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Q1FY21 result review
and reco change

Pharmaceuticals

Target price: Rs2,176

Earnings revision

(%)	FY21E	FY22E
Sales	6.1	6.1
EPS	11.9	8.4

Target price revision

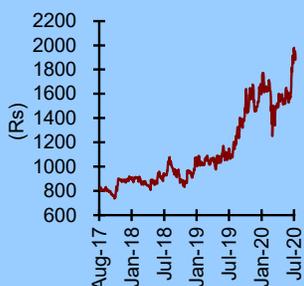
Rs2,176 from Rs1,710

Shareholding pattern

	Dec '19	Mar '20	Jun '20
Promoters	56.8	56.8	56.3
Institutional investors	30.4	30.0	30.3
MFs and other	7.7	7.6	7.3
Insurance	0.5	0.5	1.3
FIs	22.2	21.9	21.7
Others	11.8	13.2	12.4

Source: BSE India

Price chart



Research Analysts:

Sriraam Rathi

sriraam.rathi@icicisecurities.com
+91 22 6637 7574

Vinay Bafna

vinay.bafna@icicisecurities.com
+91 22 6637 7339

Dr Lal Pathlabs

BUY

Upgrade from *Add*

Rs1,889

Multiple growth levers

Dr Lal Pathlabs' (Dr Lal) Q1FY21 performance was above estimate even in challenging environment, aided by COVID-19 tests and successful cost control initiatives. COVID-19 tests contributed ~21% to sales and other revenue declined 37.3% YoY, as expected. Overall, revenue declined 20.6%, EBITDA margin was down 1,020bps to 18.2% and adj PAT was down 51.7% to Rs284mn. The business has recovered to ~90% of pre-COVID levels and we expect healthy growth in coming months. We believe Dr Lal would benefit the most with multiple growth levers such as faster shift of unorganized business to organized players in current scenario, potential consolidation in industry via inorganic or partnership route (Dr Lal has cash balance of over Rs7bn as on Mar'20) and upside from COVID-19 related RT-PCR & anti-body tests. Upgrade to BUY from *Add*.

- **Expect positive revenue growth from Q2FY21:** Dr Lal was impacted significantly in Q1FY21 due to lockdown across the country. However, COVID-19 tests helped in arresting revenue decline to 20.6% against estimated decline of 37.6%. COVID-19 tests contributed ~21% to revenue and we expect it to drop in ensuing quarters. The volumes in regular (ex-COVID) business has recovered to ~90% of pre-COVID levels and we estimate flattish volumes YoY in Q2FY21. The volume decline in ex-COVID business was 32.6% in number of patients and realisation dropped 7% as samples per patient fell. We believe business would improve materially with easing of lockdown in coming quarters and estimate flat volumes in FY21E.
- **Cost control initiatives supported margin:** Dr Lal reported an EBITDA margin of 18.2% (-1,020bps YoY) against estimated 1.0%. Reduction of 20.9% YoY in S,G&A costs was a key factor in supporting margin. This reduction was driven by negotiating new rentals, reducing promotions etc. Revenue from COVID-19 related tests also helped in absorbing fixed costs. We expect EBITDA margin to improve hereon with pick-up in patient volumes and estimate 90bps drop in EBITDA margin in FY21E.
- **Outlook:** We expect Dr Lal to outperform industry growth and register revenue, EBITDA and PAT growth at CAGRs of 15.3%, 20.9% and 26.8%, respectively, over FY20-FY22E. RoE and RoCE would remain strong at 27.3% and 25.9%, respectively, in FY22E whereas RoIC would move to 93.0%. We are positive on the long-term outlook considering the company's strong brand franchise with sustainable growth, expansion potential, healthy FCFF generation and strong return ratios.
- **Valuation:** We raise FY21-22 revenue/EPS estimates by 6-7/8-12% to factor in revenue from COVID-19 tests, early recovery in volumes and better margin as seen in Q1FY21. We upgrade Dr Lal to **BUY** from *Add* with a revised DCF-based target price of Rs2,176/share (earlier: Rs1,710/share) implying 50.0x FY22E EPS and 33.6x FY22E EV/EBITDA. Key downside risks: Higher-than-expected competition, pricing pressures and prolonged impact of COVID-19.

Market Cap	Rs158bn/US\$2.1bn	Year to Mar	FY19	FY20	FY21E	FY22E
Reuters/Bloomberg	DLPA.BO/DLPL IN	Revenue (Rs mn)	12,034	13,304	14,312	17,695
Shares Outstanding (mn)	83.3	Net Income (Rs mn)	1,992	2,259	2,441	3,629
52-week Range (Rs)	1980/1064	EPS (Rs)	24.1	27.1	29.3	43.5
Free Float (%)	43.7	% Chg YoY	17.8	12.3	8.1	48.7
FII (%)	21.7	P/E (x)	78.3	69.7	64.5	43.4
Daily Volume (USD/'000)	3,848	CEPS (Rs)	28.7	35.8	38.9	53.6
Absolute Return 3m (%)	19.3	EV/E (x)	50.8	43.7	41.6	28.8
Absolute Return 12m (%)	75.7	Dividend Yield (%)	0.3	0.6	0.4	0.6
Sensex Return 3m (%)	12.2	RoCE (%)	23.0	22.6	20.7	25.9
Sensex Return 12m (%)	1.5	RoE (%)	23.2	22.8	21.8	27.3

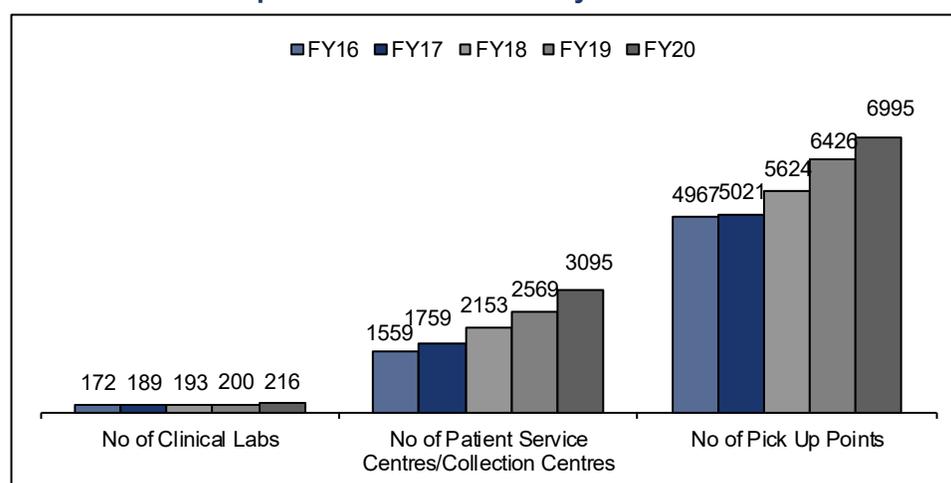
Q1FY21 result and concall highlights

- Overall sales declined 20.6% YoY to Rs2.7bn (-11.8% QoQ) with low volumes affected by COVID-19.
- **COVID-19 impact:** The pandemic has accelerated home collection and digital booking. The fear has also caused a sharp decline of walk-in patients in large labs, instead there is a surge in collection centres and smaller labs (less crowded). COVID-19 tests contributed ~21 to sales in the quarter but MoM from Apr to Jun, number of tests have been reducing. Trend continues in July. Currently, Dr Lal has received approval to conduct RT-PCR based tests for COVID-19 at three of its labs (Delhi NRL, Kolkata NRL and Indore central lab). It is working to add 3-4 more centres as it believes that COVID-19 will become part of the test basket even under normal circumstances.
- **Volume growth** for number of samples stood at -33.2% YoY in Q1FY21. The decline in volumes was large due to nationwide lockdown implementation due to COVID-19. Apr'20 and May'20 witnessed YoY declines of 62% and 25% respectively. MoM there has been improvement with Jun'20 reporting 3% growth YoY with ease of restrictions. Non-COVID tests have recovered to ~90% of pre-COVID levels in Jun'20. Recovery is partially attributed to some pent up demand. The company witnessed 28.6% YoY decline in the number of patients during the quarter.
- **Dr Lal's average realisation per patient** at Rs760 in Q1FY21 and was up 11.1% YoY. This rise in realisation was due to high contribution of COVID-19 tests. Prices are dependent on several factors such as mix of B2B and B2C business, mix of Delhi-NCR and rest of India and contribution of preventive care. Revenue per sample grew 18.9% YoY with 6.5% decline in samples per patient to 2.27.
- Company used 7.9mn samples to perform tests on 3.5mn patients during the quarter. Samples per patient declined from 2.43 to 2.27 with higher volume of COVID-19 tests. *SwasthFit* scheme, which bundles several tests in a single package, remained constant at ~15% despite the challenging environment. Company believes the pandemic would raise awareness and boost preventive care.
- Company has acquired few small and high quality laboratories in West and South India in the prior quarters. It continues to explore additional inorganic opportunities in these regions. As a cluster, the company is focussing more on West and will gradually move to South.
- The company has worked hard during the quarter to reduce expenses in few areas. These include rental costs, marketing and promotion expenditure, travelling and transportation costs and re-deployment of non-COVID resources to COVID resources post adequate training. Despite, additional expenses towards employee and customer security especially, masks and PPE, company was able to save Rs80-100mn in the quarter.
- **Gross margin** sharply declined by 730bps YoY to 71.5% (-460bps QoQ) with lower sales and higher cost of reagent for COVID-19 tests. Subsequently, reported **EBITDA margin** declined 1020bps YoY (-80bps QoQ) to 18.2%.
- **Adjusted PAT** declined 51.7% YoY to Rs284mn led by weak performance.

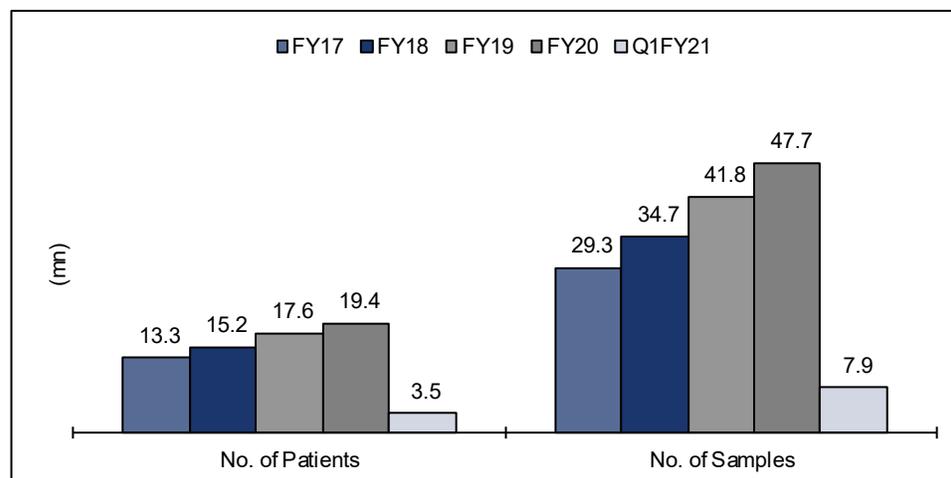
Table 1: Q1FY21 performance*(Rs mn, year ending March 31)*

	Q1FY21	Q1FY20	YoY % Chg	Q4FY20	QoQ % Chg
Net Sales	2,660	3,352	(20.6)	3,017	(11.8)
EBITDA	483	951	(49.2)	573	(15.7)
Other income	114	144	(20.8)	120	(5.0)
PBIDT	597	1,095	(45.5)	693	(13.9)
Depreciation	179	163	9.8	200	(10.5)
Interest	37	38	(2.6)	39	(5.1)
PBT	381	894	(57.4)	454	(16.1)
Tax	97	303	(68.0)	128	(24.2)
Minority Interest	-	3	(100.0)	1	(100.0)
Adjusted PAT	284	588	(51.7)	325	(12.6)
Extra ordinary income/ (exp.)	-	-	-	-	-
Reported PAT	284	588	(51.7)	325	(12.6)
EBITDA margins (%)	18.2	28.4	(1020)bps	19.0	(80)bps

Source: Company data, I-Sec research

Chart 1: Network spread across the country

Source: Company data, I-Sec research

Chart 2: Growth in samples and patients

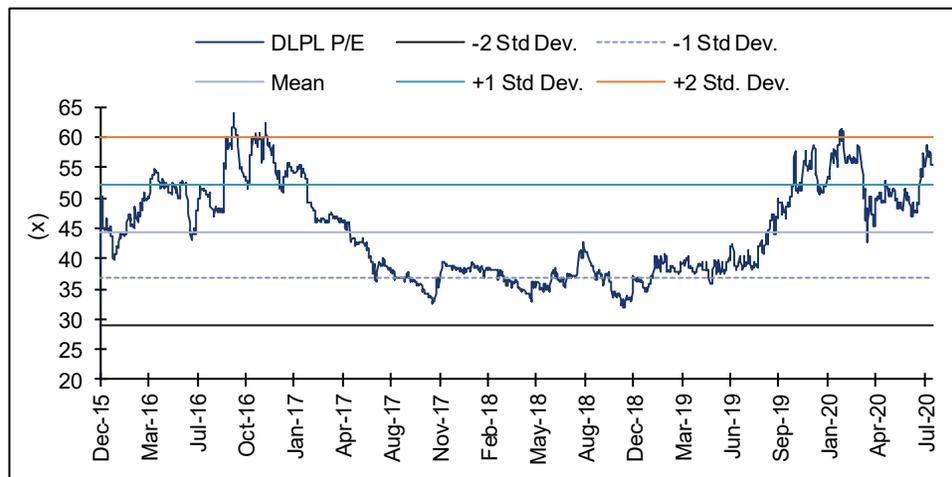
Source: Company data, I-Sec research

Valuations

We estimate earnings to grow at a CAGR of 26.8% over FY20-FY22E driven by revenue CAGR of 15.3% and rise in other income with strong free cashflow generation. Further, we expect RoCE to remain strong at ~25% despite the recent expansion in the Eastern belt. Strong brand equity in organised diagnostics market, experienced management team and continuing financial growth across parameters would benefit from premium valuations in our view.

The stock currently trades at valuations of 64.5x FY21E and 43.4x FY22E earnings and EV/EBITDA multiple of 41.6x FY21E and 28.8x FY22E. We believe Dr Lal would benefit the most with multiple growth levers such as faster shift of unorganized business to organized players in current scenario, potential consolidation in industry via inorganic or partnership route (Dr Lal has cash balance of over Rs7bn as on Mar'20) and upside from COVID-19 related RT-PCR & anti-body tests, hence, we upgrade the stock to **BUY** from *Add* with a revised DCF-based target price of Rs2,176/share (earlier: Rs1,710/share) implying 50.0x FY22E EPS and 33.6x FY22E EV/EBITDA. The stock has traded at an average P/E of 44.5x 1-year forward earnings since listing on stock exchanges in Dec'15.

Chart 3: 1-year forward P/E



Source: Company data, I-Sec research

Financial summary (consolidated)

Table 2: Profit & loss statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Total Gross Sales	12,034	13,304	14,312	17,695
Excise duty	-	-	-	-
Total Net Revenue	12,034	13,304	14,312	17,695
yoy Growth%	13.9	10.5	7.6	23.6
Total Op. Exp.	9,068	9,868	10,752	12,671
EBITDA	2,967	3,436	3,559	5,024
Margins %	24.7	25.8	24.9	28.4
yoy Growth%	12.4	15.8	3.6	41.2
Dep. & Amort.	382	728	801	836
EBIT	2,584	2,708	2,758	4,189
Other Income	459	550	658	816
Interest	8	153	153	153
EO Items	(30)	-	-	-
PBT	3,005	3,105	3,263	4,852
Tax	1,001	829	822	1,223
Tax Rate (%)	33.3	26.7	25.2	25.2
Minority Interest	13	17	-	-
Reported PAT	1,992	2,259	2,441	3,629
Adj. PAT	2,012	2,259	2,441	3,629
Net Margins (%)	16.7	17.0	17.1	20.5

Source: Company data, I-Sec research

Table 3: Balance sheet

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Paid-up Capital	833	833	833	833
Reserves & Surplus	8,622	9,495	11,198	13,731
Total Equity	9,455	10,328	12,032	14,565
Minority Interest	55	212	212	212
Total Debt	-	-	-	-
Deferred Liabilities	(215)	(229)	(229)	(229)
Capital Employed	9,295	10,312	12,015	14,548
Current Liabilities	1,395	3,203	3,391	3,899
Total Liabilities	10,690	13,515	15,407	18,447
Net Fixed Assets	2,121	4,244	3,843	3,407
Investments	-	-	-	-
Inventory	285	570	686	780
Debtors	532	514	553	683
Other Current Assets	1,002	853	892	1,023
Cash and Equivalents	6,750	7,334	9,433	12,554
Total Cur. Assets	8,569	9,271	11,564	15,040
Total Assets	10,690	13,515	15,407	18,447

Source: Company data, I-Sec research

Table 4: Cashflow statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
PBT (Adj. for Extraordinary)	3,005	3,105	3,263	4,852
Depreciation	382	728	801	836
Net Chg in WC	(44)	56	(50)	4
Taxes	(1,043)	(935)	(822)	(1,223)
Others	(124)	(268)	44	148
CFO	2,177	2,686	3,237	4,617
Capex	(426)	(1,053)	(400)	(400)
Net Investments made	(306)	295	-	-
Others	(266)	497	-	-
CFI	(997)	(261)	(400)	(400)
Change in Share capital	2	2	-	-
Change in Debts	-	-	-	-
Div. & Div Tax	(552)	(1,555)	(737)	(1,096)
Others	1,138	(83)	-	-
CFF	588	(1,636)	(737)	(1,096)
Total Cash Generated	1,767	789	2,099	3,121
Cash Opening Balance	3,135	4,902	5,691	7,791
Cash Closing Balance	4,902	5,691	7,791	10,912

Source: Company data, I-Sec research

Table 5: Key ratios

(Year ending March 31)

	FY19	FY20	FY21E	FY22E
Adj EPS	24.1	27.1	29.3	43.5
YoY Growth%	17.8	12.3	8.1	48.7
Cash EPS	28.7	35.8	38.9	53.6
EBITDA - Core (%)	24.7	25.8	24.9	28.4
NPM (%)	16.7	17.0	17.1	20.5
Net Debt to Equity (x)	(0.7)	(0.7)	(0.8)	(0.9)
P/E (x)	78.3	69.7	64.5	43.4
EV/EBITDA Core (x)	50.8	43.7	41.6	28.8
P/BV (x)	16.7	15.2	13.1	10.8
EV/Sales (x)	12.5	11.3	10.3	8.2
RoCE (%)	23.0	22.6	20.7	25.9
RoE (%)	23.2	22.8	21.8	27.3
RoIC (%)	57.7	59.1	54.2	93.0
Book Value (Rs)	113	124	144	175
DPS (Rs)	5.4	12.0	7.3	10.9
Dividend Payout (%)	22.7	44.3	25.0	25.0
Div Yield (%)	0.3	0.6	0.4	0.6
Asset Turnover Ratio	1.2	1.1	1.0	1.0
Avg Collection days	14	14	14	13
Avg Inventory days	11	16	21	21

Source: Company data, I-Sec research

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