure of the Iashvili hospital further constrains operating performance

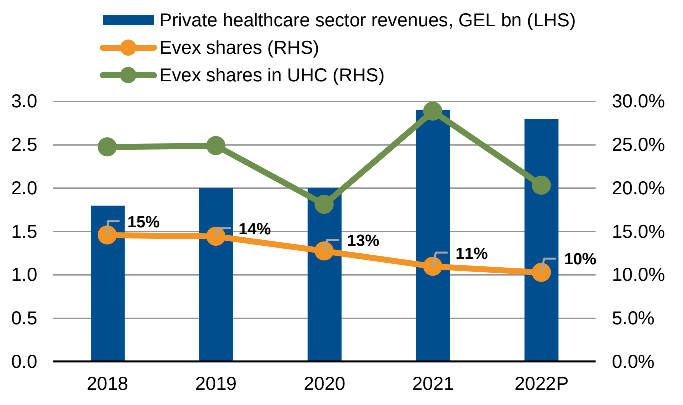
The second contributing factor that negatively affected EBITDA was the temporary closure of the Iashvili Paediatric Tertiary Referral Hospital[5] (Iashvili Hospital). The closure was necessary to carry out mandatory regulatory-related renovations, which began in October 2022 and were completed by the end of March 2023 (as confirmed by management).

Figure 1: Hospital market structure in Georgia at YE 2021



Sources: Evex, Scope (estimates)

Figure 2: Private healthcare market dynamics in Georgia and Evex' market shares by revenues



Sources: Evex, Scope

Revenues expected to rebound in the short term

We consider 2022's weak operating performance to be temporary. This view is partially supported by the anticipated revenue recovery trends that were observed in the fourth quarter of 2022 and the first quarter of 2023.

[4] For 2020-21, Evex' hospital business actively participated in supporting Georgia's Covid-19 pandemic response. It responded to government requests by mobilising seven hospitals to accommodate Covid patients, providing a total of approximately 800 beds across the country. The government fully reimbursed the costs associated with Covid-19 treatments and paid a fixed fee per bed allocated for Covid patients. As of 2022, the number of Covid cases significantly decreased in Georgia, leading the government to suspend the Covid contracts with hospitals in mid-March of that year.

[5] The largest provider of pediatric services in the country

Ability to grow organically

Furthermore, Evex seeks lucrative growth (mid-single-digit revenue growth) in the medium term mainly due to the increased utilisation potential of fully ramped-up hospitals coupled with an expansion of specialist capabilities.

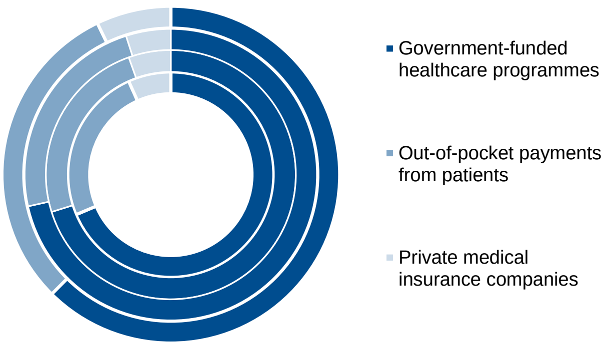
Diversification is weakest component of business risk profile

Geographical diversification remains the main constraint for Evex' business risk profile as the company only operates in one country and one industry. The limited diversification of revenue streams further limits diversification. We see potential to increase the company's share in the outpatient and planned medical services markets (i.e. by leveraging the current influx of Russian migrants by offering premium healthcare services). These are funded either by patients out-of-pocket or by private insurance, thus reducing dependence on the state insurance programme. A more widely diversified range of medical treatment services is seen as a positive driver for Evex. However, we do not expect any significant changes in revenue diversification in the medium term.

Transition to DRG reimbursement model

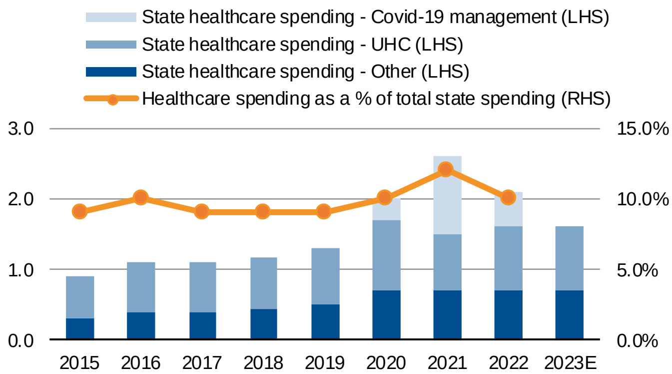
The transition to the Diagnosis Related Group (DRG) model is expected to have a net positive impact on EBITDA estimated between GEL 4m-6m for the operating performance of Evex hospitals. However, our base case does not incorporate this as the company may encounter transitional challenges due to the introduction of new regulations that impose additional operational standards. It may take time for the company to successfully integrate relatively new regulations, so we will wait for a successful transition before considering its impact on the base case.

Figure 3: Evex' revenue diversification (inner circle: Dec 2019; middle inner circle: Dec 2020; middle outer circle: Dec 2021; outer circle: Dec 2022)



Sources: Evex, Scope (estimates)

Figure 4: State healthcare spending dynamics in Georgia (GEL m)



Sources: Ministry of Finance of Georgia

Fundamental changes to the regulatory framework are unlikely to occur

The dynamics of regulatory changes on the market might give Evex an additional competitive advantage in its fragmented market. We believe future efforts to reform prices, access and healthcare reimbursement in Georgia's universal healthcare programme will be incremental rather than dramatic. This has been confirmed by the current Diagnosis Related Group model. However, we emphasise the substantial risk associated with Evex' business model's dependence on government-funded revenue streams, which remains a persistent concern (credit-negative ESG factor).

EBITDA is constrained from post-Covid transition phase

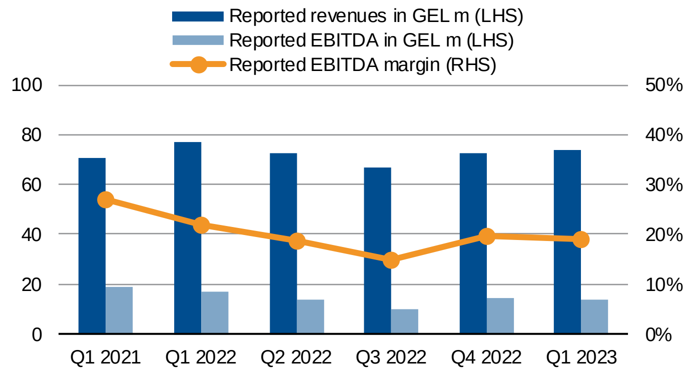
The post-Covid transition phase led to a decline in the number of admissions and occupancy rates at hospitals. As a result, hospital staff salaries, which account for most of the cost base and are fixed, created substantial profitability pressures in FY 2022. In addition, the temporary closure of the Iashvili Hospital constrained EBITDA generation by GEL 4m-6m per quarter.

Negative operating leverage further reflects increases in administrative salaries (up 3.7% YoY in FY 2022) and general and administrative expenses (up 16.6% in FY 2022 YoY), due to the launch of new products and services and higher marketing costs to support the transition to the post-Covid environment.

Scope-adjusted EBITDA margins remain above 20%

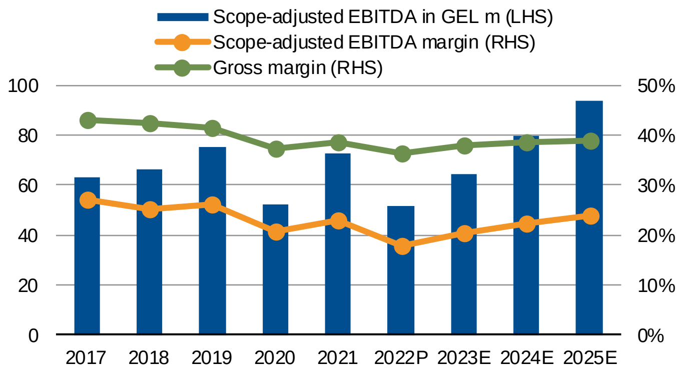
We expect pressure on EBITDA margin to fade as a consequence of restructuring the cost base of Covid hospitals and phasing out government contracts. Improved direct salary rates coupled with operating efficiency (positive social ESG factor) will likely help the company keeping its EBITDA margin above 20% during the next few years.

Figure 5: Evex' quarterly operating trend



Source: Evex, Scope

Figure 6: Evex' operating performance



Source: Evex, Scope (estimates)

Adjustments and assumptions

Financial risk profile: BB

Our financial projections are mainly based on the following assumptions:

- Revenue is anticipated to show moderate growth of around 10%-15% in the medium term. This growth can be attributed to the recovery following the post-Covid transition period. In addition, revenue growth will likely be bolstered by organic growth and an increase in admissions, resulting in higher utilisation levels at hospitals.
- We expect Evex' capital spending to stay at around GEL 20m over the next two years.
- No acquisitions are expected. No material disposals are expected, in line with the portfolio optimisation strategy of divesting assets that generate low returns.
- We anticipate dividend payments ranging from 70% to 90% of net profits. Previously, a significant portion of operating cash flow was reinvested in the business in order to take advantage of the robust demand for healthcare services in Georgia. However, with the business reaching a higher level of maturity and demonstrating relatively strong profitability, Evex might begin to distribute more substantial dividends in the short-to-medium term.
- EBITDA is adjusted by capitalised software development costs (i.e. VABACO application).

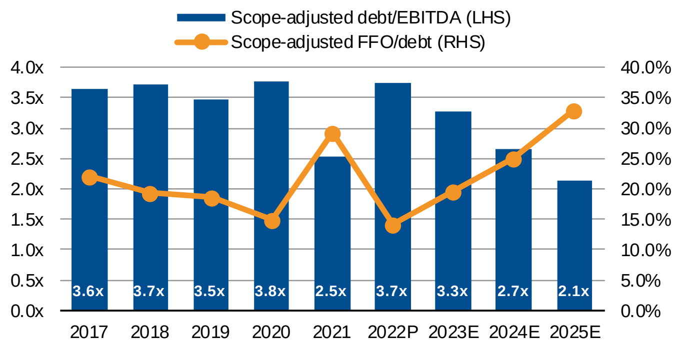
Financial risk profile at BB

Evex' financial risk profile is supported by high and comfortable EBITDA cash conversion, reflected in overall robust and predictable cash flow generation.

2022 preliminary results

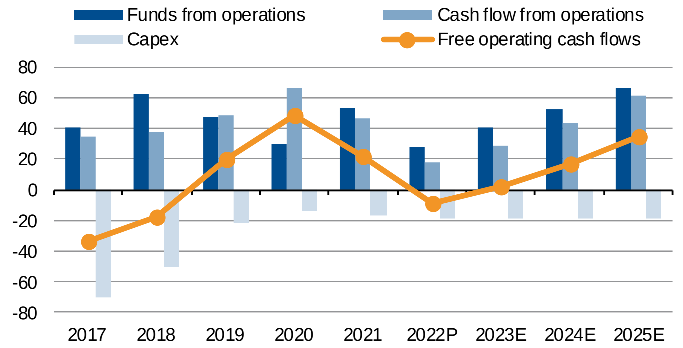
Higher-than-expected leverage in 2022 is the result of constrained EBITDA development due to the temporary closure of the Iashvili Hospital and transition effects from Covid hospitals. Foreign exchange gains on USD-denominated liabilities lowered overall reported debt by GEL 4m while net debt increased to GEL 193m. The Scope-adjusted debt/EBITDA ratio is expected to stand at 3.7x at YE 2022 (up by 1.2x YoY).

Figure 7: Leverage



Source: Evex, Scope (estimates)

Figure 8: Cash flow generation (GEL m)



Source: Evex, Scope (estimates)

Gradual deleveraging expected

Annual expected capex remain in the low double-digit million range (around GEL 20m), which is expected to keep free operating cash flow constrained. While expected capex and dividend payments will limit room to reduce financial debt in the short term, our rating case incorporates leverage returning to below 3.0x in the medium term (2024E: 2.7x; 2025E: 2.1x). Deleveraging is expected to be driven by increasing EBITDA following higher utilisation levels at fully ramped-up Covid-related hospitals (partially confirmed by operating performance in Q4 2022 and Q1 2023), while indebtedness is expected to remain at its current level. For the same reasons, we expect the Scope-adjusted FFO/debt ratio to follow a similar trend, improving to near 30% from 2024.

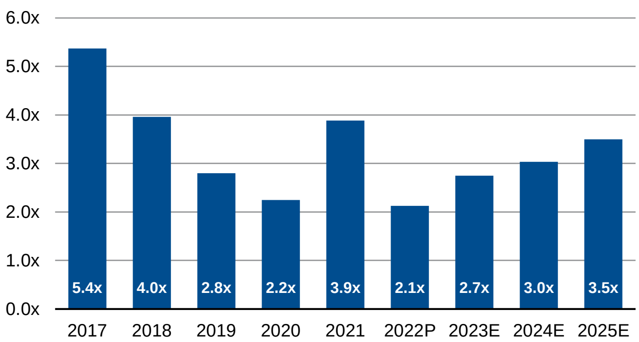
Positive free operating cash flow in medium term

As we anticipated, cash flow from operating activities was down in 2022 as the result of the 'back to normal' average collection period for revenues generated in FY 2022 while Covid-related revenues (which benefited from a relatively short collection period and high margins) faded away. We expect free operating cash flow to turn to positive going forward.

High cost of debt in Georgia

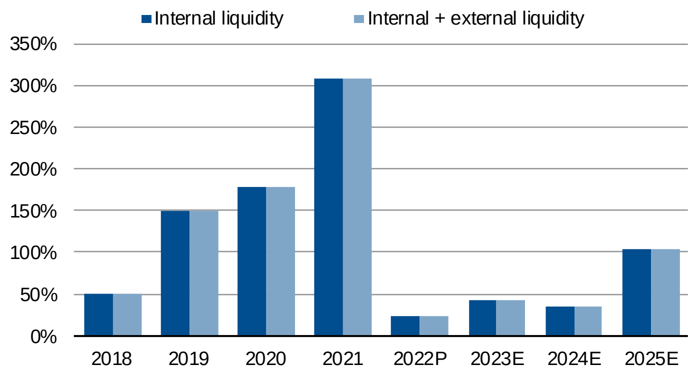
The relatively high cost of debt in Georgia puts pressure on EBITDA interest cover. While the company kept cost of debt at 11% (10.4% in 2021), Scope-adjusted EBITDA interest cover dropped to 2.1x in 2022 as a result of weak operating performance. On 10 May 2023, Georgia's central bank lowered the refinance rate by 0.5pp to 10.5%, which will support Evex' EBITDA interest cover ratio in 2023. We expect the ratio to remain at a modest level of near 3.5x in 2024-25 supported by a proven track record of rising EBITDA.

Figure 9: EBITDA cash coverage



Source: Evex, Scope (estimates)

Figure 10: Liquidity profile



Source: Evex, Scope (estimates)

Adequate liquidity

We view Evex' liquidity as adequate. Committed credit lines are limited. Short-term debt peaked at GEL 110m in FY 2021 (consisting of a GEL 50m senior secured bond and GEL 56m of bank debt) and was successfully refinanced with EBRD loans in FY 2022.

Although liquidity is expected to weaken in 2023 primarily due to relatively weak operating cash flow and in 2024 when senior unsecured debt of GEL 50m matures, we do not foresee any challenges in refinancing. This is due to well-established relationships with local banks and international financial institutions such as the European Bank for Reconstruction and Development. Additionally, it is important to consider the credit quality of the parent company, which would likely provide funding support.

Furthermore, we highlight that part of capex is of a developmental nature and will likely be funded through additional debt. Our liquidity calculation does not include potential cash inflows earmarked for funding development capex.

Balance in GEL m	2023E	2024E
Unrestricted cash (t-1)	20	15
Open committed credit lines (t-1)	0	0
Free operating cash flow (t)	3	18
Short-term debt (t-1)	53	90
Coverage	**42%**	**35%**

The company is currently in the process of deciding on a type of refinancing for a senior unsecured debt obligation maturing in 2024. It is considering issuing a new bond and/or taking out additional bank loans or bridge loans.

Supplementary rating drivers: +/- 0 notches

Credit-neutral financial policy

There are no explicit adjustments for supplementary rating drivers. While it is expected that GHG will continue to be the main source of dividend cash inflows at the level of investment holding company GC, we believe this reflects the high profitability of GHG as a whole and is consistent with a financial policy aimed at maintaining the current rating. This policy is subordinate to the goal of preserving management's leverage targets at the subsidiary level. This in turn is supported by lower-than-expected dividend payments in 2022, which can be attributed to Evex' weak operating performance during that period.

Long-term debt rating

Senior unsecured debt rating: BB

We have affirmed the rating on senior unsecured debt at BB including a GEL 50m bond (ISIN GE2700603881-1-02), reflecting our expectation of an 'average' recovery for senior unsecured debt positions in the hypothetical event of a company default. The recovery analysis is based on a hypothetical default scenario in 2025, which assumes outstanding senior unsecured debt of GEL 50m in addition to GEL 200m in senior secured loans.

Refinancing of existing bond

In our base case scenario, we anticipate a successful refinancing of the maturing senior unsecured debt in 2024 with a new bond that has comparable terms (i.e. size, ranking level).

Positive track record of well-managed operations adds value to the company

We see an improved value of claims at default for creditors after the successful completion of a heavy capital expenditure phase, the modernisation of infrastructure coupled with well-managed operational challenges during the Covid-19 pandemic and the portfolio streamlining strategy (divestiture of non-performing assets).

Emerging market risk and access to higher-ranking debt

While the recovery analysis points to an above-average recovery expectation, we constrain the debt category rating to the same level as the issuer rating given the emerging market risks and the risk that Evex could raise higher-ranking debt that would dilute the recovery for senior unsecured debtholders.

Appendix: Peer comparison

	Evex Hospitals JSC	Tegeta Motors LLC	Nikora JSC	Georgian Beer Company JSC	Nikora Trade JSC
	BB/Stable	**BB-/Negative**	**BB-/Stable**	**BB-/Stable**	**B+/Stable**
Last rating action date	5 Jun 2023	5 Oct 2022	1 Sep 2022	6 Oct 2022	1 Sep 2022
Business risk profile	**BB**	**BB-**	**BB-**	**BB-**	**BB-**
Market share	18%	18%	19%	23%	18%
Scope-adjusted EBITDA	GEL 80.m	GEL 75.0m	GEL 80.5m	GEL 18.6m	GEL 60.2m
Operating profitability	20%	12%	11%	26%	9%
Geographical diversification	Georgia	Georgia	Georgia	Georgia	Georgia
Financial risk profile*	**BB**	**B+**	**BB-**	**BB-**	**B+**
Scope-adjusted EBITDA interest cover	2.6x	2.9x	3.4x	3.0x	3.6x
Scope-adjusted debt/EBITDA	3.2x	3.9x	2.9x	2.5x	2.8x
Scope-adjusted FFO/debt	19%	16%	24%	27%	25%
Scope-adjusted FOCF/debt	1%	-10%	-3%	7%	0%
Liquidity	Adequate	Adequate	Inadequate	Inadequate	Inadequate

* Financial risk profile metrics are presented as average of current year and next two projection years.

Sources: Public information, Scope

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