# JSC Evex Hospitals
# Georgia, Healthcare Services

BB STABLE

JSC Evex Hospitals (Evex) is a subsidiary of the privately owned Georgian Healthcare Group (GHG), listed on the premium segment of the London Stock Exchange. Evex operates 18 hospitals located in major regional cities in Georgia. After its successful IPO in November 2015, GHG acquired and renovated new healthcare facilities to enlarge its network and create high-quality and wide-ranging medical services across the hospitals. In 2018, GHG decided to separate its individual businesses going forward.

## Key metrics

| | | | Scope estimates | | |
|---|---|---|---|---|---|
| **Scope credit ratios** | **2018** | **2019** | **2020F** | **2021F** | **2022F** |
| EBITDA/interest cover (x) | 3.8x | 3.2x | 3.1x | 3.6x | 4.2x |
| Scope-adjusted debt (SaD)/EBITDA | 3.3x | 3.2x | 4.0x | 3.1x | 2.6x |
| Scope-adjusted funds from operations/SaD | 25% | 23% | 19% | 26% | 33% |
| Free operating cash flow/SaD | -8% | 8% | 21% | 15% | 21% |

## Rating rationale

**Scope Ratings has today affirmed its issuer rating of BB/Stable of Georgia-based JSC Evex Hospitals. The agency has also affirmed its rating of BB for senior unsecured debt.**

The affirmation reflects our view of the company's unchanged business and financial risk profiles, despite weaker expected financial metrics in 2020 caused by the Covid-19 pandemic.

**Evex's business risk profile** (rated BB) benefits from the healthcare service industry's low cyclicality, medium entry barriers and low substitution risk. Evex remains dominant in the fragmented Georgian healthcare service industry. Around 10% revenue growth in 2019 was achieved through increased inpatient admissions, additional services in selective care and the successful ramp-up of the Tbilisi Referral Hospital and Caucasus Medical Centre.

In 2020, the company's top line will take a double hit from: i) the Covid-19 pandemic leading to the suspension of elective procedures; and ii) regulatory changes in government reimbursement rates for intensive care and cardiac services.

Diversification remains the main constraint for Evex's business risk profile as the company operates in one country and one industry. A heavy dependence on government-funded healthcare programmes further limits diversification.

We believe that Evex will be able to keep profitability margins at close to 20% in 2020. This is despite the adverse effect of diminishing marginal returns as direct personnel costs are fixed in some hospitals, partially offset by a temporary income tax break incentive from the government.

**Evex's financial risk profile** (rated BB) is supported by its healthy operating profitability, which translates into a good underlying cash generation capability.

2019 financial results remained in comfortable territory despite a slight deterioration in expected leverage. The deterioration was mainly driven by higher-than-expected capex investments, primarily to enhance digitalisation by providing an in-house software platform.

### Ratings & Outlook

| | |
|---|---|
| Corporate rating | BB/Stable |
| Senior unsecured rating | BB |


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### Related methodology

Corporate Rating Methodology


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Evex's net debt and leverage have grown due to the provision of intercompany loans to Evex clinics and its parent in the past few years. We expect this practice to increase in the short-to-medium term.

We view liquidity as adequate. Despite a lack of committed credit lines, expected positive free operating cash flow in 2020-2022 should be sufficient to fully cover (re)-financing needs.

We have affirmed rating of senior unsecured debt at BB, including the GEL 50m bond.

## Rating drivers

| Positive rating drivers | Negative rating drivers |
|---|---|
| • Market leading position in referral hospitals in Georgian healthcare market<br>• Underlying healthcare services market has low cyclicality and is protected<br>• Comparatively high operating margins<br>• Potential to generate free operating cash flow | • Low number of outpatients per capita compared to peer countries<br>• Weak diversification with operations only in Georgia, and only in one industry<br>• Unstable regulatory framework (Credit-negative ESG factor)<br>• Substantial intercompany loans |

## Rating-change drivers

| Positive rating drivers | Negative rating drivers |
|---|---|
| • SaD/EBITDA (Scope-adjusted figures) consistently trends below 3x. However, a positive rating action is deemed to be remote in the foreseeable future given the company's scope and outreach in the emerging market of the Republic of Georgia (rated BB/Negative at Scope) | • FOCF below 5% on sustained basis<br>• SaD/EBITDA above 4x |

## Financial overview

| | | | Scope estimates | | |
|---|---|---|---|---|---|
| **Scope credit ratios** | **2018** | **2019** | **2020F** | **2021F** | **2022F** |
| EBITDA/interest cover (x) | 3.8x | 3.2x | 3.1x | 3.6x | 4.2x |
| SaD/EBITDA | 3.3x | 3.2x | 4.0x | 3.1x | 2.6x |
| Scope-adjusted FFO/SaD | 25% | 23% | 19% | 26% | 33% |
| FOCF/SaD | -16% | 8% | 21% | 15% | 21% |
| **Scope-adjusted EBITDA in GEL m** | **2018** | **2019** | **2020F** | **2021F** | **2022F** |
| EBITDA | 74 | 82 | 62 | 76 | 81 |
| Operating lease payments in respective year | 1 | 0 | 0 | 0 | 0 |
| Other | 0 | 0 | 0 | 0 | 0 |
| Scope-adjusted EBITDA | 75 | 82 | 62 | 76 | 81 |
| **Scope-adjusted funds from operations in GEL m** | **2018** | **2019** | **2020F** | **2021F** | **2022F** |
| EBITDA | 74 | 82 | 62 | 76 | 81 |
| less: (net) cash interest as per cash flow statement | -19 | -27 | -20 | -21 | -19 |
| less: cash tax paid as per cash flow statement | 0 | 0 | 0 | 0 | 0 |
| Other | 9 | 6 | 6 | 6 | 6 |
| Scope FFO | 64 | 62 | 48 | 61 | 68 |
| **Scope-adjusted debt in GEL m** | **2018** | **2019** | **2020F** | **2021F** | **2022F** |
| Reported gross financial debt | 255 | 265 | 264 | 240 | 210 |
| Cash, cash equivalents | -14 | -5 | -21 | -10 | -8 |
| Pension adjustments | 0 | 5 | 5 | 5 | 5 |
| Operating lease obligations | 7 | 0 | 0 | 0 | 0 |
| SaD | 247 | 265 | 248 | 235 | 206 |

## Business risk profile

**Credit-supportive industry risk**

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

**Market dominance of Georgian healthcare industry**

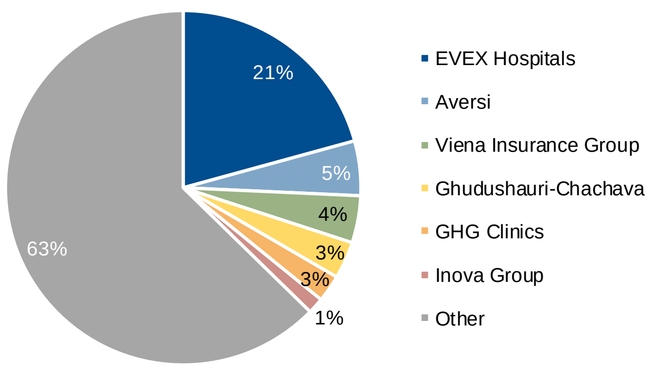
Evex remains dominant in the fragmented Georgian healthcare service industry, with more than 20% of the market by number of clinical beds and around 20% of market shares by sales. Around 10% of organic growth in 2019 was achieved through increased inpatient admissions, additional services in selective care and the successful ramp-up of the Tbilisi Referral Hospital and Caucasus Medical Centre. On the other hand, top-line growth was slightly lower than expected, mainly due to increased competition in Georgia's main cities.

**Top-line growth constrained by Covid-19 pandemic and regulatory changes**

In 2020, the company's top line will take a double hit from: i) the Covid-19 pandemic leading to the suspension of elective procedures; and ii) regulatory changes in government reimbursement rates for intensive care and cardiac services. The economic downturn may intensify and recovery may be subdued next year, while current assumptions incorporate a rebound in sales in the short term.

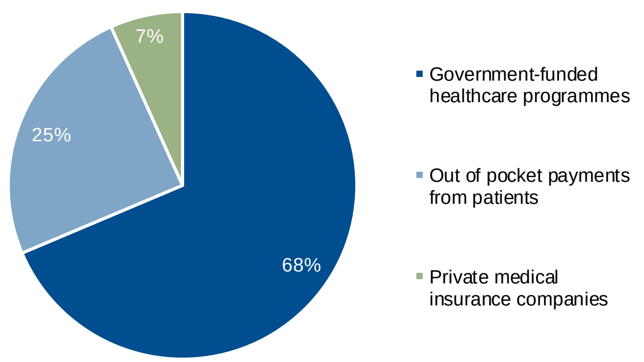
While several safety risks have increased following the pandemic, we believe that efforts to reform healthcare reimbursement, prices, and access in the coming years will be incremental rather than dramatic. In addition, inorganic growth opportunities will arise in the medium-to-long term from intermittent, selective consolidation potential in a highly fragmented market.

**Figure 1: Shares of Georgian healthcare service market in 2019**




Source: Evex, Scope

**Figure 2: Evex's revenue stream diversification in 2019**

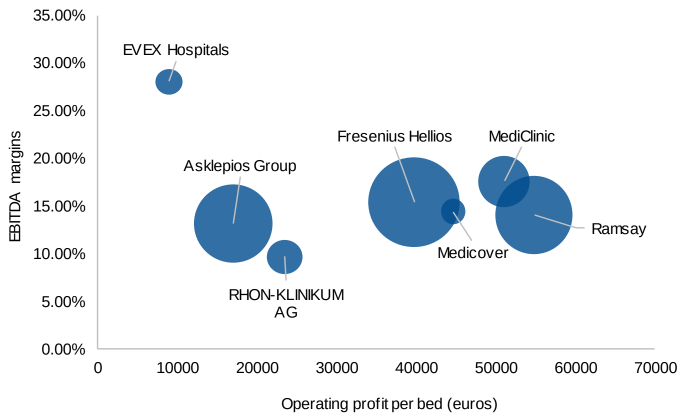



Source: Evex, Scope

**Diversification is weakest component of business risk profile**

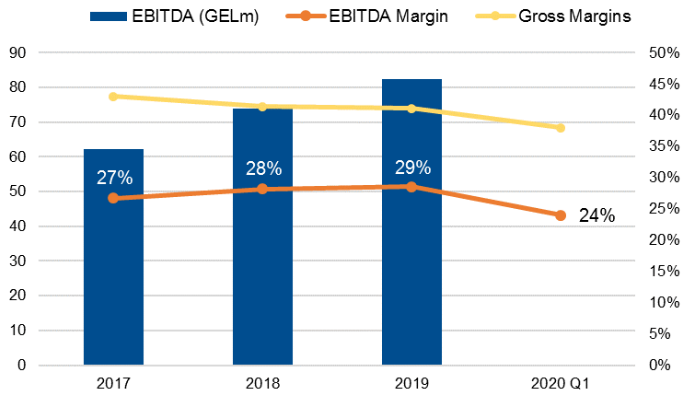
Diversification remains the main constraint for Evex's business risk profile as the company operates in one country and one industry. In addition, heavy dependence on government-funded healthcare programmes limits diversification. Management has made a commitment to reduce Universal HC dependence and boost medical tourism sales. However, we do not expect any significant changes in revenue stream diversification in the medium term.

**Figure 3: Healthcare service providers**




Source: Evex, Scope

**Figure 4: Evex's operating performance**




Source: Evex, Scope

**Solid profitability footprint impacted by Covid-19 pandemic in short term**

Despite the new pension reform (which raised the cost of salaries and other employee benefits by around 2%) and an increase in materials costs, the company managed to maintain gross margins at 41% and an EBITDA margin of around 29% in 2019, as expected. Despite relatively high operating profitability compared to international peers, Evex's profit per bed significantly lags the profit made by private hospitals operating in mature markets. This is due to lower reimbursement rates and shorter lengths of stay (days) for inpatient care, reflected in lower utilisation. We believe that Evex will be able to keep profitability margins at close to 20% in 2020. This is despite the adverse effect of diminishing marginal returns as direct personnel costs are fixed in some hospitals, partially offset by a temporary income tax break incentive from the government.

## Financial risk profile

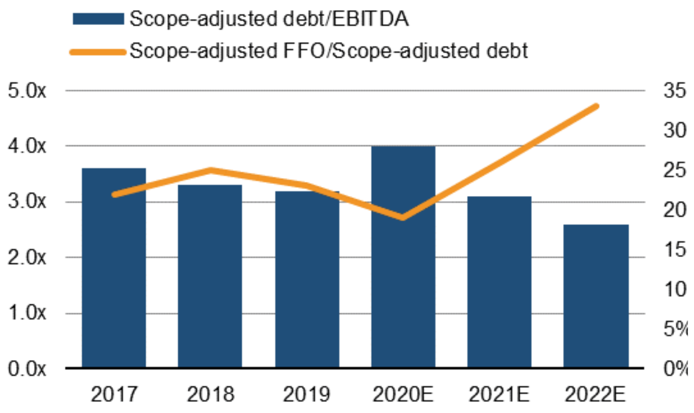
**Comfortable credit metrics despite weaker performance in 2019**

Evex's financial risk profile is supported by its healthy operating profitability, which translates into a good underlying cash generation capability.

2019 financial results remained in comfortable territory despite a slight deterioration in expected leverage. The deterioration was mainly driven by higher-than-expected capex investments, primarily made to enhance digitalisation by providing an in-house software platform. We expect a decline in Evex's credit metrics in 2020, caused by the double impact of regulatory changes and the Covid-19 pandemic, which is likely to drive leverage up. We believe that Evex will only pursue inorganic growth opportunities to a limited extent over the next few years, focusing on organic growth.

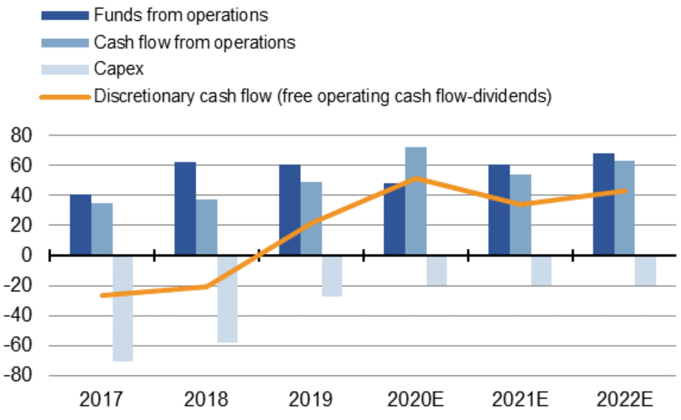
Annual expected capex in the low double-digit million range (GEL 15-20m) in 2020-2022, as confirmed by management, will leave room for deleveraging with free operating cash flows. Evex's net debt and leverage have grown due to the provision of intercompany loans to Evex clinics and its parent in the past few years. We expect this practice to increase in the short-to-medium term. Our rating case incorporates leverage gradually returning to around 3.0x (2021E: 3.1x 2022E: 2.6x).

**Figure 5: Leverage**




Source: Evex, Scope estimates

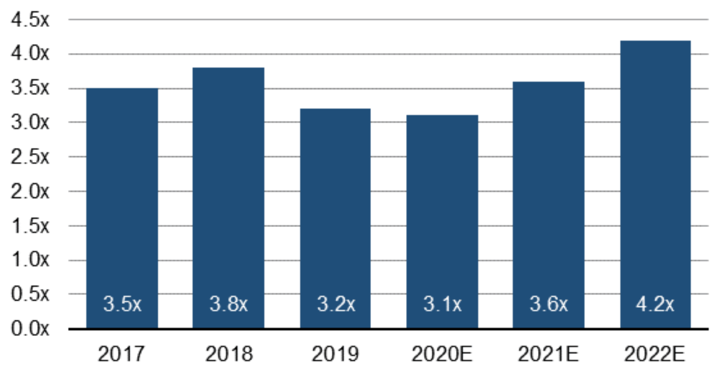
**Figure 6: Cash flow generation**




Source: Evex, Scope estimates

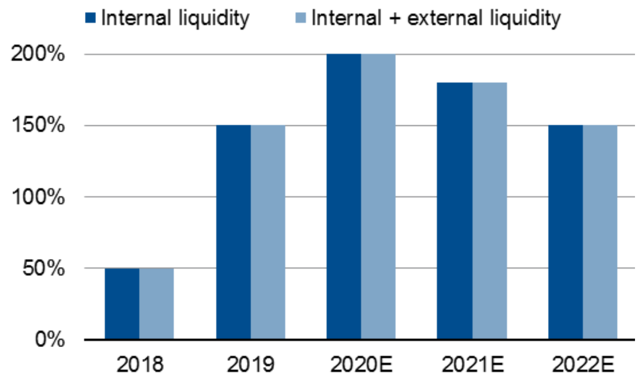
Despite relatively high interest rates in Georgia and the increased National Bank of Georgia's refinance rate in 2019, which will put pressure on Evex's EBITDA interest coverage in the short-to-medium term, we expect the ratio to remain at a modest level, towards 4.0x in 2020-2022, supported by interest proceeds on intercompany loans.

**Figure 7: EBITDA interest coverage**




Source: Evex, Scope estimates

**Figure 8: Liquidity profile**




Source: Evex, Scope estimates

**Liquidity remains adequate**

We view Evex's liquidity as adequate. Committed credit lines are limited. Nevertheless, high EBITDA cash conversion, reflected in positive free operating cash flow in 2020-2022 of above GEL 30m, should be sufficient to fully cover (re)-financing needs. In addition, the company's liquidity profile benefits from the bullet repayment structure of its bonds.

Evex has a good relationship with local banks as well as international financial institutions like the European Bank for Reconstruction and Development.

We do not expect significant changes in the company's future capital investment programme and/or debt-financed acquisitions. The latter is protected by the wide range of existing financial covenants from Proparco, EBRD and IFC.

## Outlook and rating-change drivers

**Stable Outlook**

The Stable Outlook reflects Scope's expectations that the Covid-19 pandemic will not have a negative long-term effect on the company's operations and that Scope-adjusted debt/EBITDA will remain below 4.0x on a sustained basis.

**Rating upside**

A positive rating action could be indicated by a Scope-adjusted debt/EBITDA of consistently below 3x. The decrease in leverage could be achieved by increasing profitability via organic growth, limited capex and lower intercompany loan levels, which are also explicit financial targets of the company. However, a positive rating action is deemed to be remote in the foreseeable future given the company's scope and outreach in the emerging market of the Republic of Georgia (rated BB/Negative at Scope).

**Rating downside**

A negative rating action could result from a deterioration in credit metrics, as indicated by free operating cash flow of below 5% and Scope-adjusted debt/EBITDA of above 4x on a sustained basis. The weak financial performance could be triggered by an adverse change in regulations, putting operating profitability under pressure.

## Long-term debt rating

**BB rating on Evex's GEL 50m senior unsecured bond**

We have affirmed senior unsecured debt at BB, including the GEL 50m bond (ISIN GE2700603881-1-02). Our recovery analysis indicates a relatively high recovery rate for senior unsecured debt. However, we have limited the uplift for the instrument to zero notches (average recovery) due to the risk of an appreciation in foreign-currency-denominated debt, and the risks surrounding bankruptcy resolution in Georgia, an emerging market.

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