

Metropolis Healthcare Ltd.

7th Nov 2023

Leveraging short-term effects for long-term value creation

In Q2 FY24, Metropolis Healthcare Ltd (MHL) reported a strong revenue growth of 14% on a YoY basis in its core business, reflecting a consistent trend of double-digit growth over the past six quarters. Total Revenue for Q2 FY24 has increased by 3%, primarily because of a large B2G contract insourced by the Government & high base of Covid & Allied tests. The B2C segment of the Company, contributing 51% to the revenue, grew by 16% on a YoY basis, driven by a 14% increase in volume and a 2% growth in Revenue Per Patient (RPP). The Company is rapidly expanding its network on a QoQ basis, with the 7 new labs and addition of 141 service centers opened during the quarter. Due to the network expansion, the net impact on Company's EBITDA margin was ~40 bps on a YoY basis. Further, the EBITDA margin impacted on account of one-time impact of ~110 bps on account of Provision for Doubtful Debt (PDD) and another 110 basis points on account of loss of revenue from government contracts. Going forward, the Company will focus on strengthening core business through network expansion, expanding new adjacencies through the asset-light model, growing Specialized (revenue grew by 12% on a YoY basis) and Premium Wellness (revenue grew by 27% on a YoY basis) segments, and inorganic growth to enter into new geographics.

Focus on network expansion and improving productivity

The Company's Q2FY24 performance aligns with its 90:30 program, which saw the opening of 7 labs and 141 centers. The Company further intends to increase 30 labs within the current year and another 30 labs in FY25. As part of its strategic approach, the Company aims to establish these labs in new geographic areas with the goal of boosting its B2B business within the specialty segment and expanding its presence. The Company has expanded its presence to 488 towns in Q2FY24, compared to 307 towns in Q2FY23, and aims to extend its reach to 600 towns by the end of this year. This aggressive network expansion strategy is ongoing, albeit with some margin pressure, as it typically takes 12-18 months for new labs to achieve a positive EBITDA margin of 5%. However, the Company has noted that labs opened in the last 2-3 years are now yielding positive EBITDA margins, which is expected to contribute to an improved margin profile for the Company going forward.

Margin to improve in FY25

Compared to last year, the margin is impacted due to more intensity in lab expansion, negative operating leverage because of the loss of PPP contracts, and a one-time impact on account of provision for doubtful debts taken. These three elements impacted the margin by around 2.5%. Going forward as the new lab will mature and existing ones experience improved productivity, the management is aiming to increase the EBITDA margin to 26-27%.

View & Valuation

We have revised our estimates and maintained our view on Metropolis Healthcare Ltd with a BUY rating and a target price of Rs. 1,915 (50x FY25E PE). We believe that MHL is set to grow its core segment by 15%. The Company's aggressive network expansion initiatives are expected to yield a substantial customer base, thus unlocking the potential for high growth, which is expected to improve operating margin.

BUY

CMP Rs. 1,522

TARGET Rs. 1,915 (+26%)

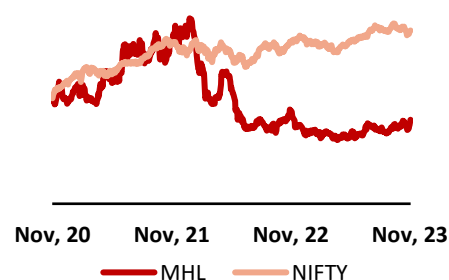
Company Data

Bloomberg Code	METROHL IN
MCAP (Rs. Mn)	77,970
O/S Shares (Mn)	51
52w High/Low	1,766 / 1,176
Face Value (Rs.)	2
Liquidity (3M) (Rs. Mn)	512

Shareholding Pattern %

	Sep 23	Jun 23	Mar 23
Promoters	49.74	49.75	49.75
FII's	24.29	25.66	25.67
DII's	16.86	14.89	13.64
Non-Institutional	9.11	9.70	10.94

MHL vs Nifty



Source: Keynote Capitals Ltd.

Key Financial Data

(Rs. Mn)	FY23	FY24E	FY25E
Revenue	11,482	12,128	13,947
EBITDA	2,883	3,032	3,710
Net Profit	1,425	1,448	1,965
Total Assets	15,016	15,672	17,136
ROCE (%)	15%	15%	18%
ROE (%)	15%	14%	17%

Source: Company, Keynote Capitals Ltd. estimates

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Metropolis Healthcare Ltd. | Quarterly Update

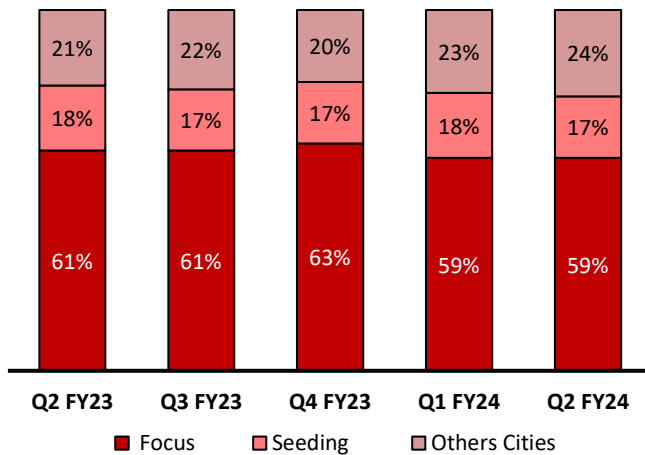
Q2 FY24 Result Update

Result Highlight (Rs. Mn)

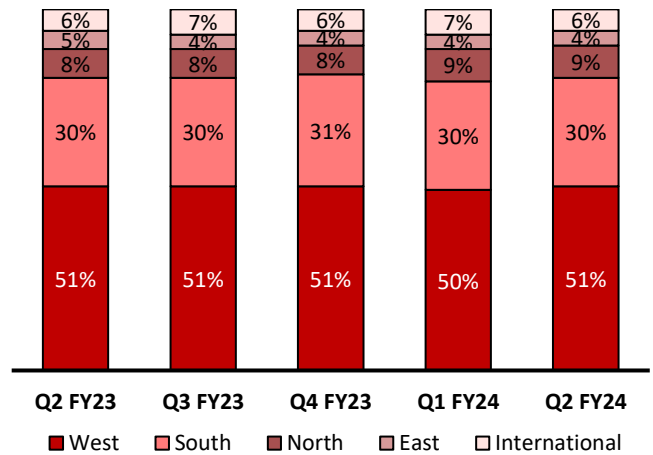
Particulars	Q1 FY24	Q1 FY23	Change % (Y-o-Y)	Q1 FY24	Change % (Q-o-Q)	H1 FY24	H1 FY23	Change % (Y-o-Y)	FY23
Revenue	3,085	3,003	3%	2,771	11%	5,856	5,802	1%	11,482
Raw Material Expenses	641	700	-8%	594	8%	1,235	1,342	-8%	2,598
Employee Cost	698	616	13%	651	7%	1,348	1,238	9%	2,527
Other Expense	999	897	11%	897	11%	1,896	1,746	9%	3,473
EBITDA	748	790	-5%	629	19%	1,377	1,475	-7%	2,883
EBITDA %	24%	26%	-206 bps	23%	154 bps	24%	25%	-190 bps	25%
Depreciation	222	216	3%	208	7%	431	428	1%	892
EBIT	526	574	-8%	421	25%	947	1,048	-10%	1,991
EBIT %	17%	19%	-209 bps	15%	184 bps	16%	18%	-189 bps	17%
Finance Cost	57	70	-19%	60	-5%	117	145	-20%	268
Other Income	12	43	-72%	31	-60%	43	74	-42%	152
PBT	481	548	-12%	392	23%	873	976	-11%	1,875
Tax	125	143	-13%	102	22%	227	236	-4%	441
Minority Interest	2	1		2		4	3		5
Net Profit	355	403	-12%	288	23%	643	737	-13%	1,429
EPS	6.9	7.9		5.6		12.5	14.4		27.8

Source: Company, Keynote Capitals Ltd.

Revenue Mix (%)

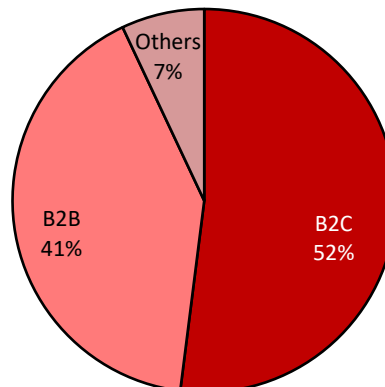


Revenue mix (%) between geographies



Source: Company, Keynote Capitals Ltd.

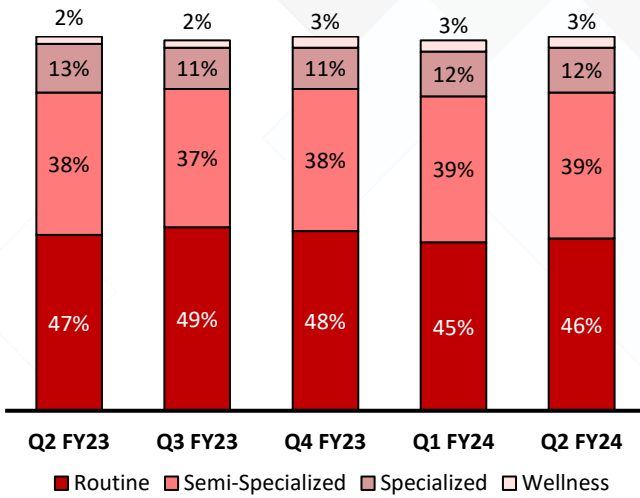
Q2 FY24 revenue mix across segment



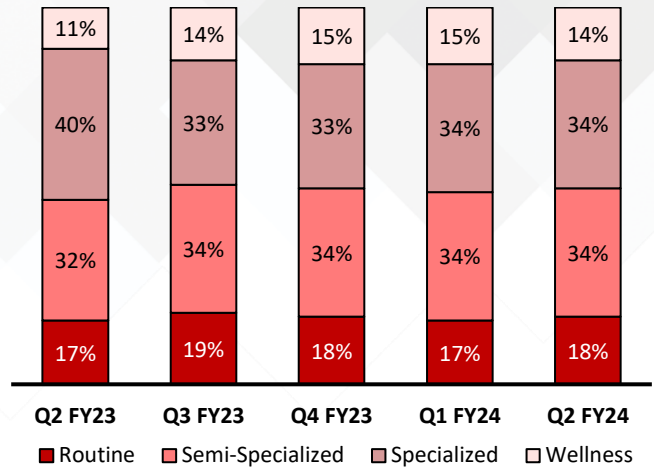
Source: Company, Keynote Capitals Ltd.

Metropolis Healthcare Ltd. | Quarterly Update

Volume mix (%)

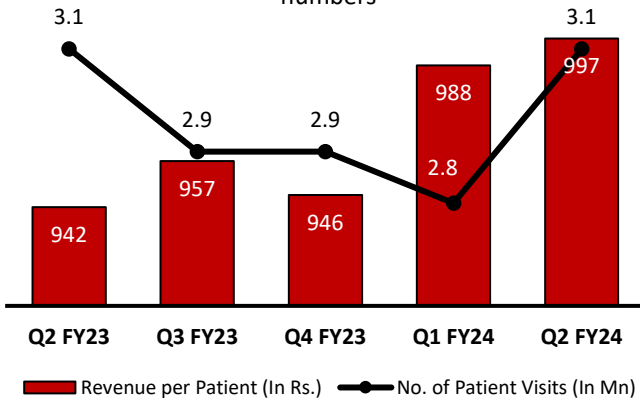


Value mix (%)



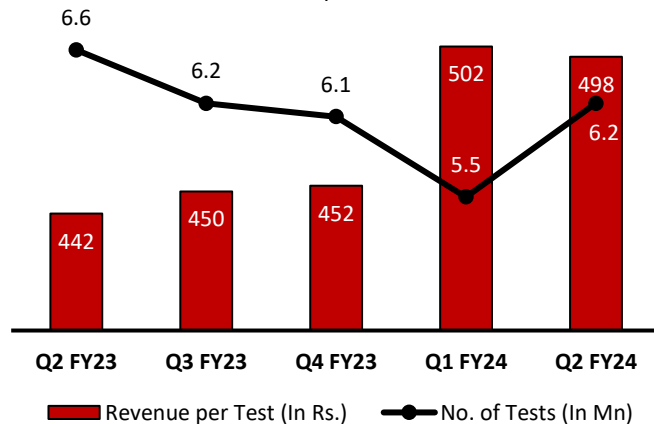
Source: Company, Keynote Capitals Ltd.

The number of patients showed a QoQ improvement, primarily driven by strong growth in the core business's patient numbers

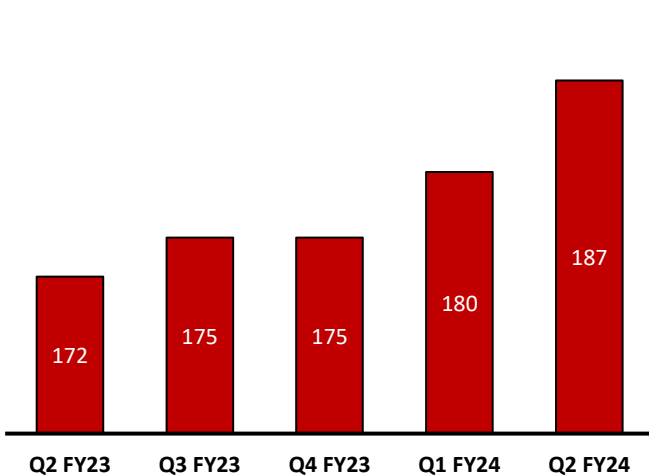


Source: Company, Keynote Capitals Ltd.

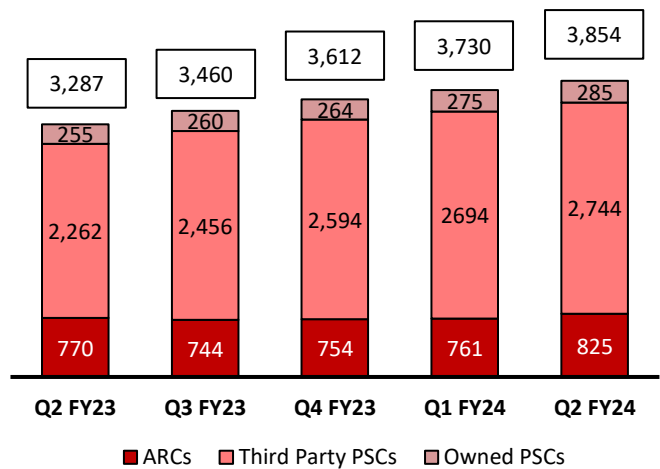
The number of tests increased on a QoQ basis, led by strong growth in the core business's patient tests



Constant increase in Lab presence



Constant increase in service center



Source: Company, Keynote Capitals Ltd.

Q2 FY24 Conference Call Takeaways

Revenue

- The performance in Q2FY24 was slightly affected due to low rainfall in Maharashtra in August, leading to a decrease in dengue and other infectious diseases in the month of September. However, the Company is witnessing a rise in illness cases during late September and October, leading to a revenue shift from Q2FY24 to Q3FY24.
- The Company has experienced consistent growth in volume over the past six quarters and are optimistic for future growth.
- The Company's volume growth surpasses the pre-COVID level of 9%.
- The Company's B2C segment contribution to revenue has increased from 45% in Q2FY23 to 51% in Q2FY24.
- The Company achieved a double-digit growth in B2B segment, driven by a range of initiatives. These initiatives include digitalization efforts to enhance B2B engagement, the establishment of a centralized helpdesk to provide robust support to B2B clients, the appointment of Key Relationship Managers, and the introduction of specialized programs for top B2B clients.

Industry

- The Company has observed a steady decrease in competition over the last two quarters. New entrants in the market are facing margin pressure, leading to a reduction in marketing budgets and higher prices compared to previous discounted rates.
- The players offering discounts are struggling to find opportunities beyond metropolitan areas.
- The Company is experiencing competition in the B2B semi-specialized accounting segment, which contributes to less than 10% of the total revenue. Within this segment, 80% of the individuals prioritize quality and testing performance over discounts. This is evident as Company is able to grow 12% in this segment, despite the intense competition.

Update on Hi-tech acquisition

- The Company had acquired Hi-tech as it was the second largest player in Chennai with a sticky customer base of B2C.
- Hi-tech promoters are looking for an exit
- The Company had acquired Hi-tech based on pre-covid numbers.
- To fully leverage the advantages of the Hi-tech acquisition, the Company integrate it and harness synergies in areas such as procurement, logistics, manpower management, and marketing.
- In H1FY24, the Company achieved a 17% growth in its Hi-tech business, along with a 14% increase in volume and witnessing an improvement in EBITDA margin.
- The Company plans to continue its expansion into the specialty business, as a majority of its current operations are in routine and semi-specialized areas.

Whistleblower complain

- The Company has recently received a whistleblower complaint from an employee regarding accounting adjustments related to debtors' accounts for FY22-23 and the current fiscal year. Upon receiving the complaint, the matter was referred to a third party for investigation. The third party has submitted a report to the audit committee, which revealed that three employees had made an accounting entry involving an amount of ~93 Mn. Out of this, ~72 Mn was adjusted between debit and credit entries in the debtors' accounts, and the remaining 21 Mn was recorded in the TDS account. Since the 72 Mn adjustment occurred between debit and credit entries, it did not have any significant impact on the Company.
- As a precautionary measure, the Company has set aside a doubtful provision of 33 Mn in Q2FY24.

Network expansion and labs

- Starting in April 2022, the Company has successfully introduced 790 new centers and has intentions to include an additional 800 centers within the current year and another 800 centers in the following year.
- The Company has expanded its presence to 488 towns in Q2FY24, compared to 307 towns in Q2FY23, and aims to extend its reach to 600 towns by the end of this year.
- Labs that were established in April 2022 accounted for 4% of the revenue and volume in Q2FY24. With these labs experiencing rapid growth, the Company anticipates a more significant contribution in the upcoming years. The Company has consistently observed margin improvements in these labs and expects to see improvements in the Company's overall margins over the next 24 months.

Other updates

- Compared to last year, the margin is impacted due to more intensity in lab expansion, loss of PPP contracts, and a one-time impact on account of provision for doubtful debts taken. These three elements impacted the margin by around 2.5%.
- The percentage of creditors relative to sales is decreasing, primarily because of prearrangements with vendors regarding discounts and payment terms. By offering advance payments, the Company secures better discounts from vendors, resulting in increased gross margins, reduced creditor balances, and an improved ROCE.
- As the Company expands, it is encountering margin pressure, even though the sustainable margin typically stands at 26-27%. The expansion strategy will persist for an additional year before gradually slowing down.
- Traditionally, the Company has observed that the second half (H2) outperforms the first half (H1), and it anticipates a similar trend for the current year.

Financial Statement Analysis

Income Statement

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	12,283	11,482	12,128	13,947	16,039
Growth %	23%	-7%	6%	15%	15%
Raw Material Expenses	2,829	2,598	2,789	3,194	3,657
Employee Expenses	2,332	2,527	2,607	2,929	3,368
Other Expenses	3,711	3,473	3,699	4,114	4,491
EBITDA	3,412	2,883	3,032	3,710	4,523
Growth %	20%	-15%	5%	22%	22%
Margin%	28%	25%	25%	27%	28%
Depreciation	632	892	1,056	1,079	1,097
EBIT	2,779	1,991	1,976	2,631	3,426
Growth %	17%	-28%	-1%	33%	30%
Margin%	23%	17%	16%	19%	21%
Interest Paid	250	268	197	163	138
Other Income & exceptional	335	152	152	152	152
PBT	2,864	1,875	1,931	2,620	3,440
Tax	768	450	483	655	860
PAT	2,096	1,425	1,448	1,965	2,580
Others (Minorities, Associates)	-5	-5	-5	-5	-5
Net Profit	2,091	1,420	1,443	1,960	2,575
Growth %	17%	-32%	2%	36%	31%
Shares (Mn)	51.2	51.2	51.2	51.2	51.2
EPS	41.86	27.75	28.21	38.30	50.32

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Cash, Cash equivalents & Bank	1,669	932	2,118	4,112	6,347
Current Investments	138	131	131	131	131
Debtors	1,355	1,219	1,395	1,674	2,005
Inventory	511	446	418	479	549
Short Term Loans & Advances	569	0	0	0	0
Other Current Assets	98	300	300	300	300
Total Current Assets	4,340	3,027	4,362	6,695	9,331
Net Block & CWIP	10,589	11,207	10,528	9,658	8,801
Long Term Investments	18	18	18	18	18
Other Non-current Assets	980	765	765	765	765
Total Assets	15,927	15,016	15,672	17,136	18,915
Creditors	1,032	941	967	1,139	1,304
Provision	551	189	189	189	189
Short Term Borrowings	999	504	304	199	0
Other Current Liabilities	843	1,015	1,015	1,015	1,015
Total Current Liabilities	3,424	2,650	2,476	2,543	2,509
Long Term Debt	1,587	286	95	0	0
Deferred Tax Liabilities	769	782	782	782	782
Other Long-Term Liabilities	1,266	1,391	1,391	1,391	1,391
Total Non-Current Liabilities	3,621	2,459	2,268	2,173	2,173
Paid-up Capital	102	102	102	102	102
Reserves & Surplus	8,760	9,780	10,795	12,282	14,090
Shareholders' Equity	8,862	9,882	10,898	12,385	14,192
Non-Controlling Interest	20	25	30	35	40
Total Equity & Liabilities	15,927	15,016	15,672	17,136	18,915

Source: Company, Keynote Capitals Ltd.

Cash Flow Statement

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Pre-tax profit	2,864	1,875	1,931	2,620	3,440
Adjustments	588	1,041	1,106	1,095	1,088
Change in Working Capital	-164	71	-122	-167	-236
Total Tax Paid	-825	-516	-483	-655	-860
Cash flow from operating	2,464	2,471	2,432	2,893	3,432
Activities					
Net Capital Expenditure	-307	-525	-377	-209	-241
Change in investments	-800	9	0	0	0
Other investing activities	-6,269	984	152	152	152
Cash flow from investing	-7,376	468	-224	-57	-88
activities					
Equity raised / (repaid)	19,746	1.84	0	0	0
Debt raised / (repaid)	2,585	-2,408	-391	-200	-200
Dividend (incl. tax)	0	-410	-433	-635	-773
Other financing activities	-979	-107	-197	-163	-138
Cash flow from financing	1,625	-2,923	-1,021	-998	-1,111
activities					
Net Change in cash	-3,287	16	1,186	1,838	2,233

Valuation Ratios

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Per Share Data					
EPS	42	28	28	38	50
Growth %	17%	-34%	2%	36%	31%
Book Value Per Share	173	194	214	243	278
Return Ratios					
Return on Assets (%)	16%	9%	9%	12%	14%
Return on Equity (%)	27%	15%	14%	17%	19%
Return on Capital Employed (%)	25%	15%	15%	18%	20%
Turnover Ratios					
Asset Turnover (x)	0.9	0.7	0.8	0.9	0.9
Sales / Gross Block (x)	1.5	0.9	0.9	1.0	1.2
Working Capital / Sales (x)	20%	6%	9%	22%	34%
Receivable Days	38	41	39	40	42
Inventory Days	59	67	57	51	51
Payable Days	133	142	126	118	120
Working Capital Days	-35	-34	-30	-27	-27
Liquidity Ratios					
Current Ratio (x)	1.3	1.1	1.8	2.6	3.7
Interest Coverage Ratio (x)	12.1	8.0	10.8	17.1	25.9
Total Debt to Equity	0.3	0.1	0.0	0.0	0.0
Net Debt to Equity	0.1	0.0	-0.2	-0.3	-0.4
Valuation					
PE (x)		50.2	55.5	40.9	31.1
Earnings Yield (%)		2%	2%	2%	3%
Price to Sales (x)		6.2	6.6	5.8	5.0
Price to Book (x)		7.2	7.4	6.5	5.7
EV/EBITDA (x)		25.6	27.0	22.0	18.1
EV/Sales (x)		6.4	6.7	5.9	5.1

KEYNOTE Rating History

Date	Rating	Market Price at Recommendation	Upside/Downside
18 th July 2023	BUY	1,448	+17.4%
4 th Aug 2023	BUY	1,364	+17.7%
7 th Nov 2023	BUY	1,522	+25.8%

Rating Methodology

Rating	Criteria
BUY	Expected positive return of > 10% over 1-year horizon
NEUTRAL	Expected positive return of > 0% to < 10% over 1-year horizon
REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
NOT RATED (NR)/UNDER REVIEW (UR)/COVERAGE SUSPENDED (CS)	Not covered by Keynote Capitals Ltd/Rating & Fair value under Review/Keynote Capitals Ltd has suspended coverage

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