Dr. Lal Pathlabs Limited

January 10, 2023

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	229.00	CARE AA; Stable (Double A; Outlook: Stable)	Assigned
Total bank facilities	**229.00 (₹ Two hundred twenty-nine crore only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

The rating assigned to the bank facilities of Dr. Lal Pathlabs Limited (DLPL) derives comfort from the company's leading position in the pathology laboratory (path lab) industry in India coupled with a strong brand image, dominant share in the organised diagnostic industry which has been supported by an established market position in business to customer (B2C) segment, thriving franchisee model and a robust network of laboratories, patient service centres and pickup points spread across India. The rating also factors in the promoters' long track record of operations in the industry of more than seven decades and the company's healthy scale of operations with steady operating margins which is expected to be sustainable on the back of a large customer base complimented by inorganic growth focused on penetration to new geographies. The rating also takes into account the company's network expansion arising from acquisition of Suburban Diagnostics India Private Limited (SDIPL) and the expected operational efficiencies as well as geographical diversification from the said acquisition. The rating takes cognizance of the company's healthy financial risk profile marked by healthy debt coverage indicators, strong net worth and Nil net debt as on March 31, 2022, and September 30, 2022, coupled with a strong liquidity profile of the company which is expected to continue on the back of healthy cash accruals and no debt-funded capex in the medium term. However, the rating is constrained by the company's presence in a fragmented industry with increasing competition from online aggregators providing diagnostics services.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Sustained improvement in scale of operations of the company with PBILDT Margin of more than 27% along with improved geographical presence
- Sustenance of cash and liquid investments of the company above ₹1,000 crore while maintaining a healthy capital structure with gearing below 0.25x (including lease liabilities)

Negative factors – Factors that could lead to negative rating action/downgrade:

- Sustained deterioration in total operating income of the company with reduction in PBILDT margin below 22% resulting in lower-than-envisaged cash accrual
- Any major debt-funded capex or acquisition resulting in an overall gearing of more than 0.5x
- Elongation in the working capital cycle of the company or significant reduction in cash and liquid investments of the company

Detailed description of the key rating drivers

<u>Key rating strengths</u>

Established track record of operation in diagnostic lab business and extensive experience of promoter:

The company is managed by Dr. Arvind Lal, the Chairman of DLPL who has experience of more than four decades and is a pioneer in bringing laboratory services in India at par with the Western world. Some of labs operated by the group are accredited by National Accreditation Board for Testing and Calibration Laboratories (NABL) and College of American Pathologists (CAP). Dr. Lal is also a member of many expert and advisory bodies constituted by the central and the state governments. He is also supported by Dr. Om Prakash Manchanda, Managing Director of the company, who has experience of more than three decades in the field of pharmaceuticals and diagnostics and is associated with the company from the past 17 years.

The group has a network of 277 clinical laboratories (including national reference lab in Delhi and regional reference lab in Kolkata), 4,731 patient service centres (PSCs) and 10,599 pick-up points spread across India. The company had recently acquired Suburban Diagnostics (India) Private Limited (SDIPL) which have a strong presence in the western part of India which would further result in improvement in operational performance of the group over the medium term. SDIPL has a network of 38

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

labs and 177 patient service centres in Maharashtra and has an established network and operations in Mumbai and Pune which provides the group with a platform to strengthen and penetrate its geographical presence in the western parts of the country.

Healthy scale of operations:

The group has maintained its dominant position in the diagnostics market as reflected by a healthy growth in the total operating income to ₹2,087.41 crore during FY22 (refers to the period April 1 to March 31) from ₹1,581.27 crore during FY21. Revenue growth appears high due to low base of last year owing to lockdowns and other restrictions to curb the COVID-19 infection. Growth in total operating income during FY22 was primarily driven by volume growth, increasing share of non-COVID business in the overall portfolio and inorganic growth by the acquisition of SDIPL. During FY22, the group served 27.3 mn patients as against 20.3 mn in FY21 and 19.4 mn in FY20. Non-Covid revenue of the company increased to ₹1,691.3 crore in FY22, delivering a growth of 34.5% and the same contributed around 81% of total operating income during FY22. Patient volumes improved by 34.7% over FY21, with non-COVID business nearly returning to pre-COVID levels. Revenue from COVID-related tests witnessed small growth in the December 2021 to January 2022 period due to outbreak of Omicron variant. The growth in COVID-related tests was primarily led by mobility relaxations post spurt in COVID caseloads, further supported by strong growth from B2B expansion, augmentation of franchise network with increased home collections. CARE Ratings Limited (CARE Ratings) expects that total operations income of the company will grow in the medium term aided by continuous increase in patient service centres and pick-up points coupled with inorganic growth focused on new and non-competing geographies.

H1FY23 performance:

During H1FY23 (refers to period April 1 to September 30), the company reported slight moderation in its total operating income to ₹1,036.50 crore during H1FY23 with PBILDT margin of around 25.2% as against ₹1,105.00 crore during H1FY22. However, results for the H1FY23 were not comparable with the results of H1FY22, due to resurgent wave of COVID-19 (second wave) in Q1FY22 (refers to period April 1 to June 30) and acquisition of the SDIPL which was consolidated with effect from November 12, 2021.

Healthy operating margins with growth in cash accruals of company on Y-O-Y basis:

PBILDT margin of the company is healthy and stood at 26.89% in FY22 as against 27.60% during FY21, which moderated slightly primarily due to slightly lower margins during Q4FY22 owing to consolidation of SDIPL which has relatively lower margins of 16-17%. However, margins are expected to stabilize over the long term. Margins are healthy vis-à-vis industry as majority of the group's revenues are derived from B2C mix of customers which enables the group to build brand loyalty and trust resulting in higher realizations. The healthy profitability of the company resulted in increase in cash accruals of the company on year-on-year basis which has grown more than 2.5x during the last five financials years. The company uses the cash accruals during the year to fund the organic and inorganic growth. With steady profitability margins, the cash accruals of the company are expected to be healthy in the medium term.

Strong financial profile characterised by healthy debt coverage metrics:

The financial risk profile of the company remains strong marked by healthy cash accrual, absence of any major debt-funded capex except for debt availed for acquisition of SDIPL, and limited reliance on the working capital limit from financial institutions. Overall gearing of remains healthy and stood at 0.51x as on March 31, 2022, which moderated slightly due to increase in total debt due to increase in lease liabilities, and additional term debt availed by the company of ₹250 crore to fund the acquisition of SDIPL. However, net debt of the company remains nil as the company has healthy liquidity in the form of free cash and bank balance and investments in liquid mutual funds. Debt coverage metrics of the company also stood comfortable marked by an interest coverage and total debt to gross cash accruals ratio of more than 18x and 1.27x, respectively, in FY22. The group has remained debt free for the past four financial years, thereby strengthening the capital structure. With healthy cash accruals and no major additional debt envisaged, CARE Ratings expects that debt coverage indicators of the group will continue to be at comfortable levels.

Liquidity: Strong

The company on consolidated level has a strong liquidity position marked by healthy cash accruals in comparison to the scheduled debt repayments and to fund incremental working capital requirements. The company expects to have cash accruals of around ₹350-400 crore per annum which will be sufficient to meet incremental working capital requirement and yearly repayment obligations of around ₹83 crore. The liquidity of the company is further supported by healthy free cash and bank balance and investments in liquid funds which stood at around ₹628 crores as on September 30, 2022. The capex requirements of the company are modular which are expected to be funded by internal accruals.

Key rating weaknesses

Fragmented nature of healthcare industry and increasing competition due to moderate entry barriers:

The diagnostics industry faces moderate entry barriers on account of average capital intensity, resulting in the emergence of a large number of diagnostic centres. The diagnostic services industry has numerous players, big and small, offering similar services, resulting in intense competition. These diagnostic chains also face competition from hospital-based, standalone centres and online aggregators providing diagnostics services. Furthermore, diagnostic centres must constantly upgrade technology to stay ahead of competition, which involves significant investment in medical equipment. However, the brand equity of the company provides an edge over its peers in the competitive landscape of the industry. The company also focuses on expanding its customer base by providing lucrative test packages and better services.

Analytical approach: Consolidated since all the consolidated entities are into same line of business and are collectively known as Dr. Lal Path Lab Group. List of the entities consolidated are as below:

	Name of the entity	% Holding as on March 31, 2022
1	Paliwal Diagnostics Private Limited	80.00%
2	Paliwal Medicare Private Limited	80.00%
3	APL Institute of Clinical Laboratory & Research Private Limited	100.00%
4	Dr. Lal Ventures Private Limited	100.00%
5	PathLabs Unifiers Private Limited	100.00%
6	APRL PathLabs Private Limited	70.00%
7	Centrapath Labs Private Limited	70.00%
8	Chanre Laboratory Private Limited	70.00%
9	Suburban Diagnostics (India) Private Limited	100.00%
10	Dr. Lal PathLabs Nepal Private Limited	100.00%
11	Dr. Lal Path Labs Bangladesh Pvt Ltd	71.83%
12	Dr. Lal PathLabs Kenya Private Limited	100.00%

Applicable criteria

Policy on default recognition
Consolidation
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Rating Methodology - Service Sector Companies

About the company

Dr. Lal Pathlabs Limited is a flagship company for the Dr. Lal Pathlabs Group and is engaged in business of providing diagnostic and related healthcare tests. The company was established as a partnership firm in 1949 by Late Dr. S. K. Lal and was converted to a Private Limited company in 1995. Furthermore, the constitution of the company was converted to a public limited company and was listed on Bombay Stock Exchange and National Stock Exchange in December 2015. The company has its corporate office in Gurugram (Haryana). The operations of the company are spread across the nation, majorly focused on Northern part of India. Along with operating within India, the group also operates its path labs in Nepal, Bangladesh, Kenya etc. through its subsidiaries which accounts for less than 1% of the total income of the company. The company offers more than 5,000 diagnostic tests and related healthcare services through a nationwide network of medical laboratory centres currently comprises of 277 clinical labs (including National Reference Lab at Delhi and Regional Reference Lab at Kolkata) out of which 31 labs are National Accreditation Board for Testing and Calibration Laboratories (NABL) accredited and 2 are College of American Pathologists (CAP) accredited.

Brief Financials (₹ crore)- Consolidated	March 31, 2021 (A)	March 31, 2022 (A)	H1FY23 (UA)
Total operating income	1581.27	2087.41	1036.5
PBILDT	436.45	561.33	261.3
PAT	296.48	350.29	130.60
Overall gearing (times)	0.13	0.51	-
Interest coverage (times)	22.45	15.02	13.47

A: Audited; UA: Unaudited

Status of non-cooperation with previous CRA: Not applicable

Any other information: No

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Term Loan		-	-	March 2025	229.00	CARE AA; Stable

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Term Loan	LT	229.00	CARE AA; Stable	-	-	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities: Not applicable

Annexure-4: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Fund-based - LT-Term Loan	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About us:
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