October 09, 2023

Vijaya Diagnostic Centre Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term/Short term – unallocated limits	34.0	34.0	[ICRA]AA-(Stable)/[ICRA]A1+ reaffirmed
Total	**34.0**	**34.0**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings reaffirmation factors in the expectation that Vijaya Diagnostic Centre Limited's (VDCL) credit profile will be supported by healthy revenue growth over the medium term, on the back of planned new centre additions, with sustained margins and cash flows. The ratings derive comfort from VDCL's established brand name with 121 centres primarily in Telangana, Andhra Pradesh and West Bengal and its diversified diagnostic offerings including radiology and imaging, nuclear medicine, conventional and speciality laboratory services, and diagnostic cardiology. While the absence of Covid-19 revenues resulted in muted growth for the company in FY2023, non-Covid-19 segments witnessed a healthy growth. The company plans to add 12-15 new centres per year in the medium, which are expected to result in a healthy revenue growth of 12-15% per annum. VDCL derives over 95% of its revenues from B2C customers, which has resulted in strong margins of ~35-40% for the company over the years. Further, the pathology-radiology mix of 65:35 is favourable compared to other major players which derive higher share of revenues from the pathology segment. The company's operating margin moderated in FY2023 on account of expenses incurred towards new centres and absence of Covid-19 revenues; however, margins remained strong at ~40.0% in FY2023 and Q1 FY2024. While initial operating expenditure towards new centres is expected to moderate the company's margins to an extent in FY2024 and FY2025, overall earnings are expected to remain healthy. The company has negligible external debt aside from lease obligations. This has resulted in strong coverage and leverage metrics with DSCR of 4.9 times in FY2023 and total debt (TD) (including lease liabilities)/TNW of 1.4 times in FY2023. ICRA expects the company's capital and coverage indicators to remain strong going forward as well.

The ratings are, however, constrained by the high geographical concentration with Hyderabad accounting for 80-85% of total revenue during the past three years and low entry barriers in the absence of stringent Government regulations, resulting in stiff competition in the medical diagnostic industry. The entry of new players and online aggregators offering deep discounts has accentuated the competition. ICRA notes that VDCL would require continued investments in medical equipment and infrastructure to remain competitive and provide quality service in the medical diagnostic industry. ICRA also notes that VDCL has significant expansion plans in the medium term; most of the expansion would happen towards adding centres outside of Hyderabad, which is expected to diversify the company's revenue base gradually.

The Stable outlook on the long-term rating reflects ICRA's opinion that the company will witness a healthy growth and will continue to maintain healthy financial and business risk profiles on the back of its reputed brand presence in Telangana and Andhra Pradesh.

Key rating drivers and their description

Credit strengths

Established presence in medical diagnostics industry – The company has a track record of more than four decades in the medical diagnostics industry. Mr. Surendranath Reddy, the founder of VDCL, is a doctor by profession and started the first diagnostic centre in 1981. VDCL provides a comprehensive range of radiology and pathology diagnostic services and is an established regional player with a wide network comprising 121 centres as on June 30, 2023, mainly in Telangana and Andhra Pradesh, with laboratories offering diagnostic services including radiology and imaging, nuclear medicine, conventional and speciality laboratory services, and diagnostic cardiology. A strong clinical team led by more than 200 qualified radiologists, pathologists, microbiologists, and other doctors, in addition to over 1,100 qualified technologists, support its operations.

Strong financial profile with healthy operating margins, comfortable capital structure and coverage metrics – VDCL's operating income declined marginally by 1% to Rs. 459.2 crore in FY2023 from Rs. 462.0 crore in FY2022 in the absence of Covid-19-related revenues while non-Covid revenues witnessed a healthy growth. In Q1 FY2024, revenues grew by 16% YoY with ramp-up of newly inaugurated centres (26 opened in FY2023). Revenue is expected to grow at healthy rate in the medium term, aided by significant expansion planned by VDCL through addition of new centres (10-15 centres per annum planned for FY2024 and FY2025).

The company recorded healthy operating margins against industry over the years, on account of its healthy customer mix, wherein it derives 95% of its revenues from B2C business and healthy mix of pathology and radiology (65:35). While the company's operating margin moderated to an extent in FY2023 (from all-time high of 44.1% in FY2022) on account of expenses incurred towards new centres and absence of Covid-19-related revenues, it remained strong at 39.6% in FY2023 and 39.8% in Q1 FY2024. Consistent strong accruals along with low debt levels (excluding lease liabilities), resulted in strong coverage and leverage metrics for the company with Adjusted Debt/TNW of 0.0 times in FY2023. (Total Debt (incl. lease liabilities)/TNW of 0.4 times). DSCR remained healthy at 4.9 times in FY2023.

Credit challenges

High geographical concentration – Hyderabad accounts for 80-85% of VDCL's revenue, indicating high geographical concentration risk. The company started its first centre in Himayat Nagar, Hyderabad, which remains its flagship centre and reference laboratory. However, ICRA notes that the company has built an established brand in the Hyderabad diagnostics market on account of its strong network of centres in the city, which enables it to have high B2C customer mix of over 95% and command higher realisations. The company is planning to expand to newer territories, going forward; it started a new hub in Kolkata in July 2023 and plans to add new centres planned in Kalaburagi (Karnataka) and cities/towns outside Hyderabad.

Highly fragmented industry with intense competition – The medical diagnostics industry is highly fragmented with presence of many standalone diagnostic laboratories and laboratories within hospitals resulting in stiff competition for organised diagnostic chains in terms of patient volumes and aggressive pricing of diagnostic tests. The low entry barriers in absence of stringent Government regulations result in intense competition in the medical diagnostic industry as illustrated by recent entry of players offering deep discounts to capture market share.

Sizeable expansion plans – VDCL has sizeable investment plans in the near term, which may constrain the improvement in its operating margins due to the operational expenditure incurred towards set-up of new centres, leading to losses during the initial months of operations before revenue from the centres scales up. Further, the company would require continuous investment in medical equipment and infrastructure to remain competitive and provide quality service in the medical diagnostic industry. However, reliance on debt is low due to healthy cash flows over the years.

Environmental and social risks

Diagnostic service providers do not face any major physical climate risk. However, they are exposed to environmental laws and regulations pertaining to handling, transportation and disposal of medical specimens, infectious and hazardous waste along with radioactive exposure during imaging procedures. This requires investments in infrastructure to handle the generated waste. Accordingly, entities in the industry have a moderate exposure to environmental risks.

VDCL's employees are trained and encouraged to use protective equipment and instruments while handling biological specimen and adhere to national and local safety guidelines, including that of biomedical waste disposal. It monitors radiation levels of all the personnel working in radiation generating area. According to the company, it provides Safety devices functions of which are regularly checked. These devices include biosafety and laminar flow cabinets, emergency showers, fire extinguishers, eye wash facilities, fire alarms, smoke detectors and fire hose reels. Fire evacuation plans and emergency exits are displayed at provisional areas.

Exposure to social risks is moderate for the healthcare diagnostic service provider sector. Social risks for industry players include litigation exposure, and compliance standard requirements given the importance of the service being provided. Further, regulatory interventions such as price control measures, if any, specifically levied could impact the earnings of industry players.

Liquidity position: Strong

The liquidity position is **strong,** with a robust cash and liquid investment balance of around ~Rs. 255.0 crore as of March 31, 2023, and expected strong retained cash flows in FY2024. Against this, VDCL is expected to incur capex of Rs. 80-90 crore towards opening new centres and general maintenance from internal accruals.

Rating sensitivities

Positive factors – ICRA could upgrade VDCL's long-term rating, if geographical diversification of revenue profile leads to significant improvement in scale of operations and earnings, while maintaining healthy profitability and debt indicators.

Negative factors – The ratings may witness a pressure if larger-than-estimated capex adversely impacts its debt metrics and liquidity profile or decline in performance of existing centres or ramp-up in new centres is slower than expected, significantly impacting operating margins. Specific credit metric that could lead to a rating downgrade includes Gross debt (incl lease liabilities)/ OPBITDA higher than 1.5 times, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology - Diagnostic Service Providers
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of VDCL and its subsidiaries (Annexure II)

About the company

Vijaya Diagnostic Centre Limited (VDCL) was founded by Dr. S. Surendranath Reddy in 1981 as a proprietorship concern and was subsequently incorporated as a private limited company in 2002 and listed in the stock market in September 2021. The company is engaged in the business of providing comprehensive range of diagnostic services spanning across radiology & imaging, nuclear medicine, conventional & specialist lab services and diagnostic cardiology. VDCPL operates 121 centres (as of June 30, 2023) primarily in Andhra Pradesh, Telangana, and West Bengal.

Key financial indicators

VDCL (Consolidated)	FY2022	FY2023	Q1 FY2024*
Operating income	462.4	459.2	121.0
PAT	110.7	85.2	26.4
OPBDIT/OI	44.1%	39.6%	39.8%
PAT/OI	23.9%	18.6%	21.8%
Total outside liabilities/Tangible net worth (times)	0.5	0.5	ND
Total debt/OPBDIT (times)	0.9	1.4	ND
Interest coverage (times)	12.4	8.7	8.2

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; ND = No data for the given period

*Source: Company financials, ICRA Research; Unaudited for Q1 FY2024**

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	FY2023	FY2022	FY2021
					Oct 09, 2023	Aug 29, 2022	May 03, 2021	-
1	**Unallocated limits**	Long term / Short term	34.0	--	**[ICRA]AA-(Stable)/ [ICRA]A1+**	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]A+(Stable)/ [ICRA]A1+	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term / Short-term – unallocated limits	Not applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Unallocated limits**	NA	NA	NA	34.0	[ICRA]AA-(Stable)/[ICRA]A1+

Source: Company

Annexure II: List of entities considered for consolidated analysis: Not applicable

Company name	Holding by VDCL	Relationship with VDCL	Consolidation approach
Medinova Diagnostic Centre Limited	62.14%	Direct subsidiary	Full consolidation
VDC Diagnostic Karnataka (LLP)	100.0%	Direct subsidiary	Full consolidation
Doctors Lab Diagnostic Centre Private Limited	100.0%	Direct subsidiary	Full consolidation
Medinova Millennium MRI Services LLP*	100.0%	Step down subsidiary	Full consolidation
Namrata Diagnostic Centre Private Limited**	100.0%	Step down subsidiary	Full consolidation

Source: Annual report of VDCL; apart from Medinova, other subsidiaries are non-operational

*Subsidiary of Medinova Diagnostic Services Limited

**Subsidiary of Doctors Lab Diagnostic Centre Private Limited

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About ICRA Limited:

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