Normalization in Healthcare Industry Post Covid-19 Pandemic

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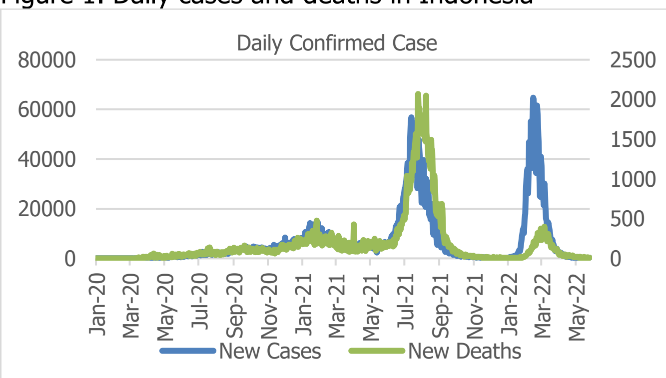
We are of the view that the outlook for healthcare industry will remain stable in the near to medium term, though we believe revenue growth to be slower as we expect operating activities to normalize following the transition from the pandemic to endemic. We expect that medical care, which was delayed because of Covid-19, to resume. Some of the hospital operators have reported an increase in number of patients since the fourth quarter of 2021 (4Q2021). PT Mitra Keluarga Karyasehat Tbk (MIKA), reported a 20% increase of inpatient admissions in the first quarter of 2022 (1Q2022) compared to third quarter of 2021 (3Q2021) when Delta variant transmission was high. MIKA also record the highest number of non-Covid patient since the second quarter of 2020 (2Q2020). PT Siloam International Hospitals Tbk (SILO), also reported a 30% increase of inpatient admission in 1Q2022 compared to 3Q2021. Research has shown that post-Covid conditions can include a wide range of ongoing health problems which further raises the importance of healthcare. Combined with rising number of educated people and the middle-income group, we expect the recovery in number of patients to continue in the near to medium term.

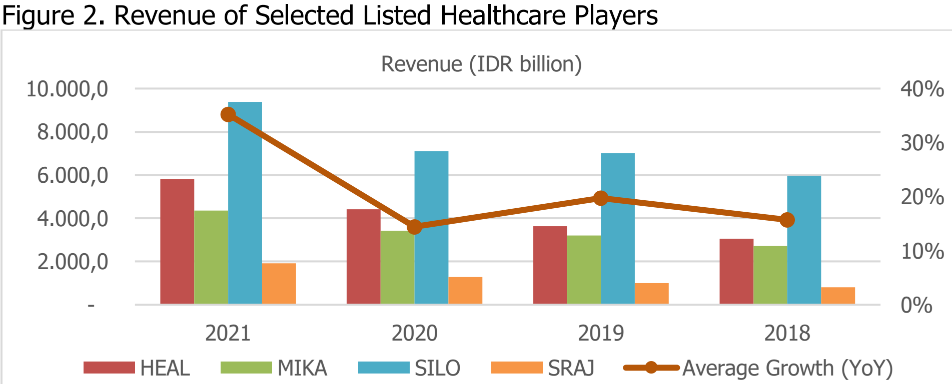
Figure 1. Daily cases and deaths in Indonesia



Source: WHO, processed by PEFINDO

However, the recovery in inpatient admission will not be followed by high revenue growth as the average ticket size is expected to decline. Hospital operators enjoy high revenue growth in 2021 because of the significantly higher revenue per patient during the pandemic. The average revenue growth in 2021 of four listed hospitals were 35%, compared to the revenue growth in 2018-2020 at less than 20%. Covid patient is also believed to be more profitable than non-Covid patient due to the more intensive treatment required and longer length of stay. Both MIKA and SILO reported a lower revenue per inpatient days and revenue per outpatient visits by 7-8% and 14-15%, respectively, in 1Q2022 compared to the same period in 2021. As a result, we view the normalization will translate into lower revenue growth and margin in the near to medium term.

Figure 2. Revenue of Selected Listed Healthcare Players



Source: Company's Financial Statement, processed by PEFINDO
Note: HEAL = PT Medikaloka Hermina Tbk, SRAJ = PT Sejahteraraya Anugrahjaya Tbk

Continue the investment program to increase capacity

Despite the expectation of slower growth, we view the hospital operators will still commit on continuing its investment program. In the last five years (2021-2017) there were more than 50 additional hospitals in Indonesia every year. The total general hospital in 2021 was 2,500 compared to 2,000 in 2016. Some of the listed healthcare companies such as PT Medikaloka Hermina Tbk (HEAL; $_{id}$AA/stable) MIKA, SILO, and PT Sejahtera Anugrahjaya Tbk (SRAJ; $_{id}$A/stable) have targeted at least one new hospital in 2022. This expansion plan was backed by the lack of capacity in Indonesia. The current hospital bed to population ratio of 1.3 bed per 1,000 people in Indonesia is still way below the global average at 2 bed per 1,000 people and 5 bed per 1,000 people in OECD countries. The low ratio makes potential demand and market for each healthcare companies to grow in Indonesia. However, we note that the expansion program entails execution risks, such as construction delays, cost overruns, as well as lower than expected ramp-up in demand, which may hamper the achievement of its profitability target; thereby, weakening its credit metrics especially for players that capital expenditure was partly funded by debt like HEAL and SRAJ. Another concern come from the tight competition in the industry. Operators face competition from government and private hospitals, as well as local health clinics as competitors. Attracting top doctors and experienced nurses will also be the main issue as the supply are quite limited. We view that failure in managing key factors can adversely affect its operating indicators in which may disrupt its business going forward.

Table 1. Financial profile of healthcare companies

Description	**HEAL Dec-2021**	**SILO Dec-2021**	**MIKA Dec-2021**	**SRAJ Dec-2021**
Total Adjusted Assets [IDR Bn]	7,586.2	8,784.8	6,425.1	4,616.0
Total Adjusted Debt [IDR Bn]	1,662.8	564.6	0.0	846.2
Total Adjusted Equity [IDR Bn]	4,386.3	6,004.4	5,489.2	1,671.6
Total Sales [IDR Bn]	5,820.1	9,381.9	4,352.9	1,924.5
EBITDA [IDR Bn]	2,072.8	2,149.0	1,789.4	407.7
Net Income after MI [IDR Bn]	1,003.1	674.1	1,228.8	165.3
EBITDA Margin [%]	35.6	22.9	41.1	21.2
Adjusted Debt/EBITDA [X]	0.8	0.3	0.0	2.1
Adjusted Debt/Adjusted Equity [X]	0.4	0.1	0.0	0.5
FFO/Adjusted Debt [%]	96.3	324.2	NR	33.8
EBITDA/IFCCI [X]	14.0	33.1	146.5	3.1

Source: PEFINDO database
FFO = EBITDA – IFCCI + Interest Income – Current Tax Expense
EBITDA = Operating Profit + Depreciation Expense + Amortization Expense
IFCCI = Gross Interest Expense + Other Financial Charges + Capitalized Interest; (FX Loss not included)
MI= Minority Interest
NR= Not Relevant

Key Success Factors for Healthcare Industry

In PEFINDO's rating methodology, we assess the business risk profile of healthcare industry by focusing on several key success factors. In analyzing its market position, we will examine the company's size and market share. Number of beds is one of the measurements to describe capacity and size of the company compared to its competitors. The company with a strong market position is expected to have better competitive advantage to deal with tightening competition and more favorable bargaining power in negotiation process with the doctors and its suppliers, resulting in better pricing flexibility. We will also assess the company's location/demographic profile through the location of its hospitals. Demographic of the population in the surrounding area may describe the potential growth of number of patients and the company's potential revenue growth in the future. The company's target segment should be in line with the demographic profile on the location, such as middle low or premium residential area, business commercial district or others.

Analysis on the service quality covers type of services and facilities provided by the hospitals. On top of the existence of qualified doctors, the array of services and hospital facilities being delivered may attract the patients to come, that will in turn raise the hospital revenue. The company's investment on advance technology medical equipment and its modernization policy could increase its service quality. Management expertise and its relationship with doctors and medical staffs are also crucial to maintain qualified human resources to service in the hospital. We also thoroughly assess the company's operating management, including risk assessments on the company's efficiency and its ability to control costs by several indicators such as occupancy rate, average length of stay, and turnover beds. The company's compliance to related regulations and having the necessary certifications are also considered as it may affect the company's business. Pricing strategy and cost management are important factors to be included in our consideration, particularly when the company faces tight competition, which should be reflected in its profitability indicators compared to other players in the same industry or other industry with similar characteristic. Receivable collection especially from health insurance and corporate clients is also considered in rating determination.

PEFINDO's financial risk assessment for healthcare industry is similar to most other corporates, in which we will assess the company's financial policy in terms of management's philosophy, strategy and policies toward financial risk, as well as examination of management's financial targets (growth, leverage, debt structure and dividend policy), hedging and other policies in an effort to reduce the company's overall financial risk. The company's track record on fulfilling its previous financial obligations is also examined to determine the degree of its commitments and willingness and consistency to pay obligations on a timely basis. For its capital structure, analysis covers examination of the company's historical, current and projected leverage (total and net debt in relation to equity and EBITDA), debt structures and composition.

We also assess the company's cash flow protection and liquidity measures by reviewing its cash flow generation and capability to meet its short-term and long-term financial obligations. The degree of its debt-servicing capability level is measured by the company's interest and debt coverage ratio. The degree of its liquidity in fulfilling its short-term liabilities relative to its sources of cash is also thoroughly assessed. While in assessing its financial flexibility, we will evaluate the company's ability in generating funding from external parties, by incorporating its access to capital and debt market and its repayment track record, the availability of its unused credit facilities or its unencumbered assets which can be collateralized for obtaining new funding facilities.