

THYROCARE TECHNOLOGIES

Wellness declines; Future hinges on new strategy

India Equity Research | Healthcare



In Q4FY18, Thyrocare posted lowest top-line growth—11%—since IPO. This was due to the first-ever decline in Wellness, led by heightened competition, which we have been highlighting for the past six quarters. Despite Q4 being a seasonally strong quarter, rising share of regional PE-backed players, especially in Delhi, coupled with non-recurrence of promotional activity, led to the deceleration. EBITDA margin also fell to 38% from past three quarters' run rate of 42%. The blip has prompted the company to undertake following changes in strategy: i) shift focus back to B2B; ii) spend 5% of sales on advertising; and iii) promote franchise model in imaging. Given the current macros, we believe successful implementation of this strategy is key. Though we believe achieving the 25% FY19 revenue growth guidance will be challenging (our estimate 18%), we will wait and watch if the new strategy is successful on a favourable base. Maintain 'BUY' with TP of INR750.

Rising competition takes a toll on Aarogyam's sales

Pathology grew in single digit for the first time, at 9%, on a high base. Sickness (up at 27%) fared better than Aarogyam (down 4%) — while Q4 is a seasonally strong quarter for Sickness, Thyrocare lost significant share to rising competition in Wellness. In Delhi, heightened competition led to a second consecutive quarter of double-digit decline. On the upside, the company's new sourcing model buoyed gross margin at 73% levels.

Growth likely to taper, implementation of strategy key

In the past, PE-backed players were drawn by diagnostics' robust growth prospects. As these players gain critical mass with their disruptive pricing, we believe the odds are stacked against Thyrocare. Going forward, we believe achieving 25% growth will be a challenge as: 1) B2B business is less sticky than B2C; 2) Thyrocare lacks presence across the value chain; and 3) price reduction in Wellness may not drive volumes as much as in Thyroid, as this time, competitors will follow suit. Implementation of the shift in strategy will be key in this challenging macro, failing which, growth is likely to taper.

Outlook and valuations: Wait and watch; maintain 'BUY'

We estimate FY19 top-line growth at 18%. Though we remain cautious on the overall business, we wait and watch if the strategy plays out against a favourable base. At CMP, the stock trades at 17.5x FY20E EBITDA. We maintain 'BUY/SU' and TP of INR750.

Financials

(INR mn)

Year to March	Q4FY18	Q4FY17	% change	Q3FY18	% change	FY17	FY18	FY19E
Net revenues	967	871	10.9	839	15.2	3,044	3,563	4,276
EBITDA	372	316	17.7	354	5.1	1,152	1,447	1,601
EBITDA margin (%)	38.5	36.3	220bps	42.2	-371bps	37.8	40.6	37.5
Adjusted profit	260	127	105.1	215	21.1	478	947	1,002
Diluted P/E (x)						73.9	37.3	35.3
EV/EBITDA (x)						29.7	23.6	21.3
ROACE (%)						24.8	34.3	31.5

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Underperform
Risk Rating Relative to Sector	High
Sector Relative to Market	Overweight

MARKET DATA (R: NA, B: THYROCARE IN)

CMP	: INR 658
Target Price	: INR 750
52-week range (INR)	: 871 / 566
Share in issue (mn)	: 53.7
M cap (INR bn/USD mn)	: 35 / 532
Avg. Daily Vol.BSE/NSE('000)	: 91.6

SHARE HOLDING PATTERN (%)

	Current	Q3FY18	Q2FY18
Promoters *	64.0	64.0	64.0
MF's, FI's & BK's	21.5	21.5	18.9
FII's	7.1	7.1	6.8
Others	7.4	7.4	10.3
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Pharma Index
1 month	10.9	4.2	3.1
3 months	(1.8)	(0.8)	(0.5)
12 months	(8.4)	14.7	(5.2)

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Q4FY18 result: Conference call highlights

Results

- Thyrocare posted low top-line growth of 11% YoY, primarily due to heightened competition from PE entrants.
- On January 31, 2018, the company entered into a transaction wherein it sold its water testing division on a slump sale. Profit from the same, amounting to INR79.68mn, has been included in other income, leading to sharper jump in other income.

Industry

- Management envisages competition to sustain as more players continue to enter and try to take the plunge from unorganised to organised.
- Growth will come by spending more to create awareness.

Pathology

- Pathology clocked mere single digit growth for the first time at 9% due to high base.
- Thyrocare's Wellness product Aarogyam continues to bring more revenue than Thyroid.
- However, Aarogyam has been extensively replicated by organised as well as unorganised players.
- The company intends to get aggressive and shift focus back to the B2B segment.
- According to the management, awareness, per capita income and shift from unorganised to organised sectors will drive growth.

Imaging

- Thyrocare has set a turnover target of INR3,000mn for FY25.
- Currently, the company has 11 scanners and intends to bring in more—tentative target of 20.
- Further, the company is evaluating proposals for initiating joint venture agreements with suitable partners on a franchisee model since radiology is relatively more organised than pathology.
- In the franchisee model, while the company's subsidiary Nuclear will own the asset, operations will be conducted by the franchisee on 50:50 profit sharing ratio.
- Currently, 10 scans/machine/day are generated.
- The company's Delhi geography has been clocking consistent volume decline. This is mainly attributable to the subsidised scanning provided by the Delhi government.
- However, the company is confident that government schemes will not be disruptors in this segment.

Guidance

- According to the management, Aarogyam will clock 10% volume growth on 5% cut in prices. Moreover, it expects volumes, and not excess advertising/campaigning, to drive growth.
- Management believes, 25% is a sustainable topline growth rate.
- Management guided for advertising expenses in coming years to range between 5% and 8% of top line; to be 5% of top line in FY19E.

Table 1: Actual versus estimates

Year to March	Actual Q4FY18	Y-o-Y Growth (%)	Edel estimates	Y-o-Y Growth (%)	Deviation from Actual (%)
Net Sales	967	10.9	1,009	15.8	(4.2)
Diagnostic testing services	894	9.4	942	15.2	(5.1)
Imaging Services	66	39.3	67	41.0	(1.2)
Gross profit	707	11.3	749	18.1	(5.7)
Gross margins(%)	73		74		
Employee Cost	113	16.7	121	25.3	(6.9)
Other expenditure	222	(0.1)	225	1.5	(1.5)
EBITDA	372	17.7	403	27.4	(7.7)
EBITDA margin (%)	38		40		
Depreciation	56	13.6	86	74.3	(34.8)
Other Income	109	403.3	33	53.1	228.7
Interest	1	NA	(3)	NA	NA
PBT	423	47.3	353	22.8	19.9
Income tax expense	163	75.6	117	25.5	39.9
Tax rate	39		33		
Add: Exceptional items	-		-		
Reported profit	260	33.7	236	21.5	10.1
Adjusted EPS	5	105.1	6	152.3	(18.7)

Source: Company, Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q4FY18	Q4FY17	% change	Q3FY18	% change	FY18	FY19E	FY20E
Net revenues	967	871	10.9	839	15.2	3,793	4,667	5,179
Cost of revenue	260	237	9.9	208	25.2	950	1,173	1,377
Gross profit	707	635	11.3	631	12.0	2,843	3,493	3,802
Other expenses	222	222	(0.1)	183	21.3	813	1,095	1,406
EBITDA	372	316	17.7	354	5.1	1,677	1,992	1,939
EBITDA margin	38.5	36.3		42.2		44.2	42.7	37.4
Depreciation	56	49	13.6	51	8.9	201	231	301
EBIT	316	267	18.4	302	4.5	1,476	1,761	1,638
Other income	109	22	403.3	37	196.3	230	97	131
Interest	1	1	49.0	1	43.3	4	-	-
Add: Exceptional items								
Profit before tax	423	287	47.3	338	25.2	1,702	1,859	1,769
Provision for taxes	163	93	75.6	123	32.3	517	613	652
Minority interest								
Reported net profit	260	194	33.7	215	21.1	1,185	1,245	1,117
Adjusted Profit	260	127	105.1	215	21.1	1,185	1,245	1,324
Diluted shares (mn)	54	54		54		54	54	54
Adjusted Diluted EPS	4.8	2.4	105.1	4.0	21.1	22.1	23.2	24.6
Diluted P/E (x)	-	-		-		29.8	33.4	30.1
EV/EBITDA (x)	-	-		-		20.4	19.8	17.4
ROAE (%)	-	-		-		29.1	28.4	26.2
Cost of revenue	26.9	27.2		24.8		25.0	25.1	26.6
Gross profit	73.1	72.8		75.2		75.0	74.9	73.4
Total expenses	61.5	63.7		57.8		55.8	57.3	62.6
Operating profit	38.5	36.3		42.2		44.2	42.7	37.4
Reported net profit	26.9	22.3		25.6		31.2	26.7	21.6
Tax rate	38.6	32.4		36.5		30.4	33.0	36.9

Company Description

Thyrocare, set up in 1995 and incorporated in 2000, is a leading pan-India diagnostic chain conducting an array of medical diagnostic investigations that focus on early detection and management of disorders. The company focuses on clinical chemistry. It has a CPL in Navi Mumbai and 6 RPLs. It is planning to set up RPLs in a few more places. Thyrocare has a nation-wide presence with over 30,000 source points for sample collection managed by its pan-India network of authorised service providers spread over more than 2,000 towns across more than 450 cities in 29 states. It has a wholly owned subsidiary Nuclear HealThyrocareare (NHL). NHL is engaged in imaging diagnostic services, viz. PET-CT scans, nuclear scanning, etc. Its scanning centres are in Navi Mumbai, New Delhi and Hyderabad. NHL is planning to set up scanning centres in more places.

Investment Theme

Thyrocare is one of India's largest diagnostics players specialising in cost-effective pathological biochemical testing. Its strategy is to marry high volumes with low costs by drawing best yields from infrastructure. Moreover, rising prevalence of evidence-based treatment, shift in favour of unorganised players and expanding product portfolio add growth left. Owing to low capex requirements, strong FCF generation phase will continue, sustaining high valuations in the medium term.

Key Risks

Success of business hinges on network expansion

Historically, Thyrocare's business growth has been primarily driven by expansion of network and through various partnership arrangements and acquisitions. It expects these to continue to be key drivers of future growth.

Rising infrastructure costs could restrict investment

Near-term upfront investments could suppress margin if infrastructure costs continue to rise.

Rising competitive intensity

In addition to established players in the market a number of new PE-backed players have entered the fray. This could suppress the company's growth in the future.

Financial Statements

Key Assumptions

Year to March	FY17	FY18	FY19E	FY20E
Macro				
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.6	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
USD/INR (Avg)	67.1	64.5	66.0	66.0
Company				
Number of samples (mn)	14	17	19	22
Realisation/ Sample (INR)	198	200	202	202
EBITDA margin (%)	40.2	44.2	42.7	37.4
Tax rate (%)	32.4	30.4	33.0	33.0

Income statement

(INR mn)

Year to March	FY17	FY18	FY19E	FY20E
Net revenue	3,044	3,563	4,276	4,957
Income from operations	3,044	3,563	4,276	4,957
Materials costs	814	950	1,173	1,377
Employee costs	320	353	406	457
Other Expenses	758	813	1,095	1,406
EBITDA	1,152	1,447	1,601	1,717
Operating profit	1,152	1,447	1,601	1,717
EBIT	971	1,246	1,400	1,448
Add: Other income	-	229.96	95.62	109.63
Less: Interest Expense	-	4	-	-
Profit Before Tax	971	1,472	1,495	1,557
Less: Provision for Tax	385	517	493	514
Reported Profit	587	955	1,002	1,043
Exceptional Items	109	8	-	-
Adjusted Profit	478	947	1,002	1,043
Shares o/s (mn)	54	54	54	54
Adjusted Basic EPS	8.9	17.6	18.6	19.4
Diluted shares o/s (mn)	54	54	54	54
Adjusted Diluted EPS	8.9	17.6	18.6	19.4
Adjusted Cash EPS	12.3	21.4	22.4	24.4
Dividend per share (DPS)	5.0	7.1	7.5	7.8
Dividend Payout Ratio(%)	56.2	40.0	40.0	40.0

Common size metrics

Year to March	FY17	FY18	FY19E	FY20E
Operating expenses	62.2	59.4	62.5	65.4
Materials costs	26.7	26.7	27.4	27.8
Staff costs	10.5	9.9	9.5	9.2
Depreciation	5.9	5.6	4.7	5.4
Interest Expense	-	0.1	-	-
EBITDA margins	37.8	40.6	37.5	34.6
Net Profit margins	15.7	26.6	23.4	21.0

Growth ratios (%)

Year to March	FY17	FY18	FY19E	FY20E
Revenues	21.4	17.1	20.0	15.9
EBITDA	11.6	25.6	10.6	7.2
PBT	6.1	51.5	1.6	4.1
Adjusted Profit	(22.3)	98.0	5.8	4.1
EPS	(22.2)	97.9	5.8	4.1

Balance sheet		(INR mn)			
As on 31st March	FY17	FY18	FY19E	FY20E	
Share capital	537	537	537	537	
Reserves & Surplus	3,541	3,896	4,417	4,959	
Shareholders' funds	4,078	4,433	4,954	5,496	
Long Term Liabilities	124	154	180	207	
Def. Tax Liability (net)	(38)	(52)	(52)	(52)	
Sources of funds	4,164	4,535	5,081	5,652	
Gross Block	1,518	1,919	2,519	3,169	
Depreciation	180	201	202	269	
Net Block	1,518	1,919	2,317	2,698	
Capital work in progress	174	-	-	-	
Total Fixed Assets	1,693	1,919	2,317	2,698	
Goodwill on consolidation	1,069	1,069	1,069	1,069	
Non current investments	78	311	311	311	
Long-term loans and adv.	6	15	11	20	
Cash and Equivalents	1,160	1,120	1,186	1,401	
Inventories	145	170	219	238	
Sundry Debtors	63	98	95	129	
Loans & Advances	70	-	84	14	
Other Current Assets	58	35	42	49	
Current Assets (ex cash)	336	304	440	430	
Trade payable	13	12	19	17	
Other Current Liab	163	191	234	259	
Total Current Liab	176	203	253	276	
Net Curr Assets-ex cash	160	102	188	154	
Uses of funds	4,164	4,535	5,081	5,652	
BVPS (INR)	76.0	82.5	92.2	102.3	

Free cash flow		(INR mn)			
Year to March	FY17	FY18	FY19E	FY20E	
Reported Profit	587	955	1,002	1,043	
Add: Depreciation	180	201	202	269	
Interest (Net of Tax)	-	3	-	-	
Others	45	175	11	(50)	
Less: Changes in WC	41	41	(5)	(30)	
Operating cash flow	772	1,293	1,219	1,293	
Less: Capex	363	363	600	650	
Free Cash Flow	409	930	619	643	

Cash flow metrics		FY17	FY18	FY19E	FY20E
Year to March					
Operating cash flow		772	1,293	1,219	1,293
Investing cash flow		(485)	(485)	(481)	(501)
Financing cash flow		(415)	(415)	(672)	(578)
Net cash Flow		(129)	393	67	214
Capex		(363)	(363)	(600)	(650)
Dividend paid		(323)	(455)	(481)	(501)

Profitability and efficiency ratios		FY17	FY18	FY19E	FY20E
Year to March					
ROAE (%)		12.4	22.3	21.3	20.0
ROACE (%)		24.8	34.3	31.5	29.4
Debtors Days		8	8	8	8
Payable Days		7	5	5	5
Cash Conversion Cycle		57	64	64	64
Current Ratio		8.5	7.0	6.4	6.6
Net Debt/Equity		(0.3)	(0.3)	(0.2)	(0.3)
Interest Coverage Ratio		-	286.5	-	-

Operating ratios		FY17	FY18	FY19E	FY20E
Year to March					
Total Asset Turnover		0.8	0.8	0.9	0.9
Fixed Asset Turnover		2.0	2.1	2.0	2.0
Equity Turnover		0.8	0.8	0.9	0.9

Valuation parameters		FY17	FY18	FY19E	FY20E
Year to March					
Adj. Diluted EPS (INR)		8.9	17.6	18.6	19.4
Y-o-Y growth (%)		(22.2)	97.9	5.8	4.1
Adjusted Cash EPS (INR)		12.3	21.4	22.4	24.4
Diluted P/E (x)		73.9	37.3	33.4	30.1
P/B (x)		8.7	8.0	7.1	6.4
EV / Sales (x)		11.2	9.6	8.0	6.9
EV / EBITDA (x)		29.7	23.6	19.8	17.4
Dividend Yield (%)		0.8	1.1	1.1	1.2

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Thyrocare Technologies Ltd	540	33.4	30.1	19.8	17.4	21.3	20.0
Dr. Lal Pathlabs Ltd	1,084	31.3	24.5	21.3	17.7	24.9	25.8
Median	-	32.4	27.3	20.6	17.5	23.1	23.6
AVERAGE	-	32.4	27.3	20.6	17.5	23.1	23.6

Source: Edelweiss research

Additional Data

Directors Data

Dr A Velumani	Chairman & Managing Director	Mr A Sundararaju	Executive Director & CFO
Mr Sohi Chand	Non-Executive Nominee Director	Mr Gopalkrishna Hegde	Independent Director
Mr Vishwas Kulkarni	Independent Director	Dr Neetin Desai	Independent Director
Mr N Palanisamy	Independent Director	Ms Amruta Velumani	Non-Executive Director

Auditors - BSR & Co LLP

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Norwest Venture Partners	9.43	Sundaram Asset Management	1.66
Reliance Capital Trustee	7.83	FIL Limited	1.44
Aditya Birla Sun Life Asset management	3.69	FID Funds Mauritius	1.35
SBI Funds Management	2.22	nomura	1.01
DSP Blackrock Investment	2.11	Grandeur Peak Global Advisors	0.94

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
22 Nov 2017	Samara Capital Partners Fund I Ltd	Sell	740000	668.18
28 Aug 2017	Reliance Mutual Fund Reliance Tax Saver Elss Fund	Buy	630000	670.00
28 Aug 2017	Norwest Venture Partners Viia Mauritius	Sell	2500000	670.00
28 Aug 2017	Reliance Mutual Fund Reliance Pharma Fund	Buy	500000	670.00
28 Aug 2017	Norwest Venture Partners Vii-A-Mauritius	Sell	2500000	670.88
28 Aug 2017	Birla Sun Life Mutual Fund A/C Birla Sun Life Ninety Five Fund	Buy	1000000	670.00

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**in last one year*



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Apollo Hospitals Enterprise	BUY	SO	L	Dr. Lal Pathlabs Ltd	BUY	SP	L
FORTIS HEALTHCARE LTD	BUY	SP	L	HealthCare Global Enterprises Limited	HOLD	SU	M
Max India Limited	HOLD	SU	M	Thyrocare Technologies Ltd	BUY	SU	H

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



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Coverage group(s) of stocks by primary analyst(s): Healthcare

Apollo Hospitals Enterprise, Dr. Lal Pathlabs Ltd, FORTIS HEALTHCARE LTD, HealthCare Global Enterprises Limited, Max India Limited, Thyrocare Technologies Ltd

Recent Research

Date	Company	Title	Price (INR)	Recos
04-Apr-18	Healthcare	Apollo and Dr. Lal to shine; Q4FY18 Result Preview		
28-Mar-18	Fortis Healthcare	Deal tilted in favour of Manipal-TPG; Company Update	123	Buy
23-Mar-18	Healthcare	Hospitals: A deep-dive into what drives profitability; Sector Update		

Distribution of Ratings / Market Cap

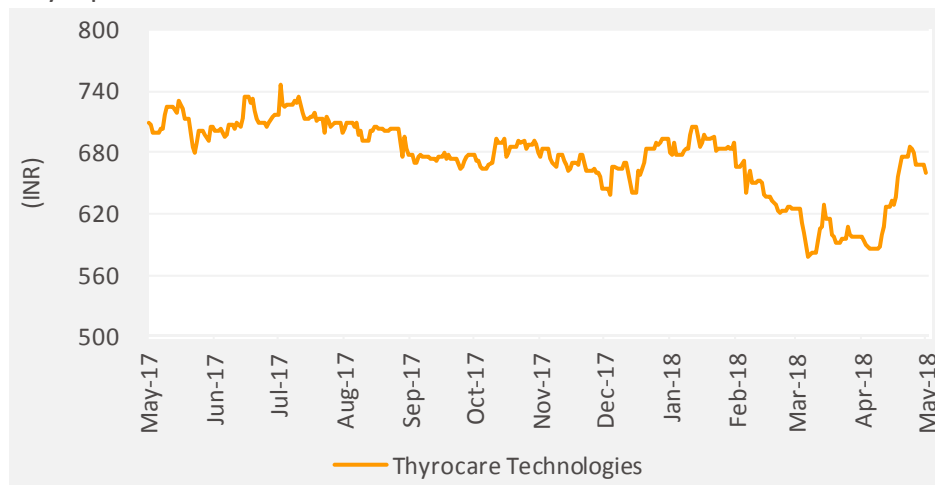
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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