

Sector update

Company update

- Apollo Hospitals (HOLD from Add)
- Aster DM (BUY from Add)
- Fortis (ADD)
- HCG (BUY from Add)
- Dr Lal Pathlabs (HOLD)
- Metropolis (HOLD)
- Thyrocare (BUY from Hold)

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Healthcare

Outlook 2022: Business recovering but *Omicron* lurking

We remain positive on the healthcare space amid secular growth and expect a healthy recovery in non-COVID business, leading to potential margin improvement from cost-control initiatives and change in mix. Sector companies under our coverage have seen steep appreciation in stock price over the last year (~50%) driven by both hospital and diagnostic companies. Key notable points for CY22: 1) occupancy level is expected to remain strong and recovery in international patients to improve mix for hospitals, 2) likely improvement in volume growth for diagnostic companies with shift from unorganised to organised players, 3) reducing contribution from COVID-19 business; however, *Omicron* variant may change assumptions and 4) EBITDA margin to sustain with improving business mix and continuation of cost-control initiatives.

► Outlook for CY22

Hospitals: We expect occupancy levels to improve, while change in case mix and reduction in ALOS would improve ARPOB. Revenues from international patients are still below pre-COVID level which we believe should normalise in CY22. We expect revenue growth to be strong ~14% in FY23E despite a higher base. Companies would continue focusing on cost-control measures which should support profitability.

Diagnostics: We believe diagnostic companies will observe strong mid-teens growth in base (ex-COVID) business in CY22. Low base of non-COVID portfolio of H1CY21 would likely help in registering very strong growth in H1CY22, while COVID-19 related revenues would contract sharply. We also expect a faster shift from unorganised to organised players in the current environment as larger brands are associated with safety & hygiene and have efficient home collection process, which has seen increased traction as well as likely consolidation in the industry.

COVID-19: *Omicron* variant is highly contagious and could force restrictive measures once again, potentially affecting growth. However, learnings from the first and second wave of COVID-19 should cushion some of the negative impact, in our view.

- **Key sector trends in CY21:** Key trends across hospital and diagnostic sectors: 1) sharp improvement in occupancy led by pent-up demand in hospitals; however, international patients are still below pre-COVID level, 2) improving profitability by most of the hospitals with reducing COVID-19 contribution and high demand for elective surgeries and 3) fast recovery in base business volumes for diagnostic companies with normalisation. We believe cost-control measures announced during the lockdown by companies would be partially sustainable over the longer term. The impact on profitability was much higher than expectation due to quick recovery in the business resulting in earnings upgrades.

- **Our view:** We are positive on secular growth of the healthcare sector given high visibility, improving reach and likely margin expansion. We also introduce FY24 estimates for all the covered companies. Considering the meaningful re-rating in valuation for Apollo we downgrade to **HOLD** from *Add* while we upgrade Aster DM, HCG and Thyrocare to **BUY** with the recent price correction. **Top picks:** Thyrocare, HCG and Aster DM.

- **Key risks:** Regulatory hurdles such as price ceiling on hospital treatments and diagnostic tests, and increase in competitive pressures.

Valuation summary

Company	Reco	CMP		TP		P/E (x)			EV/EBITDA (x)			RoE (%)		
		(Rs)	(Rs)	(Rs)	(Rs)	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Apollo Hosp	Hold	4,844	4,994			75.7	56.8	44.4	31.6	26.0	21.5	18.4	20.3	21.2
Aster DM	Buy	172	226			16.9	11.1	8.8	8.4	6.6	5.3	14.0	18.1	18.8
Fortis	Add	275	303			71.8	35.9	29.8	19.6	16.9	14.6	4.6	8.6	9.5
HCG	Buy	229	292			NA	87.9	47.7	15.4	12.8	10.8	NA	3.8	6.6
Dr Lal	Hold	3,515	3,601			71.1	64.1	54.1	47.1	41.4	36.3	29.7	27.0	26.5
Metropolis	Hold	3,278	3,190			72.4	57.6	48.1	45.8	37.1	31.7	30.2	32.3	33.4
Thyrocare	Buy	1,005	1,231			25.5	34.2	32.8	17.3	22.9	21.7	47.7	34.2	34.5

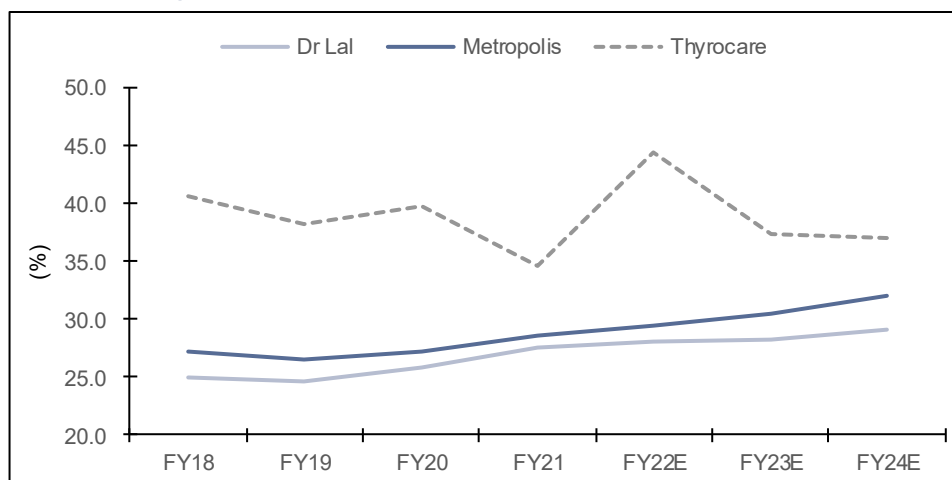
Source: I-Sec research

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Hospitals – recovery in growth to continue

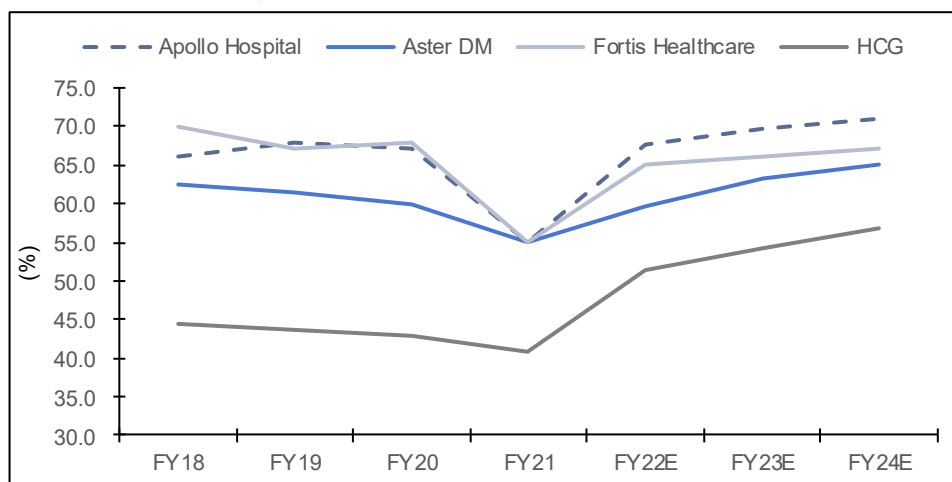
Hospital companies under our coverage have shown robust growth, mainly due to the recovery in elective surgeries, high COVID-19 patients' occupancy during second wave and revenue from vaccination drives. Margins improved in H1FY22 with higher occupancy of non-COVID patients. However, international patients are still below pre-COVID level which we expect to normalise in CY22. We expect the hospitals to likely maintain healthy occupancy levels. Further, cost-control benefits and change in mix would likely help in EBITDA margin improvement.

Chart 1: Margin expansion expected across companies

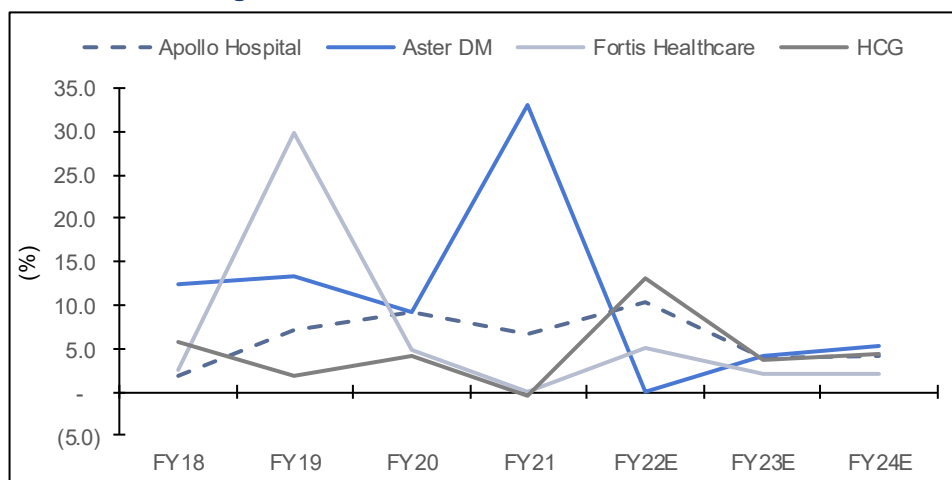


Source: Industry data, I-Sec research

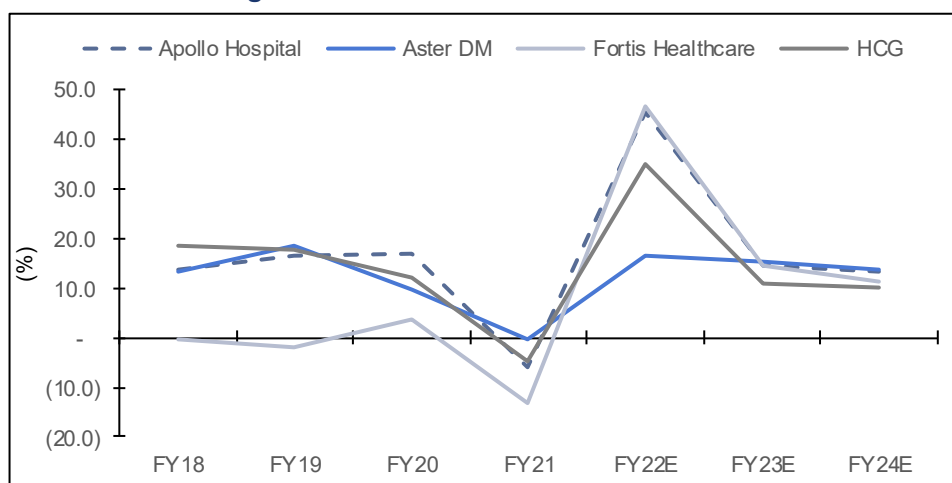
Chart 2: Occupancy trend



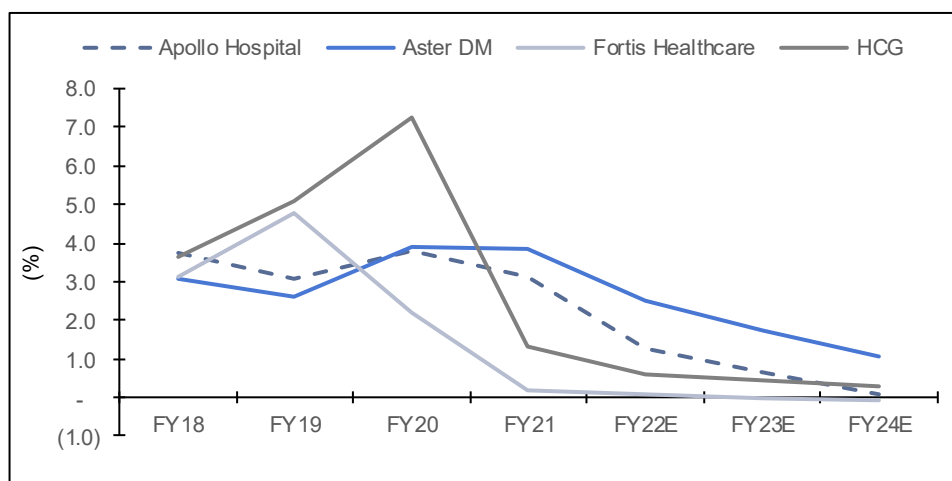
Source: Industry data, I-Sec research

Chart 3: ARPOB growth trend

Source: Industry data, I-Sec research

Chart 4: Revenue growth trend

Source: Industry data, I-Sec research

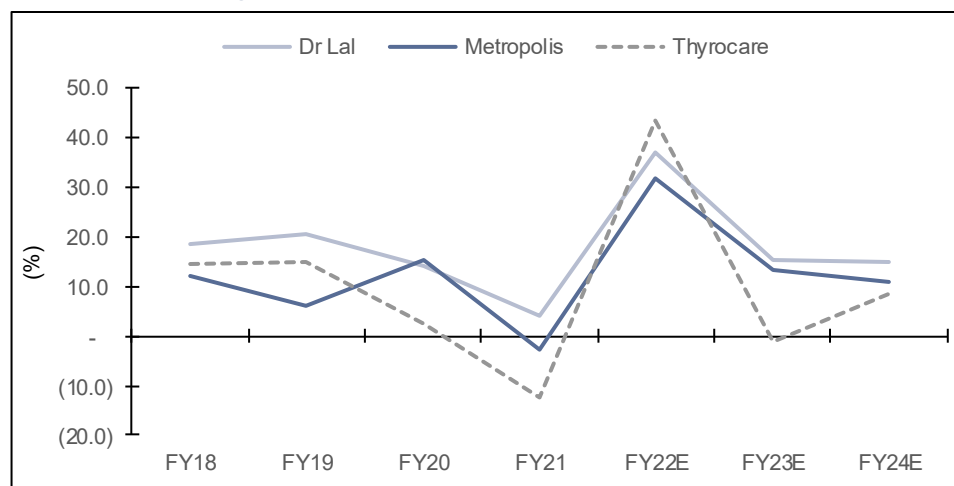
Chart 5: Net-debt to EBITDA trend

Source: Industry data, I-Sec research

Diagnostics – normalising business

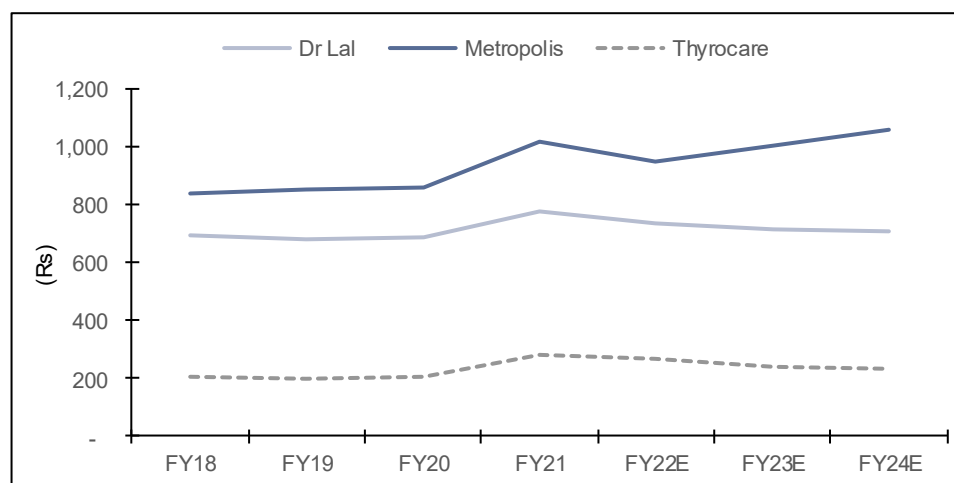
Diagnostic companies' base business (non-COVID) witnessed healthy recovery and has neared pre-COVID levels. We expect normalisation in H2FY22 with mid-teen growth in CY22 despite a higher base. Additionally, COVID-19 related tests would likely drive incremental growth depending on its continuity. Base business growth would be largely driven by volumes and marginal price hikes. We also expect a modicum of margin expansion on the back of operating leverage and improvement in RoIC.

Chart 6: Volume growth trend

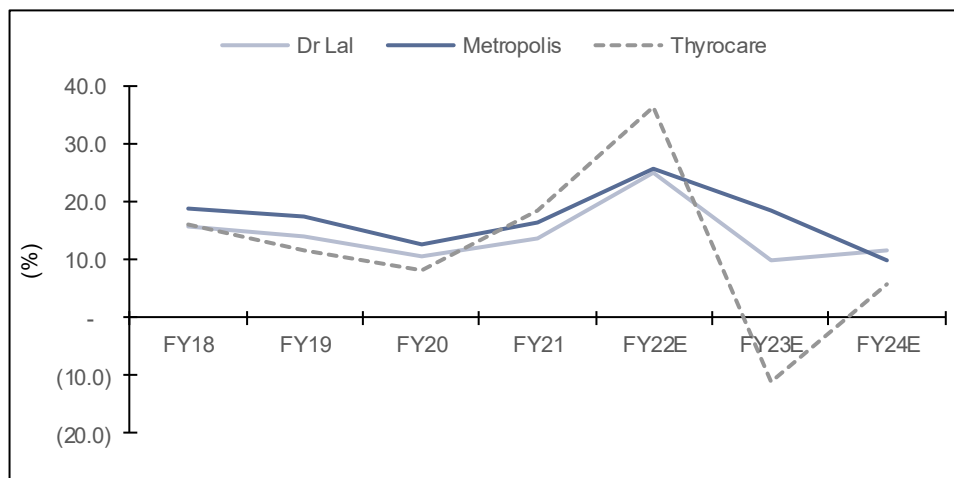


Source: Industry data, I-Sec research

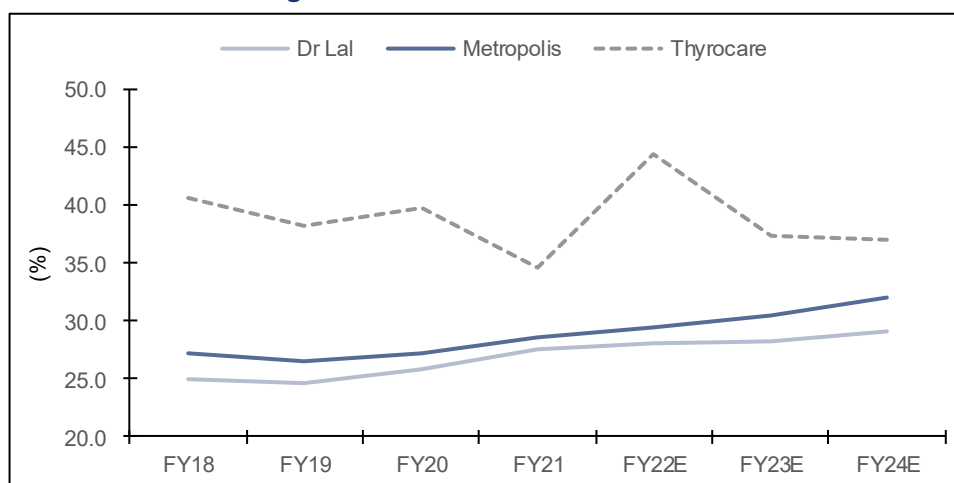
Chart 7: Realisation trend



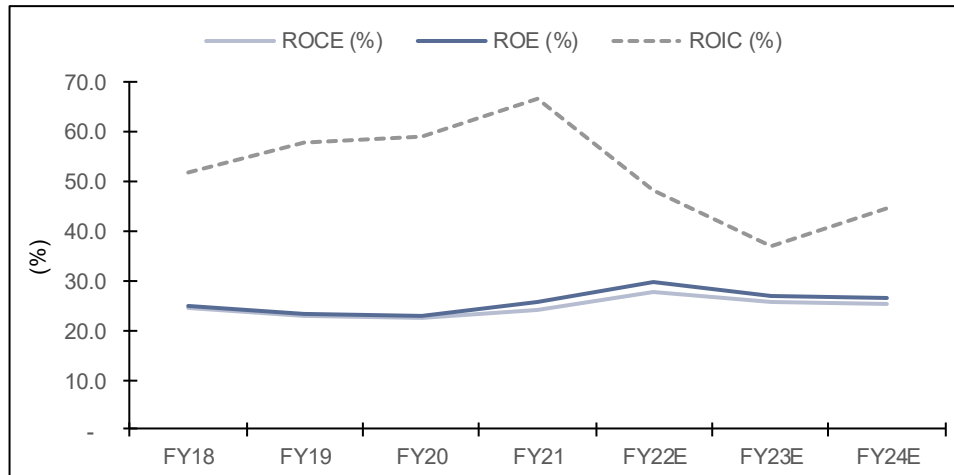
Source: Company, I-Sec research

Chart 8: Revenue growth momentum

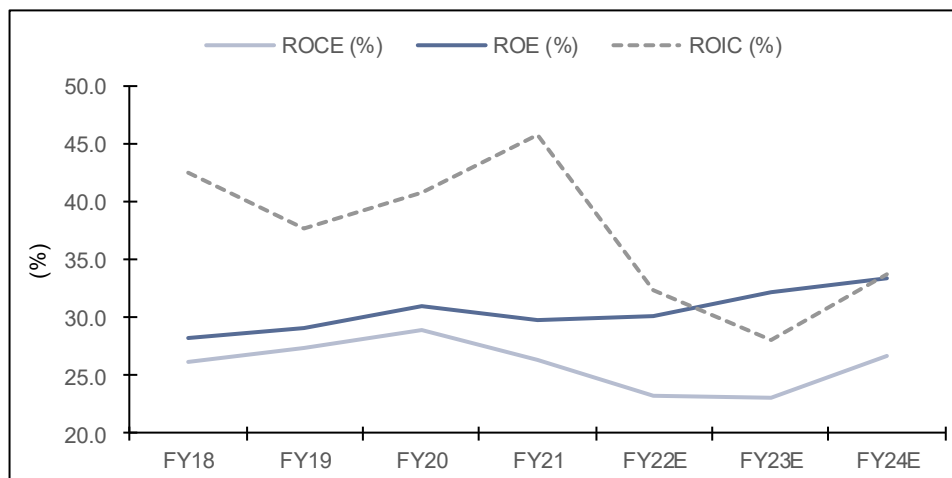
Source: Industry data, I-Sec research

Chart 9: EBITDA margin to remain stable

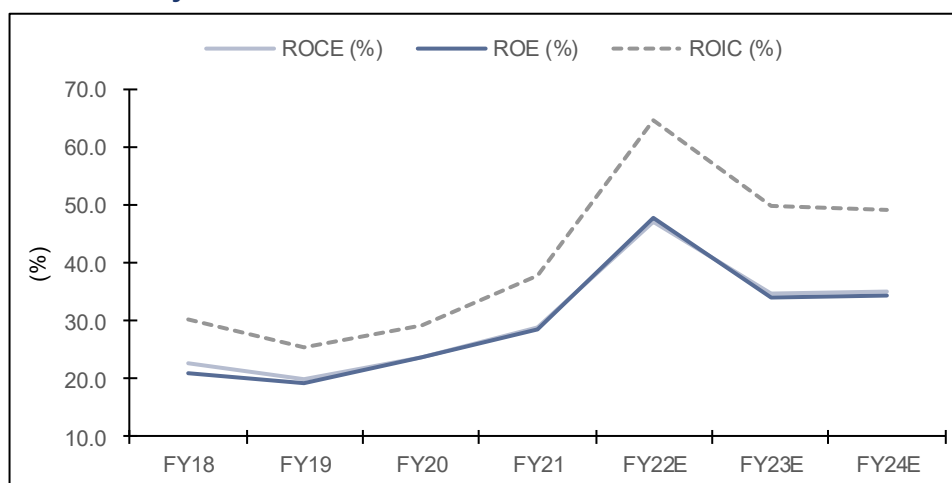
Source: Industry data, I-Sec research

Chart 10: Dr Lal return ratios

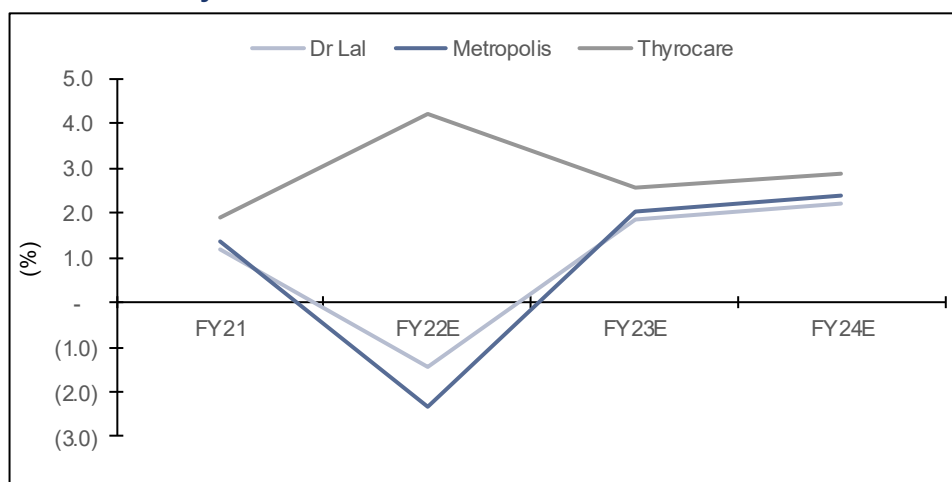
Source: Industry data, I-Sec research

Chart 11: Metropolis return ratios

Source: Industry data, I-Sec research

Chart 12: Thyrocare return ratios

Source: Industry data, I-Sec research

Chart 13: FCF yield

Source: Industry data, I-Sec research

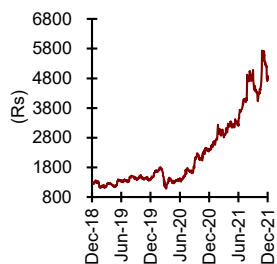
Table 1: Operational and financial comparison of diagnostic companies

Parameter	Dr. Lal Pathlabs	Thyrocare	Metropolis
FY21 Operational Metrics			
No of Central/National Labs	2	1	1
No of Regional Labs	231	11	125
No of Tests (mn)	49.7	92.8	19.1
No of Patients (mn)	20.3	16.8	9.8
No of Collection Centres	3,705	4,410	2,057
No of Tests offered	~5,000	~300	~4,000
Revenue/lab (Rs mn)	67.9	412.2	79.2
Revenue/test (Rs)	318	53	523
Revenue/patient (Rs)	779	294	1,015
Test/lab	2,13,305	77,36,667	1,51,587
Test/patient	2.45	5.51	1.94
Patient/lab	87,124	14,03,333	78,016
B2C:B2B (%)	70:30	20:80	43:57
COVID-19 (% to sales)	16.1	24.0	23.3
Financials Highlights			
FY21			
Revenue (Rs mn)	15,813	4,946	9,980
% yoy growth	18.9	14.2	16.5
EBITDA (Rs mn)	4,363	1,713	2,860
EBITDA Margin (%)	27.6	34.6	28.7
CAGR (FY16-21)			
Revenue (%)	14.9	15.5	16.0
EBITDA (%)	15.8	12.9	17.7
PAT (%)	17.1	16.9	18.9
PAT (%) (21-24)	22.9	12.7	24.0
Valuations			
EV/EBITDA	62.3	30.4	57.5
P/E	64.9	47.0	91.5

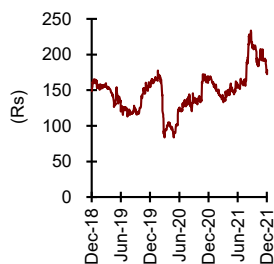
Source: Industry data, I-Sec research

Price charts

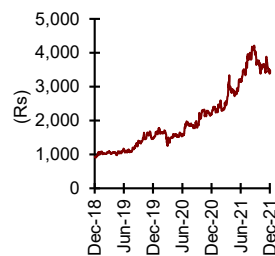
Apollo Hospital



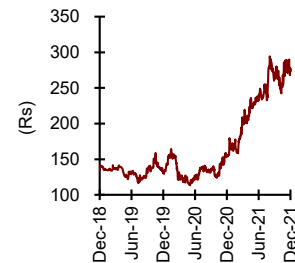
Aster DM



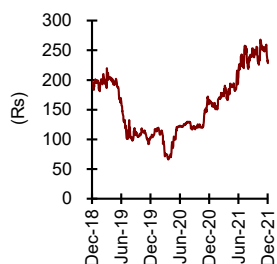
Dr Lal



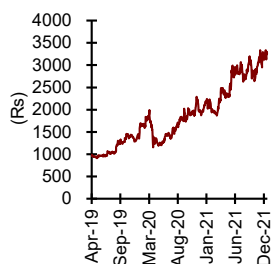
Fortis



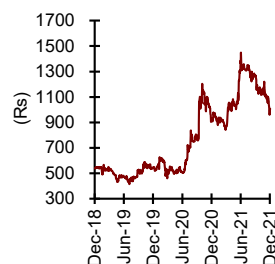
HCG



Metropolis



Thyrocare



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