

Management Discussion and Analysis

Industry structure and developments

The Indian healthcare market is poised to expand to US\$ 372 billion by 2022 on the back of greater health awareness among people, prevalence of lifestyle diseases, better access to insurance, increasing incomes and greater investment by both public and private players. The COVID-19 pandemic outbreak has further sensitized Governments and citizens across the world to the importance of healthcare infrastructure and the role the diagnostic industry will play in earlier detection, prevention and management of diseases.

The Government's expenditure on healthcare has grown to 1.6% of the nation's GDP as per the FY20 budget up from 1.5% in the previous budget. One of the flagship initiatives of the Government, the Ayushman Bharat Pradhan Mantri Jan Arogya Yojana has seen 46.5 lakh hospital treatments being provided as of September, 2019, amounting to claims worth ₹ 7,490 crores.

The Indian diagnostic market (including radiology) is estimated to be at approximately ₹ 80,000 crore and private players are estimated to constitute around ₹ 45,000 crore of this market. The diagnostic industry in India is fragmented, and while unorganized players make up for the majority of the pie, the organized sector is continuously increasing its share of the market. Especially after the COVID-19 breakout and the resulting lockdown, the shift in the industry from unorganized to organized players is expected to happen at a higher rate. The unorganized sector constitutes around 48% of the market, while the organized national branded and regional chains constitute around 15%. The remaining is occupied by hospital-based diagnostic centers. The unorganized and smaller labs offer a chance to the bigger players to expand their reach and presence through mergers and acquisitions. A diagnostic player like Dr. Lal PathLabs stands to benefit tremendously from such a situation and expand their presence pan-India. With increasing geographical penetration, the next few years offer the Indian diagnostic lab chains the potential to grow faster within overall healthcare sector.

While diagnostic tests cannot treat patients or cure illnesses, it is an integral part of the healthcare value chain. Diagnostic tests improve patient care and help to limit healthcare spending by finding potential problems sooner.

Following key trends are expected to drive sector growth in the ensuing years:

- **Changing population demographic:** As per a report from the World Bank, India's population stood at 135.26 crores in 2018. Further, the population of senior citizens i.e. 65 years and more is growing at 4%-4.5% p.a. providing ample opportunity for the healthcare industry, especially the diagnostic industry.
- **Increase in per capita income:** It is projected that approximately 3% -3.5% of private healthcare revenue growth would come from the rural population, whose income level is expected to rise to US\$ 1,500-\$2,000 annually.
- **Increasing health coverage:** As population and life expectancy grows, the demand for health insurance will rise, thereby leading to an increasing requirement for diagnostic services.
- **Greater awareness regarding preventive testing:** Increasing awareness and the measures taken by the Government to promote preventive testing via tax cuts will become a tailwind for volume growth.

The target market for the diagnostic industry is expected to rise at a robust 10% CAGR by FY23.

Opportunities and Threats

There is a great requirement for diagnostic services in the underserved regions of the country, mainly tier-II and tier-III cities. Hence, the potential for business growth in such regions is extremely encouraging. The fragmented structure of the industry provides the organized diagnostic players an opportunity to consolidate the smaller players. It is an effective way to expand geographical reach and penetration for the larger businesses.

Further regional brands are also emerging as national players, thereby leading to increased competition. E-commerce based offerings have also started to slowly creep into the industry and have initiated the onset of digitization of services, as they have in almost every other industry. With this increasing competition, margins are likely to remain stable and growth would be led by volumes and not pricing.

Outlook

The future outlook for the diagnostics industry in India is favorable with the rapid technological advancements in the healthcare industry and doctors increasingly relying on evidence-based treatment. Instances and situations like the COVID-19 outbreak also further boost the importance of diagnostics as an integral part of healthcare and the awareness among people regarding preventive testing for lifestyle and chronic diseases. Therefore, sustainable growth in the industry is likely.

With emphasis on providing quality services and compliance, the organized players will benefit from such developments. Hence, the switch in the industry from small, standalone players to larger more organized setup is also positive and welcome. At the rural end of the spectrum, there is an acute need to provide reliable diagnostics at competitive prices. Metro cities, cities and urban regions, which typically see several brands at play, also have pockets that will be better served.

Risk and concerns

Regulatory intervention

Although largely operating through un-organized laboratories, the diagnostics industry is subject to intervention from the state or central governments in order to enhance testing. During seasonal epidemics, typical guidelines will fix certain pricing for a particular test/ panel on a temporary basis. Being cognizant of the important role it has to play in society, the Company is totally compliant with such requirements. Historically, the industry has witnessed capping for instances of Swine Flu, Dengue and Chikungunya.

The closing weeks of year 2020 were marked by the spread of the Covid-19 pandemic across the world. As an industry champion, DLPL partnered with its industry peers to offer private lab testing to the citizens towards effectively halting the spread of the illness.

Competition

Established brands in the diagnostics space face competitive challenges from the multitudes of unorganized laboratories that offer variety of low-priced testing options to patients. The landscape is gradually changing with greater demand on compliance with

statutory requirements. The organized industry too has drawn in private equity investments in a bid to rapidly scale up sampling. Typically, the investee Company resorts to pricing as a lever to garner a higher share of the institutional sampling. The intensity however has reduced over the past few quarters. As past cycles have demonstrated, it is relatively easy to enter the diagnostics space for newcomers. However, to be able to establish a national presence, it takes greater focus, dedication and time. Dr. Lal PathLabs has already established trust across the network with its competitive pricing structure, high quality of service, fast turn-around time and accurate diagnosis.

Aggregators have been active in the healthcare space for few years and within the diagnostic sector, they seek to enhance patient convenience by offering better servicing compared to the unorganized players. The established national brands have built a solid online presence themselves and offer an effective counter. With its robust testing infrastructure, brand connect and service aimed at patient convenience, DLPL is comprehensively addressing the challenge posed.

Calibrated network expansion

In line with its stated objective of further developing its reach and scale, DLPL adds new laboratories each year. The patient service centres manage the bulk of the sample collection and thus the growth in network is largely asset light. DLPL thus follows a strategy of continually containing costs with a view to absorb these possibilities.

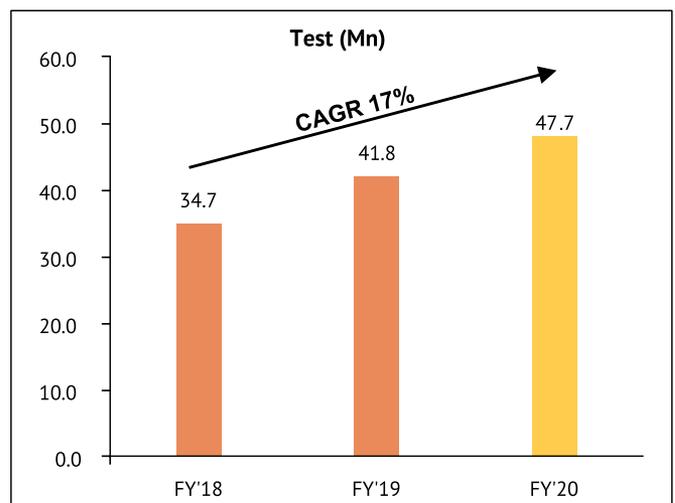
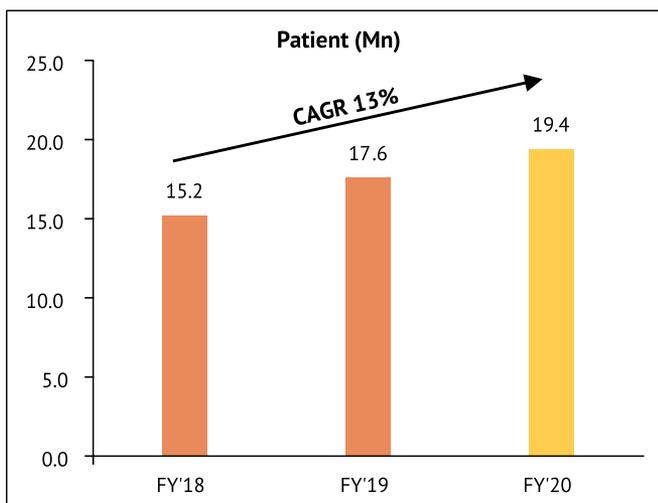
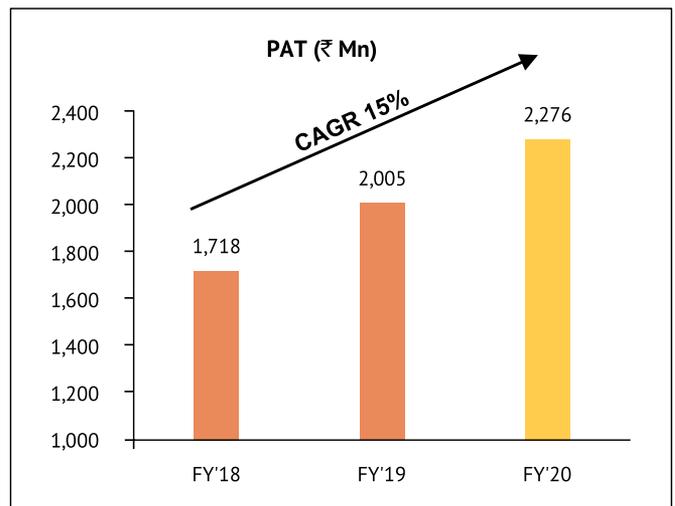
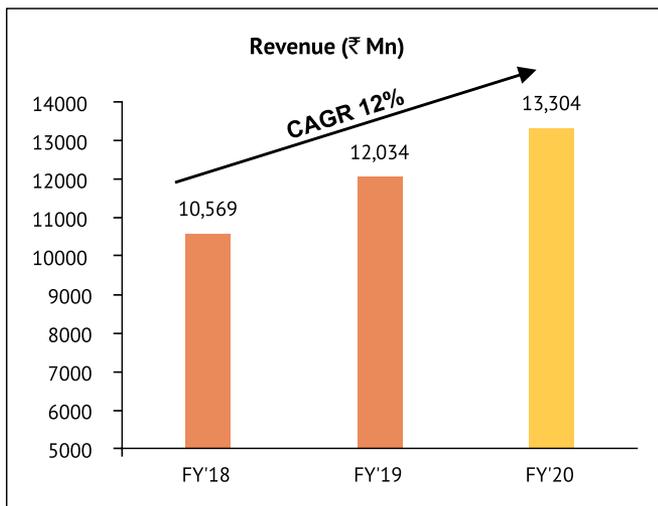
New Technologies

A highly qualified and experienced panel internally monitors and assesses the potential of commercializing novel testing technologies. This is with the primary objective of driving customer convenience. DLPL has successfully in the past, introduced novel tests and implemented the offering with targeted view on generating returns on such investments.

Other risk factors

There are additionally other risk factors as enlisted in the IPO prospectus issued in December 2015. Many of the risks mentioned therein hold true and the Company continually reviews them in order to formulate strategies to stay ahead.

Financial and Operational highlights



Revenue

The year ended March 31, 2020 saw the Company's consolidated revenues post 10.6% growth to ₹ 13,304 Mn. This was a result of 10.3 % growth in patient volumes.

Costs

The Company has laid specific focus on optimizing its cost matrix to provide opportunities to adapt to the volatile circumstances presented by the economy and the industry. The key drivers of cost during the year were expenses pertaining to widening and strengthening the outreach and infrastructure capabilities of the Company. Costs stood higher by 13.3% YoY.

The major items of cost for the Company include cost of reagents and chemicals, personnel costs, fees to collection centers, costs associated with logistics, information technology and infrastructure. These items have primarily remained in line with the growth of the operations.

EBITDA

Consolidated EBITDA (post elimination of impact of stock based compensation, CSR cost and Ind AS 116) showed a growth of 5.7% in FY'20. The EBITDA margins (post elimination of impact of stock based compensation, CSR cost and Ind AS 116) stood at 24.9%.

PBT and PAT

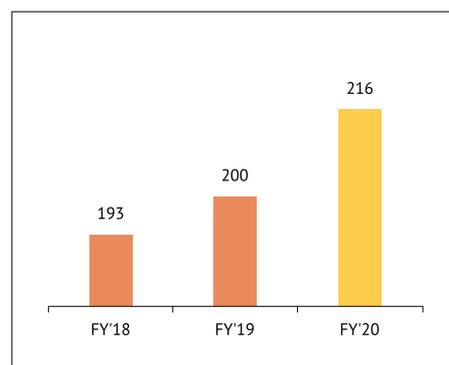
The PBT for the year stood at ₹ 3,105 mn and PAT registered a 13.5% growth over last year at ₹ 2,276 mn in FY20. The PAT margins stood at 17.1%. Diluted EPS therefore improved 13.3% to ₹ 27.37 per equity share of ₹ 10 each.

Cash and Bank

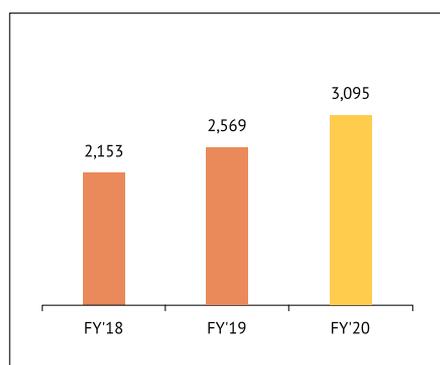
The Company's consolidated Cash and Cash Equivalents increased from ₹ 7,077 mn as at FY19 end to ₹ 7,443 mn at the end of FY20. This was the result of robust operating cash flow of ₹ 3,652 mn before working capital changes. Cash outflow towards capital expenditure during the year was at ₹ 464 mn as compared to ₹ 346 mn in the previous year. Other Income which includes interest and dividend on mutual funds was higher at ₹ 550 mn from ₹ 460 mn last year.

Operational performance

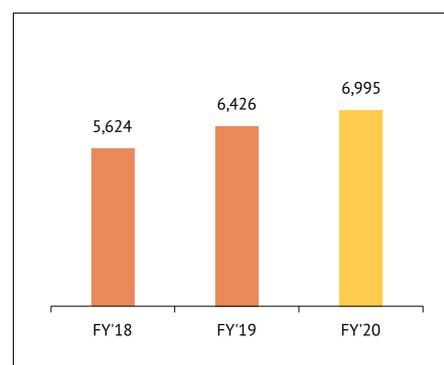
Nos of Labs, PSCs and PUPs



No. of Clinical Laboratories



No. of PSCs



No. of PUPs

Key Financial Ratios

In accordance with the SEBI (Listing Obligation and Disclosure Requirements 2018) (Amendment) Regulations 2018 the Company is required to give details of significant changes (Change of 25% or more as compared to the immediately previous financial year) in key financial ratios.

The Company has identified the following ratios as key financial Ratios:

Particulars	FY 2020	FY 2019
Revenue growth (%)	10.6%	13.9%
EBITDA Margin before ESOP, CSR charge & Ind AS 116 impact	24.9%	26.0%
PAT Margin (%)	17.1%	16.7%
Basic EPS (₹)	27.42	24.19
Diluted EPS (₹)	27.37	24.15
Fixed Assets Turnover (times)	8.5	7.5
Debtors Turnover Ratio (times)	25.9	22.6
Inventory Turnover Ratio (times)	5.2	9.2
Current Ratio	3.9	5.9

Based on consolidated results

The details of Return on Net worth are given below:

Particulars	FY 2020	FY 2019
Return on Net Worth (%)	22.7%	23%

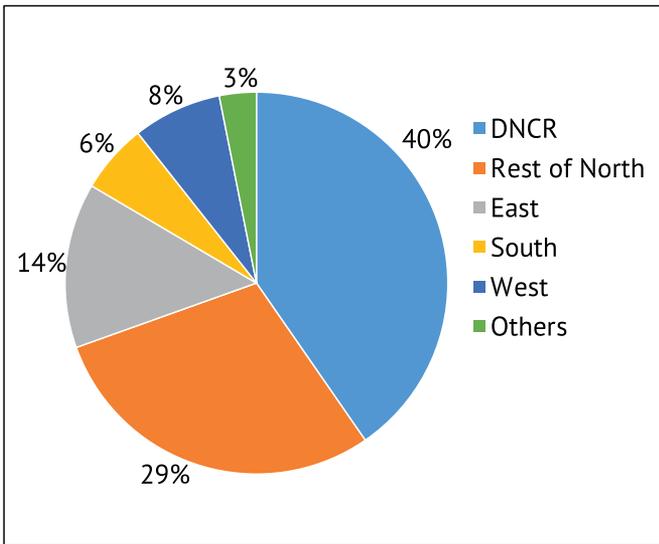
Based on consolidated results

Return on net worth is computed by dividing the net profit after tax for the year by average net worth. Net profit after tax has increased from ₹ 2,005 Mn in FY 2019 to ₹ 2,276 Mn in FY 2020. However, return on net worth in FY 2020 has reduced marginally as compared to FY 2019 because of higher base.

The inventory turnover ratio has declined due to higher inventory as at the end of March 2020 and the current ratio has declined due to creation of lease liability due to Ind AS-116.

The year under review oversaw growth of infrastructure of the Company as the net count of laboratories increased to 216, a net addition of 16 laboratories. The number of Patient Service Centres (PSCs) grew by 526 to 3,095 as at end of FY'20. The Pick Up Points also expanded by 569 to 6,995. The Company continues to make headway in this direction by strengthening its network infrastructure.

Geography wise break up of revenue



Strategy for growth

The Company continues to move forward with the following strategy at play:

- Develop online presence together with sharper focus on home collection of samples to drive customer convenience
- Target higher traction for bundled testing initiative, and augment the preventive health platform
- Acquire small but scalable laboratories that can enhance network presence in untapped geographies
- Focus on inland laboratories in proximity to existing large centers
- Widen the tests menu of the Company further
- Driving presence in Uttar Pradesh, Bihar, Jharkhand, Orissa, Madhya Pradesh, Chhattisgarh, West Bengal, North East, Bengaluru and Pune
- Tap into underserved niches within existing markets
- Continue development of network infrastructure
- Pursue select opportunities in hospital laboratory management

DLPL continues to increase the contribution of the high-end testing through better communication with doctors and developing specialized packages around select specialties like diabetes, pregnancy, neurology etc.

The Company continues to prioritize volume growth while it continues to build a stronger differentiation around its brand. As the operations grows in size, the underlying emphasis will always be on driving an optimized cost structure in order to deliver consistent growth in margins.