Ratings Methodology – Hospitals

CareEdge RATINGS AFRICA
A subsidiary of CARE Ratings Limited, India

Background

Hospitals, the largest segment of the healthcare services industry in Mauritius, has evolved from being health centres to clinics and multi-speciality hospitals managed by Government and corporates over the years. The sector comprises pharmacies, diagnostics, medical equipment and supplies and medical insurance.

Methodology

CareEdge Africa (CRAF) has a well-laid-out methodology for the rating of entities belonging to the service sector. CRAFs' rating process begins with the evaluation of the economy/industry in which the entity operates, and the assessment of the business risk factors specific to the entity. This is followed by an evaluation of the financial and project-related risk factors and the quality of the management. This methodology is adopted while analysing all entities coming under the purview of the service sector. However, considering the size and diversity of each sector, CRAF has developed methodologies specific to various sectors. These methodologies attempt to point out factors, over and above those mentioned in the broad methodology, which will be assessed while determining the rating of entities belonging to the particular industry. The following is a list of such additional factors, along with their analytical implications, considered by CRAF while arriving at the rating of the players operating in the hospital sector.

Business Risk

1. **Brand and Competitive Position**

   CRAF evaluates the brand image and competitive position of a hospital, as it has a considerable bearing on its ability to attract a larger number of patients and renowned doctors. A better brand image and competitive position not only ensures a higher market share but also leads to better profitability. While evaluating the competitive position of the hospital, CRAF evaluates factors such as track record of the hospital, specialties being provided, accreditations, presence of renowned doctors, and the number of patients. In CRAFs' view, hospitals with multi-specialty are better placed compared to a single specialty in terms of pricing power. Similarly, hospitals with renowned accreditations such as the CHKS, UKAS and Joint Commission International (JCI) command a better competitive position.

2. **Scale and diversification**

   While assigning the rating, CRAF considers the scale of business operations in terms of bed inventory and revenue diversification as important rating considerations, as these provide revenue stability and lead to economies of scale in business operations, marketing, and distribution.

   With respect to revenue diversification, CRAF analyses geographical diversification and specialty-wise diversification break-up. Under the geographical diversification, CRAF evaluates the entity's presence across Mauritius and overseas and its plans to increase its coverage.

   A healthy mix of specialty-wise diversification is important for hospital entities. Some specialties such as cardiology and neurology are high-margin contributors, whereas others such as gynaecology, paediatrics, and radiology contribute most to the occupancy. In the case of hospital chains, higher investments in new geographies may pose challenge in terms of achieving operational stability and profitability in a timely manner. CRAF looks at the mix of revenue from matured and recently established hospitals, as matured hospitals tend to provide better stability to revenues and profitability.

3. **Location analysis**

CRAF analyses the hospital's location as it is an important factor to determine the hospital's ability to attract patients and impact the occupancy and its profitability and cash flows. Hospitals near to commercial and densely residential areas will have higher average revenue per occupied bed (ARPOB) compared to hospitals located at remote places and in villages. Apart from this, CRAF also looks at the nearby hospitals and the services offered by them to do a competitive mapping.

4. **Quality of cashflow**

Hospitals receive payments in various forms and channels such as Cash business, Institutional clients, and private health insurance. CRAF evaluates the percentage of revenue from each of the channels to ascertain the health of its cash flows. A healthy mix of patients from each of the channels is critical in maintaining optimum occupancy levels for the hospitals. In CRAFs' view, a hospital with more cash business will have better cash flow compared to more of insurance business wherein the payments are realised with delay. At the same time, higher insurance business may help hospitals with higher occupancy.

5. **Operating performance**

CRAF analyses performance indicators of hospitals such as ARPOB, average length of stay (ALOS), and occupancy ratio to ascertain the operational efficiency of the issuer.

ARPOB refers to the average revenue realised by a hospital from every occupied bed. It depends on the pricing of hospitals, location of hospitals, utilisation rates of beds, maturity of hospitals, and complexity of operations conducted in them. CRAF evaluates movement in ARPOB in the past against its peers, and the ability of a hospital to charge ARPOB at a premium over industry ARPOB without compromising on occupancy levels.

CRAF also evaluates hospital's ALOS that refers to the average time spent by the patient under treatment in the hospital. In CRAFs' view, lower ALOS helps with the faster turnaround of beds and results in more patients being treated from the current facilities. In addition to this, it also helps the hospitals to increase their income as most of the revenues are made by hospitals in the initial few days of the patient's treatment.

6. **Adequacy and Quality of Medical Team**

In CRAFs' view, doctors and medical staff are a critical resource for hospitals. The presence of renowned and skilled doctors tends to attract a higher number of patients and can help hospitals to charge a premium for the services. CRAF analyses the quality, adequacy, and stability of the medical team of hospital entities. It evaluates the "Doctor per bed" ratio to ascertain the adequacy of doctors, as well. An optimum level of "doctor per bed" is needed as a low ratio can act as an impediment to the service levels, and a high ratio might lead to pressure on the margins.

The doctors' fee is one of the largest components in the hospital's cost structure and CRAF analyses remuneration models to ascertain its impact on the profitability. While a higher number of payroll doctors leads to higher costs, it also leads to better branding. On the other hand, higher visiting doctors may be cost effective but might dilute the service levels and brand. In CRAFs' view, a judicious mix of payroll and visiting doctors is needed to maintain the balance between the quality and cost of services.

Promoters/Management Analysis

Experience and market image of the promoters are given utmost importance while evaluating management competency and quality. CRAF assesses management's ability to run the business efficiently while addressing the inherent business risk associated with hospital operations and undertaking judicious expansion activities. Many of the hospitals are promoted by doctors without adequate professional set-up. In such cases, keyman risk and succession planning are also taken into consideration.

The hospital business is capital-intensive and has a long gestation period. Therefore, an entity with financially strong promoters enjoys an advantage over others as its ability to infuse and/or raise funds promptly is crucial. The strong group presence/parentage provides enhanced financial flexibility. The rating methodology for hospital entities also lays considerable stress on the commitment of the promoters and investors, not only in the form of equity but also their ability to continuously support in the initial years of operations for loss funding and debt servicing if needed and their active involvement in the operations of the entity, considering the importance of the entity in the overall group's portfolio.

Financial Risk

CRAF follows its standard ratio analysis methodology for non-financial sector entities to assess the financial risk of entities in the hospital sector (refer to CRAFs' Rating Methodology for non-financial sector at www.careratingsafrica.com).

Project Risk

While examining new/expansion plans, CRAF evaluates the rationale of the project, its strategic importance in the entity's business plan, the kind of services being offered such as the presence of treatment for critical diseases and the magnitude of the project against the net worth/asset size of the entity. CRAF also evaluates the location demand-supply situation at the time of the project completion and analyses its impact on the entity's financials and future cash flows. While examining an ongoing project, CRAF examines the stage of approvals, licenses, governmental clearance, and the possibility of time and cost overrun.

CRAF also considers the management's past track record of executing projects with a judicious mix of debt and equity components and without cost/time overruns as a critical factor. The facilities being offered, the competitive positioning, relative cost structure, cost per bed, funding sources, debt structure of the project, and accessibility of sources of funding are assessed. Due to the long gestation period, the timing of setting up or expansion is of critical importance for any entity.

With respect to the funding risk of the project, CRAF also analyses the source of funding and its consequent impact on the capital structure on the entity.

Regulatory Risk

Hospitals operate in a regulated industry that has witnessed continuous regulatory intervention in the past couple of years in the country. Healthcare sector is highly regulated and is governed by laws, such as Ministry of Health and Wellness and Medical Council of Mauritius, among others. Given the importance of healthcare facilities, the Mauritian Government has been taking steps towards increasing the affordability and coverage of healthcare services in the country. CRAF views regulatory risk to be critical for hospital operations and continuously monitors its impact on operations, business continuity, profitability, and eventual credit profile.

Conclusion

The rating outcome is ultimately an assessment of the fundamentals and the probabilities of change in the fundamentals. CRAF analyses each of the above factors and their linkages to arrive at the overall assessment of the credit quality of the issuer. While the methodology encompasses comprehensive financial, commercial, economic, and management analyses, credit rating is an overall assessment of all aspects of the issuer.

[Reviewed in October 2025. Next Review due in October 2027]

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About:

CareEdge is a knowledge-based analytical group that aims to provide superior insights based on technology, data analytics and CARE Ratings (Africa) Private Limited (CRAF) is the first credit rating agency to be licensed by the Financial Services Commission of Mauritius in May 2015. It is also recognized by Bank of Mauritius as External Credit Assessment Institution (ECAI) from May 2016. CRAF is also licensed by Capital Markets Authority of Kenya to operate as a Credit Rating Agency in Kenya. CRAF intends to expand across other geographies in Africa with Mauritius as its hub of operations. With an equitable position in the Mauritius capital market, CARE Ratings (Africa) Private Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.

CRAF's shareholders are CARE Ratings Limited, African Development Bank, MCB Equity Fund and SBM (NFC) Holdings Limited.

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CRAF has had a pivotal role to play in developing bank debt and capital market instruments including MMIs, corporate bonds and structured credit.