

Will Reliance Life Sciences do a Jio in the diagnostics space?

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Shares of diagnostic firms Thyrocare Technologies Ltd, Dr Lal PathLabs Ltd and Metropolis Healthcare Ltd slipped about 6.2%, 11.6% and 4.7%, respectively, in the past one week. Investors are worried that increased competition due to the entry of Reliance Life Sciences Pvt. Ltd into the diagnostics space could squeeze margins and reduce return on equity.

So, should investors worry about Reliance doing a Jio in the diagnostics space as well? Worries that a deep-pocketed player could disrupt the market may be overdone, according to some analysts. "Barriers to entry are high in the B2B model. Scaling up is a gradual process. One can't just storm the market with free tests in order to reach a scale. Price disruption has already happened. Hence, lower pricing may not play a major role, also as

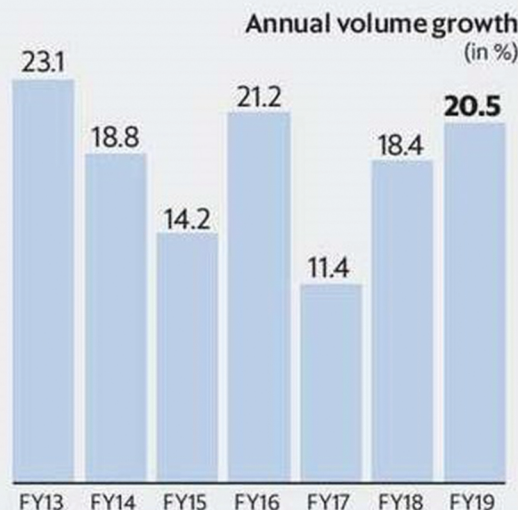
a wrong diagnosis can be a matter of life and death, and it is not about what's cheaper," said an analyst, on condition of anonymity. Of course, it's pertinent to note that naysayers

Health is wealth

High volume growth has been key to revenue and profitability gains of diagnostic firms.



Source: CLSA



NAVEEN KUMAR SAINI/MINT

Diagnostics is a highly under-penetrated sector. Hence, the volume growth momentum should continue

abounded even before the Reliance Jio Infocomm Ltd's launch, and investors seemed justified in being jittery about a possible price war.

In any case, margins may be hit if competition is severe. For instance, the Ebitda (earnings before interest, tax, depreciation and amortization) margins of Dr Lal PathLabs and Metropolis are in the range of 24-26%, while that of Thyrocare is about 38%, said a CLSA Ltd report.

Hence, there could be a valuation risk for some diagnostic firms. Dr Lal PathLabs is quoting at consumer goods company-like valuations of about 41 times one-year forward earnings per share.

Still, diagnostics is a fragmented industry and also highly under-penetrated. Hence, the volume growth momentum should continue.

"India is an undiagnosed market with enough potential for the industry to grow," added the analyst cited above. That should provide some relief for investors, though return expectations from here on have to be tempered.

"Growth over the past few years was largely driven by volumes, as realisations have been under pressure due to stiff competition in the B2B space and expansion into lower tier markets. PE valuations of listed players have expanded with the expectation of current volume growth sustaining as customer preference shifts towards organized players," said the CLSA report.