JSC Evex Hospitals
Georgia, Healthcare Services

SCOPE BB Stable

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	2.5x	3.9x	2.4x	3.3x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	3.8x	2.5x	2.9x	2.6x
Funds from operations/SaD	13%	34%	22%	29%
Free operating cash flow/SaD	24%	14%	-1%	15%

Rating rationale

The rating affirmation is driven by predictable revenue streams with high EBITDA cash conversion capability. Pandemic-related lockdowns and restrictions have had a major impact on the hospitals segment, leading to a reduction in patient footfall at healthcare facilities for elective care, which continued in FY 2021 (Georgia had a lockdown during July-August 2021). The top line was negatively affected by these restrictions, which led to low utilisation levels. Top line growth of 24.7% in FY 2021 was mainly due to a low base in FY 2020 and full year Covid-related income (27% of total sales in FY 2021). Covid-related income had relatively high operating margins. The result of overall operating performance was better-than-expected for FY 2021.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that resumed elective care treatments after the Covid-19 pandemic and the organic growth of ramped-up hospitals will cause sales to rebound while the SaD/EBITDA ratio remains below 4.0x on a sustained basis. The Stable Outlook also assumes a successful refinancing of the GEL 50m bond by Dec 2022.

A positive rating action is deemed to be remote in the foreseeable future given the company's scope and reach in the emerging market of the Republic of Georgia (rated BB/Stable). If there is a positive rating development in the sovereign, a positive rating action on Evex could be considered if the SaD/EBITDA ratio consistently trended below 3x and the company improved its diversification. A decrease in leverage could be achieved by increasing profitability via organic growth, limited capex or a lower level of intercompany loans, which are also explicit financial targets for the company.

A negative rating action could result from a deterioration in credit metrics, as indicated by free operating cash flow below 5% and a SaD/EBITDA ratio of above 4x on a sustained basis or a change to aggressive financial policy. Weak financial performance could be triggered by an adverse change in regulations that puts operating profitability under pressure, or it could follow from higher-than-expected dividend payouts.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
7 Jul 2021	Affirmation	BB/Stable
16 Jul 2020	Affirmation	BB/Stable
11 Jul 2019	New	BB/Stable

Ratings & Outlook

Issuer	BB/Stable
Senior unsecured debt	BB

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Related Methodology and Related Research

Corporate Rating Methodology; July 2021

Georgia's sovereign rating

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Positive rating drivers	Negative rating drivers
• Market-leading position in referral hospitals in Georgian healthcare market • Underlying healthcare services market has low cyclicality and is protected • Operating efficiency reflected in comparatively high operating margins (credit-positive ESG factor) • Potential to generate ree operating cash flow	• Low number of outpatients per capita compared to peer countries • Weak diversification, with all operations in Georgia and only in one industry • Unstable regulatory framework (credit-negative ESG factor) • Substantial dividend payments limiting room for active deleveraging

Positive rating-change drivers	Negative rating-change drivers
• A positive rating action is deemed to be remote in the foreseeable future given the company's scope and reach in the emerging market of the Republic of Georgia (rated BB/Stable). If there is a positive rating development in the sovereign, a positive rating action on Evex could be considered if the SaD/EBITDA ratio consistently trended below 3x and the company improved its diversification	• FOCF below 5% on a sustained basis • SaD/EBITDA ratio above 4x • Aggressive financial policy

Corporate profile

JSC Evex Hospitals (Evex) is a subsidiary of the Georgia Healthcare Group (GHG). The ultimate parent of the GHG and its subsidiaries is Georgia Capital PLC. Evex operates 17 hospitals in major regional cities in Georgia. GHG acquires new healthcare facilities and renovates existing ones to enlarge its network and create a wide range of high-quality medical services across its hospitals.

Financial overview

				Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	2.8x	2.5x	3.9x	2.4x	3.3x
SaD/Scope-adjusted EBITDA	3.5x	3.8x	2.5x	2.9x	2.6x
Funds from operations/SaD	24%	13%	34%	22%	29%
Free operating cash flow/SaD	8%	24%	14%	-1%	15%
Scope-adjusted EBITDA in GEL m					
EBITDA	82	57	80	75	84
Capitalised costs	-6	-6	-4	-4	-4
Other items	-1	2	-4	0	0
Scope-adjusted EBITDA	**75**	**53**	**73**	**71**	**81**
Funds from operations in GEL m					
Scope-adjusted EBITDA	75	53	73	71	81
less: (net) cash interest paid	-27	-23	-19	-29	-25
less: cash tax paid per cash flow statement	0	0	0	0	0
Funds from operations	**48**	**29**	**54**	**42**	**56**
Free operating cash flow in GEL m					
Operating cash flow	49	66	47	21	51
less: capital expenditure (net)	-27	-19	-21	-23	-20
Free operating cash flow	**21**	**47**	**25**	**-2**	**31**
Net cash interest paid in GEL m					
Net cash interest per cash flow statement	27	21	19	29	25
Change in other items	0	0	0	0	0
Net cash interest paid	**27**	**21**	**19**	**29**	**25**
Scope-adjusted debt in GEL m					
Reported gross financial debt	265	264	217	221	221
less: subordinated (hybrid) debt	0	0	0	0	0
less: cash and cash equivalents	-5	-67	-33	-12	-11
add: non-accessible cash	0	0	0	0	0
add: pension adjustment	0	0	0	0	0
add: operating lease obligations	0	0	0	0	0
Other items	0	0	0	0	0
Scope-adjusted debt	**261**	**198**	**184**	**209**	**210**

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Environmental, social and governance (ESG) profile[1]

Environmental		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

Legend
Green leaf (ESG factor: credit-positive)
Red leaf (ESG factor: credit-negative)
Grey leaf (ESG factor: credit-neutral)

Health and safety

Credit-positive health and safety reflects app that EVEX developed in-house, which provides quick and easy access to the entire healthcare ecosystem, including doctors' appointments, online payments and doctors' online consultations. The innovative approach of EVEX hospitals promotes the well-being of society, particularly in overall reduced wait times in hospitals, and we see this point as a credit-positive ESG factor for the rating. In the short term, it led to higher capex, but we anticipate top line growth resulted in efficient daily operations management.

Regulatory and reputational risks

Several safety or regulatory standards have been introduced on the market. This gives Evex a competitive advantage in its fragmented market. However, we believe that efforts to reform prices, access and healthcare reimbursements in the universal healthcare programme (UHC) will be incremental rather than dramatic in the next few years. Scope underlines the significant risk in the company's high dependence on governmental-funded revenue streams as any changes to the reimbursement rates could have a significant adverse effect on business performance. We see this point as a credit-negative ESG factor for the rating.

[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BB

Credit-supportive Industry risk

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

Market dominance in Georgian healthcare industry

The business risk profile remains supported by company's dominant market position in the fragmented Georgian healthcare service industry. It had around 18% of the market by number of clinical beds and around a 20% market share by sales as of YE 2021. Its market position remains constrained by a relatively limited addressable market (less than GEL 2.0bn).

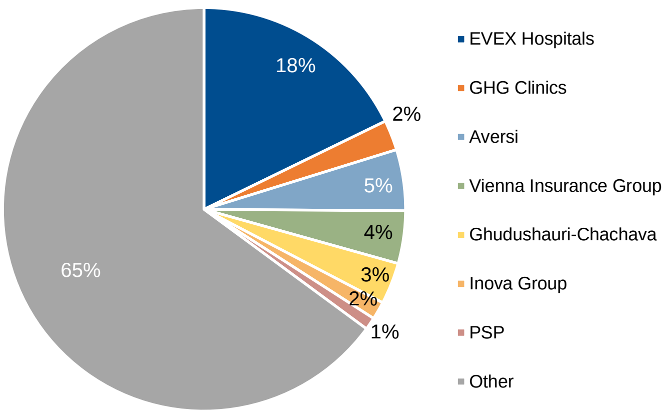
Strong top line performance in FY 2021 supported by Covid-related revenues

The rebound in demand for regular elective care and outpatient services, along with Covid-19 treatments, resulted in positive sales growth in FY 2021 despite pandemic-related restrictions. Top line growth of 24.7% in FY 2021 was mainly due to a low base in FY 2020 and full year Covid-related income (27% of total sales in FY 2021). Pent-up demand for elective procedures along with increased utilisation improved occupancy rates by 12.2 pps to 65.3% as of YE 2021 (YoY).

Top-line growth expected in medium term

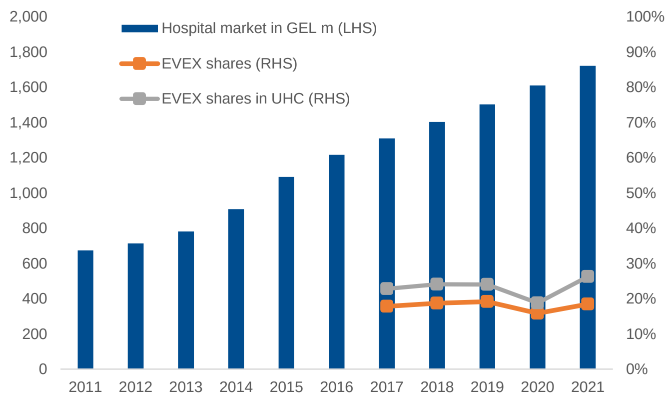
We believe Evex seeks lucrative growth (mid-single-digit revenue growth) in the medium term mainly due to increased utilisation potential from fully ramped-up hospitals coupled with an expansion of specialist capabilities. However, short-term growth could be muted, with lower-than-expected GDP growth for the country as the consequence of elevated inflation and inflationary risks created by the Russia-Ukraine war.

Figure 1: Hospital market structure in Georgia at YE 2021



Sources: Evex, Scope estimates

Figure 2: Hospital market dynamics in Georgia and market shares of EVEX by sales



Sources: Evex, Scope

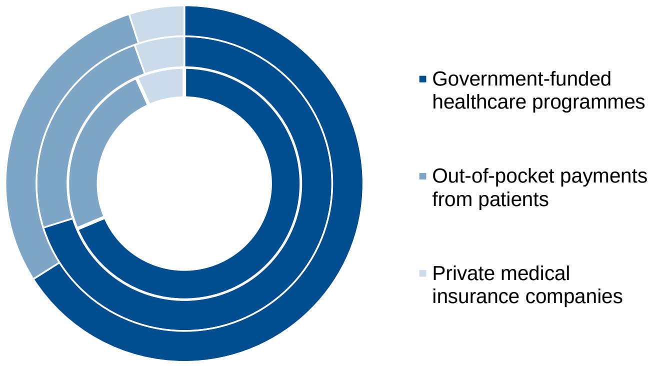
Diversification is weakest component of business risk profile

Geographical diversification remains the main constraint for Evex's business risk profile as the company only operates in one country and one industry. In addition, dependence on government-funded healthcare programmes further limits diversification. We do not expect any significant changes in revenue-stream diversification in the medium term.

Changing regulatory environment

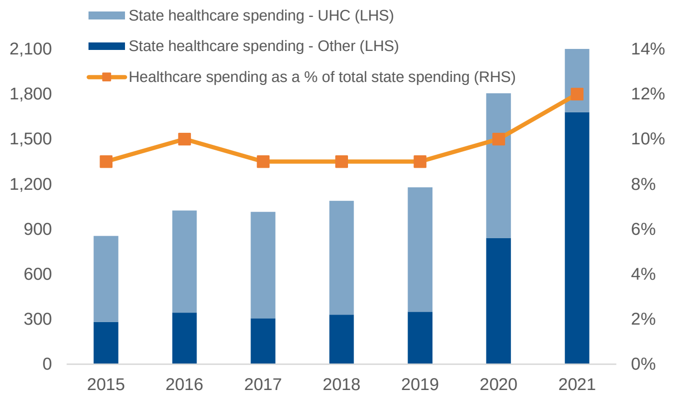
Several safety or regulatory standards have been introduced on the market (the main reason behind higher-than-expected capex for YE 2021). This gives Evex a competitive advantage in its fragmented market. However, we believe that efforts to reform prices, access and healthcare reimbursements in the universal healthcare programme (UHC) will be incremental rather than dramatic in the next few years. We underline the significant risk in the company's high dependence on governmental-funded revenue streams as any changes to the reimbursement rates could have a significant adverse effect on business performance (negative social ESG factor).

Figure 3: Evex's revenue diversification (inner circle: Dec 2019; middle circle: Dec 2020; outer circle: Dec 2021)



Sources: Evex, Scope estimates

Figure 4: State healthcare spending dynamics in Georgia (GEL m)



Source: Ministry of Finance of Georgia

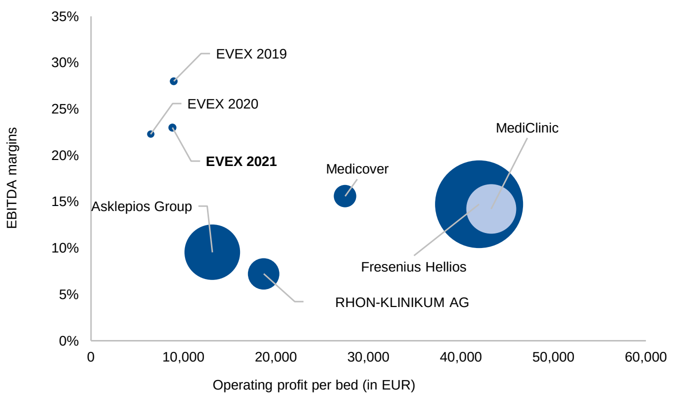
Fixed-base payment per bed designated for COVID patients

Scope-adjusted EBITDA margins remain above 20%

Despite pandemic-related bonuses granted to medical personnel, the direct salary rate showed an improvement in FY 2021, falling by 3.1 pps mainly due to relatively high profitability of Covid-related income. In the short term, we expect pressure on EBITDA margin as a consequence of restructuring in the cost base of Covid hospitals and a phase-out of government contracts. The ability to control direct salary rates coupled with operating efficiency (positive social ESG factor) will help the company keep its EBITDA margin above 20% in the next few years.

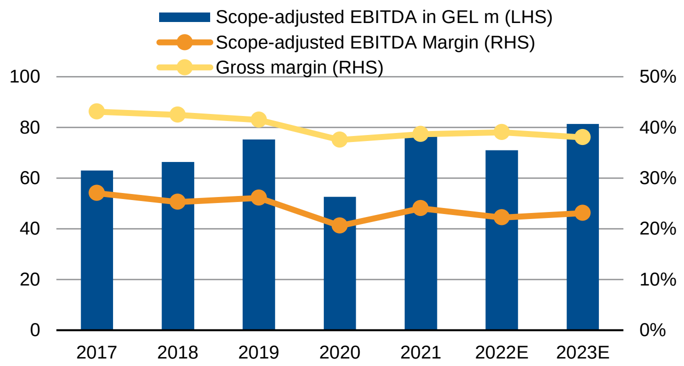
More visible adverse effects (organic growth, EBITDA margin, profit per hospital bed) on operating performance during the pandemic underscore once again that the Georgian healthcare market is less robust than more mature European markets.

Figure 5: Healthcare service providers



Sources: Evex, Scope

Figure 6: Evex's operating performance



Sources: Evex, Scope estimates

Financial risk profile: BB

Our adjustments and assumptions

Our financial projections are mainly based on the following assumptions:

- Muted revenue growth in the short term as the consequence of a transition period of six hospitals previously reserved for Covid patients. Going forward, mid-single-digit percentage growth on top line.
- We expect capital spending to remain around GEL 20m over the next two years.
- No acquisitions are expected. No material disposals are expected – in line with the portfolio optimisation strategy to divest assets generating low returns.
- We expect dividend payments of 70%-90% of net profits as the result of ownership change. As most of the company's operating cash flows were reinvested in the business to capitalise on strong demand for healthcare services in Georgia, the increased maturity of the business and its relatively good profitability could mean that Evex could start paying more meaningful dividends in the short-to-medium term.
- Net present value of operating lease obligations added to SaD (pre-2019, as Evex implemented IFRS 16 as of 1 January 2019)
- EBITDA is adjusted by capitalised software development costs for EKIMO application.

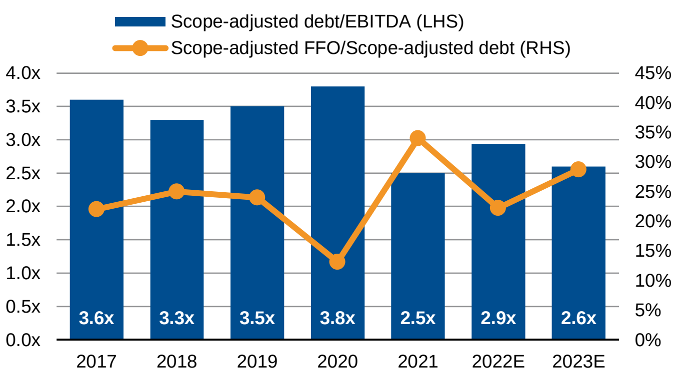
Financial risk profile affirmed at BB

The financial risk profile is supported by comfortable operating profitability, reflected in robust and predictable cash flow generation. Better-than-expected operating performance for 2021 was mainly driven by elevated EBITDA as Covid-related revenue streams had relatively high profit margins.

Comfortable leverage despite expected weaker operating cash flow performance in 2022

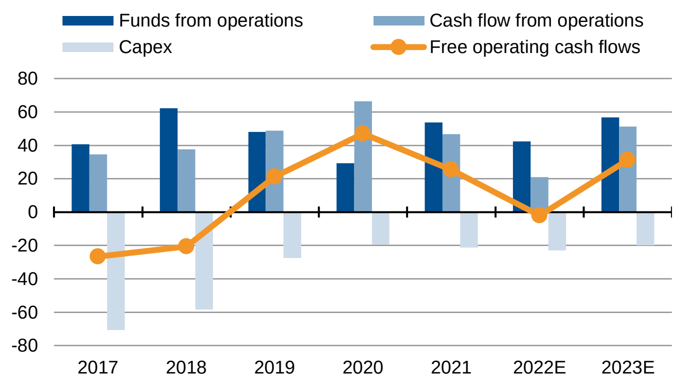
We expect weaker operating cash flow in 2022 as a result of the return to a normal, average collection period for the revenues generated in 2021-2022 while Covid-related revenues (which benefited from a relatively short collection period and high margins) fade away. Although expected negative free operating cash flow will limit room to reduce financial debt in the short term, our rating case incorporates leverage returning to around 2.5x in the medium term (2023E: 2.6x). Deleveraging will be driven by increasing EBITDA following the company's increased utilisation levels from fully ramped-up hospitals while indebtedness remains at current levels. For the same reasons, we expect the funds from operations/Scope-adjusted debt (SaD) ratio to follow a similar trend, improving to levels near 30% from 2023.

Figure 7: Leverage



Sources: Evex, Scope estimates

Figure 8: Cash flow generation (in GEL m)



Sources: Evex, Scope estimates

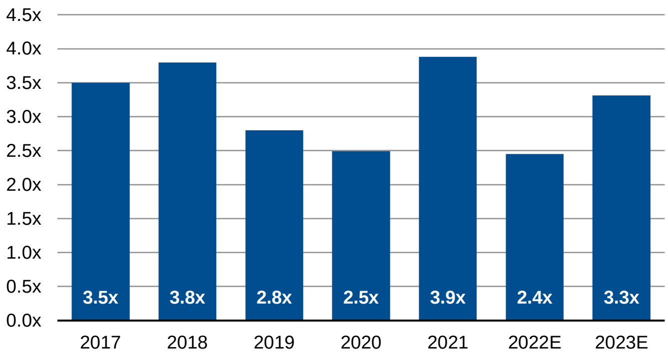
Positive free operating cash flow in medium term

Annual expected capex, with its increased share of maintenance, remains unchanged in the low double-digit million range (around GEL 20m). This is expected to push free operating cash flow into negative territory. We believe that Evex will focus on organic growth and that it will only pursue inorganic growth opportunities to a limited extent over the next few years. An expected GEL 10m of cash proceeds from divestitures of hospitals generating low returns will further increase the company's financial flexibility.

High cost of debt in Georgia

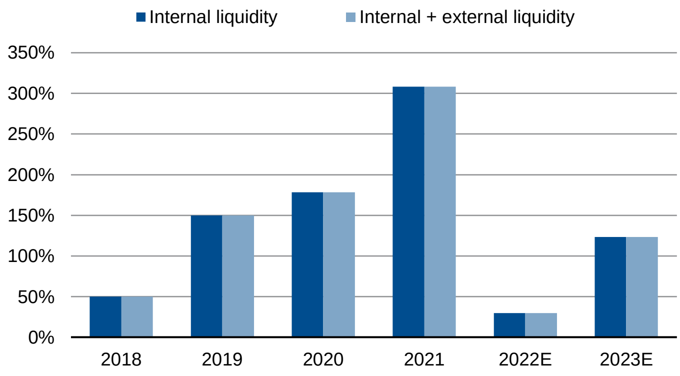
To curb inflationary pressure, the National Bank of Georgia continues to tighten monetary policy. The refinancing rate is up 2.0 pps over the last twelve months, to 11% from 9%, which will cause Evex's EBITDA/interest coverage to deteriorate in FY 2022. Scope expects the ratio to remain at a modest level near 3.5x in 2022-23, supported by a proven track record of increased EBITDA and expected deleveraging in the medium term.

Figure 9: EBITDA cash coverage



Sources: Evex, Scope estimates

Figure 10: Liquidity profile



Sources: Evex, Scope estimates

Adequate liquidity

We consider the company's liquidity to be adequate. Short-term debt peaked at GEL 110m in FY 2021 (consisting of a GEL 50m senior secured bond and GEL 56m of bank debt). Such high debt positions can hardly be redeemed from the company's operating business, but we do not anticipate any difficulties for refinancing given well-established relationships with local banks as well as international financial institutions like the European Bank for Reconstruction and Development, plus expected disposals of hospitals. Furthermore, parent company GHG needs to be considered as it could provide downstream financing if required.

The company has confirmed that part of its short-term debt was already refinanced through bank loans. It is currently in the process of deciding on how to refinance its senior secured debt obligation maturing in December 2022. It is considering issuing a new bond and/or additional bank loans or bridge loans.

Balance in GEL m	2022E	2023E
Unrestricted cash (t-1)	33	12
Open committed credit lines (t-1)	0	0
Free operating cash flow (t)	-2	31
Short-term debt (t-1)	106	35
Coverage	**30%**	**123%**

Supplementary rating drivers: +/- 0 notches

Credit-neutral financial policy

There are no explicit adjustments for supplementary rating drivers. We do not expect significant changes in the dividend payment policy (no more than GEL 30m p.a. for 2023-24) despite the fact that Georgia Capital PLC (the ultimate parent of Evex) disposed one of its dividend-generating portfolio companies (Georgia Water and Power). While GHG is expected to contribute most dividend inflows at the level of Georgia Capital PLC, the pharma division in GHG remains a cash cow for upstreaming dividends despite some regulatory changes in the Georgian pharma (OTC) market in 2021. While the dividend payout ratio is high, we believe this reflects the company's overall high profit generation and that it is appropriate in the context of a financial policy orientated around preserving the present rating – subordinated to maintain management's leverage goals.

Long-term debt rating

Senior unsecured debt rating: BB

We have affirmed the senior unsecured debt rating at BB including the GEL 50m (ISIN GE2700603881-1-02) bond. This reflects our expectation of an 'average' recovery for senior unsecured debt positions in the hypothetical event of a company default. The recovery analysis is based on a hypothetical default scenario in 2024, which assumes outstanding senior unsecured debt of GEL 50m in addition to GEL 175m in senior secured loans.

Appendix: Peer comparison (as at last reporting date)

	Evex hospitals JSC	Tegeta Motors LLC	Nikora JSC	Georgian Beer Company JSC	Nikora Trade JSC
	BB/Stable	BB-/Stable	BB-/Negative	BB-/Negative	B+/Stable
Last reporting date	9 June 2022	04 November 2021	02 September 2021	05 October 2021	02 September 2021
Business risk profile	BB	BB-	BB-	BB-	BB-
Market share	18%	18%	33%	23%	19%
Scope-adjusted EBITDA	GEL 80.0m	GEL 75.0m	GEL 54.9m	GEL 18.6m	GEL 44.8m
Operating profitability	23%	12%	9.1%	26%	9%
Geographical diversification	Georgia	Georgia	Georgia	Georgia	Georgia
Financial risk profile*	BB	BB-	B+	BB-	B+
Scope-adjusted EBITDA/interest cover	2.9x	2.9x	3.3x	2.8x	2.8x
SaD/Scope-adjusted EBITDA	2.8x	3.6x	3.0x	3.2x	3.4x
Funds from operations/SaD	25%	14%	22%	20%	18%
Free operating cash flow/SaD	7%	7%	-1%	8%	-3%
Liquidity	Adequate	Adequate	Inadequate	Inadequate	Inadequate

* Financial risk profile metrics are presented as average of projections

Sources: Public information, Scope

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