Thyrocare Technologies

IPO Note – Not much upside

Thyrocare Technologies is one of the leading diagnostic chains in India with market share of ~3% amongst organised players. The core business of the company is diagnostic testing (~97.1% of sales as on 9MFY2016) while the company through its wholly owned subsidiary also operates imaging centres.

A differentiated model enables higher margins: Unlike other organized players, which operate more on a B2C model, Thyrocare is more of a B2B player with ~85% of its revenues coming through the channel (as against 30-40% for its peers). This enables the company to keep its other expenditure lower vis-a-vis its peers, which spend higher on promotional expenses. In terms of services, the company is more focused on the preventive & wellness, and the non-preventive segments, while its peers follow a portfolio model of providing a full range of tests and services, which entail higher manpower costs. The company's operations are relatively more automated in nature, thereby requiring less manpower intervention, unlike its peers which need to employ qualified manpower like Phds and doctors. As a result, employee costs for Thyrocare account for 10% of sales V/s 20% of sales for its peers. This contributes towards the company enjoying better margins compared to the industry (~41% for Thyrocare's diagnostic business V/s ~26% for Dr Lal Pathlabs). We believe, over the medium term the company would be able to sustain its margins and also scale up its business, given the opportunities in the industry. This coupled with the low capex requirement for the diagnostic segment makes its diagnostic business a high ROIC business.

Outlook and Valuation: The company is valued at a P/E multiple of 42.3-44.9x its FY2016E annualised EPS at the lower and upper end of the issue price band. This compares with a P/E multiple of 61.9x FY2016E EPS for Dr Lal Pathlabs. Although the issue seems to be priced at a discount to Dr Lal Pathlabs, we believe that Thyocare's consolidated ROIC will come under pressure in the near term as it has entered the molecular imaging space by acquiring Nuclear Healthcare Ltd (NHL). According to the company, this business will take 3-4 years to attain peak profitability while it accounts for almost 40% of its fixed assets of the company (as on 9MFY2016). Thus, though Thyrocare could potentially provide listing gains, the pressure on its ROIC in the near term and the not-so cheap valuation demanded by it will keep the upside in the stock limited. **We are Neutral on the issue.**

Key Financials

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015
Net Sales	109	134	150	183
% chg	*44.2*	*23.1*	*11.7*	*22.0*
Net Profit	35	45	46	44
% chg	*53.5*	*28.3*	*3.0*	*(3.7)*
EPS (₹)	6.5	8.3	8.6	8.3
EBITDA Margin (%)	42.6	44.7	43.3	34.7
RoE (%)	41.1	34.1	25.2	18.5
RoCE (%)	33.3	29.4	24.5	15.8

Source: Company, Angel Research; Note: FY2015 numbers are consolidated and rest standalone

NEUTRAL

Issue Open: April 27, 2016
Issue Close: April 29, 2016

Issue Details
Face Value: ₹10
Present Eq. Paid up Capital: ₹53.7cr
Fresh Issue**: NA
Offer for sale: 1.07cr Shares
Post Eq. Paid up Capital: ₹53.1cr
Market Lot: 33 Shares
Issue (amount): ₹451-479cr
Price Band: ₹420-446
Post-issue implied mkt. cap ₹2,256cr*-2,396cr**

*Note:*at Lower price band and **Upper price band*

Book Building	
QIBs	50%
Non-Institutional	15%
Retail	35%

Post Issue Shareholding Pattern(%)	
Promoters Group	64.0
MF/Banks/Indian FIs/FIIs/Public & Others	36.0

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Company background

Thyrocare is among the leading diagnostic chains. It conducts an array of medical diagnostic tests that center on early detection and management of disorders and diseases. The company operates its testing services through a fully-automated central processing laboratory (CPL) in Navi Mumbai, which acts as a hub to branches. The company has recently expanded its operations to include a network of five regional processing laboratories (RPLs). Out of these, four RPLs were set up in 2015 (one each in New Delhi, Coimbatore, Hyderabad, and Kolkata) while it set up one in Bhopal in 2016.

The company as of February 29, 2016, had a network of 1,041 authorized service providers (ASPs), comprising of 687 Thyrocare Aggregators (TAGs) and 354 Thyrocare Service Providers (TSPs) spread across 466 cities, 24 states and one union territory. These ASPs operate under a franchise agreement with the company and deliver samples directly to one of the RPLs or to one of the 22 hub locations if the sample is to be processed at the CPL.

As of February 29, 2016, it offered 198 tests and 59 profiles of tests to detect a number of disorders. Its profiles of tests include 16 tests administered under its "Aarogyam" brand, which offers patients a suite of wellness and preventive health care tests. In terms of revenue, Wellness & Preventive Healthcare tests account for ~50% of the revenue (of which thyroid tests account for 20% and the balance 30% are accounted by non-thyroid tests).

The company's wholly owned subsidiary, NHL, operates a network of molecular imaging centers in New Delhi, Navi Mumbai and Hyderabad which focus on early and effective cancer monitoring.

Issue details

The issue is an offer for sale by Promoters and Non-Promoters of 1.07cr equity shares aggregating to ₹479cr at the upper end of the price band. The issue constitutes 20% of the paid-up equity share capital of the company. Since it is an offer for sale, the company will not receive any proceeds from the sale of shares.

Exhibit 1: Shareholding pattern

Particulars	Pre-Issue		Post-Issue	
	No. of shares	(%)	No. of shares	(%)
Promoter group	34,898,981	65.0	34,361,745	64.0
Others	18,824,552	35.0	19,361,788	36.0
Total	**53,723,533**	**100.0**	**53,723,533**	**100.0**

Source: Company, Angel Research

Industry

The domestic diagnostic market is highly fragmented and has a current size of ~US$6.2bn. The industry is expected to grow at 16-18% CAGR to ~US$9.3-$9.8bn by FY2018 as per CRISIL estimates.

Diagnostic centres in India can be classified as hospital-based, diagnostic chains and standalone centres. Standalone centres form the majority share (48%) followed by hospital based (37%) centres, while diagnostic chains account for the balance (15%). The absence of stringent regulations and low entry barriers has led to the evolution of standalone centres, while hospitals tend to have their own pathology labs. Within diagnostic chains, large pan-India chains form 35-40% and regional chains form 60-65%.

Specialized tests require expensive infrastructure, which has led to the formation of diagnostic chains in India. These follow the hub and spoke model and enable economies of scale. However, the fragmented nature of the industry indicates low pricing power for service providers in the near term.

The key drivers for the industry are- increase in evidence-based treatments, huge demand-supply gap, increase in health insurance coverage, need for greater health coverage as population and life expectancy increase, rising income levels making quality healthcare services affordable, and growing demand for lifestyle diseases-related healthcare services.

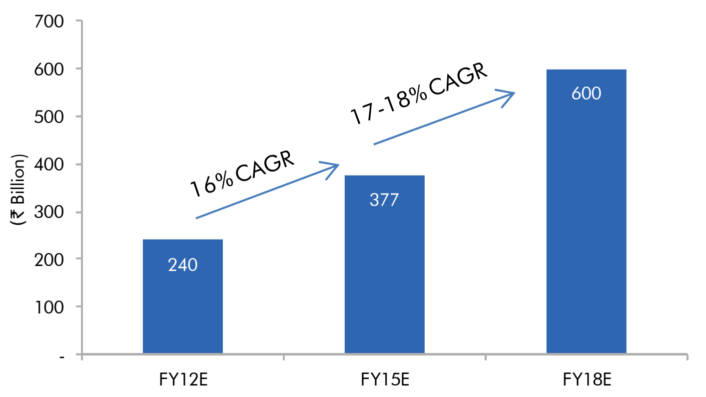
Key investment rational

One of the leading players in the high growth market with strong drivers in place

As per CRISIL, the Indian diagnostic industry which has grown at a CAGR of ~16% over FY2012-2015 to ₹37,700cr, is expected to maintain its momentum and grow at 16-18% CAGR to reach the ~₹60,000cr mark by FY2018E. This growth is likely to be supported by rising awareness towards wellness and a higher tendency among the population to take preventive actions against diseases. Changing lifestyle is perpetuating higher chronic diseases and with rising income levels, demand for diagnostic testing in India is on the rise. Further, the health insurance penetration level in India is currently low with ~17% of the population availing to it. Moreover, ~86% of the healthcare related expenses are borne directly by consumers in case of private healthcare services. Increase in penetration levels of health insurance is expected to indirectly increase demand for diagnostic services.

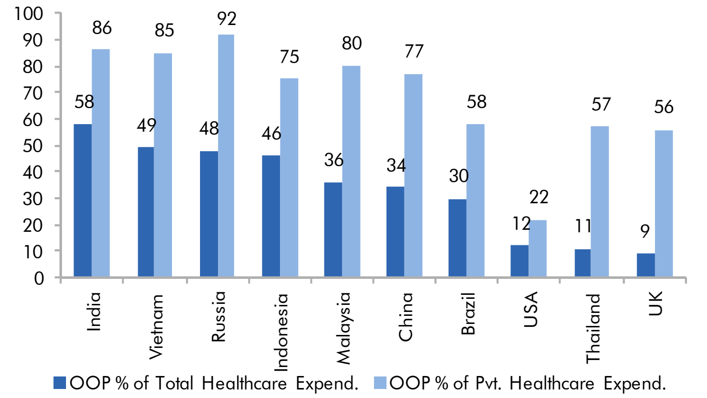
Of the diagnostic market large pan-India chains account for 35-40% and regional chains cover the balance 60-65%. Also, they can eat into unorganised sectors market share which stands at 48%. This leaves a lot of room for organised players like Dr Lal Pathlabs, Thyocare and SRL amongst others to grow faster than the industry. Thyocare has posted a CAGR of 23.0% over FY2011-2015. Going forward, given the cash rich balance sheet of the company, it can easily grow at 30% over the medium term.

Exhibit 2: Indian diagnostic sector



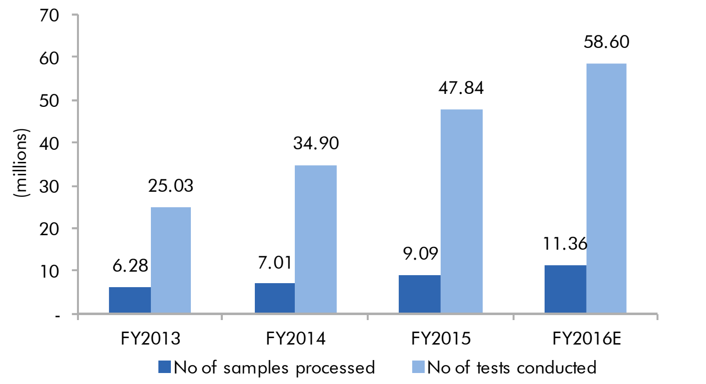
Source: RHP, Angel Research

Exhibit 3: Out-of-pocket spending on healthcare (2013)



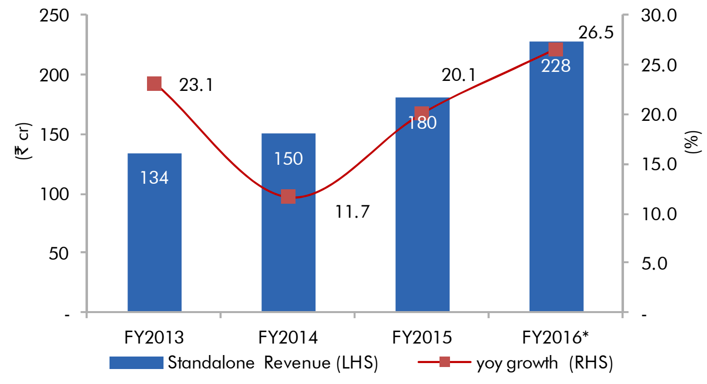
Source: WHO Global Healthcare Expenditure Database, Angel Research

Exhibit 4: Strong growth in Samples and Tests



Source: Company, Angel Research

Exhibit 5: Standalone top-line growth



*Source: Company, Angel Research; note*9M annualised*

A differentiated model enables higher margins

Thyrocare's business model differs from that of its competitors in a couple of ways. One of the striking difference is that unlike other organized players, which mostly follow a B2C model, Thyrocare is more of a B2B player with ~85% of its revenues coming through the channel (as against 30-40% for its peers). This enables the company to keep its other expenditure lower vis-a-vis its peers, which spend higher on promotional expenses. In terms of services, the company is more focused on the preventive & wellness, and the non-preventive segments, while its peers follow a portfolio model of providing a full range of tests and services, which entail higher manpower costs. The company's operations are relatively more automated in nature, thereby requiring less manpower intervention, unlike its peers which need to employ qualified manpower like Phds and doctors. As a result, employee costs for Thyrocare account for 10% of sales V/s 20% of sales for its peers. This contributes towards the company enjoying better margins compared to the industry (~41% for Thyrocare's diagnostic business V/s ~26% for Dr Lal Pathlabs). We believe, over the medium term the company would be able to sustain its margins and also scale up its business, given the opportunities in the industry. This coupled with the low capex requirement for the diagnostic segment makes it a high ROIC business.

The company's standalone business derived ~51% of its FY2015 revenues from wellness and preventive healthcare tests segment. This segment grew at a CAGR of ~29% over FY2013-15E while the overall top-line posted a growth of ~16% over the same period. Going forward, CRISIL estimates that this segment is expected to grow at 25% over the next three years which augurs well for the company as the company is keen on growing its wellness and preventive offerings.

Core business asset light in nature, debt free status

The company's volumes and strong ties with its vendors has enabled it to develop an equipment leasing model for the CPL that has resulted in minimal capex for its otherwise expensive diagnostic equipments. The model entails leasing of equipments and instruments for the CPL in exchange for a commitment to purchase reagents and consumables from these vendors for a specified period of time. The RPLs conduct routine tests which do not require complex equipments; hence, the capex required for equipments is minimal and the same are purchased outright by the company. Additionally, the premises required to set up these RPLs are leased, thus resulting in lower capital outlay to set up these RPLs (₹2-3cr required for set up a RPL). As a result, the company has been able to expand its operations without relying on debt. The company as of 9MFY2016 has no debt on its books.

Low capex requirements and high asset turnover along with high margins enable the company to generate high ROIC on the core diagnostic business, which is around ~40%. This will enable the company to fund its growth with ease and warrant it to make a high dividend payout. In fact it has cash and bank and investments of ₹91cr as of FY2015 on a consolidated basis. The net cash flow from operating activities is around ₹40-45cr/year and will be used to fund the next phase of growth.

Valuation

The company is valued at a P/E multiple of 42.3-44.9x its FY2016E annualised EPS at the lower and upper end of the issue price band. This compares with a P/E multiple of 61.9x FY2016E EPS for Dr Lal Pathlabs. Although the issue seems to be priced at a discount to Dr Lal Pathlabs, we believe that Thyocare's profitability will come under pressure in the near term as it has entered the molecular imaging space by acquiring Nuclear Healthcare Ltd (NHL). According to the company, this business will take 3-4 years to attain peak profitability while it accounts for almost 40% of the fixed assets of the company (as on 9MFY2015). Thus, though Thyrocare could potentially provide listing gains, the pressure on its ROIC in the near term and the not-so cheap valuation demanded by it will keep the upside in the stock limited. **We are Neutral on the issue.**

Risks to upside

- Highly fragmented market with intense local competition (standalone centers are 48% of the industry).
- High dependence on preventive wellness which accounts for almost 51% of its sales with thyroid tests accounting for 20% of the overall sales.
- High investments in the imaging business with high gestation periods would keep the profitability in check.
- Margins could be under pressure in case the company moves higher in the value chain.

Consolidated Profit & Loss Statement

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	9MFY2016
Gross sales	107	131	146	175	169
Less: Excise duty	-	-	-	-	-
Net sales	107	131	146	175	169
Other operating income	2.5	3.5	3.7	8.3	6.9
Total operating income	**109**	**134**	**150**	**183**	**176**
% chg	*40.1*	*23.1*	*11.7*	*22.0*	*(3.9)*
Total expenditure	60	71	81	111	104
Net raw materials	29	36	43	56	51
Personnel	7	9	12	18	17
Other	24	26	27	38	37
EBITDA	**47**	**60**	**65**	**63**	**65**
% chg	*37.6*	*28.9*	*8.4*	*(2.3)*	*2.1*
(% of Net Sales)	*43.6*	*45.9*	*44.4*	*36.3*	*38.3*
Depreciation& amortisation	2	3	6	13	13
Interest & other charges	-	-	-	-	-
Other income	5	6	7	7	5
(% of PBT)	-	9	-	11	7
Share in profit of Associates	-	-	-	-	-
Recurring PBT	**52**	**62**	**69**	**66**	**63**
% chg					
Extraordinary expense/(Inc.)	-	(12)	-	-	-
PBT (reported)	**52**	**74**	**69**	**66**	**63**
Tax	17.07	21.06	22.74	23.07	22.98
(% of PBT)	*30.6*	*32.7*	*32.0*	*34.8*	*36.5*
PAT (reported)	**35**	**57**	**46**	**43**	**40**
Add: Share of earnings of asso.	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	(1)	-
Prior period items	-	-	-	-	-
PAT after MI (reported)	**35**	**57**	**46**	**44**	**40**
ADJ. PAT	**35**	**45**	**46**	**44**	**40**
% chg	*40.8*	*28.3*	*3.0*	*(3.7)*	*(9.9)*
(% of Net Sales)	*32.8*	*43.5*	*31.6*	*25.4*	*23.7*

Note: Consolidated for FY2015 and 9MFY2016

Consolidated Balance Sheet

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	9MFY2016
SOURCES OF FUNDS					
Equity share capital	11	11	11	51	54
Preference Capital	-	-	-	-	-
Reserves & surplus	92	149	195	224	314
Shareholders funds	**102**	**160**	**206**	**274**	**367**
Minority Interest	-	-	-	36.0	-
Total loans	31	32	32	12	11
Deferred tax liability	(0)	0	1	(1)	(2)
Total liabilities	**133**	**193**	**239**	**321**	**377**
APPLICATION OF FUNDS					
Net block	**20**	**75**	**87**	**151**	**152**
Capital work-in-progress	-	10	6	6	3
Goodwill	-	-	-	45	107
Long Term Loans and Adv.	3	5	6	14	10
Investments	24.0	77.2	119.0	85.9	81.6
Current assets	**90**	**28**	**27**	**26**	**37**
Cash	59	18	12	5	7
Loans & advances	22	2	4	9	14
Other	9	9	11	12	16
Current liabilities	3	4	6	7	14
Net current assets	**86**	**24**	**21**	**19**	**23**
Mis. Exp. not written off	-	-	-	-	-
Total assets	**133**	**193**	**239**	**321**	**377**

Note- Consolidated for FY2015 and 9MFY2016

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