

India Diagnostic Sector Playing the long game



Sustainable growth in a highly underpenetrated and underserved market

Covid vacuum and competition - short term challenges

High cash generating business with robust return profile available at an attractive valuation - BUY

Diagnostics: Playing the long game

We believe India's diagnostic industry of INR 920-980 bn is a long-term growth story and the recent correction presents an opportunity to participate in value creation. Concerns around Covid and competition remain overstated as core competencies will once again drive growth albeit on a high base. The intangibles guiding the sector such as economies of scale, specialised testing, doctor-patient approach, lab network, digitization etc. is a gradual process which outweighs apparent near-term concerns. We believe that aggressive network expansion and volume growth will once again place the organised players on a growth trajectory, aided by acquisitions. The industry has solid room to grow although FY23 could remain optically subdued due to a high base as EBITDA margins revert to pre-pandemic levels. In our view, non-covid revenue is poised to grow at c.19% CAGR over FY22-25 for our coverage universe (including recent acquisitions). High cash generation will continue to drive organic and inorganic acquisitions as all listed players under coverage remain engulfed with cash.

We resume coverage with a **BUY** on (1) **Dr Lal Pathlabs**- the leader of the pack which has consistently delivered growth over the years. A classic example of Dr Lal's superlative business model is the massive operating leverage that played out during Covid transcending street expectations; (2) **Metropolis'** strong thrust on retail expansion and leadership in Western India visible in its superior average realisation per patient validates its strong brand recall. Metropolis' widening discount to Dr Lal makes it an attractive bet; (3) **Krsnaa's** unique PPP model, disruptive pricing and radiology-pathology combination insulates it from current competition. We believe that Krsnaa Diagnostics is set to outpace peers in earnings growth. We initiate coverage on **Vijaya Diagnostics** with a **BUY** given its integrated regional model and sharp B2C focus contributing over 90% of revenue, leading to industry best EBITDA margin of over 40%.

Dr Lal - Unwavering commitment to growth

Dr Lal, the leader of the pack, has consistently delivered growth (c.15% Revenue CAGR over FY15-20) and created value over the years. We believe Dr Lal is poised to grow its non-covid revenue at c.18% CAGR over FY22-25 (including acquisition). Dr Lal has outpaced peers in terms of network expansion in FY21-22 by expanding its FY20 network by c. 51% (vs. c.16% of peers). The management has guided for mid-teens growth in the base business propelled by this network expansion. We believe a part of volume growth will also come from Suburban, whose 3Y Revenue CAGR has been over 30%. Dr Lal has historically traded at higher multiples given its dominant position, high margin-growth and robust cash generation profile. We assign a near pre-pandemic multiple of 46x FY24E earnings to derive a Jun'23 Price Target of INR 2,570. **BUY**.

Metropolis - Transitioning to a new normal

Metropolis' strong thrust on retail expansion (B2C in focus cities at 60%) and unassailable leadership in Western India (53% of non-covid revenue) is visible in its superior non-covid realisation validating its strong brand recall amid increasing competitive intensity. Metropolis' young service network offers a long runway for growth (expansion to 245 labs and 4,670 collection centres by FY24). We believe the aggressive expansion plan coupled with Hitech acquisition will generate non-covid Revenue CAGR of 17% over FY22-25. At c.31x FY24 earnings, Metropolis trades below pre-Covid multiples and -1 SD below its 5Y average. Metropolis has always traded at a discount to Dr Lal which has now widened to 37%. We assign a near pre-Covid multiple of 36x 1Y forward earnings (implying a c.21% discount to Dr Lal's) thereby arriving at a Jun'23 Price Target of INR 1,760. **BUY**.

Krsnaa Diagnostics - On a tender-winning spree

Krsnaa Diagnostics is the undisputed PPP leader having 2071 centres spanning across 15 states. Despite Krsnaa's disruptive pricing model, it has maintained robust EBITDA margin (better than leaders). Krsnaa recently won tenders in Uttar Pradesh, Chandigarh, Himachal Pradesh (pathology) and Tripura in addition to existing tenders it won in Maharashtra, Punjab, Himachal and Karnataka. We believe the aforesaid wins will add INR 2 bn+ in revenue and expand EBITDA margin above 30% in FY24. At c.14x FY24E EPS, the valuations are at a significant discount to peers. We assign a multiple of 24x (vs. 46x of Dr Lal given Krsnaa's high PPP tender execution risk) to derive a Price Target of INR 930 as the company is set to be the best performer of the sector. **BUY**.

Vijaya Diagnostics - Margin leadership

We initiate coverage on Vijaya Diagnostics, the largest integrated diagnostic chain in the South with 95 state-of-the-art centres across 16 cities. Vijaya's sharp B2C focus (>90% revenue), strategic brand positioning over 4 decades and optimal mix of radiology-pathology (35:65) has resulted in a superior average realisation per patient (ARPP) of INR 1277 and margin profile (the best among listed peers). We factor in Vijaya's high capex intensity to drive non-covid Revenue CAGR of c. 19% over FY22-25 with any inorganic expansion posing upside risks to our estimates. We assign a multiple of 32x FY24E earnings (implying a c.30% discount to Dr Lal's), giving a Jun'23 Price Target of INR 420. **BUY**.

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JM Financial Research is also available on: Bloomberg - JMFR <GO>, Thomson Publisher & Reuters, S&P Capital IQ, FactSet and Visible Alpha

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Krsnaa Diagnostics | BUY

On a tender winning spree

Krsnaa Diagnostics is the undisputed PPP leader with 2,071 centres spanning across 15 states. Despite its disruptive pricing model, it has maintained robust EBITDA margin (better than leaders). Krsnaa recently won tenders in Uttar Pradesh, Chandigarh, Himachal Pradesh (pathology) and Tripura in addition to existing tenders that it won in Maharashtra, Punjab, Himachal and Karnataka. We believe the aforesaid wins will add INR 2 bn+ in revenue and expand EBITDA margin above 30% in FY24. At c.14x FY24E EPS, the valuations are at a significant discount to peers. Our thesis is based on (1) Unique PPP business model; (2) Insulated from competition; (3) On a tender-winning spree. We assign a multiple of 24x (vs. 46x of Dr Lal given Krsnaa's high PPP tender execution risk) to derive a Jun'23 Price Target of INR 930 as the company is set to be the best performer of the sector. BUY.

- Unique PPP business model:** Krsnaa's unique business model enables it to maintain robust EBITDA margin (better than the leaders) despite offering services at disruptive prices i.e. 45-60% discount to market prices in radiology and 40-80% discount to market prices in pathology. The aforesaid prices are 5-6% below the CGHS rates. The key features of their unique business model are: (1) long term Government contracts with annual 2-5% price increases; (2) competitive cost structure with cost efficiencies like no rent and no doctor referral fees inherent in the PPP model, discount on equipment (c.15% to market price) due to large procurement; (3) ability to bid competitively with a high success ratio; (4) robust order wins and execution leading to long-term revenue visibility; and (5) debt-free company with ICRA A & A1 rating.
- Insulated from competition:** Krsnaa's contracts have an annual price escalation clause and extension clause which improve realisation and revenue visibility vis-à-vis peers who may face a decline in realisation due to increasing competitive intensity. Around 55% of the revenues come from radiology, which is expected to insulate the company from any pricing pressures. The management intends to launch B2C pathology centres in four states with disruptive pricing- targeting 1,000 collection centres from FY23 by leveraging existing infrastructure. The company is also selling healthcare packages through online aggregators (e.g. MFine). It is evaluating a few private hospital partnerships (typically 10 years, higher pricing than PPP due to 15-30% revenue sharing with hospitals), which along with new B2C focus, will gradually increase private revenue share from 33% (in FY21) to 50% over the medium term.
- On a winning spree; execution remains key:** Krsnaa is in the process of completing orders won in Maharashtra, Karnataka, Himachal Pradesh and Punjab which is expected to contribute c. INR 2 bn in FY24. Most of the revenue is expected from Maharashtra and Punjab. Additionally, the company also won new PPP contracts in Himachal Pradesh, Tripura, Chandigarh and Uttar Pradesh and it is expecting a total of 5 tender wins by Dec'22. As guided by the management, the typical time to operationalise centres post an order win is 6-12 months.
- Expected to outpace peer earnings growth:** The management has guided for 30%-35% EBITDA margin in FY23 and FY24 and has ambitious plans to double revenue and triple profit over 2-3 years as INR 2 bn+ is expected from new centres already contracted as existing centres with maturity continue to deliver growth. However, we conservatively build in 20% Revenue CAGR and 24% EBITDA CAGR over FY22-25E. Krsnaa has had



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Recommendation and Price Target

Current Reco.	BUY
Current Price Target (12M)	930
Upside/(Downside)	75.8%

Key Data – KRSNAA IN

Current Market Price	INR529
Market cap (bn)	INR16.6/US\$0.2
Free Float	72%
Shares in issue (mn)	31.4
Diluted share (mn)	31.4
3-mon avg daily val (mn)	INR63.1/US\$0.8
52-week range	1,100/480
Sensex/Nifty	52,908/15,752
INR/US\$	79.0

Price Performance

%	1M	6M	12M
Absolute	-5.6	-28.3	0.0
Relative*	-0.5	-18.8	0.0

* To the BSE Sensex

Financial Summary					(INR mn)
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E
Net Sales	3,965	4,555	5,483	6,796	7,926
Sales Growth (%)	53.4	14.9	20.4	24.0	16.6
EBITDA	938	1,315	1,650	2,134	2,528
EBITDA Margin (%)	23.7	28.9	30.1	31.4	31.9
Adjusted Net Profit	315	683	885	1,163	1,388
Diluted EPS (INR)	12.3	21.8	28.2	37.0	44.2
Diluted EPS Growth (%)	-4.3	77.5	29.5	31.4	19.4
ROIC (%)	41.1	18.6	15.0	16.3	17.3
ROE (%)	180.8	14.9	12.1	14.0	14.5
P/E (x)	43.2	24.3	18.8	14.3	12.0
P/B (x)	2.6	2.4	2.1	1.9	1.6
EV/EBITDA (x)	18.0	10.9	9.1	6.9	5.5
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0

Source: Company data, JM Financial. Note: Valuations as of 01/Jul/2022

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leadership changes (CS and COO) post listing and an independent director resigning due to personal reasons. Overall, we believe that the company geared up to outperform the sector.

- **Valuation:** The stock has seen a steep correction of c.52% from its highs. At c.14x FY24E EPS, we believe that the valuations are extremely attractive. We assign a multiple of 24x (c.48% discount to Dr Lal given Krsnaa's high PPP tender execution risk) to arrive at a Jun'23 Price Target of INR 930 as the company is set to be the best performer of the sector. **BUY.**

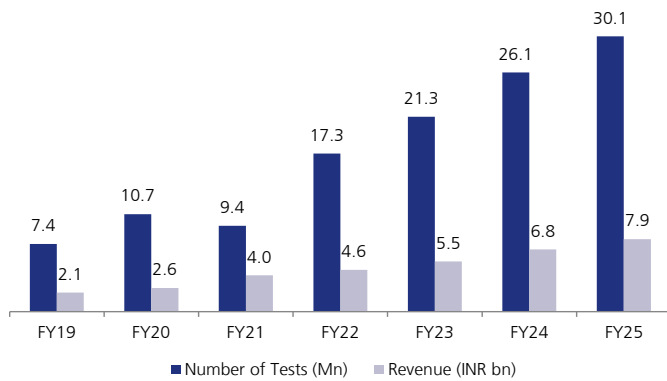
Exhibit 1. Valuations across the sector have corrected; Krsnaa- a collateral damage



Source: JM Financial, Bloomberg

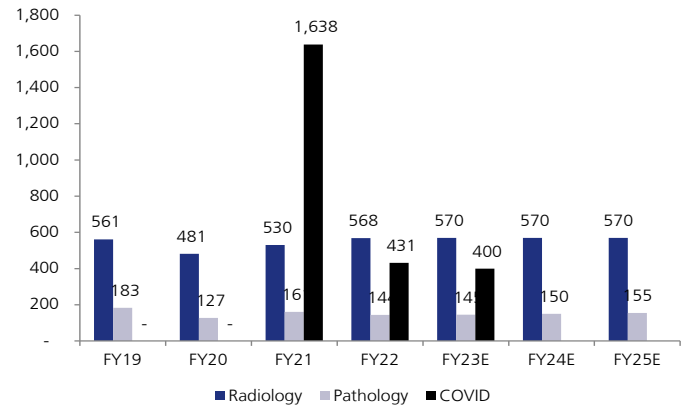
Focus Charts

Exhibit 2. Revenue growth of c.20% CAGR over FY22-25



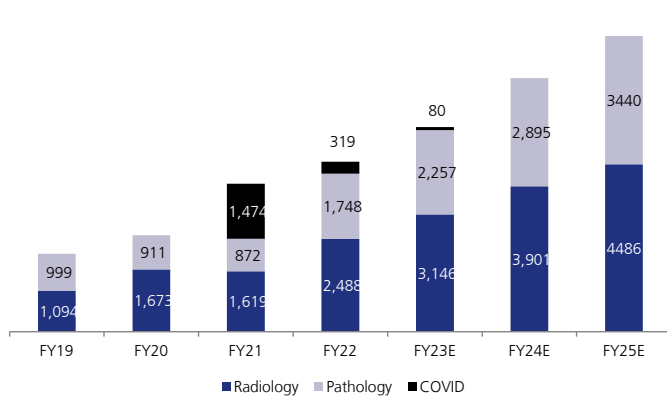
Source: Company, JM Financial

Exhibit 3. Realisations largely stable



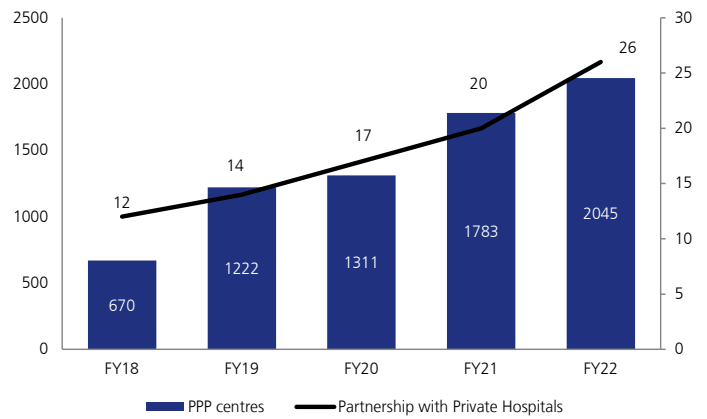
Source: Company, JM Financial

Exhibit 4. Covid contribution minimal in FY22



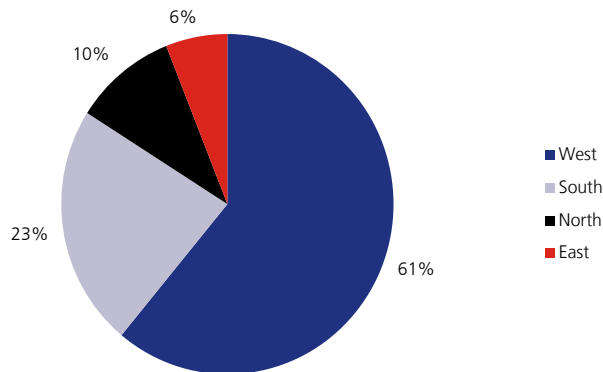
Source: Company, JM Financial; Figures in INR mn

Exhibit 5. Network has grown 3x over the years



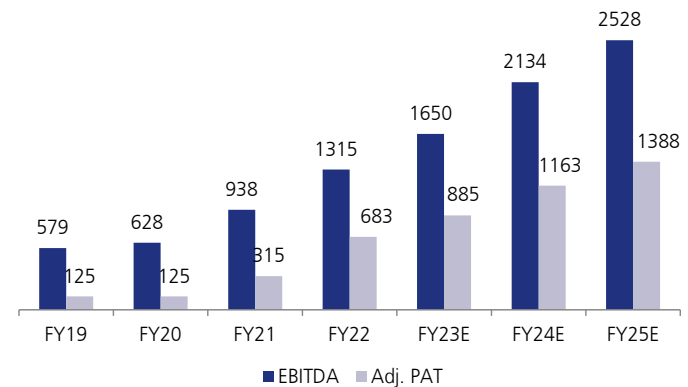
Source: Company, JM Financial

Exhibit 6. Revenue by Geography (FY22)



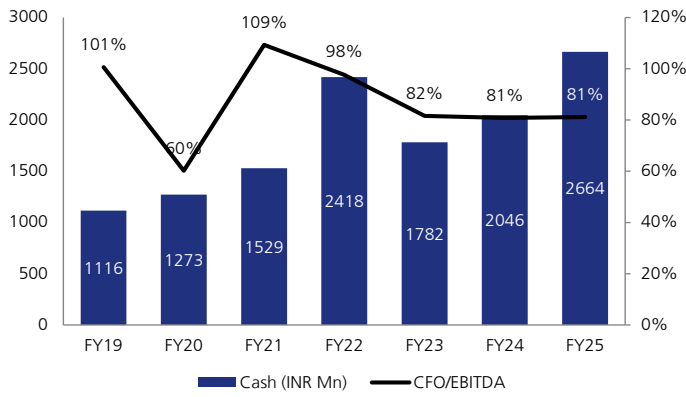
Source: Company, JM Financial; Patients in mn

Exhibit 7. Earnings growth to outpace peers



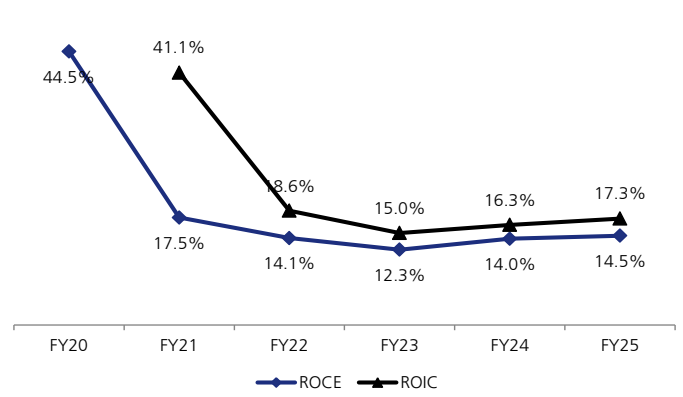
Source: Company, JM Financial

Exhibit 8. High Cash generation with receivable days at 46 (FY22)



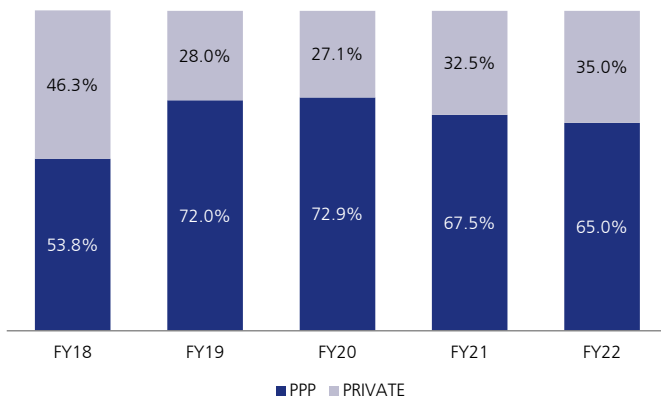
Source: Company, JM Financial

Exhibit 9. Mature centres have 33% ROCE in FY22



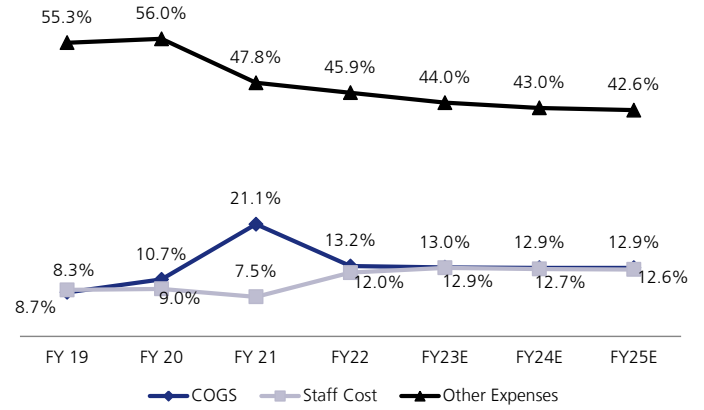
Source: Company, JM Financial

Exhibit 10. Private share gradually inching up



Source: Company, JM Financial

Exhibit 11. Inflation has nearly no impact on cost



Source: Company, JM Financial

Exhibit 12. Centres by type

Type of Diagnostic Centre	FY19	FY20	FY21	FY22
Radiology	833	897	1365	1488
Pathology	440	455	465	583
Collection Centres	409	422	425	534
Processing Centres	31	33	40	49

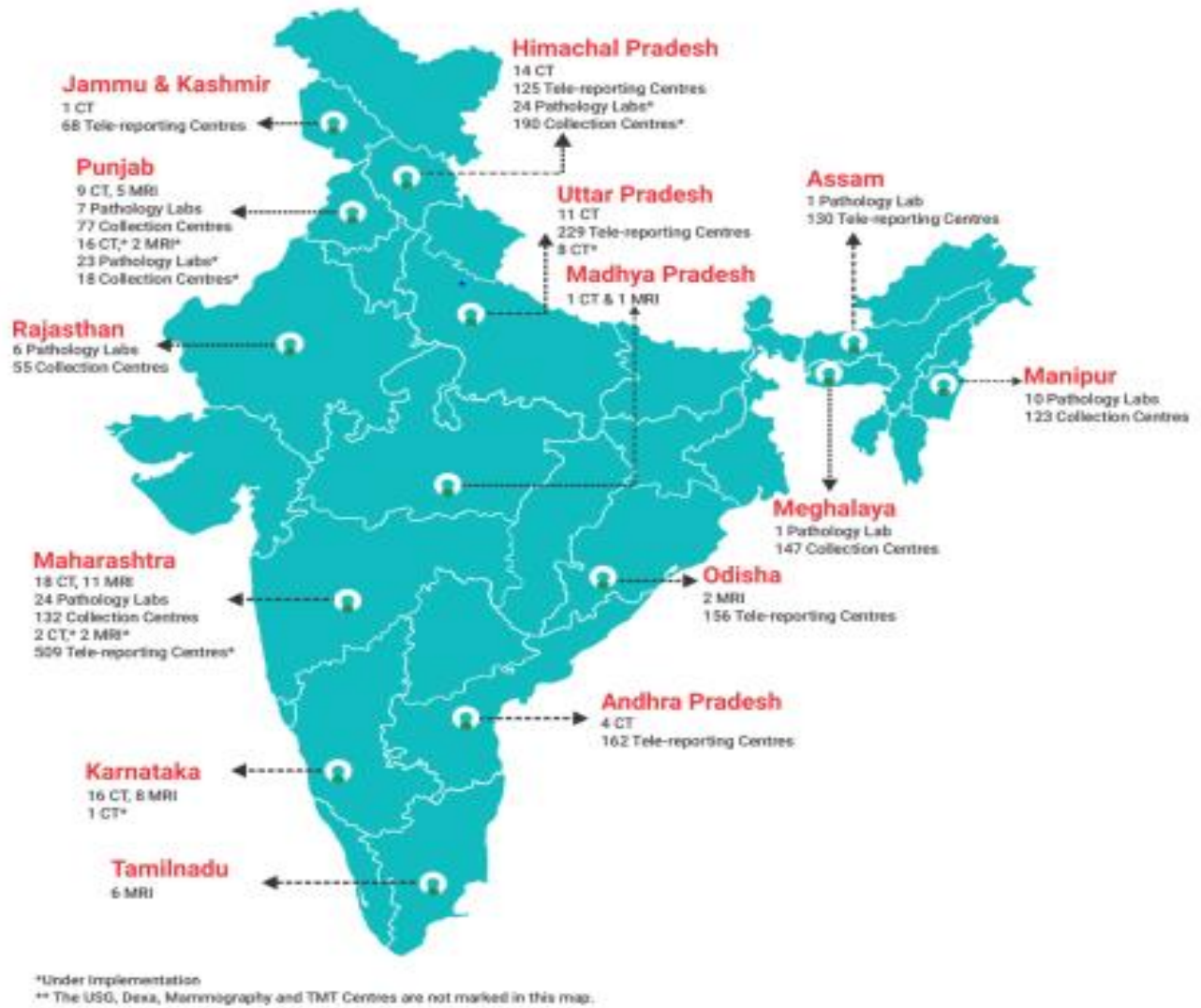
Source: Company

Exhibit 13. Disruptive pricing

Segment	Test	Player 1	Player 2	Player 3	Krsnaa	% from min price
RDL	CT Brain	4,500	4,500	3,500	2,000	(43%)
RDL	MRI Brain	8,000	8,250	7,000	3,500	(50%)
PTH	CBC	250	250	200	146	(27%)
PTH	Blood Sugar	85	80	70	26	(63%)
PTH	Thyroid	500	550	550	216	(57%)
PTH	Vitamin D	1,500	1,250	1,450	595	(52%)
PTH	Vitamin B12	1,000	1,100	1,300	243	(76%)
PTH	HbA1C	550	440	400	141	(65%)

Source: Company

Exhibit 14. Pan India presence



Source: Company

Exhibit 15. Telereporting hub has sufficient capacity to process expected large volumes

Test	Monthly Capacity	FY22 Annual Volumes	Headroom
CT Scans	1,45,000	7,27,466	2.4x
MRIs	40,000	2,31,698	2.1x
Tele Reporting	2,000,000	34,21,875	7.0x

Source: Company

Exhibit 16. Tender wins

STATE	PROJECT DETAILS
Uttar Pradesh	<ul style="list-style-type: none"> UP Government awarded contract in February 2022. National Health Mission backed contract Duration 10 Years Deploy 8 CT scanners in districts hospitals
Chandigarh	<ul style="list-style-type: none"> Chandigarh health department awarded contract in February 2022 Duration 10 Years Deploy 1 MRI scanners at Govt. Multi Specialty Hospital, Chandigarh
Himachal Pradesh	<ul style="list-style-type: none"> Himachal Pradesh department of health and family awarded contract in February 2022 Duration 5 Years Establish 24 Labs and 190 collection centres with Hub and Spoke model
Tripura	<ul style="list-style-type: none"> The Mission Director, National Health Mission, State Health & Family Welfare Society, Tripura. Duration 5 Years Provide free diagnostic service - X-ray Tele Radiology Services in District Hospitals/ Sub-District Hospitals/ Community Health Centres in the state of Tripura
Punjab	<ul style="list-style-type: none"> Required to establish centres in 24 government hospitals with the deployment of 23 CT scanners and 6 MRI machines; bid to establish pathology diagnostic centres
Maharashtra	<ul style="list-style-type: none"> MCGM Contract: Establish diagnostic centres in MCGM hospitals; CT scan centre at Pandit Madan Mohan Malviya Shatabdi Municipal General Hospital, Govandi; an MRI and CT scan centre at Rajawadi Hospital, Ghatkopar; a CT scan centre at Bhabha Hospital, Kurla
Maharashtra	<ul style="list-style-type: none"> KJ Somaiya Hospital (Private Radiology): Establishment, management and maintenance of a diagnostic centre at K J Somaiya Hospital & Research Centre, Sion
Himachal Pradesh	<ul style="list-style-type: none"> Required to establish a CT scan centre each in government hospitals located in Solan and Bilaspur
Karnataka	<ul style="list-style-type: none"> Required to set up one spiral CT scan centre in a hospital located in Ramanagara and one MRI centre in a hospital located in Udupi

Source: Company

Exhibit 17. Status of projects (mentioned in RHP)

Radiology Centres Growth

State	Total Centres	Operational Till March 22	To be Operationalized in Q1 FY23	Construction Completed	Construction WIP
Punjab	25	9	7	8	1
MCGM Mumbai	3	1	1	-	1
Himachal Pradesh	2	2	-	-	-
Karnataka	2	1	-	-	1
Somaiya Hospital Mumbai	1	-	1	-	-
Total Radiology	33	13	9	8	3

Pathology Centres Growth

State	Total Centres	Operational Till March 22	To be Operationalized in Q1 FY23	Construction Completed	Construction WIP
Punjab Labs	30	7	11	8	4
Punjab Collection Centres	95	77	2	-	16
Total Pathology	125	84	13	8	20

Total Capital Expenditure incurred of Rs. 59 Crore from IPO Proceeds for setting up new centres

Source: Company

Financial Tables (Consolidated)

Income Statement		(INR mn)				
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E	
Net Sales	3,965	4,555	5,483	6,796	7,926	
Sales Growth	53.4%	14.9%	20.4%	24.0%	16.6%	
Other Operating Income	0	0	0	0	0	
Total Revenue	3,965	4,555	5,483	6,796	7,926	
Cost of Goods Sold/Op. Exp	837	603	713	877	1,022	
Personnel Cost	296	547	707	863	999	
Other Expenses	1,893	2,089	2,412	2,922	3,377	
EBITDA	938	1,315	1,650	2,134	2,528	
EBITDA Margin	23.7%	28.9%	30.1%	31.4%	31.9%	
EBITDA Growth	49.3%	40.1%	25.5%	29.3%	18.5%	
Depn. & Amort.	374	414	553	673	793	
EBIT	564	901	1,098	1,461	1,736	
Other Income	2,650	149	143	161	182	
Finance Cost	259	185	76	71	66	
PBT before Excep. & Forex	2,955	865	1,164	1,551	1,851	
Excep. & Forex Inc./Loss(-)	0	0	0	0	0	
PBT	2,955	865	1,164	1,551	1,851	
Taxes	1,105	182	279	388	463	
Extraordinary Inc./Loss(-)	0	0	0	0	0	
Assoc. Profit/Min. Int.(-)	0	0	0	0	0	
Reported Net Profit	1,849	683	885	1,163	1,388	
Adjusted Net Profit	315	683	885	1,163	1,388	
Net Margin	8.0%	15.0%	16.1%	17.1%	17.5%	
Diluted Share Cap. (mn)	25.7	31.4	31.4	31.4	31.4	
Diluted EPS (INR)	12.3	21.8	28.2	37.0	44.2	
Diluted EPS Growth	-4.3%	77.5%	29.5%	31.4%	19.4%	
Total Dividend + Tax	0	0	0	0	0	
Dividend Per Share (INR)	0.0	0.0	0.0	0.0	0.0	

Source: Company, JM Financial

Cash Flow Statement		(INR mn)				
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E	
Profit before Tax	2,955	865	1,164	1,551	1,851	
Depn. & Amort.	374	414	553	673	793	
Net Interest Exp. / Inc. (-)	140	62	-67	-90	-115	
Inc (-) / Dec in WCap.	148	-7	-24	-22	-13	
Others	-2,515	16	0	0	0	
Taxes Paid	-77	-66	-279	-388	-463	
Operating Cash Flow	1,026	1,284	1,347	1,724	2,053	
Capex	-668	-1,322	-2,000	-1,500	-1,500	
Free Cash Flow	357	-38	-653	224	553	
Inc (-) / Dec in Investments	-57	-1,265	0	0	0	
Others	114	180	143	161	182	
Investing Cash Flow	-611	-2,406	-1,857	-1,339	-1,318	
Inc / Dec (-) in Capital	7	3,853	0	0	0	
Dividend + Tax thereon	0	0	0	0	0	
Inc / Dec (-) in Loans	555	-1,894	-50	-50	-50	
Others	-254	-200	-76	-71	-66	
Financing Cash Flow	308	1,760	-126	-121	-116	
Inc / Dec (-) in Cash	723	637	-636	264	618	
Opening Cash Balance	-476	247	884	248	512	
Closing Cash Balance	1,529	2,418	1,782	2,046	2,664	

Source: Company, JM Financial

Balance Sheet		(INR mn)				
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E	
Shareholders' Fund	2,319	6,844	7,729	8,892	10,280	
Share Capital	65	157	157	157	157	
Reserves & Surplus	2,254	6,687	7,572	8,735	10,123	
Preference Share Capital	0	0	0	0	0	
Minority Interest	0	0	0	0	0	
Total Loans	2,027	410	360	310	260	
Def. Tax Liab. / Assets (-)	107	70	70	70	70	
Total - Equity & Liab.	4,453	7,324	8,159	9,272	10,610	
Net Fixed Assets	3,122	4,140	5,587	6,414	7,121	
Gross Fixed Assets	3,733	4,908	6,908	8,408	9,908	
Intangible Assets	12	23	23	23	23	
Less: Depn. & Amort.	661	1,075	1,627	2,300	3,093	
Capital WIP	37	283	283	283	283	
Investments	3	3	3	3	3	
Current Assets	2,920	4,611	4,138	4,634	5,452	
Inventories	72	92	110	137	160	
Sundry Debtors	725	579	697	863	1,007	
Cash & Bank Balances	1,529	2,419	1,782	2,046	2,664	
Loans & Advances	0	0	0	0	0	
Other Current Assets	594	1,522	1,549	1,588	1,621	
Current Liab. & Prov.	1,593	1,430	1,570	1,780	1,966	
Current Liabilities	888	794	934	1,144	1,331	
Provisions & Others	705	636	636	636	636	
Net Current Assets	1,327	3,182	2,569	2,855	3,485	
Total - Assets	4,453	7,324	8,159	9,272	10,610	

Source: Company, JM Financial

Dupont Analysis						
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E	
Net Margin	8.0%	15.0%	16.1%	17.1%	17.5%	
Asset Turnover (x)	0.8	0.8	0.7	0.8	0.8	
Leverage Factor (x)	28.6	1.3	1.1	1.1	1.0	
RoE	180.8%	14.9%	12.1%	14.0%	14.5%	

Key Ratios						
Y/E March	FY21A	FY22A	FY23E	FY24E	FY25E	
BV/Share (INR)	201.1	218.0	246.1	283.2	327.4	
ROIC	41.1%	18.6%	15.0%	16.3%	17.3%	
ROE	180.8%	14.9%	12.1%	14.0%	14.5%	
Net Debt/Equity (x)	0.2	-0.3	-0.2	-0.2	-0.2	
P/E (x)	43.2	24.3	18.8	14.3	12.0	
P/B (x)	2.6	2.4	2.1	1.9	1.6	
EV/EBITDA (x)	18.0	10.9	9.1	6.9	5.5	
EV/Sales (x)	4.3	3.2	2.7	2.2	1.8	
Debtor days	67	46	46	46	46	
Inventory days	7	7	7	7	7	
Creditor days	95	87	87	88	89	

Source: Company, JM Financial

APPENDIX I

JM Financial Institutional Securities Limited

Corporate Identity Number: U67100MH2017PLC296081

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SEBI Registration Nos.: Stock Broker - INZ000163434, Research Analyst – INH000000610

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