

Hospitals: nil per mouth

Marc Hasenfuss: Financial Mail, 23 April 2020

There are few, if any, places to seek shelter on the JSE while the Covid-19 pandemic rages. One JSE subsector that has, unfortunately, been busy during the pandemic is the private hospital cluster dominated by Mediclinic International, Netcare and Life Healthcare. Over the past 90 days the share prices of these counters have dropped 23 percent, 24 percent and 26 percent respectively. It is tempting to see these shares as recovery plays for an eventual business-as-usual scenario. But recent trading statements from Mediclinic and Netcare might be prescriptions for caution. It wasn't so much the actual trading statements, which largely reflect life before Covid-19 really took hold, but rather the commentary around working in this brave new world. Of note is that as of Tuesday some private hospitals had been temporarily closed after staff tested positive for Covid-19. This is likely to happen at more facilities, further disrupting business.

Short-term earnings impacted

The underlying gist of the trading statements is that, put simply, care provided for Covid-19 patients will not make up for delays and postponements in elective surgeries at private hospitals. Short-term earnings will be impacted, though private hospitals groups - which are all geared - probably won't, for now, face balance sheet distress.

Asief Mohamed, chief investment officer at Aeon Investment Management, said the reduced number of cars on the roads and the ban on alcohol sales have led to fewer trauma admissions for all hospitals. He said the number of Covid-19 cases needing intensive care unit beds in SA is well below international norms and has not offset the significant drop in revenue from elective procedures and trauma treatment. Even before Covid-19, "the return on invested capital for hospitals has been poor", he said, adding that is unlikely that prospects will improve unless economic growth picks up on a sustainable basis.

Offset

Mediclinic CEO Ronnie van der Merwe concedes the pandemic and lockdown will have a significant impact on results for financial 2021. But, he said, "this will be offset by Mediclinic's response to the crisis in addition to the ongoing range of primary and acute care services offered across the group". At this point Mediclinic has no material nearterm debt maturities, the next being a \$145-million (R2.83-billion) bond due in February 2021 at Hirslanden hospital group in Switzerland. But as a precautionary measure, the dividend has been iced. Life Healthcare's interim trading statement to end-march said conducting emergency-only surgeries has resulted in a "significant decline" in surgical volumes throughout its facilities. Medical volumes and emergency cases have also been affected by the lockdown. Life says average occupancies are about 40 percent. Life noted that although it is difficult to adapt to volume reductions of such magnitude, the hospital business has reduced the utilisation of agency staff, redeployed theatre staff and has also requested staff to utilise leave. The group has temporarily closed seven surgical facilities and has redeployed permanent staff. Victor Mupunga, research analyst at Old Mutual Wealth private client securities, said patient volumes at private hospitals were already softening before the lockdown, indicating that people have been trying to stay away from hospitals because of fear of contagion. Mupunga warned that given the fixed costs of hospitals, they will take a material hit on near-term earnings. And with management's attention focused on navigating the crisis, strategic projects and related capital expenditure will be pushed out further. He said this will start to negatively affect medium- and long-term profitability. While Netcare has spent R150-million to enhance its hospital network's Covid-19 preparedness, it has suspended its R800-million strategic projects plans. Other groups have taken similar steps.

Treatment at cost for state patients

Mupunga said there was a view that higher numbers of Covid-19 patients would result in more hospital admissions and improved profits, but that has not happened. What is more, in the event of state hospitals being overwhelmed by the number of infected patients, some private hospital groups have offered to take in patients on a no-profit basis. Mediclinic and Life say tariff negotiations for state hospital patients admitted to private facilities is still under negotiation. For investors in Mediclinic and Life particularly, there are Covid-19 developments in other regions of the world to

contemplate. Mediclinic had some good news in that elective surgeries at some of its hospitals in Switzerland can begin next week. But Life's recently acquired diagnostic imaging subsidiary Alliance Medical Group, which is active in the UK, Italy and Ireland, has seen an average 65 percent fall in volumes as national healthcare systems prioritise urgent and emergency cases.

Uncertainty

Terence Craig, portfolio manager at Element Investment Managers, argues that even if Covid-19 admissions prove net-positive for private hospital groups over the short-term there is the worry over cost inflation and additional staffing costs. The overriding issue remains the uncertainty over when the pandemic will wind down and private hospitals can return to normal operations. Van der Merwe, for one hasn't offered much comfort.

He said it's a very fluid situation and vastly different scenarios could play out. Mupunga believes any recovery in the sector "will be a slow one, at best". He said hospital groups, once considered one of the surest blue-chip bets, have not shown any consistent and meaningful growth in the past few years. He does see a silver lining, though. He said the ongoing collaboration between the government and the hospital groups will result in a reduction in the trust deficit that was evident prior to the crisis. This could potentially ease the regulatory burden on the sector and foster the type of co-operation we have seen over the last few weeks.

• There have been seven more Covid-19 related deaths, raising the total death toll in SA to 65. The Health Ministry said on Wednesday evening that five fatalities were recorded in the Western Cape, while the other two were in KwaZulu-Natal. Meanwhile, the total number of Covid-19 cases in the country was 3 635. This was an increase of 170 cases from the 3 465 reported on Tuesday.