

Medi Assist

To: BVP Group
From: Vishal Gupta and Chitresh
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Re: Medi Assist Healthcare Services



Overview

1 USD = 40 INR

We recommend a \$16 million investment to finance the management buyout of Medi Assist, a Bangalore based third party administrator (TPA) of health insurance related claims. Medi Assist is the largest player in the growing health insurance administration space in India.

India is one of the most privatized healthcare markets. Total healthcare spending is estimated at \$35 billion annually (versus \$1 trillion in the US). The healthcare services sector is dominated by private players who contribute 82% of total services provided and the rest is between federal and the state governments. This is an extremely high proportion by international standards. The healthcare spend is predominantly met through out of pocket by the consumer (62%), government and employer spend is 35% and only 3% is met through some form of commercial health insurance cover.

The total private health insurance penetration in India is still very low and covers only 20 million lives (versus a 1.1 billion population). Since deregulation of the insurance sector in 2002, the health insurance premium has been growing at a CAGR of 35% and aggregated to \$1.8 billion in premiums for FY10; the market expected to touch \$5 - 6 billion by the year 2015. TPAs provide a variety of services such as pre-authorization, claim settlements, customer interfacing, reimbursements, hospital networks and specialized value-added services for corporate customers.

Medi Assist is India's largest TPA with a network of 4,750 hospitals across 20 states and provides services to all health insurers in India. It is a profitable and rapidly growing player with \$9.7 million in revenues with 33% EBITDA margins. It has a ~10% share of India's health insurance premium under management in FY10. Over the last three years, revenues have grown at 72% CAGR. Medi Assist services 5 million lives with \$176 million in insurance premiums in FY10 and is projected to grow by 42% in FY11. In the first six months of FY11, it has generated \$6 million in revenue and \$2.5 million in EBITDA. For the full year ending March 2011, Medi Assist should deliver \$13.4 million of revenue, \$4.7 million in EBITDA. However, due to an accounting deferment, the FY11 Revenue and EBITDA will be \$11.8 million and \$3.1 million respectively with net income of \$1.9 million.

The health insurance industry in India

The insurance industry was opened to the private sector in 2001 and since then the health insurance premium has grown to \$1.8 billion from \$125 million, representing a CAGR of 35%. However, today, only 10-11% of the population is covered through health financing schemes with 3% covered through commercial health insurance offered by general (non-life) or health insurance companies and the balance covered through state and central government funded plans & corporate plans. The health insurance industry is projected to grow to \$5.5 billion by 2015.

Health insurance products can be divided into two segments – corporate/group cover and retail/individuals. Both these segments are growing at 25%+ number of lives covered. Insurers are pushing the retail channel and with growing awareness and affluence retail customers are buying health insurance. Individuals are incentivized through income tax breaks for the insurance premium they pay for their parents, self and other dependents. For companies it's a function of providing incentives to the employees as well as growth in number of employees that is increasing aggregate health insurance cost. The Insurance Regulatory and Development Authority (IRDA) eliminated tariffs on general insurance in 2007; as a result, all the tariff products which were extremely profitable are now being sold at significant discounts. Health insurance rates were not guided by any tariff, hence was cross subsidizing the profitable products. Post de-tarification, the insurers are focusing on product profitability and are raising the premium rates for health insurance to offset the cross subsidy.

There are currently 20 general (non-life) insurers who offer health insurance in India. About 60% of the health premium is underwritten by the four public sector insurers and another 33% is underwritten by the top five private sector insurers. The health insurance portfolio is causing huge losses for the general insurance industry, especially as it contributes about 23% of the total premium underwritten. The industry average claims to the premium underwritten ratio is about 106% and the public sector insurers are working in the 115-125% range. Last year, three largest private insurers – ICICI Lombard, Bajaj Allianz and Reliance have lost market share in a conscious effort to attain profitability. The health insurers need an efficient claims management system and to reduce the claims cost. The following are some of the items that require immediate attention for running the operations profitable and smoothly.

Fraud Control – Insurers claim that with effective fraud control the claims outgo could reduce by as much as 15-20% from current levels.

Standard rate card for treatment – It has become a standard practice of many hospitals to charge the insured based on the amount of health insurance cover they have. Pre-negotiated standard rate cards for treatments can prevent hospitals from overcharging.

Seamless operations – Claims is a strenuous process today as each segment of the claim settlement process work independently. A seamless operations network will not only remove the hassles of reconciliation but will help deliver services within the desired turnaround time. The Insurers will be able to manage the float for claims payment and the Hospitals will receive the payment more efficiently.

The health claims administration industry

There are currently 27 health insurance Third Party Administrators (TPAs) licensed by the regulator. Nine players command more than 80% of market share. The TPAs are responsible for administration of the policy on behalf of the insurer and currently administer the entire private insurance market of \$1.8 billion in premiums. Recently the self, state and federal funded health schemes have also started moving towards third party administrators. These would add another \$3-5 billion of potential insurance premium to be administered with more than 60 million new lives covered each year.

Medi Assist recently won a contract under such self-funded schemes, the Yashisvini scheme which covers 3.2 million farmers in Karnataka. There are two other contracts in the bidding stage where the policy covers 200 thousand families of police staff in the state of Maharashtra and another where 1.8 million families below poverty line are covered in a district in Karnataka. These three schemes can earn Medi Assist a guaranteed annual fee of \$1 million for the next three years.

Currently the administrator provides claims administration and settlement, cashless hospitalization, reimbursement, identification cards, hospital networks, pre- authorization, pre policy medical checks and other services. The insurers pay the administrator a fee anywhere between 4.5% and 5.5% of the premium serviced. The fee is a negotiated rate between the TPA and the insurer.

As the premium per life is moving up, the TPAs are being asked to charge fee on per life serviced basis. It is expected that individual/retail policies will be given to the TPAs on a per life fee basis while the corporate/group policies on % of premium underwritten. The average fee per life today is \$1.76 for the Medi Assist portfolio. Most TPAs will not be able to sustain at this revenue per life and hence we see this as the floor price in the industry. The Premium per life is expected to grow at 8-10% per annum and the TPA fee per life at 5-8% per annum.

Medi Assist history and business overview

Medi Assist was established in 2002 by N S Raghavan (ex-Infosys founder) and was subsequently acquired by Reliance in May 2006. Since then, it has gone on to become the largest player and most profitable player from the fifth largest. It currently manages \$176 million of premiums and has 10% of India's Health Insurance premium under its management.

The insurance companies give out business to health administrators regionally based on their provider network capability in that region, past track record in claims administration (claims ratio), customer satisfaction with the TPA and the relationship. The fee for the TPA service is negotiated regionally and ranges from 4.5% to 5.5% of the premium serviced. The retail segment is awarded by regions; however, all corporate entities have the flexibility to pick their administrator and their decision is primarily driven by service levels and relationship. The insurance company at the start of every month based on the expected claims ratio provides a fortnightly float to the administrator for settling claims and then keeps topping it up every week or fortnight.

Medi Assist has traditionally been extremely strong in the corporate sector for administering of their health insurance schemes. It has serviced and managed the top IT service companies in India such as Infosys, TCS, Wipro, HCL and Mphasis and has all the major multinational IT companies such as HP, Intel and IBM as customers. It also services the large conglomerates such as Reliance, Tata, LIC and a whole host of other customers. Most of them have been with Medi Assist for the last three years or more.

Medi Assist today has one of the largest provider networks in India with more than 4,700 empaneled hospitals across 20 states. It also ranks the highest among customer satisfaction because of speedy settlement of claims and fastest turnaround times on pre-authorization.

Reliance Divesture

Reliance is divesting this business as it is no longer of strategic priority. Even in a best-case scenario, the business is likely to generate less than \$15 million in revenues inside a multibillion-dollar conglomerate which is far more focused on power and infrastructure projects.

The health insurance eco-system

Along with Medi Assist MBO the consideration for the transaction includes two companies which run disease management and PBM.

Disease and wellness management

This Company will service insured with chronic diseases, ailments contributing significantly to claims for the insurer. This is an evolving industry with very few players, the insurers are currently not offering cover for chronic diseases except in corporate plans. This company will offer Value Added Services (VAS) to the corporate clients and insurers provided cover for chronic diseases. Today the company has revenue of \$1 million and is EBITDA positive.

Pharmacy benefits management (PBM)

Medybiz Pharma is a wholly owned subsidiary of Medi Assist. Medybiz is in the business of home delivery prescription refill, Mail order refill, Disease management, Formulary management. It is currently serving 5,000 customers in 11 cities.

Acquisitions under negotiation

Medi Assist is currently in conversations for two small tuck in acquisitions with a total cost of \$2 million which will allow the company to offer seamless payer provider connectivity and have an analytics engine for claims analysis.

Claims Exchange

Healthsprint has built a platform which enables the TPAs to efficiently communicate with the Hospitals. The entire data that resides on the platform enables all users to do analytics on predictive medication and payment schedules. The TPA can offer superior services to both the claimant and the hospitals by streamlining right from the policy coverage verification to the payment process.

Claims Analytics

The biggest grievance of the health insurer is the rising claims cost, the most common request of the Insurer to the TPA is to analyze claims effectively and control fraud and instances of overcharging of treatment cost. Medi Assist has both financial and medical data for the claimants, which could be used for marketing analytics, predictive modeling and forecasting treatment outcomes and cost.

The founder – Dr. Vikram Chhatwal

Dr. Chhatwal comes with a rich 10 years of experience in the healthcare services industry. He is currently the Chief Executive Officer for Reliance Health and is on the board of Medi Assist. Prior to this he held top management positions at the Apollo Hospitals group during the period between 2000 and 2005. Dr. Chhatwal is a trained cancer surgeon and a PhD in Palliative care. He did his doctorate in Medicine from NUS Singapore and his MBA from ENPC – Paris. We have known Vikram for last seven years and he comes across as a scrappy and high integrity entrepreneur with deep domain knowledge. He is very well connected and respected within the healthcare ecosystem in India.

The deal

BVP will work with the management to buyout of Medi Assist and Net Logistics for a consideration of \$16 million (INR 72 crore). The company has \$4 million of cash as of July 2010, the cash is expected to move up to \$5.7 million by March 2011. The company has no debt, and the cash will remain within the company post the transaction. Hence, the effective enterprise value of the company by the time we acquire will be closer to \$14.3 million. The company is being valued at 4.6 times FY11 EV/EBITDA and 8 times FY11 PE.

P&L Statement (in US\$ million) *

	FY 10A	FY11P
Total PUM	176	250
Average TPA Fee %	4.60%	4.60%
TPA Fee	8.1	11.5
TPA Fee Recognized	8.8	9.8
Other Revenue Streams	0.9	1.9
Total Revenue	9.7	11.8
Personnel Cost	3.0	4.3
Admin Expenses	3.5	4.4
EBITDA	3.2	3.1
EBITDA Margin	33%	26%
Depreciation	0.4	0.3
Interest	0.1	0.1
PBT	2.7	2.7
Taxes	0.0	0.9
Net Income	2.7	1.8
Net Income Margin	28%	15%

*As per the accounting rules a TPA can recognize revenues only for the period the policy has been serviced. Hence at the end of the financial year, the revenues for the unexpired period are deferred to next year's P&L statement. In FY 10, the revenue earned from FY09 deferment was higher than the revenue deferred to FY11, hence the Revenue and EBITDA reported was higher than the Cash Revenue and Cash EBITDA. On Cash Basis, the EBITDA has grown from \$2.5 million in FY10 to \$4.7 million in FY11.

Cash Flow Statement (in US\$ million)

PAT	2.7	1.8
Depreciation	0.4	0.3
Change in Working Capital	-1.4	-0.4
Cash Flow from Operations	1.7	1.7
Cash Flow from Financing	-	-
Cash Flow from Investments	-2.5	2.1
Opening Cash	2.7	1.8
Total Cash	-0.8	3.8
Closing Cash	1.8	5.7

Balance Sheet Statement (in US\$ million)

	FY10	FY11
Share Capital	0.9	0.9
Reserves & Surplus	5.4	7.2
Total Sources of Fund	6.3	8.1
Fixed Asset		
Gross Block	2.0	2.4
Less: Depreciation	1.4	1.8
Net Block	0.6	0.6
Investments	2.5	-
Deferred Tax Asset	0.1	0.1
Sundry Debtors	2.3	5.0
Unbilled Revenue	0.8	-
Cash and Bank Balances	1.8	5.7
Loans and Advances	2.2	1.4
Other Current Assets	0.1	-
Current Assets	7.1	12.1
Current Liabilities	3.7	4.7
Provisions	0.2	-
Net Current Asset	3.2	7.4
Total Uses of Fund	6.3	8.1

Scenario analysis

Probability	Scenario	PAT \$ mn	PE (x)	Valuation \$ Mn	Our Investment \$ mn	Multiple (x)	IRR
5%	Everything that can go wrong goes wrong. MA does not get any PSU business; the new ventures fail. The large private sector insurers move all business in house, and we have to pay for the tax withholding liability. The company winds up with no assets.	-	-	-	16.0	-	-100.0 %
30%	MA loses much of its business to the Common TPA, gets only 10% of the PSU Business. They do only 6% of Private insurance business, as most of them run in-house TPAs. The value-added business does not take off as well as planned.	3.7	8.0	29.8	16.0	1.5	10.4%
35%	MA retains most of the corporate customers as before, even though In-house administration and Common TPA are successfully run. MA retains its 10% market share of Insurance Premium.	9.7	10.0	97.2	16.0	4.9	48.5%
25%	MA retains most of the corporate customers as before; MA is the preferred TPA after the common TPA and does a large portion of the corporate business with private Insurers. MA garners a 15% Insurance Premium. The VAS and PBM Business get traction and run at an EBITDA of \$5 million.	16.1	12.0	193.6	16.0	9.7	76.4%
5%	MA retains most of the corporate customers as before. The Common TPA does not take off well. MA is the preferred TPA after the common TPA and does a large portion of the corporate business with private Insurers. MA garners a 18% Insurance Premium. The VAS and PBM Business run at an EBITDA of \$10 million.	19.6	15.0	294.0	16.0	14.7	95.8%
100%	Weighted Average	9.5		106.0	16.0	5.3	51.7%

Risks

1) *Common TPA*: The four public sector insurers are planning to set up a Joint Venture with a healthcare BPO/Indian TPA to migrate a bulk (~50%) of the claims to this JV. This will allow them to negotiate better rates with the provider network. Medi Assist is the only Indian TPA which has been short listed based on the technical criteria and other Indian healthcare BPO's. The timing and probability of this is uncertain given resistance from local TPA's and regulatory approval.

2) *In-House Administration:* Large private insurers such as ICICI Lombard, Star Health and Bajaj Allianz, which have 80% of the private sector health insurance premium, are servicing most of the policies in-house. In-house administration has a high cost structure especially if the premium under management is low. The insurers are moving the administration in-house for primarily two reasons. 1) Effective claims control through fraud management and standard price list with the hospitals, and 2) For quality service to its customers. Based on our interactions with Insurers, if the TPA can do manage these efficiently for them, they would rather get rid of the hassle of managing the in-house team and the process. Medi Assist has been able to do improvements in this direction and has been able to use claims analytics as an effective tool for claims control.

3) *Financing growth:* Given the relatively small BVP India fund size, our ability to finance tuck in acquisitions will be quite limited. We may have to concede majority control of the economic interests if there is an opportunity for material acquisitions.

Conclusion

We believe that this is a fast-growing industry with limited risk and have a shot at consolidating market share from smaller players. We are backing the leader in this space and Dr Vikram Chhatwal who we think has the right relationships and capability to build a team in this space. We have an opportunity to invest ~\$16 million in Medi Assist and the allied companies. We enthusiastically recommend this investment.

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