kotak Institutional Equities

UPDATE

Health Care Services

India

Sector View: **Cautious** NIFTY-50: **21,983** **February 29, 2024**

SC diktat serves as a reminder on regulatory risks

In an ongoing PIL, the Supreme Court (SC) has told the central government that if it, along with the states, does not come out with a proposal for hospital rates in line with the Clinical Establishment Act (CEA), it will implement CGHS rates across hospitals as an interim measure. While this issue cannot be taken lightly given the SC's strong diktat, we believe it is very difficult to implement uniform pricing across hospitals (public and private). Apart from practical challenges and the unviability of uniform rates for prominent hospitals, implementation of this pan-India might also likely warrant a change in legislation, as only 12 states and 7 union territories (UTs) have adopted the Act. Hence, we expect a very low probability of implementation. Nevertheless, amid steep valuations, this diktat creates an overhang and assumes more relevance, especially as regulatory interventions reduced in the recent past.

Details about the PIL and what exactly did the SC say

In a public interest litigation (PIL) filed by an NGO, the petitioner has requested for rates of fees chargeable from the patients in line with the Clinical Establishment Rules, 2012. According to the NGO, since the central government has notified the CGHS rates until it finds a solution regarding the rates of fees chargeable in line with the Act, CGHS rates should be levied across hospitals in India as an interim measure. As per the Clinical Establishment Act, the central government cannot determine hospital rates unless there is a response from the states and UTs. As a result, the SC has directed the Secretary, Department of Health, to hold a meeting with states and UTs and create a concrete proposal by the next date of hearing, which is scheduled after six weeks. Worryingly, the SC has said that if the central government does not come up with a concrete proposal in six weeks, it will levy CGHS rates in the interim across hospitals.

Difficult to implement, yet serves as a reminder on risks amid steep valuations

Even as uniform pricing is difficult to implement, we cannot take this issue lightly, given the SC's stringent tone. In the worst case, if CGHS rates are levied, almost all hospitals under our coverage will turn EBITDA negative (assuming insurance companies also negotiate lower prices). Apart from challenges such as subjectivity and variance involved in clinical outcomes, quality of doctors, infrastructure and implementation of this pan-India might also likely warrant a change in legislation. Two years ago, the SC had clearly said that no government can fix rates for patients in private hospitals. Looking at past precedents, including during Covid, we do not believe the government (Centre and States) would be keen to actively manage public health care services. Nevertheless, amid steep valuations, this diktat creates an overhang (especially on future price hikes and expansion) and assumes more relevance, particularly as regulatory interventions reduced in the recent past.

Companies having the highest exposure (measured as a percentage of operational beds falling under states and UTs, which have adopted the CEA) are Medanta, KIMS, Rainbow, Apollo, Max, Narayana and Aster DM (in that order).

Company data and valuation summary

	Rating	Fair Value (Rs)	EV/EBITDA (X) 2024E	2025E	2026E
Health Care Services					
Apollo Hospitals	ADD	6,860	36.9	28.7	22.6
Aster DM Healthcare	ADD	480	13.6	11.0	9.4
Dr Lal Pathlabs	SELL	1,975	31.1	26.6	22.9
Global Health	REDUCE	1,160	42.2	35.0	28.2
KIMS	ADD	2,275	29.1	22.6	18.7
Max Healthcare	REDUCE	705	40.5	33.1	26.4
Metropolis Healthcare	REDUCE	1,500	28.5	21.5	18.5
Narayana Hrudayalaya	REDUCE	1,365	22.8	19.9	17.1
Rainbow Children's Medicare	REDUCE	1,215	32.5	26.4	22.7
Health Care Services	**Cautious**		**30.8**	**25.0**	**20.3**

Source: Bloomberg, Company data, Kotak Institutional Equities estimates

Prices in this report are based on the market close of February 29, 2024

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Within our coverage, Medanta has the highest beds in states that have adopted the CEA

While we await clarity on how this diktat impacts states and UTs such as Delhi, which have not adopted the CEA, coverage companies having the highest exposure (measured as a percentage of operational beds falling under states and UTs, which have adopted the Clinical Establishment Act) are Medanta, KIMS, Rainbow, APHS, Max, NARH and Aster DM (in that order).

Among our coverage companies, Medanta has the highest absolute beds in states/UTs that have adopted the CEA

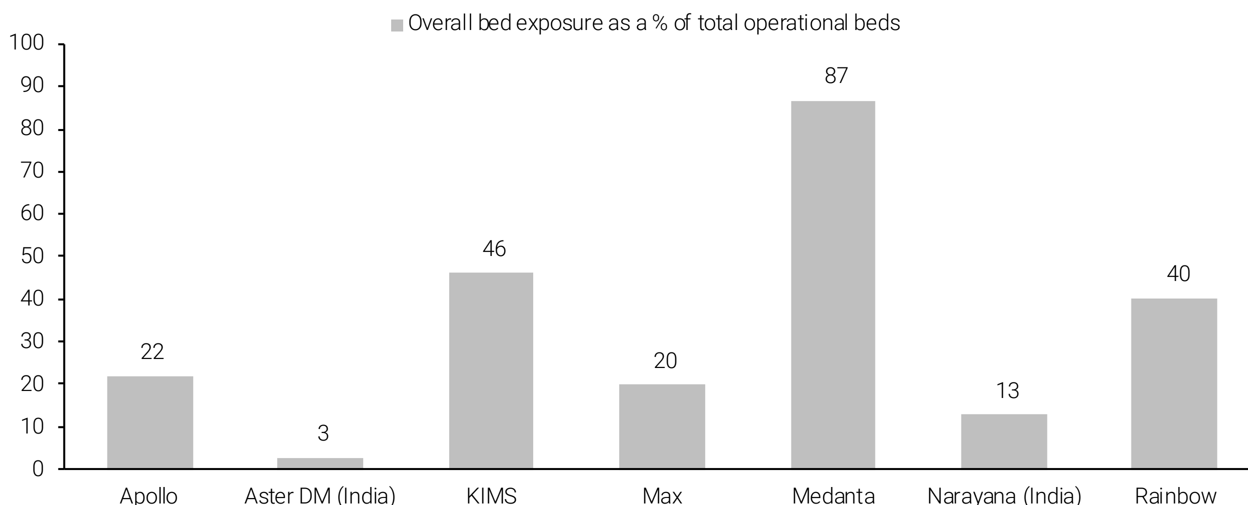
Exhibit 1: Bed exposure in concerned states/UTs, which have accepted the CEA, March fiscal year-end, 2024E

		Bed exposure						
	Status	Apollo	Aster DM (India)	KIMS	Max	Medanta	Narayana (India)	Rainbow
State/UT								
Haryana	State	—	—	—	92	1,156	—	—
Uttar Pradesh	State	330	—	—	376	368	—	—
Telangana	State	1,050	98	1,612	—	—	—	518
Jharkhand	State	—	—	—	—	159	150	—
Bihar	State	100	—	—	—	241	—	—
Uttrakhand	State	—	—	—	201	—	—	—
Himachal Pradesh	State	—	—	—	—	—	—	—
Arunachal Pradesh	State	—	—	—	—	—	—	—
Sikkim	State	—	—	—	—	—	—	—
Rajasthan	State	32	—	—	—	—	377	—
Mizoram	State	—	—	—	—	—	—	—
Assam	State	214	—	—	—	—	148	—
Chandigarh	UT	—	—	—	—	—	—	—
Ladakh	UT	—	—	—	—	—	—	—
Puducherry	UT	—	—	—	—	—	—	—
Dadra and Nagar Haveli	UT	—	—	—	—	—	—	—
Daman and Diu	UT	—	—	—	—	—	—	—
Andaman & Nicobar	UT	—	—	—	—	—	—	—
Lakshadweep	UT	—	—	—	—	—	—	—
Total operational beds in the above states/UTs		**1,726**	**98**	**1,612**	**669**	**1,924**	**675**	**518**

Source: Clinicalestablishments.gov, Kotak Institutional Equities

Even in terms of proportion to total operational beds, Medanta has the highest bed ratio in states/UTs that have accepted the CEA

Exhibit 2: Bed exposure, as a proportion of total operational beds, March fiscal year-end, 2024E (%)



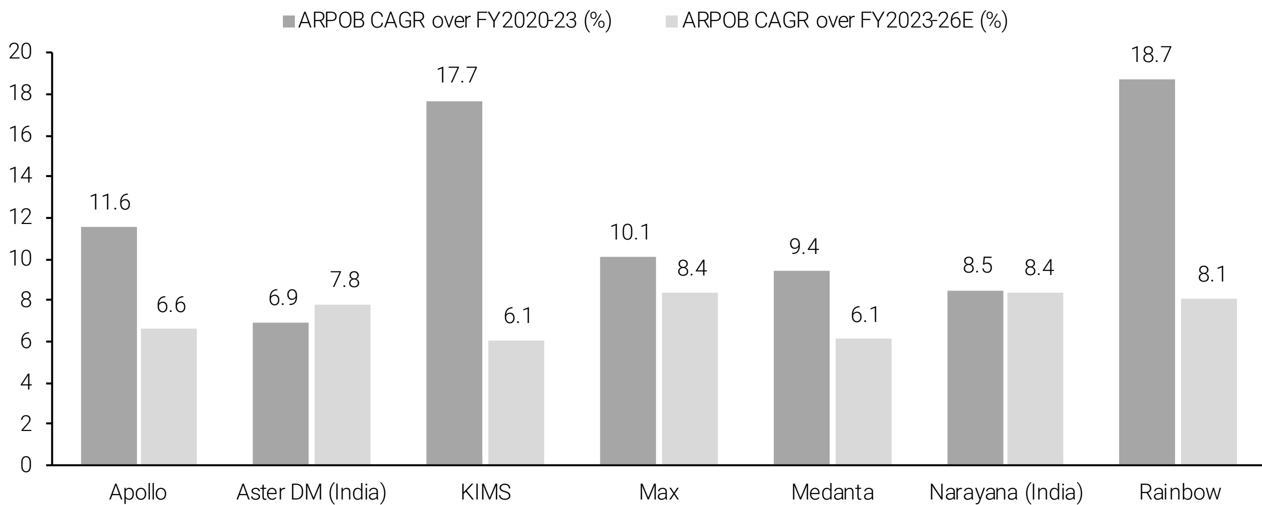
Source: Clinicalestablishments.gov, Kotak Institutional Equities

SC has warned about notifying CGHS rates as an interim measure unless the government acts

In a PIL filed by an NGO, “Veterans Forum for Transparency in Public Life”, through its General Secretary Wing Commander (Retd) Bishwanath Prasad Singh, the petitioner has requested for rates of fees chargeable from the patients in line with the Clinical Establishment Rules, 2012. According to the NGO, the central government has notified the hospital rates, which are applicable to the CGHS-empaneled hospitals. Hence, the NGO states that until a solution is found by the central government regarding the rates of fees chargeable in line with the Clinical Establishment Rules, CGHS rates should be levied across hospitals in India as an interim measure. Out of the 28 states and 8 UTs, we highlight the CEA has been adopted by just 12 states and 7 UTs. Thus, this diktat likely cannot be implemented in the remaining states and the union territory of Delhi. According to the CEA, the central government cannot determine hospital rates unless there is a response from the state governments and UTs. As per the central government, while there have been various attempts in the past, there has not been any response from state governments and UTs. In response, the SC has stated that the central government cannot shirk responsibility by merely stating that state governments are not responding. As a result, the SC has directed the Secretary, Department of Health, to hold a meeting with his counterparts in state governments and UTs, and come up with a concrete proposal by the next date of hearing, which is scheduled after six weeks. The SC has agreed with the petitioner’s plea to notify CGHS rates as an interim measure until a concrete solution is found. Accordingly, the SC has said that if the central government does not come out with a concrete proposal by the next date of hearing in six weeks, it will levy CGHS rates in the interim across hospitals.

We bake in 6-8% ARPOB CAGR over FY2023-26E for our India hospitals coverage, largely driven by mix improvement

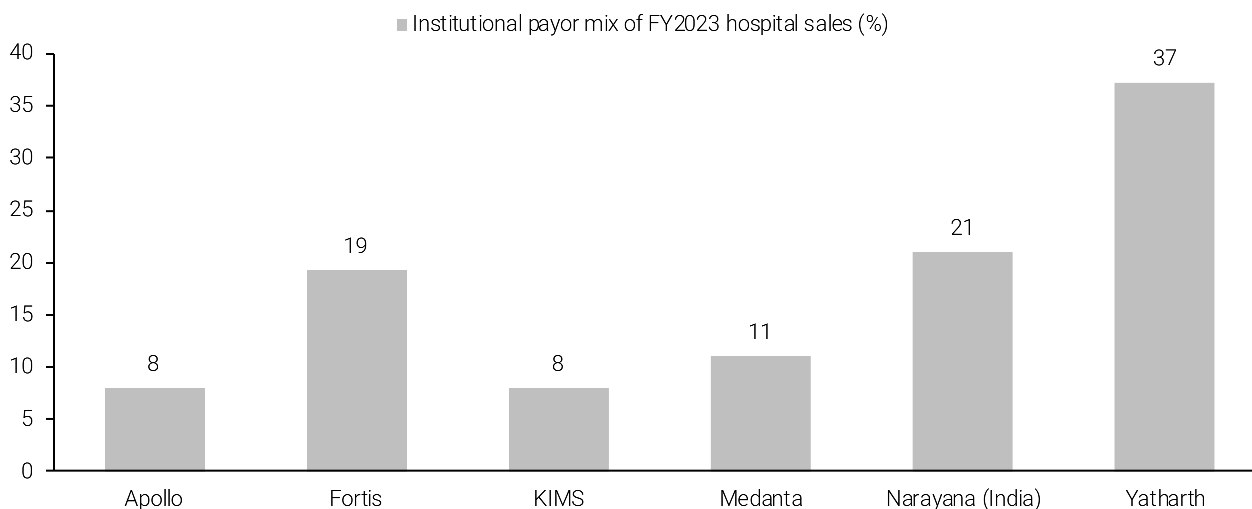
Exhibit 3: Historical and forecast ARPOB CAGR, March fiscal year-end, 2020-26E (%)



Source: Companies, Kotak Institutional Equities estimates

As of FY2023, Fortis, Narayana and Yatharth had the highest institutional payor mix by revenues

Exhibit 4: Institutional payor mix, March fiscal year-end, 2023 (%)



Source: Kotak Institutional Equities

This legal/regulatory intervention comes after a while, amid elevated valuations for most hospitals

Even as uniform pricing is difficult to implement, we cannot take this issue lightly, given SC's stringent tone. In the worst case, if CGHS rates are levied, almost all hospitals under our coverage will turn EBITDA negative (assuming insurance companies also negotiate lower prices). Apart from the practical challenges such as uniform pricing being unviable for prominent hospitals and subjectivity involved around clinical outcomes, quality of doctors, infrastructure and others, implementation of this pan-India will also likely warrant a change in legislation, as only 12 states and 7 UTs have adopted the Clinical Establishment Act. We add that the PIL also talks about displaying rates clearly to patients, which large private hospitals generally follow. Two years ago, the SC had clearly said that no government can fix rates for patients in private hospitals. Looking at past precedents, including recently during Covid, we do not believe the government (both Centre and States) would be very keen to actively manage public health care services. Nevertheless, amid steep valuations, this diktat creates an overhang and assumes more relevance, especially as regulatory interventions had reduced in the recent past.

We have given below some notable regulatory interventions in the Indian hospital sector over the past decade:

- In February 2017, the NPPA had capped the price of stents at up to 85% below their existing price. Since then, many global stent makers have withdrawn their high-end devices from India.
- In August 2017, the NPPA once again wielded its powers of price control on knee implants, which are devices used to replace parts of the knee joints that are damaged. It slashed the prices of knee caps by up to 69%.
- In September 2018, the central government launched its ambitious Pradhan Mantri Jan Arogya Yojana (PM-JAY), which proposes to provide an insurance coverage of Rs0.5 mn to ~500 mn to patients, thus covering ~40% of India's population. State governments are responsible for implementation of this scheme, with a funding split in the ratio of 60:40 between center and state. As of CY2023, 33 states/UTs had agreed to participate in this scheme.
    - According to PM-JAY, three models are proposed: 1) Insurance model, where insurance companies provide the cover, 2) trust model, where claims will be disbursed from a state run trust and (3) hybrid model, which involves a combination of the two. Majority of states have opted for the trust model.
    - While the scheme is a positive step, we do not see private hospitals witnessing significant gains, moving forward. Key challenges include (1) prices of packages are well below (~50-60%) rates of

private players and (2) hospitals in the past have faced receivables-related issues with respect to previous state schemes and have consciously cut down on scheme/PSU patients.

- In December 2022, the Haryana government asked multispecialty hospitals, which received Haryana Shahari Vikas Pradhikaran (HSVP) land to reserve 20% of their bed capacities for EWS patients. In Gurugram, hospitals for which the direction was applicable were Medanta, Fortis and Artemis. Other private hospitals, which also got subsidized HSVP land, were asked to reserve 10% of the beds for EWS patients. For those admitted under this policy, treatment up to Rs0.5 mn would not be charged. EWS patients would have to pay 10% if the bill amount was between Rs0.5-1 mn and 30% of the bill if the amount exceeded Rs1 mn.

- In April 2023, the Rajasthan government passed the Right to Health (RTH) Bill, proposing the right to emergency treatment and care without prepayment at any public health institution, health care establishment and designated healthcare center. After protests, the government agreed to keep private hospitals, which have not taken land or any other benefits at subsidized rates from it, outside the ambit of the legislation.

Indian hospitals—implied valuations

Exhibit 5: March fiscal year-ends, 2024-26E (Rs mn, X)

	EV	Post-Ind AS-116 EBITDA (Rs mn)					Pre-Ind AS-116 EBITDA (Rs mn)				
Company	(Rs mn)	2022	2023	2024E	2025E	2026E	2022	2023	2024E	2025E	2026E
Apollo (hospitals)	677,790	18,032	21,330	23,699	28,058	33,150	17,760	21,034	23,339	27,688	32,772
Aster (India)	140,022	3,928	4,867	6,165	7,074	8,237	3,528	4,029	5,302	6,185	7,322
Fortis (hospitals)	280,308	6,571	9,297	11,264	13,647	16,087	6,211	8,459	10,401	12,758	15,171
Global Health	360,269	4,365	5,916	8,220	9,847	12,183	3,953	5,517	7,792	9,362	11,633
KIMS	212,647	5,158	6,040	6,504	8,316	10,029	5,062	5,628	6,249	8,038	9,727
Max Healthcare	760,521	12,771	15,525	17,902	21,997	27,738	12,442	15,186	17,246	21,229	26,912
Narayana Hrudayalaya (India)	202,814	3,574	6,087	7,418	8,827	10,315	3,026	5,515	6,829	8,220	9,690
Rainbow	137,709	3,049	3,964	4,225	5,188	6,038	2,518	3,357	3,548	4,408	5,134

	Current price	Post-Ind AS-116 EV/EBITDA (X)					Pre-Ind AS-116 EV/EBITDA (X)				
Indian hospitals	(Rs)	2022	2023	2024E	2025E	2026E	2022	2023	2024E	2025E	2026E
Apollo Hospitals	6,102	37.6	31.8	28.6	24.2	20.4	38.2	32.2	29.0	24.5	20.7
Aster (India)	471	35.6	28.8	22.7	19.8	17.0	39.7	34.8	26.4	22.6	19.1
Fortis	408	42.7	30.2	24.9	20.5	17.4	45.1	33.1	27.0	22.0	18.5
Global Health	1,364	82.5	60.9	43.8	36.6	29.6	91.1	65.3	46.2	38.5	31.0
KIMS	2,257	41.2	35.2	32.7	25.6	21.2	42.0	37.8	34.0	26.5	21.9
Max Healthcare	793	59.6	49.0	42.5	34.6	27.4	61.1	50.1	44.1	35.8	28.3
Narayana Hrudayalaya (India)	1,342	56.7	33.3	27.3	23.0	19.7	67.0	36.8	29.7	24.7	20.9
Rainbow	1,357	45.2	34.7	32.6	26.5	22.8	54.7	41.0	38.8	31.2	26.8

Notes:

(a) Consensus estimates used for Fortis, which is not under our coverage.

Source: Bloomberg, Kotak Institutional Equities estimates

KIE—health care services valuation summary

Exhibit 6: March fiscal year-ends, 2024-26E (Rs, X)

		Price (Rs)	Fair Value	Upside	Mkt cap.		EPS (Rs)			P/E (X)			EV/EBITDA (X)		
	Rating	29-Feb-24	(Rs)	(%)	(Rs bn)	(US$ bn)	2024E	2025E	2026E	2024E	2025E	2026E	2024E	2025E	2026E
Health Care Services															
Apollo Hospitals	ADD	6,102	6,860	12	877	10.6	64	95	133	95.5	64.3	45.8	36.9	28.7	22.6
Aster DM Healthcare	ADD	471	480	2	235	2.8	7	13	17	63.6	35.5	27.9	13.6	11.0	9.4
Dr Lal Pathlabs	SELL	2,352	1,975	(16)	196	2.4	43	50	57	55.3	47.1	40.9	31.1	26.6	22.9
Global Health	REDUCE	1,364	1,160	(15)	366	4.4	18	22	28	75.3	62.1	48.8	42.2	35.0	28.2
KIMS	ADD	2,257	2,275	1	181	2.2	41	54	68	54.8	42.1	33.0	29.1	22.6	18.7
Max Healthcare	REDUCE	793	705	(11)	771	9.3	13	16	20	59.2	50.4	39.5	40.5	33.1	26.4
Metropolis Healthcare	REDUCE	1,602	1,500	(6)	82	1.0	27	40	49	60.2	39.7	32.8	28.5	21.5	18.5
Narayana Hrudayalaya	REDUCE	1,342	1,365	2	274	3.3	41	43	51	32.7	30.9	26.3	22.8	19.9	17.1
Rainbow Children's Medicare	REDUCE	1,357	1,215	(10)	138	1.7	21	26	30	64.4	51.4	45.0	32.5	26.4	22.7
Health Care Services	**Cautious**				**3,121**	**37.6**				**63.1**	**49.1**	**38.6**	**30.8**	**25.0**	**20.3**

Source: Kotak Institutional Equities estimates

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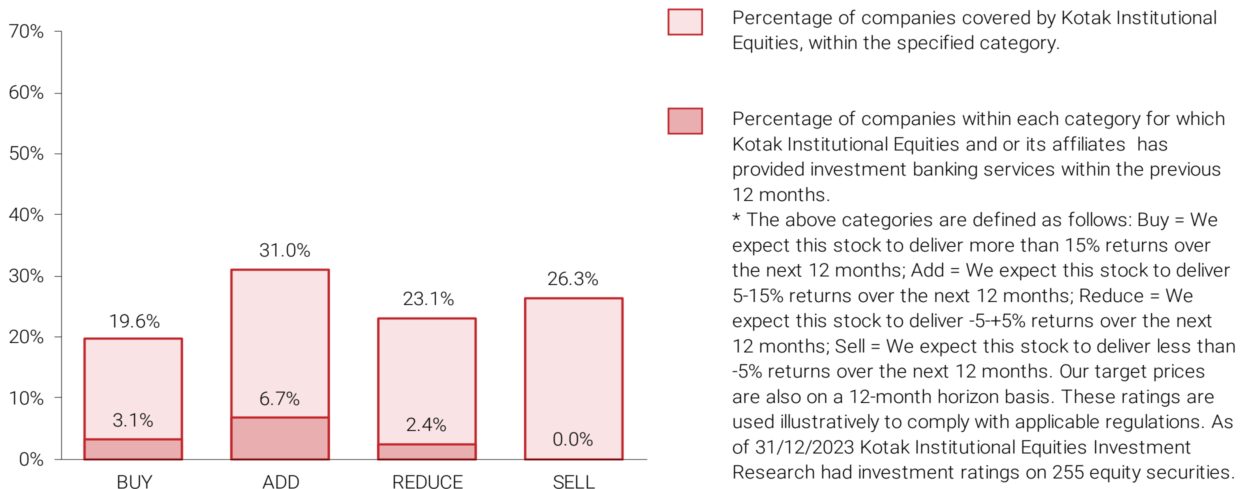

Source: Kotak Institutional Equities

As of December 31, 2023

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