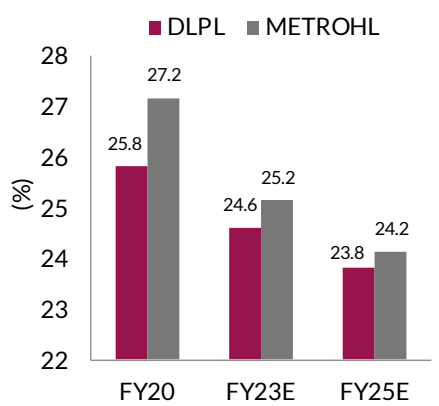


Sales and operating metrics

Non-Covid	9M'23	Q3'20-Q3'23
Sales (Rs mn)		
DLPL	16%	13%
DLPL (ex-Suburban)	10%	11%
METROHL	20%	8%
METROHL (ex-Hitech)	14%	5%
Sample (in mn)		
DLPL	9%	14%
METROHL	22%	9%
RPS^ (Rs)		
DLPL	6%	-1%
METROHL	-2%	-1%

Source: Company, Axis Capital, Realization per sample

EBITDA margin trend



Source: Company, Axis Capital

PE deratings are likely to persist in the diagnostic segment as two factors continue to pressure valuations: (1) sliding margins – from 27% in FY22 to 24% in FY25 (9MFY23 at 24.8%) on weaker pricing power/ increasing online competition and costs, and (2) falling ROE following expensive M&As. After three exciting phases in the past decade, we expect growth to normalize to ~12-13% over FY23-25E (-5% in 9MFY23, 17% in non-Covid sales, 11% ex-M&A) on the back of favorable segmental macros and geographical expansion. We value DLPL and Metropolis at a 10% discount to the historical mean on margin challenges. We initiate coverage on DLPL (REDUCE, TP of Rs 1,800, 44x FY25E) and METROHL (ADD, TP of Rs 1,400, 40x FY25E). Notably, our FY24/ 25 EPS estimates are ~15-20% lower than consensus.

Prognosis positive for sustainable growth on broad macros

We concur with industry expectations of 14% CAGR over FY21-26. Our rationale: (1) Favorable macros that factor in the opportunity presented by growing healthcare spends, increasing disease burden and shift towards organized markets and (2) Criticality of diagnostics as a part of the healthcare prevention and intervention process (detection-treatment-monitoring). We underscore our view of the industry's timeline over the past decade: (i) Phase 1: Strong growth of 20% CAGR over FY12-17, off a low base, (ii) Phase 2: Steady growth of 13%-15% CAGR over FY17-20 led by geographical expansion, (iii) Phase 3: Covid impact, which saw 20-25% growth over FY21-22 and (iv) Phase 4: Current recovery in non-Covid sales during 9MFY23.

Competition unabated though discounts compact

Low entry barriers and high ROCEs for the sector in the past decade have seen the entry of many online and conventional healthcare companies. Our channel checks with online players like Tata 1mg and Redcliffe reiterate sustained and fierce competition. Their bundling of wellness/ chronic routine tests bears this out, with disruptive pricing at 40%-75% lower than incumbents with service offerings spreading across Tier 1/2 cities. Increasingly scarce funding and high customer acquisition costs are compelling online companies to reduce discounts. We note DLPL's recent price hikes in select specialized tests, but these are nascent yet, and we watch the growth-vs.-margin trend closely.

Sales growth to normalize; margins/ ROE to see declining trend

We expect sales growth for organized players to normalize post Covid to 12-13% led by (1) continued focus on the illness market (acute, chronic) with expanding test portfolios, (2) wellness scale-up, (3) growing access to doctors and quality services with better TAT, and (4) volume growth from growing proliferation within core markets (entering Tier 2/3 cities) and non-core markets in key cities. CFO/ FCF remains strong, while we expect a declining trend in EBITDA margins on pricing pressure (negligible price increase in 3-5 years, discounts by online players, declining trends in realization per sample) and cost pressures (led by expansion) – more so in PAT margin/ ROE on amortization increases/ interest expenses from M&A.

Valuations to de-rate further; initiate coverage on Metropolis and DLPL

We value DLPL and Metropolis at a 10% discount to the historical mean. The PE derating from the 65-80x peak during Covid to ~35-50x at present has yet to see its bottom, we see declining profitability and return ratios pruning valuations further.

Valuation snapshot

Companies	Mcap Ratings (USD bn)	CMP (Rs/ sh)	TP	EV/EBITDA (x)		PE (x)		RoE %	
				FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
DLPL	2.0 Reduce	1,988	1,800	29	26	56	49	19	19
METROHL	0.8 Add	1,310	1,400	21	19	42	37	16	16

Source: Company, Axis Capital

Prakash Agarwal
prakash.agarwal@axiscap.in

Mehul Sheth
mehul.sheth@axiscap.in

Sudarshan Agarwal
sudarshan.agarwal@axiscap.in

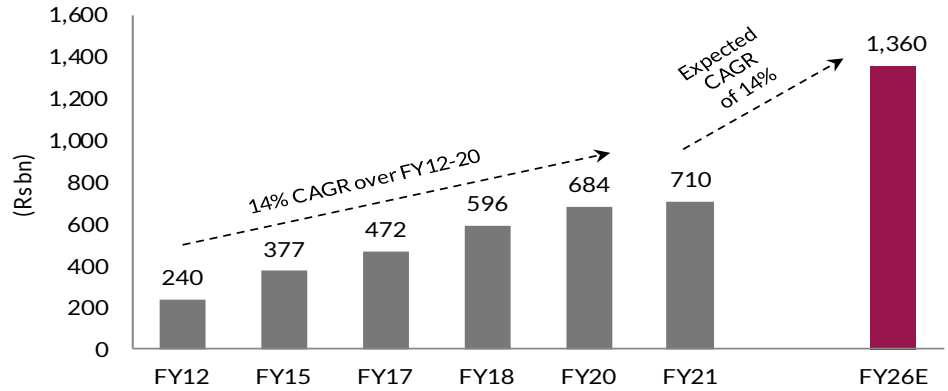
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Key Charts

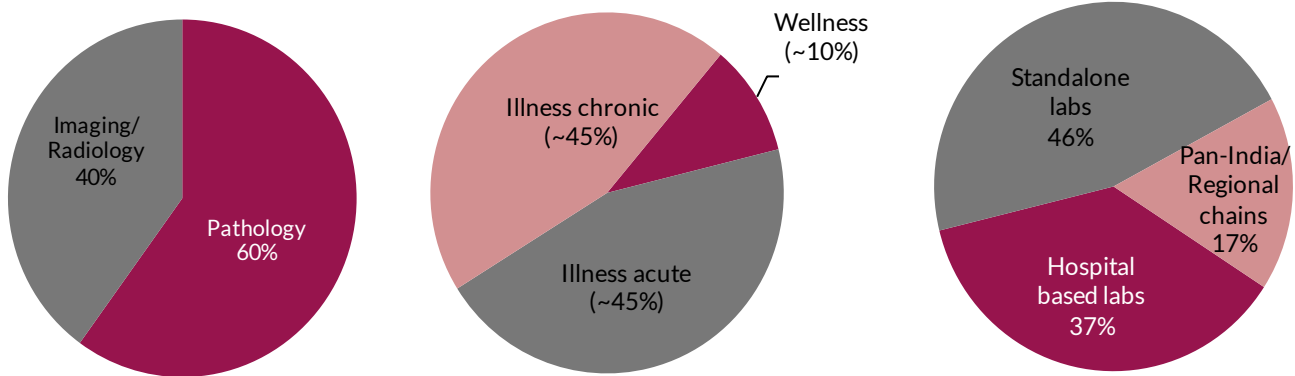
India Diagnostic Sector – market outlook, structure, and key players

Exhibit 1: India diagnostic market to see steady growth



Source: Vijaya Diagnostic RHP from FY12-20, Dr Lal Path AR FY2022, Industry data for FY21-26E

Exhibit 2: Pathology accounts for ~60% of diagnostics, ~90% of this comes from illness market (acute and chronic)

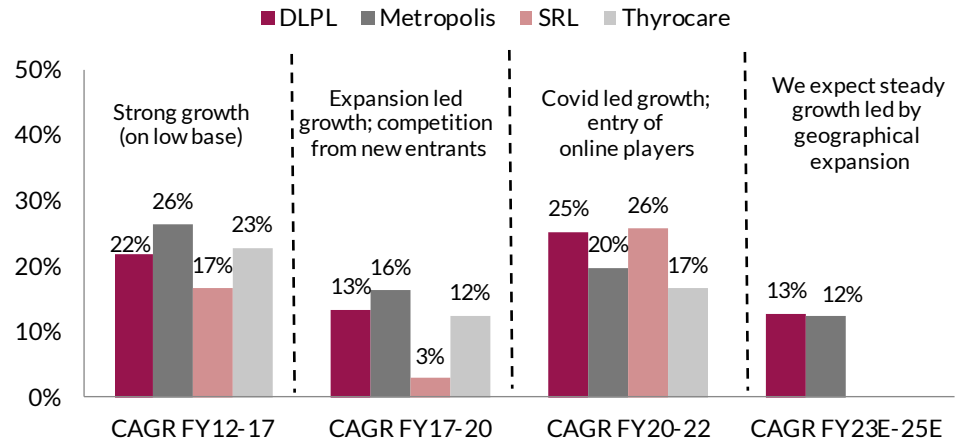


Source: Dr Lal Path annual report 2022, ACL channel checks

Exhibit 3: Organized market contributes ~17% to overall diagnostic market

Pure diagnostic	Sales FY22 (Rs bn)	Online players	Sales FY22 (Rs bn)	Hospital Labs	Sales FY22 (Rs bn)	Other corporates	Sales FY22 (Rs bn)	PE backed	Sales FY22 (Rs bn)
DLPL (1949)	21	Tata 1 mg (2015)^	2	Apollo Diagnostic (2015)	4	PathKind (2016)	2.8	Neuberg (2017)	10
SRL (1999)	16	Healthians (2015)	2	Aster Labs* (2020)	1	MedPlus (2018)	0.1	Redcliffe (2018)	4
Metropolis (2000)	12	Practo (2008)	n.a.	Max Labs (2020)	1	Lupin (2022)	n.a.	Orange Health (2020)	n.a.
Thyrocare (2000)	6	MediBuddy (2000)	n.a.			Torrent Pharma (Announced)	n.a.	Atulaya (2008)	n.a.
Vijaya (2009)	5					Adani (Announced)	n.a.	Medall (1994)	n.a.
Krsnaa (2011)	5								
Total	64	Total	4	Total	6	Total	3	Total	14

Source: Companies, Axis Capital, ^ 1 mg – considering service revenues as diagnostic business, * Aster Labs assuming 50% sales of Labs and Pharmacy segment

India Diagnostic Sector – growth normalizing; realizations to remain muted
Exhibit 4: India diagnostic market growth phases – normalizing now


Source: Companies, Axis Capital

Exhibit 5: Margins/ ROE have been muted

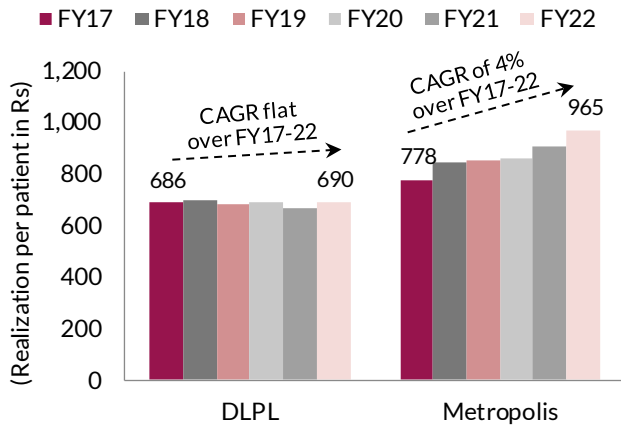
Financial metrics (Rs bn)	FY17	FY18	FY19	FY20	FY21	FY22	9M'23	CAGR FY12-17	FY17-20	FY20-22	9M'23 YoY
EBITDA											
DLPL	2.4	2.6	2.9	3.4	4.4	5.6	3.7	22%	13%	28%	-29%
Metropolis	1.5	1.8	2.0	2.3	2.9	3.4	2.2	22%	15%	21%	-6%
SRL	1.7	1.6	1.8	1.8	1.8	4.1	1.9	32%	1%	53%	-43%
EBITDA margin											
DLPL	26.0	25.0	24.4	25.8	27.6	26.9	24.5	75 bps	-21 bps	103 bps	-292 bps
Metropolis	27.9	27.2	26.3	27.2	28.7	27.9	25.2	-463 bps	-71 bps	72 bps	-386 bps
SRL	18.2	16.1	17.8	17.4	16.9	25.7	18.7	849 bps	-75 bps	825 bps	-852 bps
RoE %											
DLPL	28	25	23	23	26	25	17	-1471 bps	-528 bps	221 bps	NA
Metropolis	38	34	32	32	31	25	15	1471 bps	-609 bps	-734 bps	NA
SRL	10	8	8	7	10	13	NA	NA	-268 bps	607 bps	NA

Source: Companies, Axis Capital; SRL financials – EBITDA for FY12-15 from company presentation, RoE % calculated as of H1FY23 data for DLPL and Metropolis

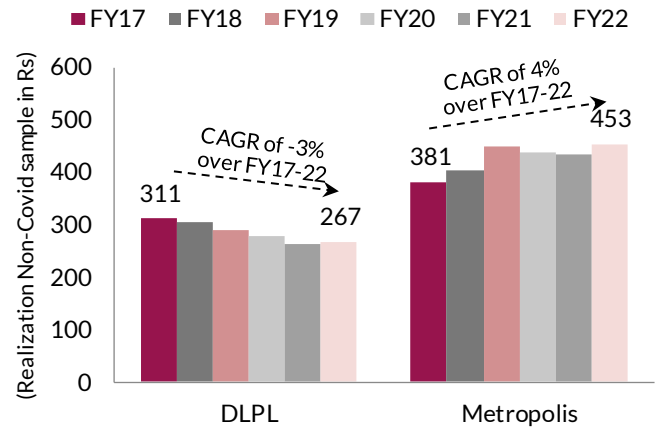
Exhibit 6: Strong volume growth but realizations were muted

Operating metrics	FY17	FY18	FY19	FY20	FY21	FY22	9M'23	CAGR FY17-20	FY20-22	FY17-22	9M'23 YoY
No. of patients (mn)											
DLPL	13	15	18	19	20	27	21	13%	19%	15%	0%
Metropolis	7	8	9	10	11	13	9	13%	16%	14%	-6%
SRL	15	16	14	14	11	21	13	-3%	25%	7%	-23%
No. of samples (mn)											
DLPL	29	35	42	48	50	66	55	18%	18%	18%	5%
Metropolis	14	16	17	20	19	26	19	11%	15%	12%	-2%
SRL	35	38	30	30	24	44	29	-5%	21%	5%	-12%
Thyrocare	14	16	19	19	16	21	17	10%	5%	8%	7%
Realization per patients (Rs)											
DLPL	686	695	684	686	779	765	741	0%	6%	2%	-4%
Metropolis	778	840	855	856	905	917	973	3%	3%	3%	0%
SRL	612	617	739	736	936	750	808	6%	1%	4%	6%
Realization per sample (Rs)											
DLPL	311	305	288	279	318	316	279	-4%	6%	0%	-10%
Metropolis	381	404	448	437	525	478	460	5%	5%	5%	-5%
SRL	267	259	336	335	439	363	347	8%	4%	6%	-6%
Thyrocare	213	218	215	225	313	279	232	2%	11%	6%	-20%

Source: Companies, Axis Capital, SRL – number of patients for FY19 and FY20 calculated assuming 2.2 test per patient

Exhibit 7: Muted realization per patient...


Source: Companies, Axis Capital

Exhibit 8: ...and muted realization per sample


Source: Companies, Axis Capital

Exhibit 9: Non-Covid sales improving (on low base); realization per sample remains muted on a 3-year CAGR basis

Rs mn	Q3'20	Q3'21	Q3'22	Q4'22	Q1'23	Q2'23	Q3'23	YoY growth	9MFY23	CAGR Q3'20-Q3'23
Non-Covid sales										
DLPL	3,279	3,424	4,379	4,195	4,817	5,138	4,784	9%	16%	13%
DLPL (Ex-Suburban)	3,279	3,424	4,132	3,901	4,462	4,763	4,434	7%	10%	11%
Metropolis	2,229	2,046	2,319	2,547	2,617	2,875	2,780	20%	20%	8%
Metropolis (Ex-Hitech)	2,229	2,046	2,153	2,308	2,415	2,651	2,580	20%	14%	5%
SRL Labs	2,319	2,327	3,147	2,904	3,123	3,336	3,216	2%	11%	12%
Sample (in mn); non-Covid										
DLPL	11.60	13.0	16.3	13.3	18.0	19.0	17.2	5%	9%	14%
Metropolis	4.78	4.4	5.4	5.7	5.6	6.5	6.2	13%	22%	9%
SRL Labs	6.80	6.1	10.2	9.6	9.7	9.8	9.3	-10%	-3%	11%
Realization per sample (Rs)										
DLPL	283	264	268	315	268	270	278	4%	6%	-1%
Metropolis	466	468	426	447	466	442	450	6%	-2%	-1%
SRL Labs	341	383	308	302	322	342	348	13%	14%	1%

Source: Companies, Axis Capital, Metropolis Q3FY23 non-Covid sales growth was led by ~1.9x surge in PPP business; excluding PPP Q3FY23 growth was at ~13%

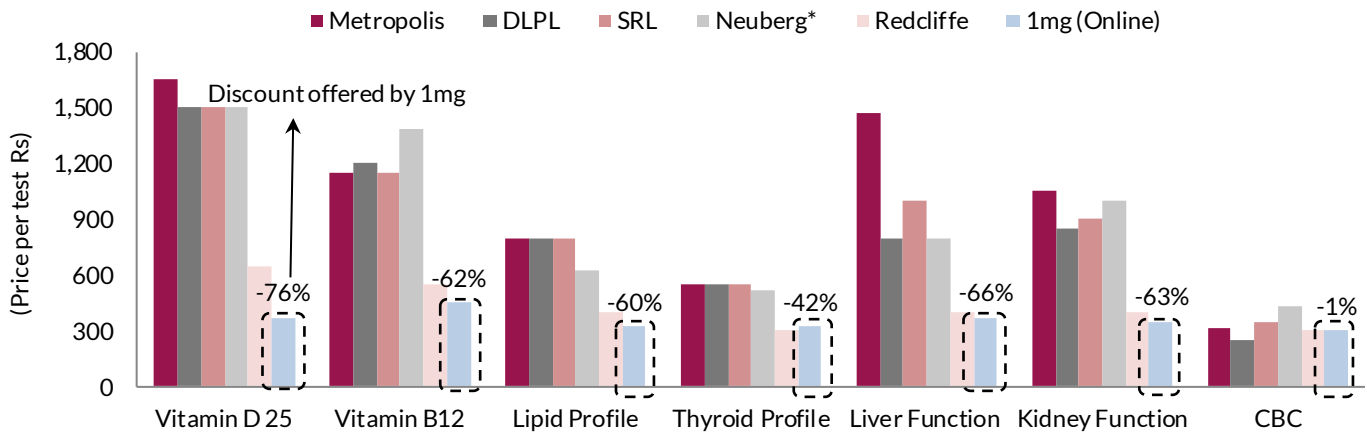
Online players to impact wellness/ chronic segment given aggressive pricing

Exhibit 10: Aggressive pricing by online players to impact Wellness/ chronic tests; Acute influenced by Doctor's recommendation

Category	Acute Patient	Chronic Patient	Preventive Customers
Doctor Influence	Highest	Moderate	Lowest
Price Factor	Lowest	Moderate	Highest
Online aggregators impact	Lowest	Moderate	Highest

Source: Metropolis/ Bain & Company

Aggressive discounts to keep margins/ ROEs under check

Exhibit 11: Price range for top 7 tests – online peers (1mg) are significantly lower than traditional companies


Source: Companies, Axis Capital; Note: Tests/profiles may differ, Price as of Feb 2023; *Test prices for Bangalore used (others on Mumbai)

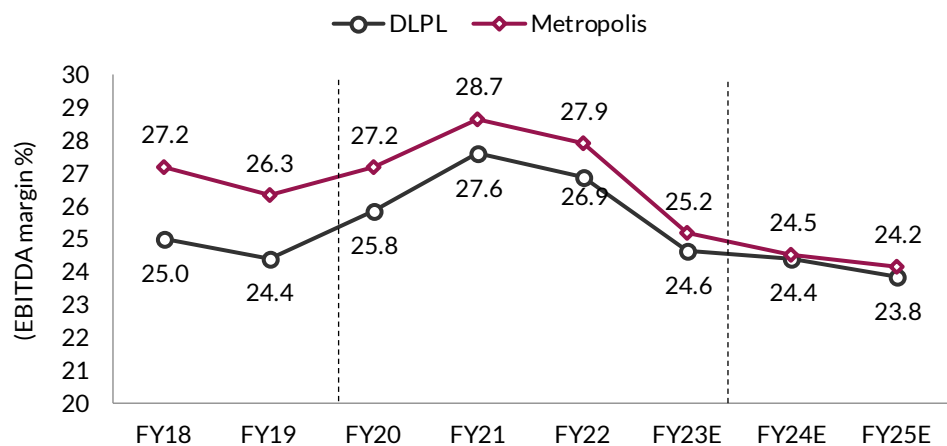
Exhibit 12: Prices for organized players remain static; Tata 1mg discounts remain high but intensity is reducing

Price in Mumbai (Rs)	Metropolis		DLPL		SRL		1mg (online)			Average discount %	
	Sep'22	Feb'23	Sep'22	Feb'23	Sep'22	Feb'23	Sep'22	Dec'22	Feb'23	Sep'22	Feb'23
CBC	310	310	250	250	350	350	319	299	299	5%	-1%
Glucose fasting	90	90	85	85	80	80	99	99	99	16%	16%
Vitamin D 25	1,650	1,650	1,500	1,500	1,500	1,500	199	299	370	-87%	-76%
Vitamin B12	1,150	1,150	1,100	1,200	1,150	1,150	199	299	449	-82%	-62%
Lipid Profile	800	800	800	800	800	800	149	249	320	-81%	-60%
Thyroid Profile	550	550	550	550	550	550	149	249	320	-73%	-42%
Liver Function	1,475	1,475	800	800	1,000	1,000	199	249	370	-82%	-66%
Kidney Function	1,050	1,050	850	850	900	900	199	249	349	-79%	-63%

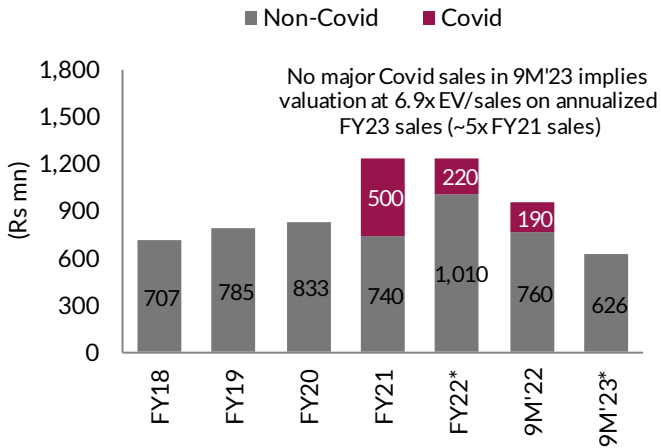
Source: Companies, Axis Capital; Note: Tests/ profiles may differ; Peer set for calculating 1mg discount comprises Metropolis, DLPL and SRL only

Despite volume growth over last few years, price growth was muted due to lack of pricing power and increased competition – this coupled with increasing costs led to muted EBITDA margin (FY21/22 was led by Covid benefits)

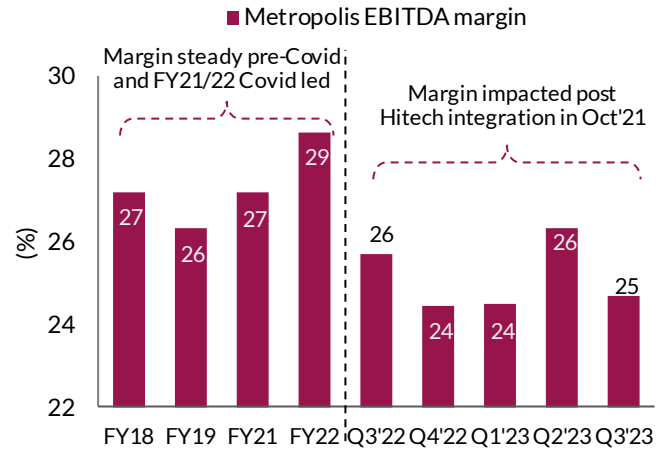
We expect margin to be in declining trend for near-term

Exhibit 13: EBITDA margin to remain under pressure given competition and cost pressure


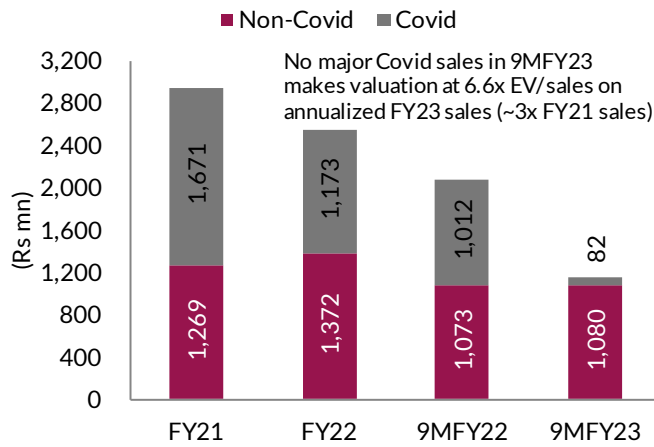
Source: Companies, Axis Capital

Exhibit 14: Hitech acquisition seems expensive post Covid


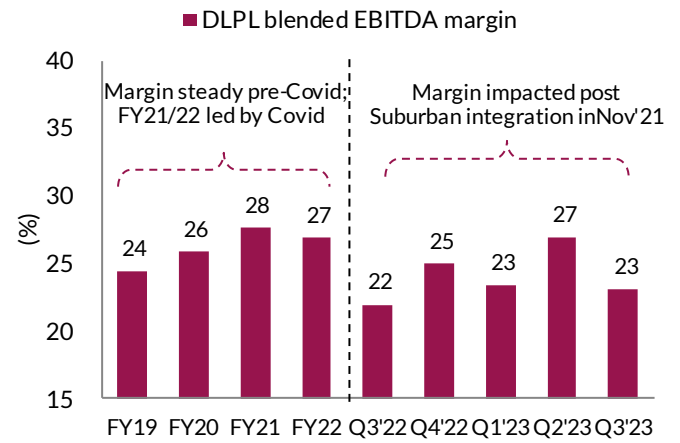
Source: Company, Axis Capital, FY22 Hitech sales in Metropolis was ~Rs 399 mn, 9MFY22 sales as per Feb 2022 presentation, No major Covid sales in 9MFY23

Exhibit 15: Blended margin impact post Hitech integration


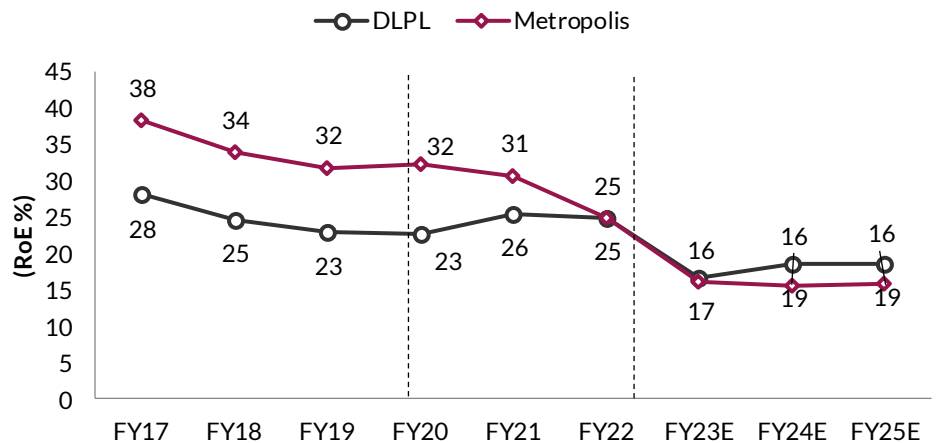
Source: Company, Axis Capital

Exhibit 16: Post Covid – Suburban valuation looks expensive


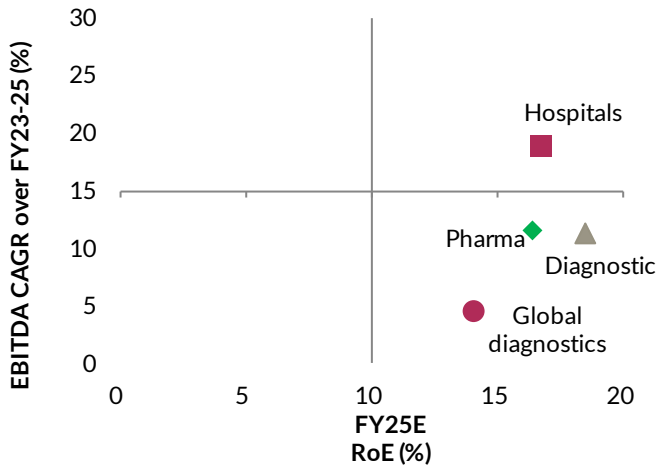
Source: Company, Axis Capital

Exhibit 17: DLPL margin impacted due to Suburban integration


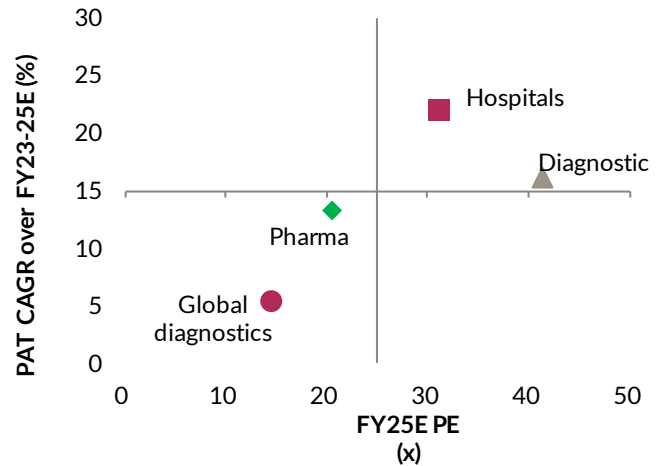
Source: Company, Axis Capital

Exhibit 18: Declining profitability leading to lower return ratio


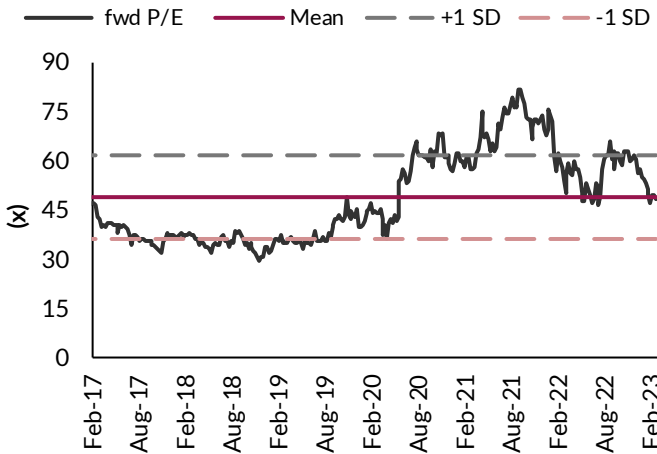
Source: Companies, Axis Capital

Diagnostics vs. other related healthcare segments – financials and valuations
Exhibit 19: Higher RoE but lower growth


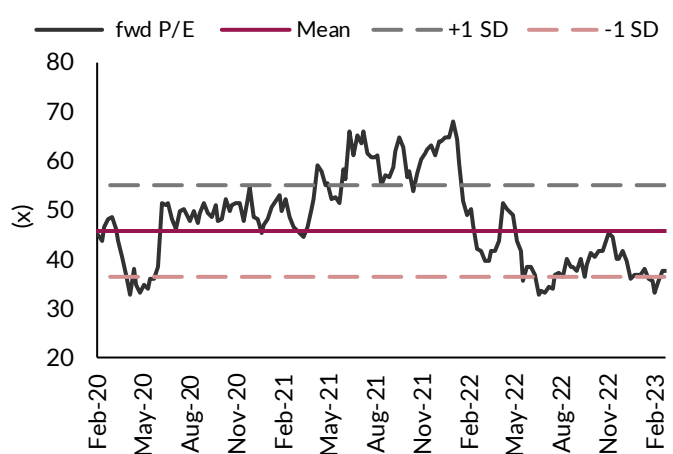
Source: Companies, Axis Capital, Bloomberg

Exhibit 20: Moderate PAT growth but richly valued


Source: Companies, Axis Capital, Bloomberg

Exhibit 21: DLPL: 1-year forward P/E


Source: Bloomberg

Exhibit 22: METROHL: 1-year forward P/E


Source: Bloomberg

Exhibit 23: DLPL- valuations

Valuations	FY25E
EPS (Rs)	41
Multiple (x)*	44
TP (Rs / share)	1,800
No of share (mn)	83
Equity value (Rs mn)	1,50,141
Add: Net Debt (FY25E; Rs mn)	(6,798)
Total EV (Rs mn)	1,43,342
EBITDA (Post IND AS; Rs mn)	6,212
Implied EV/EBITDA (x)	23
Pre IND AS EBITDA (Rs mn)	5,160
Implied EV/EBITDA (x)	28

Source: Company, Axis Capital, *Given profitability challenges, valuing at 10% discount to 5-year average P/E of 49x

Exhibit 24: METROHL - valuations

Valuations	FY25E
EPS (Rs)	35
Multiple (x)*	40
TP (Rs / share)	1,400
No of share (mn)	51
Equity value (Rs mn)	71,702
Add: Net Debt (FY25E; Rs mn)	(270)
Total EV (Rs mn)	71,432
EBITDA (post IND AS; Rs mn)	3,566
Implied EV/EBITDA (x)	20
Pre IND AS EBITDA (Rs mn)	3,017
Implied EV/EBITDA (x)	24

Source: Company, Axis Capital, *Given profitability challenges, valuing at 10% discount to 5-year average P/E of 44x

Valuation snapshot – diagnostics vs. other related peers

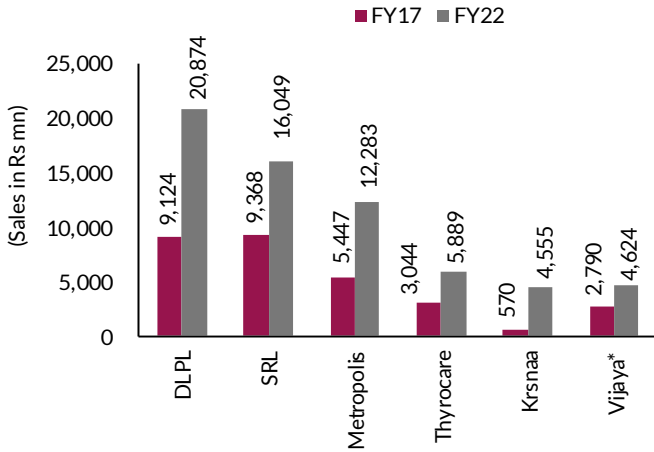
Exhibit 25: Valuation snapshot – diagnostic companies vs. other related peers

	Mcap (USD bn)	PAT (CAGR) FY23-25E	PE (x)			EV/ EBITDA (x)			RoCE (%)	
			FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY21	FY22
Sun Pharma	27.8	12	27.8	23.8	22.3	18.3	16.2	15.1	15.0	20.1
Cipla Ltd	8.9	18	23.9	19.0	16.7	13.9	11.5	10.2	14.1	12.9
Torrent Pharma	6.0	26	32.1	24.7	20.3	19.0	16.2	13.9	19.1	20.1
Eris Lifescience	1.0	10	21.6	17.6	16.7	16.0	13.0	11.1	24.7	23.3
Alkem Labs	4.6	27	30.2	22.8	18.7	22.3	17.4	14.6	21.5	18.0
India Pharma weighted average			27.7	22.8	20.5	17.9	15.4	13.9	16.2	18.6
Apollo Hospitals	7.7	32	78.4	50.2	37.8	30.9	24.5	20.3	6.6	17.1
Max Healthcare	5.0	9	38.4	35.1	32.2	27.9	24.2	21.4	1.5	14.5
Fortis Healthcare	2.4	23	37.8	30.2	24.7	19.3	16.4	14.3	- 1.7	9.0
Narayana	1.9	7	26.1	25.1	22.6	16.6	14.7	13.3	- 1.3	26.2
KIMS	1.3	16	33.0	27.8	24.1	18.3	15.3	13.6	27.5	29.6
Aster DM	1.3	26	25.7	18.5	16.2	9.0	8.0	7.4	12.9	11.6
India Hospital weighted average			51.6	37.8	30.9	25.0	20.8	17.8	5.3	16.7
Dr Lal PathLabs	2.0	17	66.2	56.2	48.7	32.4	29.0	26.4	25.6	25.1
Metropolis	0.8	10	45.1	41.8	37.0	23.3	21.4	19.3	29.8	26.9
Thyrocare	0.3	22	27.8	22.9	18.6	16.2	13.7	11.3	28.5	36.9
Vijaya Diagnostic	0.5	24	47.6	37.8	30.9	21.0	17.9	15.6	26.6	26.5
India Diagnostics weighted average			55.9	47.8	41.3	27.6	24.6	22.1	26.9	26.6
Laboratory CP	21.3	7	14.1	12.8	11.9	10.5	9.8	9.4	18.3	24.1
Quest Diagnostic	15.4	5	15.9	15.2	14.2	10.8	10.4	9.9	23.0	30.1
Sonic Healthcare	10.7	1	21.4	21.8	20.9	10.2	10.1	9.8	22.0	21.4
Dian Diagnosti-A	2.4	- 5	9.3	11.9	10.0	5.7	8.2	7.1	18.5	22.1
Global weighted average			16.0	15.5	14.5	10.3	10.0	9.5	20.6	25.3
HUL	69.9	15	58.2	49.5	43.6	40.7	34.9	31.0	28.6	18.4
ITC	56.6	11	25.0	22.6	20.2	17.9	16.2	14.5	21.0	24.8
Britannia	13.0	15	55.4	48.1	42.0	39.8	34.8	30.9	46.9	49.9
Godrej Consumer	11.4	21	53.8	42.4	36.7	37.9	30.7	26.6	19.9	17.0
India FMCG Weighted average			45.1	38.7	34.1	31.9	27.6	24.5	26.6	23.4
Avenue Supermart	26.8	26	91.1	70.9	57.2	58.7	46.4	37.2	9.5	11.5
Titan Co Ltd	25.5	19	63.1	53.5	44.4	44.4	38.0	31.9	13.7	25.9
Jubilant Foodworks	3.5	28	61.9	48.9	40.6	25.3	21.1	17.8	18.2	24.9
India Retail Weighted average			76.4	61.6	50.3	50.0	41.0	33.6	12.0	18.9

Source: Companies, Axis Capital, Bloomberg; India Pharma and Apollo Hospital, Max Healthcare and Aster DM estimates as per Axis Capital, Date as of Feb 28, 2023

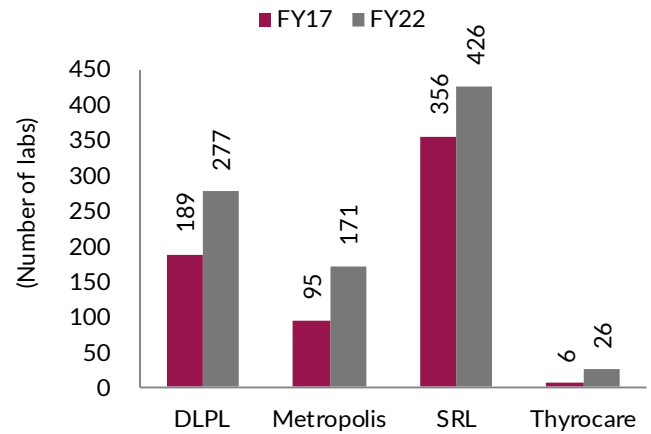
India diagnostics – peer comparison

Exhibit 26: DLPL is the largest organized player in India



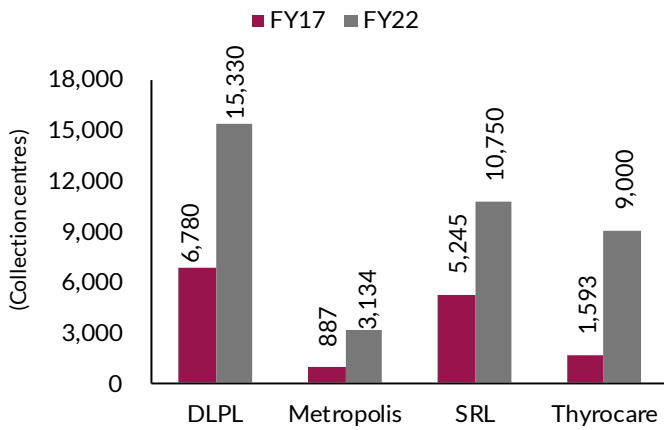
Source: Companies, Axis Capital, *Vijaya sales data available from FY19

Exhibit 27: Increasing clinical labs count – to improve TAT



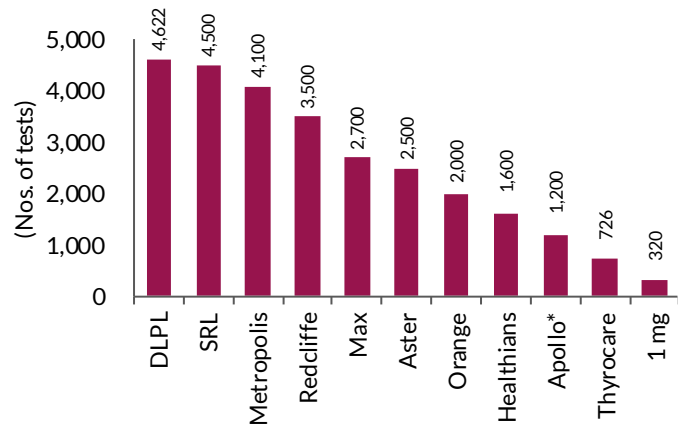
Source: Companies, Axis Capital, TAT – Turnaround time

Exhibit 28: Collection centers expanded across players



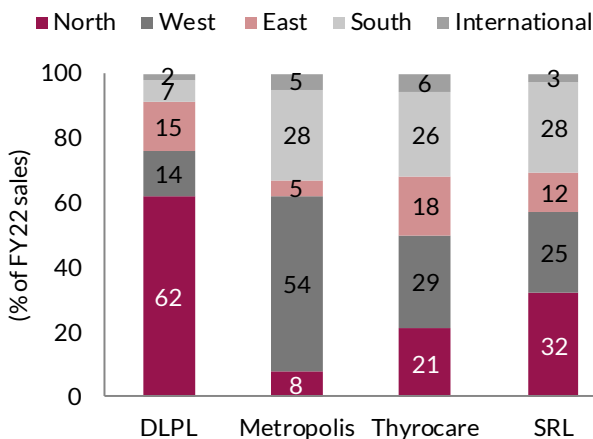
Source: Companies, Axis Capital

Exhibit 29: Diagnostic test offerings across key players



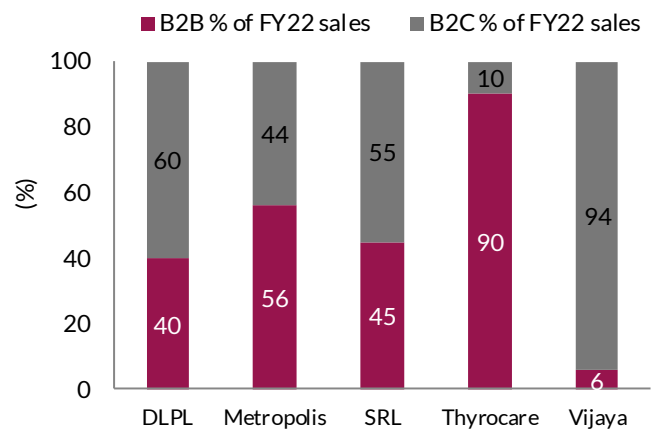
Source: Company, Apollo test count for Chennai only, As of Dec 2022

Exhibit 30: Peer – region mix



Source: Companies, Axis Capital

Exhibit 31: Peer – business mix in FY22



Source: Companies, Axis Capital

ACL diagnostic universe – financial snapshot

Exhibit 32: DLPL and Metropolis – financial trends

	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
DLPL							
Operating metrics							
Sample volume (mn)	42	48	50	66	74	83	93
YoY growth (%)		14%	4%	33%	12%	12%	12%
Realization per patient (Rs)	288	279	318	316	278	280	281
YoY growth (%)		-3%	14%	-1%	-12%	0%	0%
Financials (Rs mn)							
Sales	12,034	13,304	15,813	20,874	20,509	23,126	26,077
YoY growth (%)		11%	19%	32%	-2%	13%	13%
EBITDA	2,937	3,436	4,363	5,607	5,049	5,644	6,212
YoY growth (%)		17%	27%	29%	-10%	12%	10%
PAT	1,992	2,259	2,916	3,448	2,504	2,953	3,405
YoY growth (%)		13%	29%	18%	-27%	18%	15%
Key ratios %							
EBITDA margin	24.4	25.8	27.6	26.9	24.6	24.4	23.8
PAT margin	16.6	17.0	18.4	16.5	12.2	12.8	13.1
RoE	23	23	26	25	17	19	19
RoCE	34	30	32	29	19	22	24
Other financial data							
Operating cash flow (Rs mn)	2,185	2,839	3,982	4,467	4,193	4,674	5,233
Free cash flow (Rs mn)	1,765	2,043	3,386	-294	3,637	4,074	4,583
OCF/EBITDA (%)	74%	83%	91%	80%	83%	83%	84%
Net (cash)/ debt (Rs mn)	(6,750)	(6,040)	(8,750)	(1,504)	(1,403)	(3,899)	(6,798)
Working capital days (nos)	-4	-8	-17	-8	-7	-3	-4
Metropolis							
Operating metrics							
Sample volume (mn)	17	20	19	26	25	28	32
YoY growth (%)		15%	-3%	35%	-1%	11%	12%
Realization per patient (Rs)	448	437	525	478	461	463	466
YoY growth (%)		-2%	20%	-9%	-4%	0%	1%
Financials (Rs mn)							
Sales	7,612	8,564	9,980	12,283	11,717	13,092	14,763
YoY growth (%)		13%	17%	23%	-5%	12%	13%
EBITDA	2,004	2,328	2,860	3,428	2,948	3,210	3,566
YoY growth (%)		16%	23%	20%	-14%	9%	11%
PAT	1,201	1,519	1,831	1,983	1,488	1,603	1,811
YoY growth (%)		26%	21%	8%	-25%	8%	13%
Key ratios %							
EBITDA margin	26.3	27.2	28.7	27.9	25.2	24.5	24.2
PAT margin	15.8	17.7	18.3	16.1	12.7	12.2	12.3
RoE	32	32	31	25	16	16	16
RoCE	44	40	36	27	16	17	18
Other financial data							
Operating cash flow (Rs mn)	902	2,150	2,490	2,533	2,602	2,625	2,917
Free cash flow (Rs mn)	651	1,664	2,154	-4,153	2,079	2,075	2,267
OCF/EBITDA (%)	44%	90%	85%	72%	88%	82%	82%
Net (cash)/ debt (Rs mn)	(937)	(1,564)	(3,158)	1,979	1,433	597	(270)
Working capital days (nos)	55	19	9	19	18	16	16

Source: Companies, Axis Capital

Executive Summary

India's diagnostic market to see steady growth given favorable macros

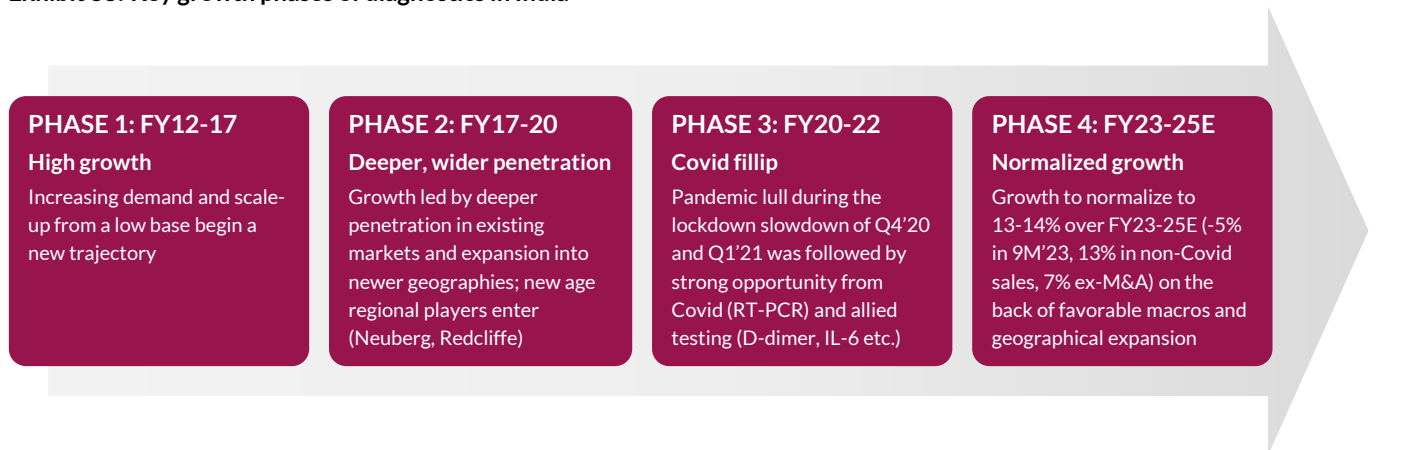
After three exciting phases in the past decade, i.e. strong growth in FY12-17, steady growth in FY17-20 and high Covid-led growth in FY21-22, we expect growth to normalize to 12-13% over FY23-25E (-5% in 9MFY23, 17% in non-Covid sales, 11% ex-M&A) on the back of favorable segmental macros, geographical expansion and the steady shift towards the organized sector.

India's diagnostic market size was ~Rs 710 bn in FY21 and the pathology segment accounted for ~60% of this. Notably, ~17-20% of all-India pathology revenues comes from organized players. The industry posted healthy CAGR of 13-14% over FY17-20. Structural and cultural changes in doctor-patient behavior reinforce our outlook with diagnostics increasingly playing a role through the entire treatment cycle, from health management to detection of disease, prognosis, diagnosis, determination of treatment regimen and finally, post-treatment monitoring.

PE deratings are likely to persist in the diagnostic segment as two factors steadily tamp down valuations: (1) sliding margins - from 27% in FY22 to 24% in FY25 (9MFY23 at 24.8%) on weaker pricing power/ increasing online competition and costs, and (2) lowering ROE following expensive M&As.

We initiate coverage on DLPL with a REDUCE rating and TP of 1,800 (44x FY25E). We also initiate coverage on METROHL with an ADD rating and TP of 1,400 (40x FY25E).

Exhibit 33: Key growth phases of diagnostics in India



Source: Axis Capital

B2B as well as B2C important for expansion and sustained growth

- B2B model allows for rapid increase in volumes through samples collected from hospitals, nursing homes and other such establishments.
- B2C model ramp-up is gradual, sticky and usually generates higher margins.

Attractive industry dynamics

Steady growth and expansion-led growth in the last few years were supported by low capex (asset light). This coupled with superior EBITDA margin, return ratios and strong cash generating business model have led to shorter break-even.

Consumers get more demanding: Want quality, home collection, online and health packages

Consumers are becoming more attentive to health and wellbeing, giving rise to bundled test offerings and preference towards quality organized players. Demand trends are changing towards home collection and online bookings.

Online players and large corporate entrants intensify competition

- Over the last few years, new entrants like corporate chains, online players/ aggregators, hospital-based labs have started diagnostics via both B2B and B2C channels.
- A few online/ healthcare players are offering bundled wellness/ chronic routine tests at disruptive pricing (40-75% lower) in Tier 1/2 cities. This has exacerbated pressure on pricing for existing players like DLPL/ Metropolis whose prices were already stagnant for several years.
- Our channel check highlights that customer acquisition cost (CAC) remains high and thus discounts are reducing by online players as they have started focusing on improving profitability/ reduce losses as funding is getting scarce.

Organic and inorganic strategies for growth

- The organic approach enables brand building and is the most preferred approach to increase density through cluster-based expansion in the core market.
- Inorganic approach allows faster scale-up in new geographies, but it comes at the cost of higher acquisition costs and relatively lower margin.

Key risks

- Increasing competitive intensity given low entry barriers
- Geographic concentration
- Price capping by the government under NEDL (National Essentials Diagnostic Test List)
- Higher input costs and inflationary pressure
- Shortage of skilled manpower and increasing attrition rate

India diagnostics: Industry rationale

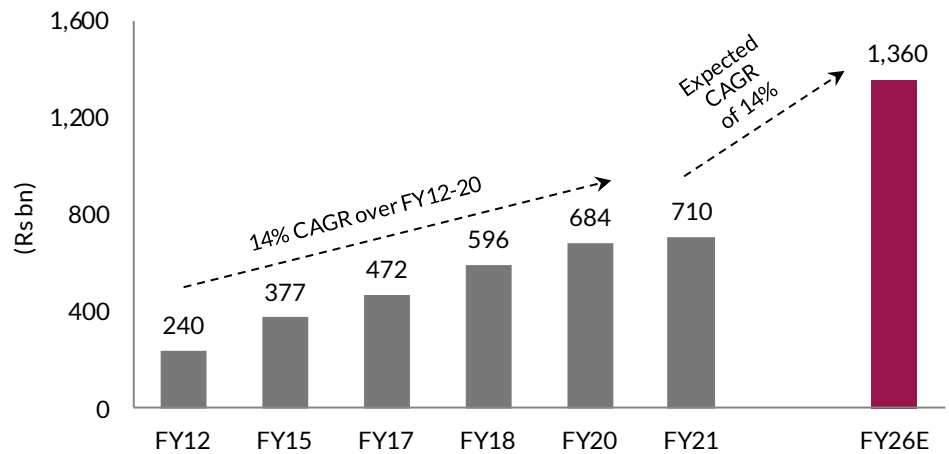
Diagnostics: From wellness to treatment and recovery

Diagnostics play a key role in the management of health and the prevention, evaluation, and treatment of disease. It has a role in every step of the healthcare value chain, from wellness testing to detection of disease right up to post-treatment monitoring and management.

We see steady growth ahead for the industry in the light of favorable macro factors such as low healthcare spending, increasing burden of non-communicable diseases, aging population etc. These factors assume significance in the context of a highly fragmented diagnostic market – India’s organized market share is ~17%, which includes pan-India players like Dr Lal PathLabs, Metropolis, SRL, Thyrocare, and some regional players like Vijaya, Neuberg, Suraksha, etc.

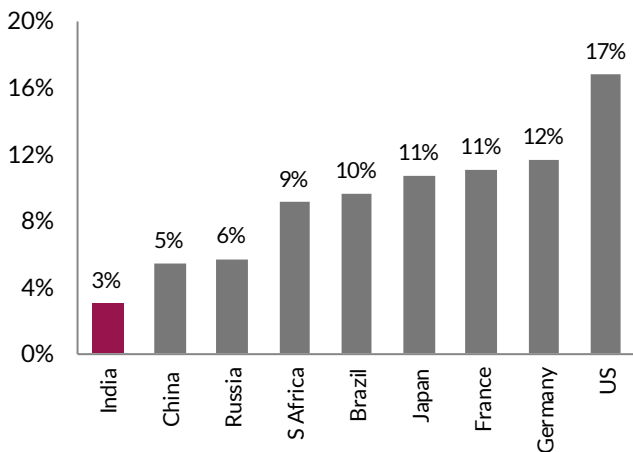
India diagnostics industry is expected to see CAGR of ~14% over FY21-26

Exhibit 34: India diagnostics market to see steady growth



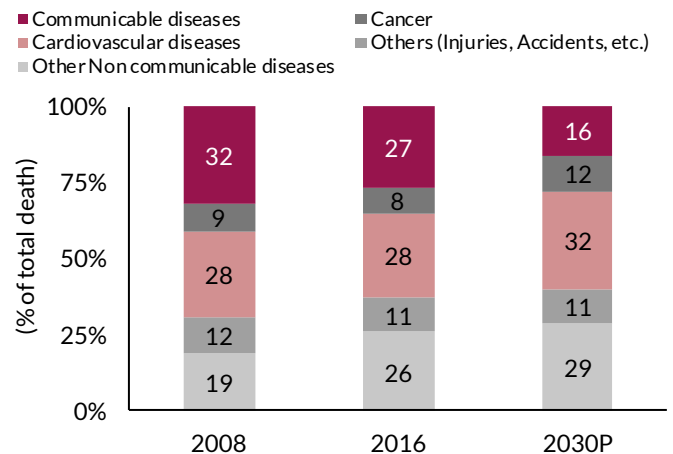
Source: Vijaya Diagnostic RHP from FY12-20, Dr Lal Path AR 2022, Industry data for FY21-26E

Exhibit 35: India healthcare spending lower as % of GDP

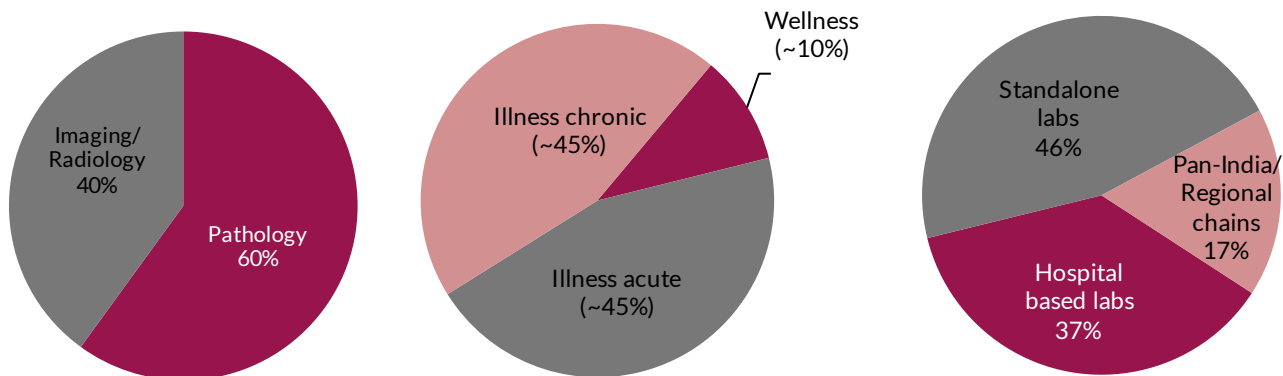


Source: World bank, Data as of 2019

Exhibit 36: Increasing non-communicable diseases burden



Source: World bank, Data as of 2019

Exhibit 37: Pathology accounts for ~60% of diagnostics, ~90% of which comes from illness market (acute and chronic)


Source: Dr Lal Path annual report 2022, ACL channel checks

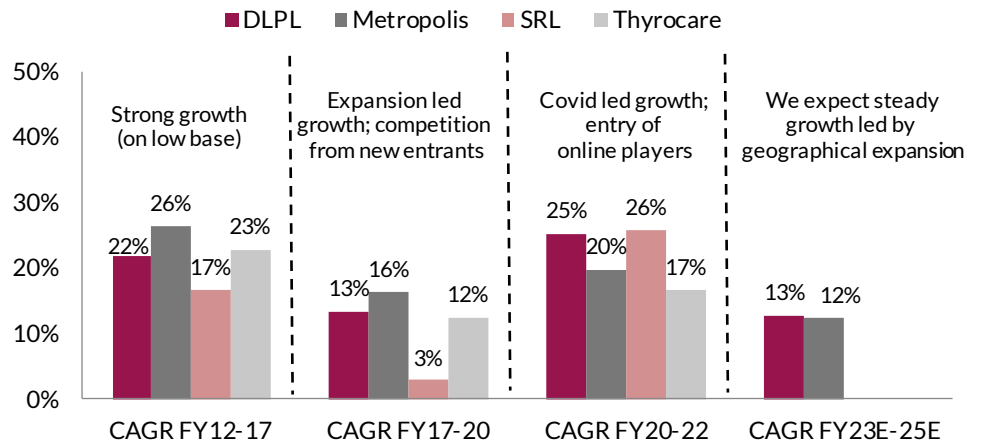
Key growth phases of diagnostics in India: Entering a normalizing Phase 4

- Phase 1 – FY12-17: High growth.** This phase was led by increasing demand and scale-up from a low base.
- Phase 2 – FY17-20: Deeper, wider penetration.** Growth was led by deeper penetration in existing markets and expansion into newer geographies. Regional as well as organized new age regional players (like Neuberger and Redcliffe) entered the market.
- Phase 3 – FY20-22: Covid fillip.** The pandemic impact during Q4FY20 and Q1FY21 (due to lockdown) was followed by the strong opportunity from Covid (RT-PCR) and allied testing (D-dimer, IL-6 etc.).
 - This phase saw major structural changes like consumer awareness on health (demand for wellness packages), accessibility (online/ home collection) and focus on quality (accuracy, consumer service experience and better TAT).
 - Structural changes coupled with attractive financial dynamics in the diagnostic industry triggered a rise in conventional and innovative competition including the online aggregator model (collection of samples only), e-diagnostics (e-pharmacy players diversified into diagnostics), large pharma as well as non-pharma corporates like Lupin, Adani, Reliance, and Torrent as well as new-age players like Neuberger and Redcliffe.
- Phase 4 – FY23-25E: Normalized growth.** After three exciting phases in the past decade, we expect growth to normalize to 12-13% over FY23-25E (-5% in 9MFY23, 17% in non-Covid sales, 11% ex-M&A) on the back of favorable macros and geographical expansion.

Key factors to watch:

 - Strengthening of brand equity: keen focus on quality of services, better consumer experience, accuracy of test outcomes, and lower TAT.
 - Wellness and chronic testing: strong pricing in this sub-segment is attracting online players/ aggregators.
 - Acute illness segment: the need for extended medical treatment is highly dependent on doctor's recommendations.

Post three exciting phases in the past decade, we expect growth to normalize to 12-13% over FY23-25E on the back of favorable segmental macros and geographical expansion

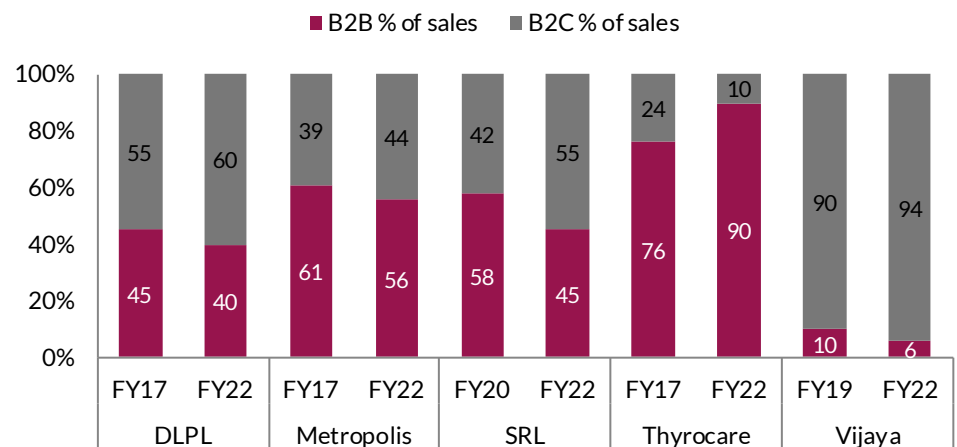
Exhibit 38: Growth phases in India's diagnostics market, beginning to normalize


Source: Companies, Axis Capital

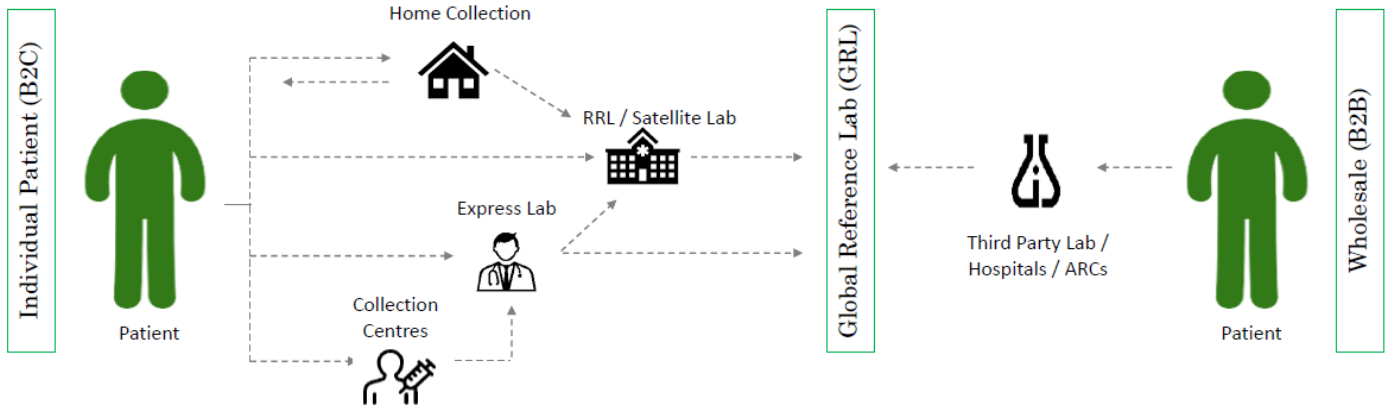
Focus on B2B and B2C for sustained growth

- The B2B model helps enter newer geographies and non-core markets. It allows for a rapid increase in volumes through samples collected from hospitals, nursing homes and other such establishments.
- The B2C model is the most preferred by diagnostic players, calling for substantial investment in brand building and sustainability.

Key drivers for B2C: automation (to improve TAT), new test offering and availability of complete test portfolio across network, customer engagement, accuracy in reports, clinical excellence, superior customer experience

Exhibit 39: B2B and B2C share in leading diagnostics companies


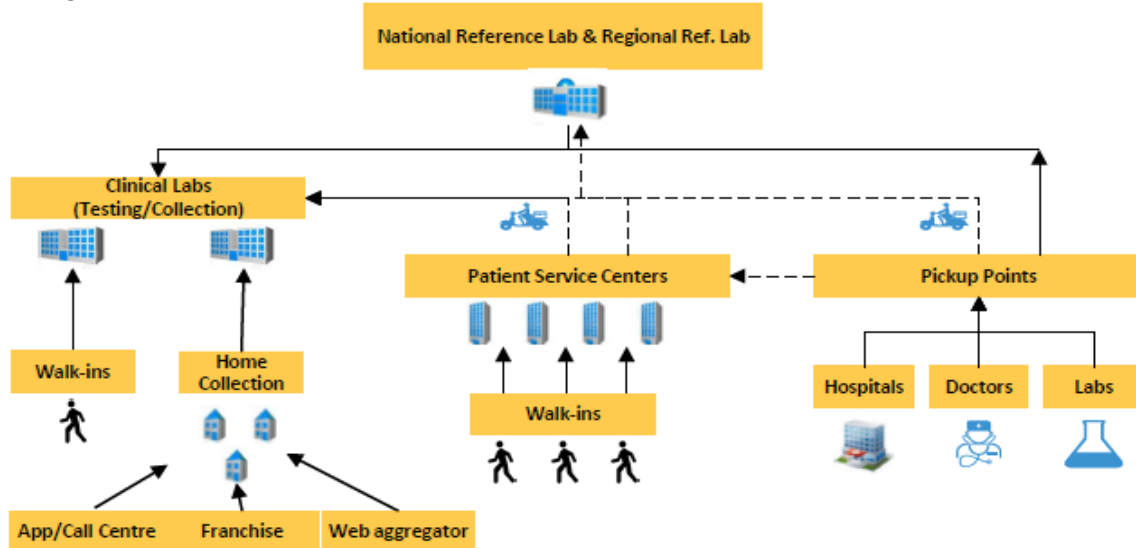
Source: Companies, Axis Capital; Note: DLPL FY17/FY22 and Thyrocare FY22 revenue split as per management

Exhibit 40: Patient and sample flow in B2B and B2C model


Source: Metropolis Dec 2022 presentation

Traditional players ride on attractive dynamics in India diagnostics

Steady growth and expansion-led growth in the last few years was supported by a low-capex, asset-light strategy. This coupled with superior EBITDA margin, return ratios and strong cash generating business model led to shorter break-even.

Exhibit 41: Asset-light hub-and-spoke model for expansion


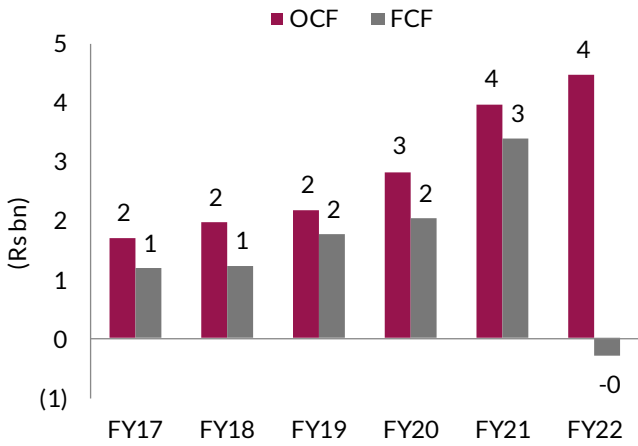
Source: Dr Lal PathLabs Mar 2022 presentation

Exhibit 42: Low capex model – key differentiation for better cash generation and superior return ratios

Unit economics			
Type	Capex (Rs mn)	Break-even period	Comments
Regional reference lab	120-150	2-3 years	Regional labs are equivalent to central labs, but scale is small; in core markets break-even could be much faster
Satellite labs	20-40	1-2 years	Capability of carry out top 200-300 routine and semi specialized test; also, wellness package; helps in improving TAT
Collection centres	0.4-0.6	3-6 months	Franchisee (FOFO) or own (COCO) model - B2C touch points
Hospital linked labs	Minimal	Quick	Expansion in region for B2B business followed by B2C via collection networks
Web aggregators	NA	NA	Collection aggregators - touch points to collect sample and transfer to near-by labs for processing

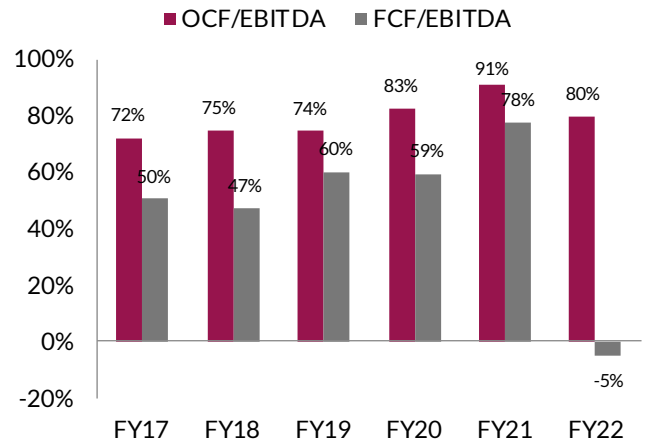
Source: Axis Capital

Exhibit 43: DLPL: Strong OCF/ FCF on asset light and lower WC



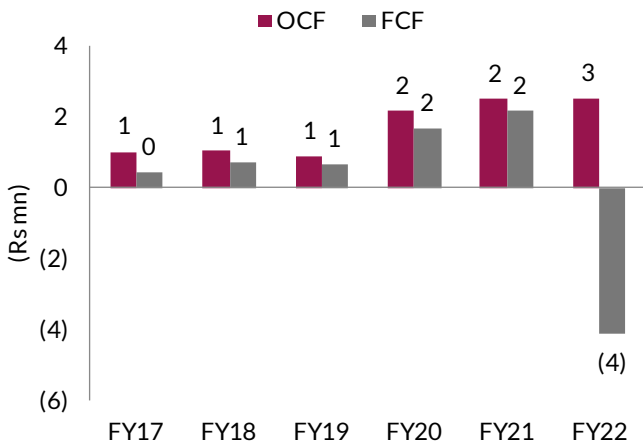
Source: Company, Axis Capital; Note: ex-M&A FY22 FCF was at ~Rs 3.5 bn

Exhibit 44: Strong cash conversion from EBITDA; M&A in FY22



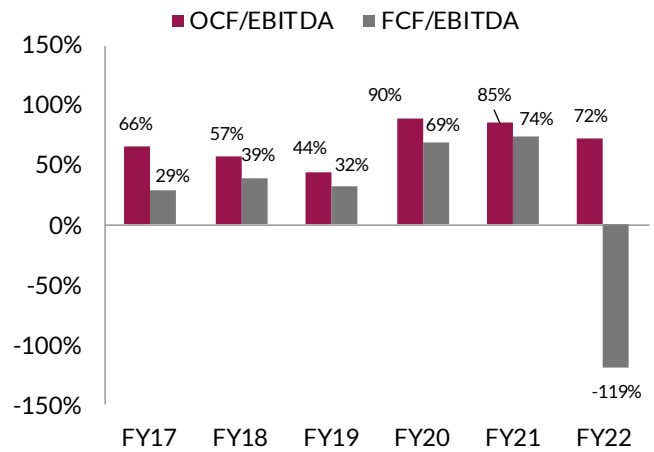
Source: Company, Axis Capital; Note: ex-M&A FY22 FCF/EBITDA was at ~63%

Exhibit 45: Metropolis: Steady OCF/ FCF on moderate capex



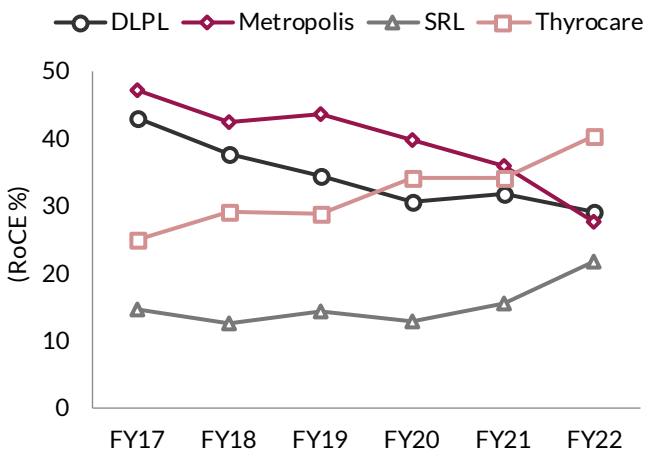
Source: Company, Axis Capital; Note: ex-M&A FY22 FCF was at ~Rs 2.2 bn

Exhibit 46: Cash conversion from EBITDA, M&A in FY22



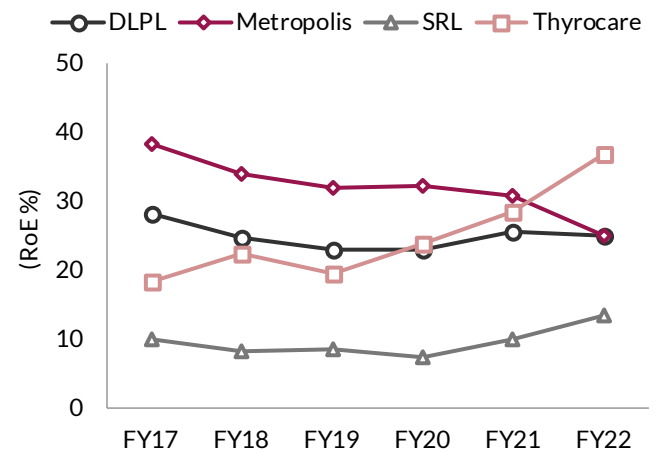
Source: Company, Axis Capital; Note: ex-M&A FY22 FCF/EBITDA was at ~65%

Exhibit 47: Steady margin and asset light model led to...



Source: Companies, Axis Capital

Exhibit 48: ...superior RoCE and RoE for leading companies



Source: Companies, Axis Capital

Building brand equity through improvement in business operations remains key

Larger diagnostic chains have greater flexibility in meeting critical diagnostic needs. Their extensive offerings allow patients one-stop-shop convenience and standardized services.

Exhibit 49: Larger diagnostics peers are adequately accredited

Accreditation	DLPL	Metropolis	Thyrocare	SRL Labs
NABL	✓	✓	✓	✓
College of American Pathologist Accreditation	✓	✓	✓	✓
British Standards Institution (BSI)	✓	✓	✓	✓
ISO	✓	✓	✓	✓
South African National Accreditation System		✓		

Source: Companies, Axis Capital

Exhibit 50: Test offering capabilities of leading Indian players

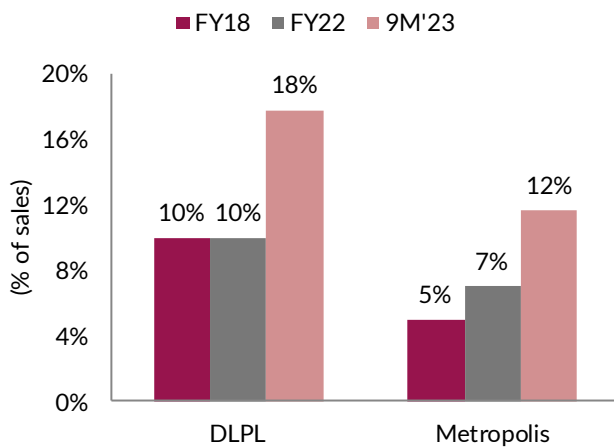
Test category	DLPL	Metropolis	Thyrocare	SRL Labs
Microbiology	✓	✓	✓	✓
Haematology	✓	✓	✓	✓
Immunology	✓	✓	✓	✓
Biochemistry	✓	✓	✓	✓
Molecular	✓	✓		✓
Radiology	✓	✓	✓	✓

Source: Companies, Axis Capital

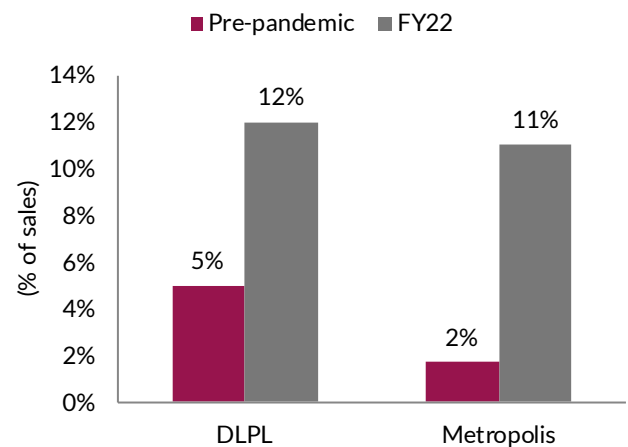
Change in consumer preference towards quality and wellness

Post Covid, consumers are more attentive to health and wellbeing, giving rise to bundled test offerings as well as home collection and online bookings. Leading companies like DLPL and Metropolis have seen significant jumps in their wellness and home collection business as the companies responded to changing consumer preferences.

Most companies have created value-add digital touch points such as (1) Patient App/ Website: order booking, reports, find nearby center, test information, report TAT, App notifications, (2) Partner Portal: registration, report download, AI-enabled recommendations, (3) home collection portal: customer order booking, report status, and (4) Others – omnichannel experience, phlebotomist tracking, real-time sample status, demographic corrections, patient history graphs etc.

Exhibit 51: Increasing share of wellness business...


Source: Companies, Axis Capital

Exhibit 52: ...and home collection for leading players


Source: Companies, Axis Capital

Attractive dynamics of India diagnostics led to entry of online players and large corporates

Over the last 2-3 years, India's diagnostic industry has seen new entrants like corporate chains, both from within and outside the healthcare domain. These companies have been attracted by the dynamics of the industry such as strong cash generation, low entry barriers, low capital investments and superior RoCE.

Online players – aggressive price discount strategy to capture volume share

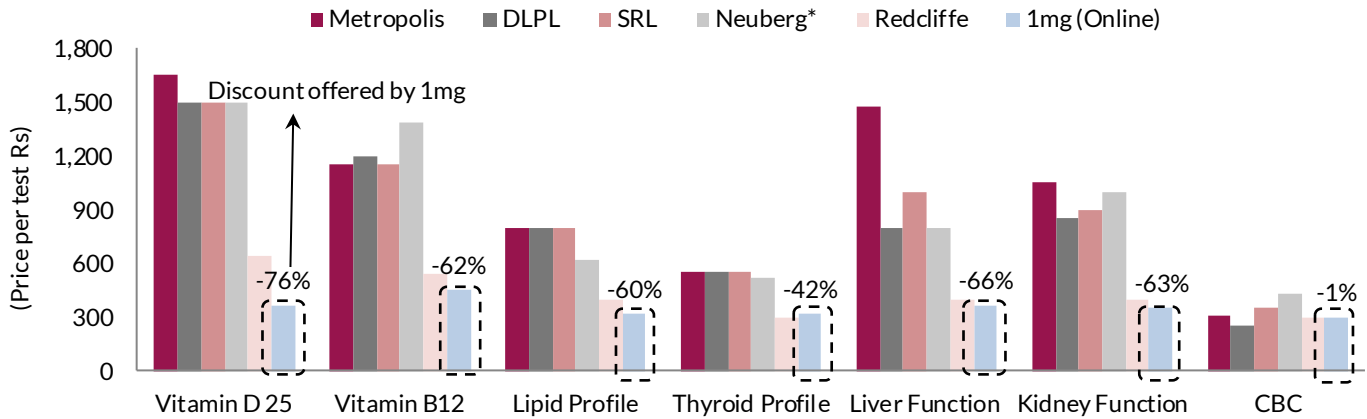
Online players are relying on high discounts to capture volume share and many have paid dearly. The cost of customer acquisition (payout for search engines and other related costs) has led to heavy cash burn outs.

Exhibit 53: Wellness packages/ bundles offered by key diagnostic players

Target/profile	Company	Package/ bundle name	No. of Parameters	Price (Rs)
Male	Metropolis	TruHealth Master	75	4,500
	Healthians	Healthians Advance male package	13	3,099
	Thyrocare	Aarogyam male with UTSH	99	2,400
	DLPL	Men Gold package	62	2,350
	SRL	Evergreen care for 40+ male	65	1,999
	Pharameasy	Men's Wellness Health package	92	1,949
	Tata 1 mg	Men Health premium	44	1,799
	Redcliffe	Stayfit Full body Checkup - male	96	1,799
Female	Metropolis	TruHealth SmartWoman	75	5,000
	Thyrocare	Aarogyam female with UTSH	101	2,600
	Neuberg	Women care basic	16+	2,500
	Pharameasy	Women's advanced Healthcare	90	2,199
	Healthians	Basic female package	60	2,099
	SRL	Evergreen care for 40+ female	63	1,999
	Tata 1 mg	Women wellness premium	46	1,799
	DLPL	Swasthfit Woman	46	1,399
Redcliffe	Women Health package	90	1,299	
Senior Citizen				
--Male	Neuberg	Senior care - male	50+	6,000
	Metropolis	TruHealth Senior	82	5,000
	DLPL	Swasthfit Sr Citizen Male	70	5,000
	Tata 1 mg	Senior citizen comprehensive male	75	3,600
	Healthians	Advance senior male	63	2,599
	SRL	Evergreen care for 60+ male	56	2,299
	Redcliffe	Senior citizen care advance - male	66	1,599
--Female	Neuberg	Senior Care female	51+	6,500
	Metropolis	TruHealth SeniorWoman	82	5,000
	DLPL	Swasthfit Sr Citizen Female	70	5,000
	Healthians	Gold senior female	79	3,399
	SRL	Evergreen care for 60+ female	59	2,299
	Tata 1 mg	Senior Citizen premium female	61	2,299
Redcliffe	Senior citizen care advance - female	66	1,499	
--Combined	Pharameasy	Senior Citizen Health Checkup	95	3,999

Source: Company websites; Note: Test prices as of 23rd February 2023 and are subject to change as per discounting policies adopted by individual companies. The list of wellness bundles is an indication of similar target group/patients and not substitutable with each other directly. Data is not an exhaustive list of bundles offered. Neuberg prices based on Bangalore location (others based on Mumbai)

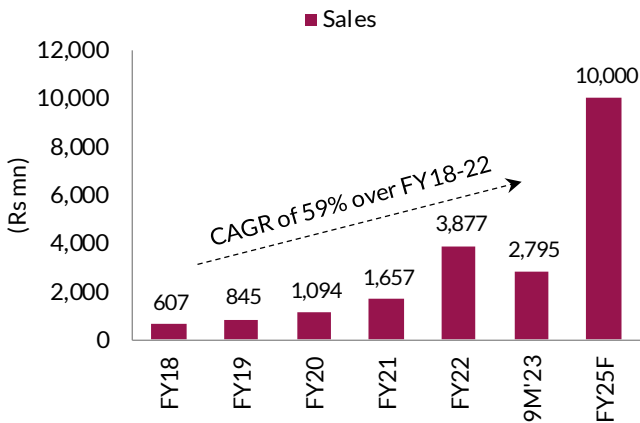
Exhibit 54: Price range for top 7 tests – online peers (1mg) are significantly lower than traditional companies



Source: Companies, Axis Capital Note: Some tests/profiles may differ under certain brands, Price as of Feb 2023; *Test prices for Bangalore used (others on Mumbai)

Hospital based Labs. Hospitals such as Apollo clinics, Max Labs and Aster Labs are also venturing into the diagnostics, buttressed by strong moats like doctor referral, strong cross-sell opportunities and strong execution experience.

Exhibit 55: Apollo Diagnostics targets Rs 10 bn in FY25



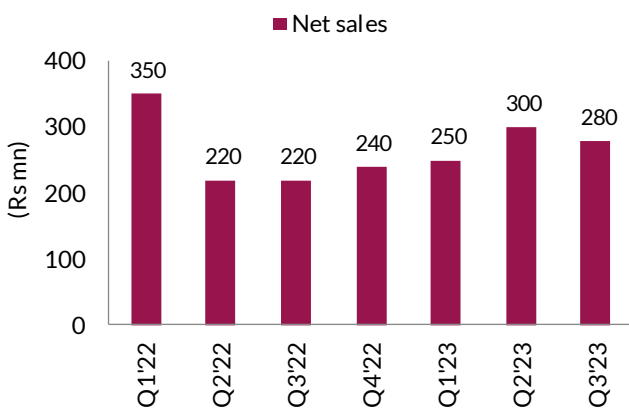
Source: Company, Axis Capital

Exhibit 56: Apollo Diagnostics expanded by ~5.8x in 5-6 years

Metrics	FY18	FY19	FY20	FY21	FY22	9M'23
Network	270	523	650	796	1,228	1,570
Footfalls/Day	2,089	3,645	5,075	6,546	13,409	12,069
Gross ARPP (Rs.)	495	548	549	741	760	744

Source: Company, Axis Capital

Exhibit 57: Max Lab net sales trend



Source: Company, Axis Capital

Exhibit 58: Max Lab network expansion

Nos	Q1'22	Q2'22	Q3'22	Q4'22	Q1'23	Q2'23	Q3'23
Partnered collection center	145	220	265	300	350	410	380
Company owned	9	13	18	25	26	23	23
Phlebotomist	120	135	160	155	155	190	200
PUP	165	200	210	210	240	240	230
Hospital based Lab	17	19	25	28	36	38	40
Cities of operations	14	20	24	25	30	34	34

Source: Company, Axis Capital

Pharma companies: Corporates well placed in the pharma industry are now venturing into diagnostics by leveraging existing doctor and distribution network.

- Lupin Diagnostics was launched in Oct 2021 and it has 300+ centers and offers 2,500+ tests which indicates its presence even in the non-routine segment. It is currently present in East India and West India.
- Pathkind Diagnostics (promoted by Mankind Pharma) has 2,000 collection centers and a network of 80+ labs which offer specialized tests too, thus becoming a full-scale diagnostics player. The company has provided its services to ~10 mn customer till date.
- Torrent Pharma and Adani Health are expected to launch their diagnostic arms soon.

Online companies: The surge in competition from and amongst companies with innovative models is scaling-up since Covid with aggressive online aggregators like Practo, Meditest, Spice Health, MFine (only collection of samples) and e-diagnostic companies (e-pharmacy players diversified into diagnostics).

- **Tata 1mg:** Started in 2013 as a medicine content platform and by 2014 further diversified into a marketplace platform with a focus on e-pharmacy. The company added e-diagnostic services in 2015, initially as an online aggregation and fulfilment platform for leading companies like DLPL, Metropolis, SRL etc. Tata 1mg has since expanded to offer (1) its own test portfolio of 320 tests, (2) 40 city coverage, and (3) 12 Labs (Delhi, Gurgaon, Mumbai, Pune, Nagpur, Hyderabad, Chennai, Bangalore etc.) - of which 10 are NABL accredited and two are newly commissioned in Dec'22. The company has plans to further expand in the near term - to add 10 new labs over the next two years.
- **FY22 financial highlights** (as per Registrar of companies - ROC filing): Revenues jumped 1x YoY to Rs 6.27 bn (vs. Rs 3.09 bn in FY21) and reported EBITDA loss of Rs 5.22 bn (vs. loss of Rs 3 bn in FY21) largely due to increased staff cost and other expenses (expansion, promotions etc.). This resulted in net loss of Rs 5.26 bn in FY22 (vs. loss of Rs 3.14 bn in FY21). Assuming the company's sale of services (~30% of total sales) is generated entirely by its e-diagnostic business, diagnostic sales grew ~62% YoY to Rs 1.85 bn in FY22 (vs. ~Rs 1.14 bn in FY21).

Exhibit 59: New age players

Company	Redcliffe	Neuberg diagnostic	Healthians
Founded	2018	2017, 4th largest diagnostic in India	2015
Founder	Dheeraj Jain	G.S.K Velu	Deepak Sahani
Based out of	Noida	Chennai	Gurgaon, Haryana
Cities	200+	250+	250+
Key markets/ focus	Delhi NCR, UP, Jharkhand, West Bengal, Maharashtra, Karnataka, MP	Tamil Nadu, Karnataka, Kerala, Telangana, Rajasthan, Gujarat	9 metro cities - Bangalore, Chennai, Mumbai, Kolkata, Delhi, Pune, Gurgaon, Hyderabad, Noida North, West and South India
Other markets	-	Delhi, Chhattisgarh, Haryana, UP International: US, UAE (Dubai) and South Africa	UAE, Bangladesh
Test menu	3500+	6000+	1600+ (adding another 2500 in the year)
Labs	48	150+; 120 in FY21; 50 in FY19	30+
Collection centers	1500+	2000; 1200 in FY21; 400 in FY19	2500+ Phlebotomists
Other details	70% customers taking preventative tests. -Partnered with Skye Air to transport routine/ specialised test samples from, Uttarkashi to Sahastradhara (Dehradun) in Uttarakhand in just 90 minutes	Several acquisitions such as Bengaluru based Anand Diagnostics, Ahmedabad-based Supratech Micropath, Pune based AG Diagnostics, Chennai based Ehrlich Labs, Global Labs (South Africa), Minerva Diagnostics (Dubai), etc.	70% in the preventive and chronic segment

Source: Companies

Competition in wellness and routine chronic is on rise; discounting intensity reducing

Most of the new entrants are focusing on opportunities in the routine chronic testing space and bundling test through packages (Wellness) at disruptive pricing and largely focused on metros and Class I cities. Our channel checks highlight that customer acquisition cost (CAC) remains very high and thus discounts are reducing by online players as they have started focusing on profitability as funding gets scarce.

Exhibit 60: Prices for organized players remain static; Tata 1mg discounts remain high but intensity is reducing

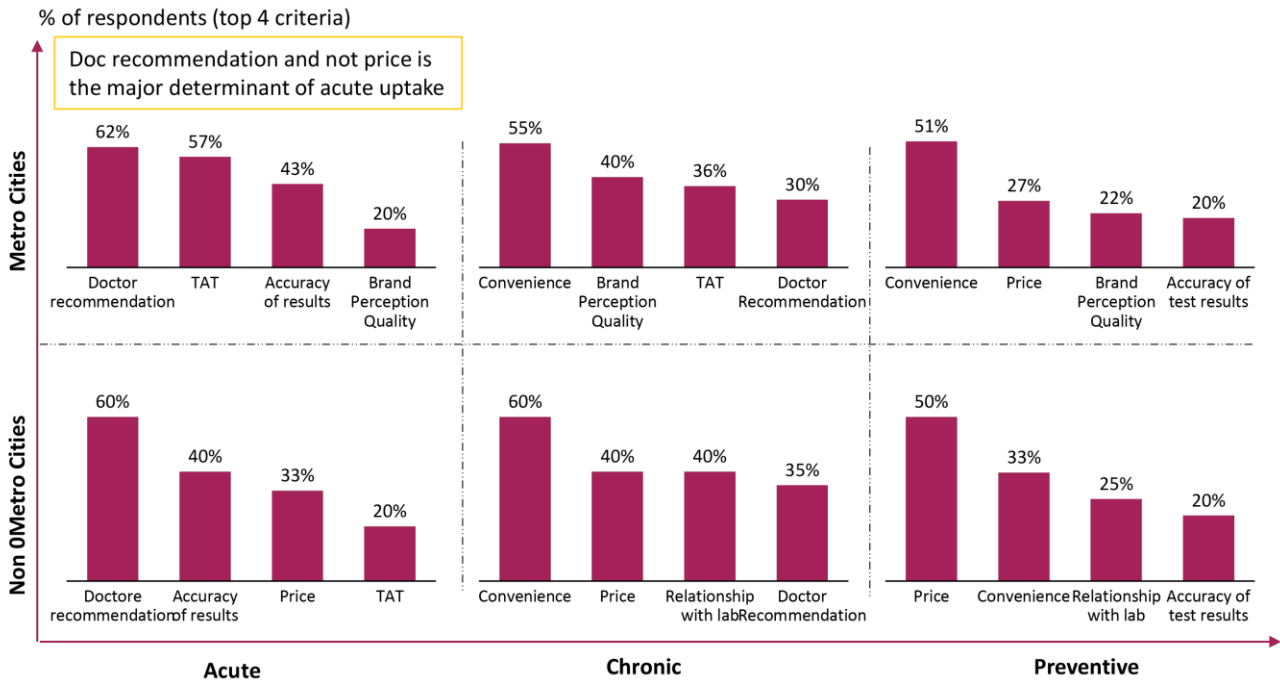
Price in Mumbai (Rs)	Metropolis		DLPL		SRL		1mg (online)			Average discount %	
	Sep'22	Feb'23	Sep'22	Feb'23	Sep'22	Feb'23	Sep'22	Dec'22	Feb'23	Sep'22	Feb'23
CBC	310	310	250	250	350	350	319	299	299	5%	-1%
Glucose fasting	90	90	85	85	80	80	99	99	99	16%	16%
Vitamin D 25	1,650	1,650	1,500	1,500	1,500	1,500	199	299	370	-87%	-76%
Vitamin B12	1,150	1,150	1,100	1,200	1,150	1,150	199	299	449	-82%	-62%
Lipid Profile	800	800	800	800	800	800	149	249	320	-81%	-60%
Thyroid Profile	550	550	550	550	550	550	149	249	320	-73%	-42%
Liver Function	1,475	1,475	800	800	1,000	1,000	199	249	370	-82%	-66%
Kidney Function	1,050	1,050	850	850	900	900	199	249	349	-79%	-63%

Source: Companies, Axis Capital; Note: Some tests/profiles may differ under certain brands; Peer set to calculate discount by 1mg comprises Metropolis, DLPL and SRL

Exhibit 61: Aggressive pricing by online players to impact Wellness/ chronic tests; Acute influenced by Doctor's recommendation

Category	Acute Patient	Chronic Patient	Preventive Customers
Doctor Influence	Highest	Moderate	Lowest
Price Factor	Lowest	Moderate	Highest
Online aggregators impact	Lowest	Moderate	Highest

Source: Metropolis / Bain & Company

Exhibit 62: Decision making plays important role in testing and not price


Source: Metropolis/ Bain & Company

Geographic and capability expansion to provide volume growth visibility

Over the last few years, most companies have expanded their presence by densifying existing markets to strengthen their presence in targeted regions/ states. The focus on local markets within regions provides better access and help in creating brand equity. Leading companies are going in for core market proliferation and choosing the M&A route for quick access to patient bases in new markets. DLPL and Metropolis for instance, are using their strong cash flows to expand their footprints via M&As.

Exhibit 63: Organic growth strategies across leading companies

Company	Expansion strategy
DLPL	Being the leading player in North and having already expanded its presence in East and central India through setting-up the clinical Labs in Kolkata and Indore (through acquisition)- by creating Hubs and further expanded the collection centres either through franchise model or own collection centres.
Metropolis	Being market leader in West region, it is focusing on creating presence in North and south India regions with similar approach of creating central reference labs and expansion in collection centre across region.
Thyrocare	Has strong presence in South and west India region have set-up a central laboratory in Delhi NCR as part of expansion strategy.
SRL	Leading player in West and North region and focus is to expand in East and South region through clinical labs and collection centres

Source: Companies, Axis Capital

Exhibit 64: Inorganic growth strategies

Company	M&A activities
DLPL	Set-up a subsidiary PathLabs Unifiers with focus on small scale regional acquisitions; over last few quarters it has completed ~6-8 M&A In Oct'21, the company acquired 100% stake in Maharashtra base Suburban Diagnostics - west India expansion strategy (~4.1x EV/ Sales)
Metropolis	Focus on M&A since last 5-10 years In Oct'21, completed the acquisition of 100% stake in of Hitech Diagnostic Centre and its arm Centralab Healthcare (~5.1 EV/sales); Chennai and Bangalore expansion strategy
SRL	Continue to expand through small regional players across the country Expanded in South India by acquiring balance 50% stake in DDRC a Kerala base company

Source: Companies, Axis Capital

Profitability to remain challenging given increased competition

- We expect organized players to grow at 12-13% led by a sustained focus on the illness market (acute, chronic). This will find support from (1) larger test portfolios, widening reach to doctors and stronger quality services (better TAT), (2) expanding geographical footprint and (3) increased focus on wellness.
- We remain cautious on revenue and EBITDA growth and PAT margin expansion given sustained pressures on cost (led by expansion), pricing (higher discount/ competition) and overall profitability (on increase in depreciation/interest).

Exhibit 65: DLPL and Metropolis – financial trends

	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
DLPL							
Operating metrics							
Sample volume (mn)	42	48	50	66	74	83	93
YoY growth (%)		14%	4%	33%	12%	12%	12%
Realization per patient (Rs)	288	279	318	316	278	280	281
YoY growth (%)		-3%	14%	-1%	-12%	0%	0%
Financials (Rs mn)							
Sales	12,034	13,304	15,813	20,874	20,509	23,126	26,077
YoY growth (%)		11%	19%	32%	-2%	13%	13%
EBITDA	2,937	3,436	4,363	5,607	5,049	5,644	6,212
YoY growth (%)		17%	27%	29%	-10%	12%	10%
PAT	1,992	2,259	2,916	3,448	2,504	2,953	3,405
YoY growth (%)		13%	29%	18%	-27%	18%	15%
Key ratios %							
EBITDA margin	24.4	25.8	27.6	26.9	24.6	24.4	23.8
PAT margin	16.6	17.0	18.4	16.5	12.2	12.8	13.1
RoE	23	23	26	25	17	19	19
RoCE	34	30	32	29	19	22	24
Other financial data							
Operating cash flow (Rs mn)	2,185	2,839	3,982	4,467	4,193	4,674	5,233
Free cash flow (Rs mn)	1,765	2,043	3,386	-294	3,637	4,074	4,583
OCF/EBITDA (%)	74%	83%	91%	80%	83%	83%	84%
Net (cash)/ debt (Rs mn)	(6,750)	(6,040)	(8,750)	(1,504)	(1,403)	(3,899)	(6,798)
Working capital days (nos)	-4	-8	-17	-8	-7	-3	-4
Metropolis							
Operating metrics							
Sample volume (mn)	17	20	19	26	25	28	32
YoY growth (%)		15%	-3%	35%	-1%	11%	12%
Realization per patient (Rs)	448	437	525	478	461	463	466
YoY growth (%)		-2%	20%	-9%	-4%	0%	1%
Financials (Rs mn)							
Sales	7,612	8,564	9,980	12,283	11,717	13,092	14,763
YoY growth (%)		13%	17%	23%	-5%	12%	13%
EBITDA	2,004	2,328	2,860	3,428	2,948	3,210	3,566
YoY growth (%)		16%	23%	20%	-14%	9%	11%
PAT	1,201	1,519	1,831	1,983	1,488	1,603	1,811
YoY growth (%)		26%	21%	8%	-25%	8%	13%
Key ratios %							
EBITDA margin	26.3	27.2	28.7	27.9	25.2	24.5	24.2
PAT margin	15.8	17.7	18.3	16.1	12.7	12.2	12.3
RoE	32	32	31	25	16	16	16
RoCE	44	40	36	27	16	17	18
Other financial data							
Operating cash flow (Rs mn)	902	2,150	2,490	2,533	2,602	2,625	2,917
Free cash flow (Rs mn)	651	1,664	2,154	-4,153	2,079	2,075	2,267
OCF/EBITDA (%)	44%	90%	85%	72%	88%	82%	82%
Net (cash)/ debt (Rs mn)	(937)	(1,564)	(3,158)	1,979	1,433	597	(270)
Working capital days (nos)	55	19	9	19	18	16	16

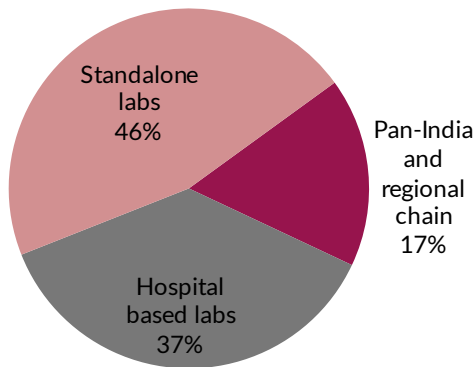
Source: Companies, Axis Capital

Key risks

Rising competitive intensity within organized market

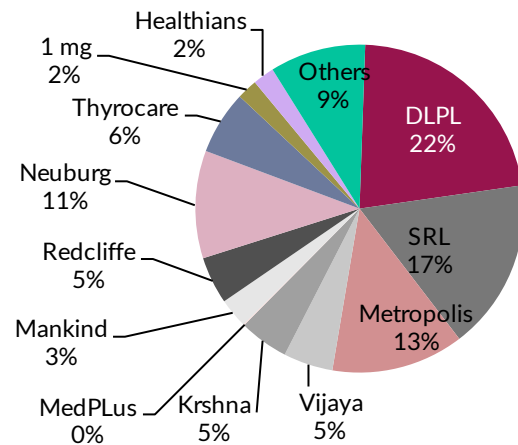
Given the highly fragmented nature of the market with organized players share at ~17-20% makes the addressable market even smaller. Changing preferences by the consumer, attractive industry dynamics and superior return ratios in India diagnostics have attracted multiple new entrants thereby increasing competition.

Exhibit 66: Organized market share was at ~17%



Source: Dr Lal Path annual report 2022 – Pathology market break-up

Exhibit 67: Largely distributed amongst key players



Source: Companies, Axis Capital

Low entry barriers for the business

Scale-up in India's diagnostic business is led by the asset light model like third party arrangement or franchisee – this reduces the initial set-up cost for the business. Also, there is no specific and stringent regulation by the government making it easy for new players to enter the fray.

Geographical concentration

Most of the recent competition is focused on key metros and Class I cities like Delhi NCR, Mumbai, Pune, Hyderabad, Bangalore, and Chennai. Even the overall diagnostic market is concentrated in urban region of India (~78% of overall share). Moreover, many small diagnostic chains that operate 3-4 centers or that are concentrated in a particular place/region are susceptible to the demand-supply dynamics of that location.

Price capping by the government under NEDL

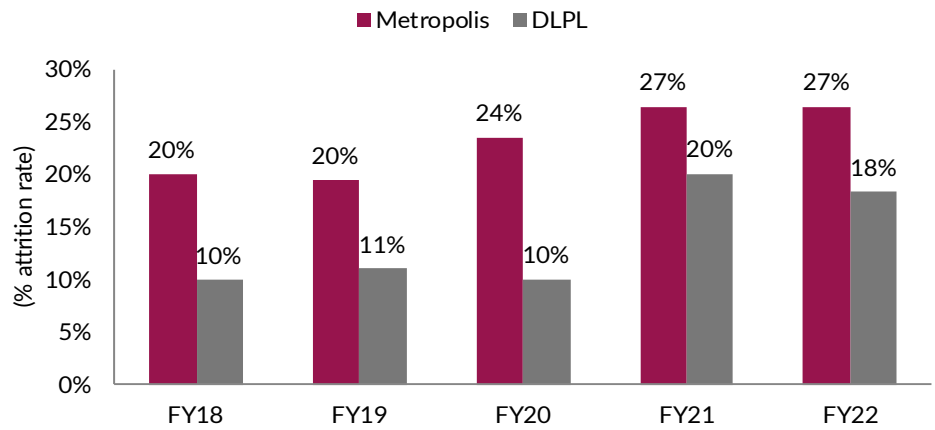
Any government-ordained price cap under NEDL (National Essential Diagnostic list) could be a major risk for routine tests which account for ~40-60% of sales for most of the leading layers.

Higher input costs and inflationary pressure

Over the last few quarters, the price of input reagents is increasing due to the higher cost of chemicals as well as USD appreciation (vs. Rs) leading to some pressure on gross margins. Also, inflation-led increases in costs for logistics (higher fuel price), utility costs and employee costs impacted the EBITDA margin for most of the players. If such a scenario continues, it could keep margin under pressure.

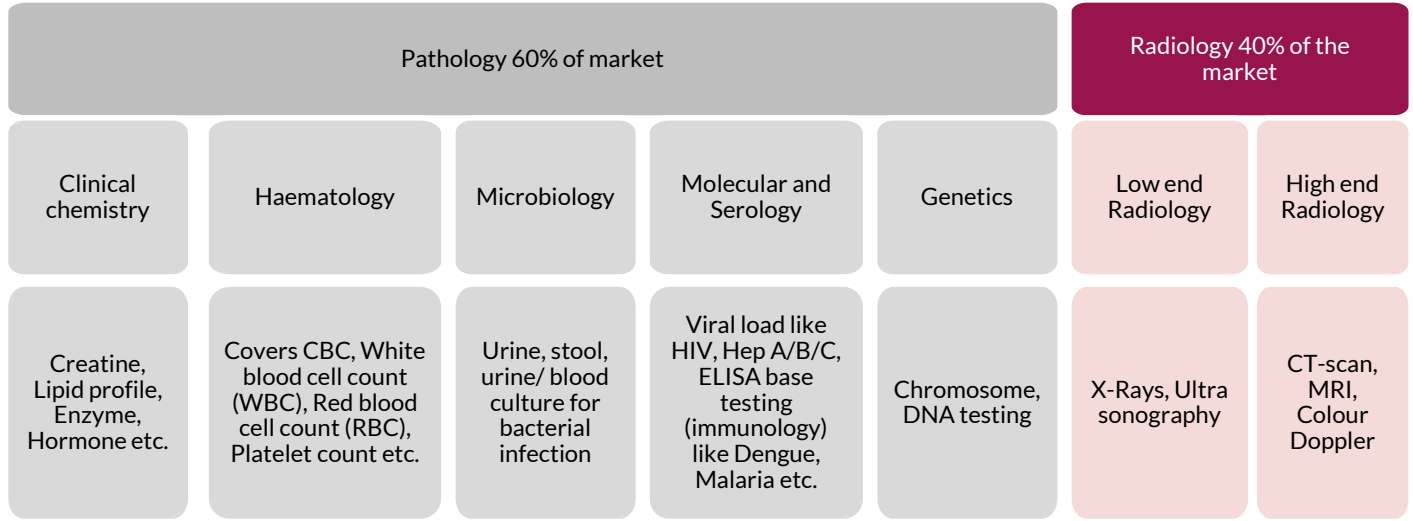
Shortage of skilled manpower and increasing attrition rate

Considerable shortages of full-time doctors and staff in the diagnostics industry prompt several laboratories to recruit such resources on an hourly basis. Another area of concern is the training and retention of critical employees such as laboratory technicians, who are employed at labs and collection centers 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 laboratory technicians and pathologists, thereby affecting the quality of outcomes. For large players like DLPL and Metropolis, the rising attrition rate is a key concern.

Exhibit 68: Attrition rate increasing for leading companies


Source: Companies, Axis Capital, attrition rate calculated as average of attrition range per year

India diagnostic Industry – overview

Exhibit 69: India diagnostic market – segmentations based on types of testing


Source: Axis Capital

Exhibit 70: India diagnostics business models

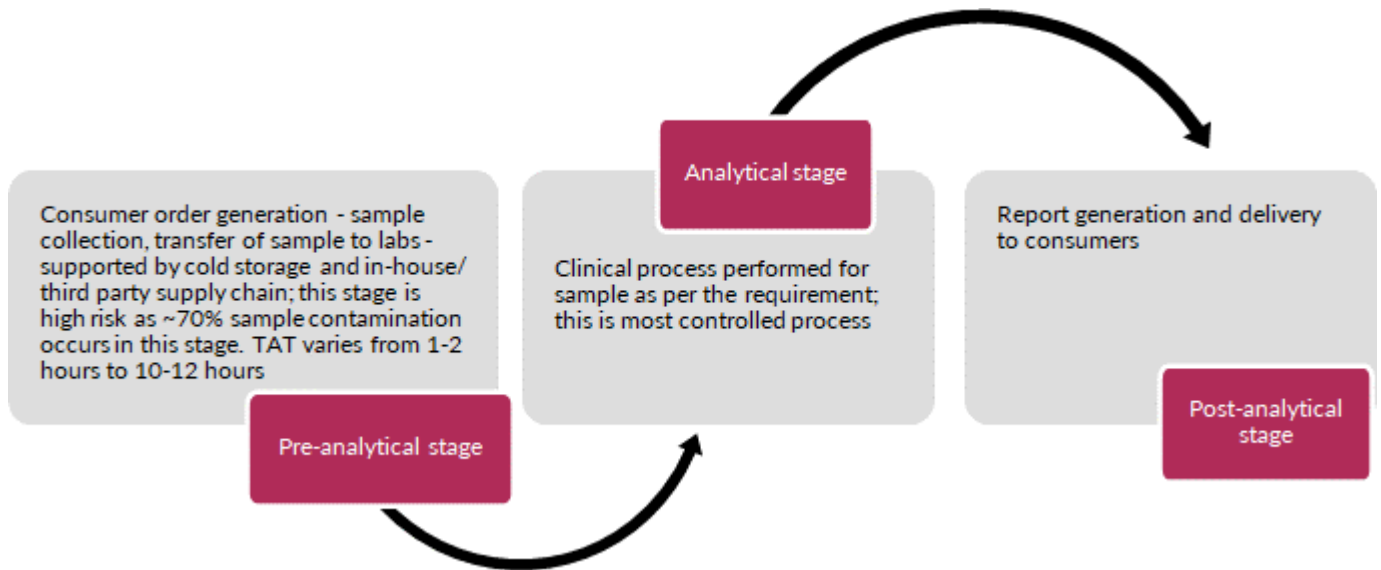
Business model	Comments	Companies
Large chains - mix of B2B and B2C	Companies operates in typical "Hub-and-Spoke" model; collection centres supported by lab infra; preferred model for geographical expansion	DLPL, SRL
Large chains - specialized testing	Companies with focus on high end testing - limited competition space	Metropolis
Regional chains	Companies with geographical concentration	Vijaya Diagnostic
Institutional - B2G and PPP model	Participation only in government tenders	Krsnaa Diagnostic

Source: Axis Capital

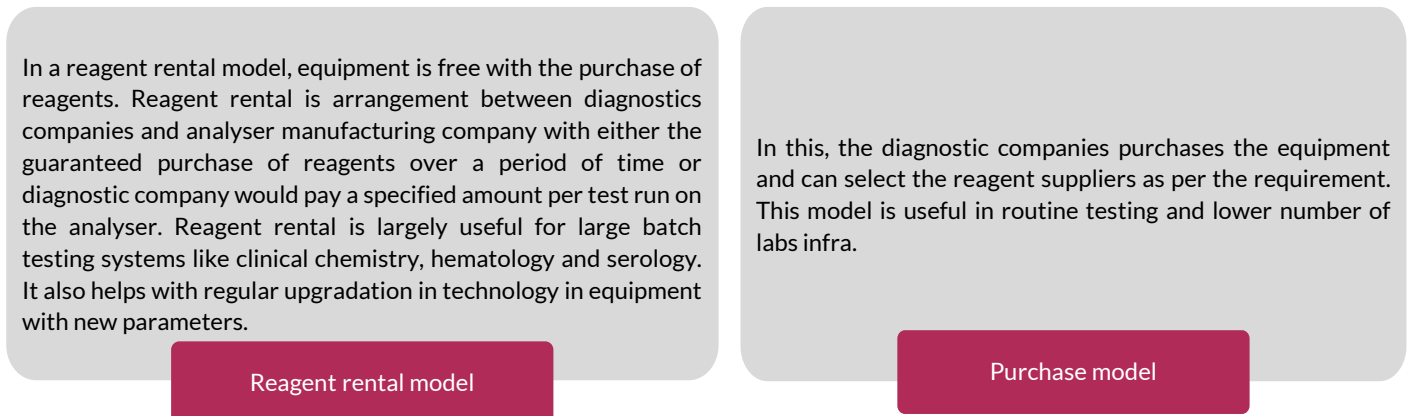
Exhibit 71: Performance of companies in different business model

Companies	DLPL	SRL	Metropolis	Vijaya	Krsnaa
Business model	Large chains - mix of B2B and B2C		Large chains - specialized focus	Regional chains	Institutional - B2G and PPP model
Revenues (Rs mn)					
FY20	13,304	10,163	8,564	3,388	2,584
FY21	15,813	10,351	9,980	3,767	3,965
FY22	20,874	16,049	12,283	4,624	4,555
EBITDA (Rs mn)					
FY20	3,436	1,770	2,328	1,326	540
FY21	4,363	1,750	2,860	1,660	831
FY22	5,607	4,119	3,428	2,037	1,184
EBITDA margin %					
FY20	25.8	17.4	27.2	39.1	20.9
FY21	27.6	16.9	28.7	44.1	21.0
FY22	26.9	25.7	27.9	44.1	26.0

Source: Companies, Axis Capital

Exhibit 72: Stages of diagnostic process: Pre-analytical and analytical stage are key to improve TAT


Source: Axis Capital

Exhibit 73: Business model: Reagent rental and purchase model


Source: Axis Capital

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Axis Capital Limited

Axis House, C2, Wadia International Centre, P.B Marg, Worli, Mumbai 400 025, India.

Tel:- Board +91-22 4325 2525; Dealing +91-22 2438 8861-69;

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