OPINION: Prognosis for private hospitals still uncertain

Patsy David: Business Day, 12 June 2020

• David is head of research at All Weather Capital

COVID-19 has far-reaching implications but is first and foremost a global health pandemic. As news of the pandemic evolved, investors tried to assess the impact, looking for defensive stocks to mitigate investment portfolio risks, but also looking for investment opportunities in this catastrophe. Considering the potential demand for hospitalisation, it was reasonable to assume that private hospitals could fare well.

This has not been the case. Recent results from hospital groups show pressure on occupancies and profitability since mid-March, when groups had to initially prepare for Covid-19 and then saw a decline in elective surgeries, and in medical and trauma cases since April. Acute hospital occupancies fell below 40 percent (from about 65 percent before coronavirus), general practitioner visits fell 50 percent and dental visits declined by 67 percent.

Decline in revenue

Revenues declined about 40 percent-50 percent and, with the negative effect on margins from lower case mix, limited ability to adjust the cost base and the additional costs for Covid-19 preparations, earnings before interest, tax, depreciation and amortisation turned negative in April. There are early signs of improving operational trends. With resumption of necessary medical procedures and more trauma/emergency cases as lockdown eased, patient admissions are increasing, and occupancy rates are moving higher. This has stemmed the decline in revenues, but results are still well below those achieved earlier in the year. The private hospitals have undertaken several interventions to mitigate operational and liquidity risks. Cash conservation activities include lower utilisation of agency staff, extended payment terms with suppliers and landlords, and the deferral of non-critical capital expenditure. Idle capacity with still low insured patient admissions and virtually no uninsured admissions is problematic.

Different scenarios

Companies are planning for different scenarios, with critical assumptions being timing the peak of the pandemic and the number of infected insured and uninsured patients who will need hospitalisation while retaining capacity to manage non-Covid-19 patients.

The latter issue is fluid in terms of determining when and what percentage of deferred electives will return. Insured patients are fully funded by their medical schemes, while uninsured patients will be paid for by provinces using the global fee per day (R20 118 for critical, acute and palliative care) agreed between the government and the private sector. This fee is on a cost-recovery basis, and hospitals will have to negotiate referral and admission protocols with each province. Covid-19 will probably drive operational and share price performance over the short-term. Longer-term, valuations should consider SA's muted economic outlook, the effect of increasing unemployment and affordability on medical scheme membership, and funder moves to mitigate their cost pressures by managing utilisation and moving to restricted schemes to manage premium increases. Healthcare regulations remain an overhang and now there is an additional concern

that the Covid-19 agreement on treating state patients becomes a blueprint for National Health Insurance pricing.

All three listed groups have pulled their guidance, which speaks to the high level of uncertainty. Forecast risk will remain high.

With low earnings visibility, our bias is to invest in Netcare because of its low debt and attractive valuation.