Dr. Lal Path Labs Ltd. (DLPL). : Quality comes at a premium, "SUBSCRIBE"

4th December, 2015

Dr Lal PathLabs, incorporated in 1995 and headquartered in Delhi is India's first diagnostic service provider to get listed on Indian equity bourses. Initially, the business was established by Dr. S. K. Lal, who commenced the business of providing pathology services and maintaining blood bank in the year 1949. Until recently, before getting converted into public company, it was operating as partnership firm with 50:50 shares between Dr. Vandana Lal and Brig. Dr. Arvind Lal. DLPL is provider of diagnostic and related healthcare tests and services in India. Operates in Hub and spoke model, with presence across major cities like – Delhi, Mumbai, Bengaluru, Chennai, Hyderabad and Kolkata. DLPL is capable of performing 1,813 pathological tests, 1,555 radiology and cardiology tests as well as services that cover a range of specialties and disciplines. DLPL has a Pan – India integrated coverage with 172 clinical labs (including National Reference Lab at Delhi), 1,554 Patient Service Centers (PSCs) and 7,059 Pickup points. Through its integrated, nationwide network, DLPL offers patients and healthcare providers a broad range of diagnostic and related healthcare tests and services for use in core testing, patient diagnosis and the prevention, monitoring and treatment of disease and other health conditions. The Company collected and processed approximately 21.8 million samples from approximately 9.9 million patients in FY15 and ~13.4 mn samples from ~6.2 mn patients in H1FY16. DLPL customers include individual patients, hospitals and other healthcare providers and corporate customers. Today, Dr. Lal Pathlabs is a established consumer healthcare brand in diagnostic services.

Over the period FY13-15, topline witnessed a CAGR of 20.7% to touch Rs. 6.6bn. EBITDA registered a CAGR of 25.8%YoY to to Rs1.6bn. DLPL witnessed margin improvement of 190bp from 22.1% to 24.0%. Reported PAT increased 30.7%YoY from Rs. 556m to Rs. 949mn. The stellar performance in business is attributed to (i) the growth of the network as well as the expansion of diagnostic portfolio and related healthcare tests and services, (ii) improvements in operating efficiency, including management of costs and expenses, (iii) lower capital expenditure due to use of a "reagent rental" model (iv) the strategy of prioritizing resources and investments in accordance with their significance to its business. The Company's Competitive strengths include: a) Business model focused on the patient as a customer and an established consumer healthcare brand associated with quality services, in a market where patients generally choose their diagnostic healthcare service provider, b) well-positioned to leverage upon one of the fastest-growing segments of the Indian healthcare industry. c) a network whose growth yields greater economies of scale, combined with a "hub and spoke" model that is scalable for further growth, d) centralized information technology platform that fully integrates its network and is scalable, e) attractive financial performance, financial profile and return on invested capital, f) experienced leadership team with strong industry expertise and successful track record. At the upper end of the price band of Rs. 550, the issue is richly valued at a P/E of 48x on post issue FY15 EPS. With due consideration to factors like a) DLPL well positioned in one of the fastest – growing segments of the Indian Helathcare Industry, b) established consumer healthcare brand in diagnostic services, c) leader in largely fragmented and unorganized industry, c) brand recognition for quality diagnostic services, d) attractive operating metrics and multiple levers in place to drive next phase of growth, e) debt – free Company, f) robust past financial performance, g) consistent Free Cash Flow generation over last five years and sustainable - strong Return on Equity, we believe premium valuations are justified and recommend long term investors to "SUBSCRIBE" the issue .

Issue date	Dec. 08 - 10, 2015
Issue size	Rs. 6,380 mn. at upper end of the price band
Type of issue	Offer for sale of 11.6 mn. Shares - By Promoter Selling Shareholders (4.11 mn equity shares) and Investor Selling Shareholders (7.49 mn equity shares)
Face Value	Rs.10
Price Band	Rs. 540 - 550 per share
Lot size	20 equity Shares and in multiples of 20 equity shares thereof
Issue structure	QIB: 50%, Retail: 35% Non – Institutional: 15%
Post issue market cap	Rs. 45.25 bn at upper price band
Book Running Lead Managers	Kotak Securities and Citi Global Markets
Registrar to the issue	Link Intime

Y/e 31 Mar (Rs. mn)	H1FY16	FY15	FY14	FY13
Revenue (Gross)	4,050	6,596	5,579	4,517
Growth (%)	-	18	24	32
EBITDA	882	1,589	1,408	1,005
EBITDA Margin (%)	21.1	23.6	24.8	21.6
Reported PAT	375	950	803	556
PAT margin (%)	9.1	14.3	14.3	12.2
*Post issue EPS (Rs.)	-	11.55	9.76	6.76
P/E (x)	-	48	56	81
Equity Capital	822.7	812.62	803.10	50.20
Networth	4,091	3,411	2,315	1,621
RoE (%)	-	32.9	40.4	39.6
P/BV (x)	-	13	20	28

Shareholding Pattern (%)	Pre Issue	Post Issue
Promoters group	68.7	58.7
Public and others	31.3	21.3
Total	100	100

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Objects of the issue

The Objects of the offer are to achieve the benefits of listing the Equity Shares on the Stock Exchanges and for the Offer for Sale of up to 11.60 mn equity shares. Offer for sale comprises of Promoter Selling Shareholders ((Hony.) Brig. Dr. Arvind Lal – 1.26 mn equity shares, Dr. Vandana Lal – 2.05 mn equity shares, Eskay House (HUF) – 0.23 mn equity shares, Mr. Anjaneya Lal – 0.55 mn equity shares and Investor Selling Shareholders (Wagner – 5.86 mn equity shares, WCF – 1.47 mn equity shares and SIH 0.16 mn equity shares). The Company will not receive any proceeds from the offer.

Business Strategy

1) Continue to expand its presence in the markets in which it operates.
2) Expand into other markets in India through strategic acquisitions and partnerships.
3) Increase the breadth of its diagnostic healthcare testing and services platform.
4) Continue its focus on providing its customers quality diagnostic and related healthcare tests and services.
5) Leverage its network efficiencies to expand its management of hospital – based and other clinical laboratories.

Industry Overview

CRISIL Research estimates the size of the diagnostics industry at around Rs. 377 bn in 2014-2015. Overall market for wellness and preventive diagnostics, as per CRISIL Research's estimations, was 6-8% of the total diagnostic services market in 2014- 2015. CRISIL Research expects that the diagnostics industry will continue to grow by 16%-17% over the next three years. According to CRISIL Research, pathology testing has the larger share of the overall domestic diagnostics market. Pathology includes biochemistry, immunology, hematology, urine analysis, molecular diagnostics and microbiology, among others, whereas imaging diagnostics, or radiology, includes, for example, ultrasound, X-ray, CT scan, MRIs and positron emission tomography – computed tomography, or PETCT.

Key risks

1) **Operates in a highly competitive business environment:** India's diagnostics industry is highly competitive with standalone centers (independent clinical laboratories, smaller – scale providers) having close to a 48% market share, compared to around 37% for hospital-based diagnostic centers. This increases competition for organized diagnostic chains in terms of volumes of patients' samples and aggressive pricing of diagnostic tests.

2) **Shortage of manpower:** Key area of concern is the training and retention of critical staff such as lab technicians, who are employed at labs and collections centers and are responsible for the collection and preservation of patient samples. The situation is even more critical for standalone diagnostic centers, which may not be able to employ well-trained lab technicians and pathologists.

3) **Technological advancements may pose a threat:** Advances in technology may lead to the development of more cost effective technologies which may offer stiff competition from other players having latest technology. To stay ahead of the competition, diagnostics centers have to constantly upgrade their technology. However, these upgrades not only involve significant capital investments but also increase maintenance costs. This significantly increases cost overheads for service providers. Moreover, two versions of certain equipment could have a significant price differential, making it difficult for service providers to upgrade. This is especially the case for smaller players who face a paucity of funds.

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