Notes from Interviews of OM Manchanda, MD of Dr Lalpath Labs

- Compiled by Venkatesh (@SuccessProject_)

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Important Update

- These notes were made to understand the diagnostic industry ecosystem.
- This work is an ongoing work, where I update it periodically as and when I listen to/read the new interview.
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Consistent Compounders" Webinar with Om Manchanda, Managing Director of Dr Lal PathLabs

https://www.youtube.com/watch?v=5YkgDi--VE8

This webinar is hosted by Mr Saurabh Mukherjea, whom I have referred to as "SM" in the notes. Mr Om Manchanda, has been referred to as "OM".

SM: Indian diagnostic market including radiology is an 80,000 crore market. Organized chains account for 15% of the market. Is Covid driving consolidation in this sector?

OM: Before starting want to give the perspective of what is happening in the last 12 – 13 months.

- When the world went on lockdown in 2020, we had to work 24 x 7 to serve the market.
- The people who collect the sample and their family has to be protected - So they were put in a separate place.
- Employees travelled by roads to get the kits from Pune - Very few flights were there then.
- There were a lot of administrative challenges like moving people between states.
- Many states did not have the facility of even a single private lab doing this test.

- There was more scare but fewer cases and managed the first wave very well.
- Non-covid business took a complete nosedive.
- The teams were divided into two parts and one group will only focus on non-covid.
- The non-covid business depends on the movement of samples.
- Hospitals were functioning, it is just the logistics must work.

On the Covid front, the fees for testing of RT-PCR were fixed at 4,500. In our business more than the variable cost it is the fixed cost which is a huge component. The price of the test was coming down on one side and on another side, the cost of raw materials was also coming down. The covid demand is not predictable. We don't know what is the level of spiking. There is a lot of unpredictability. Over some time, a portfolio of tests has emerged in the covid space.

Pathology is not only about the diagnosis of the disease but living through the progression and monitoring the disease. Once covid is diagnosed, the progress is monitored. An antibody test is there, which is used to diagnose the immune response of the system to the infection. There is various type of Antibody test. Covid is not just an RT-PCR test, but it is a portfolio of tests. There are three segments of reporting, (1) Non-covid, (2) RT-PCR and (3) Covid allied test. In the second wave, the covid allied tests increased.

Demand Spike in the current wave

- In the current wave there is a huge supply and demand gap and this happened in a very short period.
- When compared to Feb/Mar 2021, the demand almost went up by 10 – 15 times.
- Demand came from some of the tests, that were not anticipated i.e. IL6 test.
- Even if anticipated, we did not think it will go so high in that direction.
- Many of the needed reagents are not manufactured in India.
- There is always a lag, where you estimate the demand, contact the vendor for # kits, they are manufacturing in Germany or other country, flights are not there and it is going to take time - There was no time to wait.
- Even supply we got affected, a large number of our people were down with Covid and operation was affected.
- Most of the demand was for home collection.
- There were operational challenges.

SM: You have told me over the last 10 years, how it was difficult to scale up in a profitable sustainable manner? Does this current situation make scaling more easier? As smaller labs suffer even more than you. It is mind-blowing to see the challenges you faced.

I will try to answer the **first question**, What are the challenges in Pathlab business to scale nationally profitably and sustainably. There is a historical reason behind this.

- It is much fragmented, the expenses are out of pocket, it is a prescription driven business and this prescription is from the doctor.
- The brand building in healthcare is building a relationship between two individuals, patients and doctors.

- There is a trust factor behind - The patient trusts the doctor and consumes the medicine prescribed by the doctor.
- This relationship idea also applies to diagnosis - This relationship is very unique and cannot be brought.
- One cannot buy this relationship by throwing money advertising it - It has to happen one on one.
- There is a therapy which happens when you talk to the doctor, which does not exist in consulting. (Though it did raise with covid times and came down steeply post covid)
- Even without doctor prescribing medicines a small amount of interaction does the magic.
- Similarly there is also the relationship between a doctor and a lab.
- It is required as part of their brand-building that they diagnose the illness correctly.

The doctor needs to trust a lab that provides a quality report. This is one factor *(First factor: trust)* which makes scaling a bit difficult. I may a big person in Delhi, but when I go to Chennai, there is someone who is already enjoying that trust and relationship that I am enjoying there. It is very very difficult to break that relationship. It is similar to investment banking where you nurture the relationship over some time.

The second factor…

- Health care is a need and not a want.
- None of us got to the hospital or lab by choice.
- It is not a frequent purchase cycle in healthcare - The current situation is unusual, so forget the covid situation.
- In normal times for a normal person in a younger age group and not having any chronic disease, you would visit the hospital once in a while.
- If a lab is opened, it requires a lot of patience to build a customer base.
- There should be 100 walk-ins (or pickup), the broad math is that you must have 100 patients a day to make the business viable.
- This is not easy to build in a new market and it takes time, which needs patience.
- By the time, a lot of operating cost is incurred. This is another barrier – a kind of large gestation period of several years. Clubbed with the relationship (The first factor) it is quite a bit of a challenge.

Some businesses resort to B2B, as there is a quick turnaround and can ramp up a bit faster. But in this piece, the competition intensity is very high. You cannot build a brand, you just have a contract. A few labs in this country operate only on a B2B set-up and do not have a direct walk-in portion.

The third factor, OTC

Let me also tell you what has happened in the last 10 – 15 years.

- This industry has taken the shape of direct to consumer.
- There is a nice journey of Rx to OTC, Prescription to OTC. OTC brands are not built with consumers in mind to start with.
- They also start with doctor's prescribed brands. In the later part of the life cycle, they become OTC brands, assuming that technically they qualify to be OTC.
- From a behavioural perspective, it is a shift from Rx to OTC.
- That is the kind of switch I see in the Pathology space.

- What makes the switch to OTC? It is not about the test, as that has to be prescribed by the doctor. But where to get this test done is getting shifted to the consumer or the patient. Here branding takes importance.

Branding: There are two sides to a brand, one is the medical side and the other is the service side. The medical side was very good and had a reputation. We started focussing on the service side, showing empathy to patients and giving all kinds of convenience. Way back in 2005, the patient gives a sample in the morning, and the patient has to come in the evening to check if the report is ready and 20% of the time it was not ready. We made bit convenient by focussing on technology. We started focussing on the "Wellness", (No prescription intervention) where the patient does a few checks once a year to see if all is ok. There is a small income tax benefit if am not mistaken, (SM Chuckles 😊). This gave us reasons to talk to the patients directly. We then moved to the home collection, which added another level of convenience. The whole business which earlier was a back end business through doctors suddenly became a direct-to-consumer brand. Now it is not backend anymore and facing the consumer right in front.

Answer to the second question: How do I see covid impacting this.

1. Health is going to become the number 1 agenda in everyone's life. While people are memory short, this memory is not going to be shorter. People now realize to take care of health accounts like a bank account. This is merely not about weight management. The level of understanding about health, Pre and Post covid is going to be a little different.
2. All of us are not equal. People will start understanding that all of us are unique. There is somebody type, which is unique from a medical perspective, which drives us to know more about ourselves. Now people are realizing the risk factor of co-morbidity.
3. Invasion of technology in health care. Health care has two pillars, one is the Medical or technical pillar. Lots of creativity and innovation will happen in this area. Covid has triggered a series of research activities all across. RT-PCR is supposed to be a confirmatory test. It is not widely available. Even today, the sample is sent to some labs and takes 24 to 36 hours before we get the results. To do this test in every nook and corner, I need to figure out what is the alternative, which was the Rapid Antigen test. These are nothing but innovations but come with a compromise. It is not a gold standard and is less reliable. See the disease cycle, it does not start with diagnosis, but with symptoms which act as a trigger. Some innovations may help to pick it up early. A simple example is an oximeter is small diagnostic equipment at home, to trigger action. There is going to be innovations around screening test or DIY tests. There are certain principles by which the test is done. There could be another way of doing the same test to pick it up early. The other areas are correlations: co-morbides, there are cases of black fungus, and people are not able to figure out if it is due to steroids or diabetics. There are many patterns, linkages and dots which his yet not connected. There is going to be a lot of what is going to happen to understand the whole thing. There could be work around genomics, genetic related stuff.

SM: In this context of greater awareness of health, greater use of technology. More PE money is going to come into diagnostics and healthcare. Will the conventional format of going to the lab to give blood will completely move to the home collection?

OM:

- That is another piece related to the service aspect, which aims at taking testing closer to the patient.
- For this lot of collection centres have to be opened to reduce patient travel i.e. Only 2 km instead of 10 km.
- This ability comes because of splitting testing and collection as two activities.
- The second stage is to reduce even that 2 km, by home collection.
- This home collection is there to stay and grow.
- This Covid has brought a shift from walking into the lab to home collection.

But it also carries a bit of challenge and is not simple as it sounds.

- The operational aspect becomes complex as another layer of logistics gets added i.e. Home to drop up point.
- The second aspect is the capacity of the collection gets reduced.
- A phlebologist sitting in one place can collect 30 – 40 samples but home collection can collect only 5 or 6 samples.
- To collect the same number of samples, you need more people.
- There is a bit of challenge from the patient's point of view also.
- Because many of the tests involve fasting and if the phlebologist does not land up it is a problem.
- Another way also can happen where patients make phleobo wait as they have other appointments.
- Many people are confusing home collection as a home delivery business say Pizza.
- In delivery you can drop the box outside and walk off, but in-home collection he goes inside and there is a different level of interaction.
- If the patient delays it affects another appointment of Phlebo.
- In Pathology 70% of the errors are due to pre-analytical errors, which is the stage before loading the sample into the machine.
- We are further losing control in this aspect as well.
- So far home collection we were doing ourself.
- But during home collection we have to pull in the entire franchise network into this.
- If something does not go well at the franchise level, I get an email that your phlebologist did not turn up. I cannot say it is not my mistake, it is a Franchise mistake. The client would say that I only know you and not your franchise.

Consumers want the home collection, but it is operationally more challenging. However, challenges are an opportunity for us to excel and to that extent reduce the competition.

RR: As the diagnostic business becomes more digital how would DLPL, being in brick-mortar DNA for 15 years handle the transformation.

OM: Digital operating models are very different from traditional models. The front end may be non-medical but at the back end, we are very medical. 70% of my manpower is inside the labs without exposure to the outside world. It is challenging to make them adapt to a change. Our companies are built on ERP and LIMS, these are never consumer-facing. People walk in and the IT part starts from there when you do the

registration. Today it all has shifted to apps. We have started to take steps and have our apps. Need to take external help as this is one knowledge which does not exist internally. The digital part has to come to us, as they do not know the testing side.

RR: If tests are routed through health insurance, what competitive advantage does DLPL have?

OM: The core of our brand is quality and trust. What people have in their hands is the final report. People come back to us again and again because they trust us. Patients are now thinking, about why they should go to multiple locations. Why not interact, with the doctor, who gives a prescription with some tests and medicines. Patients feel that it should take the digital route from here. Technology is going to connect these dots and integration is going to be a big idea in healthcare.

In the covid time, there is a seamless flow between the Government and private players. Even before you get the results, it is there in the Government system. Systems are going to talk to each other and integration of all this will take place in future. Hospitals, labs and health insurance would be connected. Today all are paying the same amount of premium. But tomorrow based on the track of a healthy person and someone with co-morbid, the premium would be different. There are a lot of possibilities once the integration is made.

RR: It is a bit challenging to expand geographically due to loyalty with the incumbents. You have recent plans to enter Mumbai and Bangalore with reference labs. What makes you believe that you can make up in these markets in a short time.

OM: It is difficult to get into newer markets but not impossible. In 2005, when I came nearly 70 – 80% of our revenue was coming only from Delhi NCR. Today it is around 35%. All that happened because of a carefully crafted plan to expand geographically in other markets. There is a gestation period to hit the inflexion point when you take off from there. From Delhi, we went to the nearby state of Punjab, UP, Haryana, Bihar, Orissa etc. Even in south markets, we have been there for a fairly long time. We started in Pune and Bengaluru as focus cities now we have reached a point of the next trigger to have a regional lab and widen the test menu. Not every lab can do an RT-PCR test, this is where we have brought some brand awareness. We have carefully picked up Bengaluru, as it is much more cosmopolitan. I am confident that a combination of organic or inorganic growth will help in the south and west region.

RR: How are Genomics different from the normal business? How will the operational model of this business be different from the current model?

OM: Today's specialized test will become a routine test for tomorrow. There were many biochemistry tests which were specialized in the past, but are routine today. Thyro profile and Vitamin D were a specialized tests, but now it is routine. Now the world is moving to molecular diagnostics. The RT-PCR test is molecular. Now a third wave called gene sequencing and genomics is coming. Many diseases have some kind of linkage to genes. This is due to advancements in science. Not only diagnostics even treatment want to know what kind of drug will suit a particular genetic make-up. Right now in diagnostics, all this is under one umbrella called Pathology. This industry needs to move into segmentation. There will be divisions like respiratory,

onco etc. The medical side of genomics is a very specialized field and needs technical people. We need to segment and create divisions to manage some of these things. We already have a division called Gene evolve which looks after this. Segmentation also can be done this way... have an allergy as one platform, because there are all kinds of allergies. There can be one for Cancer. All these are a portfolio of test to create a segment around it.

RR: 15 Years ago, Pan India chains were non-existing, there were only stand alone. Today Pan India chain is roughly 15%, and what would be the share in the next 10 years.

OM: As more awareness comes in, people know some are accredited and some are not. Smaller labs cannot sustain the cost structure, as larger labs have huge operating leverage, the benefit of scale, quality of management, and attract talent. There is a lot of +ve for scale and size in the business. Will it completely kill them? I have a doubt. All will co-exist, and there will be a level of partnership. I don't believe that unorganized will completely wipe out organized. I have 3500 collection centres, without them, we cannot scale. Technically they are representing my brand. I will figure out how to work with them. Large players are not intended to wipe out small players. But work looking to work with them. They cannot invest high in technology as well. We will just co-exist.