December 13, 2021

IPO NOTE | Sector: Pharmaceuticals

MedPlus Health Services IPO

Expensive valuation for a mid-sized chain, no room for execution disappointment | AVOID

A physical presence coupled with a readiness to handle online mean MedPlus is positioning itself for growth in the both the channels. We understand unit store economics for a mature store doing in excess of 10% EBIDTA margin translates in to ~20% ROCE after accounting for 22 days of warehouse inventory and corporate costs. Albeit, we believe it might be difficult to grow ROCE beyond a point even at a mature store level. Moreover, at a company level, it would be difficult to extrapolate store level economics as corporate costs and need to open new stores would consistently act as a drag on margin and ROCE. Indeed, there will also be cases of new stores earning <10% margin which would act as a drag. Given the fragmented market, we think there is space for MedPlus and others like it to grow. However, challenge from online only players offering pharmacy plus (OPD, diagnostics) is already present, which would lead to a need for matching discounts. Mcap demanded of ~Rs95bn on FY22 annualized PAT works out ~71x PE and ~2.8x FY22 annualized sales which we reckon is a premium valuation for a mid-sized retail chain which is not being a platform business (dominated by brick & mortar in foreseeable future and lagging in app penetration compared to peers). We believe current offering is expensive given the proposition of likely low ROE/ROCE potential at a blended level.

Pharmacy chain – room to grow but online competition beckons

Organized pharmacy retail market in India is expected to clock 27% cagr from FY21 to FY25, with share of organized players increasing from 10% to 20%. Complimented by online sales and better management of supply chain through use of technology, pharmacy is expected to see strong dominance from a few players. Albeit, competition from cash rich companies can create a consistent drag from discounting.

Business Overview

- Commencing its business from 48 stores in Hyderabad, MedPlus is now a leading pharmacy retail chain having a well-established brand and a track record of 15 years in India.
- MedPlus operates 2,165 stores, up from 1,488 stores in FY18, implying a ~12% cagr in store addition. 80% of the stores are located in South, while 12% are located in East and 8% in West.
- MedPlus commands a 21% market share in the modern Brick & Mortar Pharmacy market. This is only 2nd to Apollo Pharmacy which is the leader in the industry with a 41% share.
- MedPlus was the first pharmacy retailer to launch an omni-channel platform in India. Online sales contributed 9% of its overall revenue in FY21.
- Apart from pharmaceuticals, MedPlus stores offer wellness products and FMCG products which are margin accretive in nature.
- Key geographies with primary warehouses located are Bangalore, Chennai, Hyderabad, Vijaywada, Kolkata, Pune, Bhubaneshwar, Mumbai and Nagpur.

Key Strengths

- MedPlus is ranked 1st in Chennai and 2nd in Hyderabad in terms of number of stores.
- Revenue from sale of private labels is highest amongst its peers at 10% of revenue. These products have a higher margin in the range of 20-40% and the company plans to double down on the same.
- MedPlus caters to acute and chronic patients both, whereas online retailers are only catering to chronic market, which is roughly 40% of the overall pharma market.

Reco	:	**AVOID**
IPO Price	:	Rs780-796
Issue Opens	:	13-Dec-21
Issue Closes	:	15-Dec-21

Issue details

Face value (Rs)	2
Issue Size*	Rs13.98bn
Offer for sale*	Rs7.98bn
Fresh Issue	Rs6bn
Post-issue M-cap*	Rs94.9bn
Issue type	100% Book building

* At upper price band

Share reservation (of net offer)

QIB	Not less than 50%
Non-institutional	Not more than 15%
Retail	Not more than 35%

Issue Manager

BRLM	Axis Capital, Edelweiss Financial Credit Suisse Securities Nomura Financial Advisory
Registrar	KFin Technologies Pvt. Ltd.
Listing	BSE, NSE

Company management

Gangadi Madhukar Reddy	MD & CEO
Anish Kumar Saraf	Non-Executive Director
Cherukupalli Bhaskar Reddy	COO – Outlet Operation
Surendranath Mantena	COO – MedPlus Mart
Hemanth Kundavaram	CFO

Financial Summary – Y/E March (Rs mn)

(Rs mn)	FY19	FY20	FY21
Revenue	22,727	28,706	30,693
Gross margin	18.9%	18.6%	21.0%
EBITDA margin	5.2%	5.8%	7.1%
PAT	118	17	630
EPS (Rs)	1.15	0.21	6.13
RoE (%)	4.1%	8.3%	10.0%

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MANAGEMENT TEAM

GANGADI MADHUKAR REDDY (Managing Director & CEO)

Gangadi Madhukar Reddy is the promoter of the company and has been with the company since its inception in November 2006. He is the Chairman and Managing Director of the company. He holds a bachelor's degree in medicine and surgery from the Sri Venkateswara University and a master's degree in business administration from the Wharton School, University of Pennsylvania.

Anish Kumar Saraf (Non-Executive Director)

Anish Kumar Saraf is a Non-Executive Director of our Company. He is a chartered accountant with the Institute of Chartered Accountants of India. He holds a post-graduate diploma in management from the Indian Institute of Management, Ahmedabad. He is the managing director of Warburg Pincus India Private Limited and has been in the employment of the company for 15 years.

Cherukupalli Bhaskar Reddy (COO)

Cherukupalli Bhaskar Reddy is the chief operating officer – outlet operations of our Company. He holds a bachelor's degree in medicine and surgery from Sri Venkateswara University and a master's degree in surgery from Faculty of Medicine, Kasturba Medical College, Manipal Academy of Higher Education. He was previously a fellow of the Royal College of Surgeons, Edinburgh. He joined MedPlus on March 1, 2007 as the chief operating officer. He has over 14 years of experience in the pharmaceutical industry.

Hemanth Kundavaram (CFO)

Hemanth Kundavaram is the CFO of our Company. He holds a bachelor's degree in commerce from Sri Venkateswara University and a master's degree in business administration from the Periyar Institute of Distance Education, Periyar University. He is an associate of the Institute of Chartered Accountants of India. He was previously associated with Dodla Dairy, Cogent Glass Limited, Tintometer India Private Limited, Rockwell Collins (India) Enterprises Pvt. Ltd., Ford Business Services Center Pvt. Ltd., IBM Daksh Business Process Services Pvt. Ltd. and Thomson Corporation (International) Pvt. Ltd., and has over 15 years of experience in corporate finance and accounting in various industries. He joined MedPlus on January 2, 2021.

Usage of proceeds from IPO

- Fresh Issue: MedPlus is planning to raise Rs6,000mn from fresh issue of shares in the IPO. Out of this, Rs4,672mn is planned to be utilized by the company for fulfilling its working capital needs for FY22, FY23 and FY24. The balance of net proceeds from the IPO will be utilized for general corporate purposes.
- Offer for sale: Promoter Lone Furrow and Agilemed are planning to sell shares worth Rs4,500mn. Premji Invest and Warbug Pincus will sell shares worth Rs5,000mn. Other investors will also take part in the OFS and sell their stakes to the tune of Rs890mn. The complete OFS amounts to Rs10,387mn.

Financial Highlights

- MedPlus has increased its revenues from Rs22,727mn in FY19 to Rs30,693mn in FY21, indicating a revenue cagr of 16.2% over the period.
- Retail pharmacy industry works on lean margins. EBITDA Margins for MedPlus have inched up from 5% in FY19 to 7% in FY21. Mature stores (3 years and older) command higher margins than new stores (11% Vs 8% in FY21). As company plans to grow rapidly by increasing its store presence, the margins are expected to remain on the lower end for the coming years.

- Company plans to take on several initiatives to improve its margin profile in the coming years: increasing the share of private label sales as a percentage of overall revenue, increase direct procurement proportion from pharmaceutical companies, improving distribution infrastructure and benefiting from economies of scale in procurement as they open more stores.
- Mature stores have a payback period of 3 years, EBITDA margins of ~11%, store level operating ROCE of 60% and SSSG of 8% during FY19 to FY21.
- MedPlus has more than doubled its Operating EBITDA per store from Rs0.4mn in FY19 to Rs0.9mn in FY21.
- ROCE for the company has remained constant for the company in the range of 12-13% over the past 3 years.

Ownership Background

- Gangadi Madhukar Reddy, founded MedPlus in 2006, building a pharmacy brand
- In 2007, Pharmaceutica Ventures, Peepul Capital and NEA-IndoUS invested Rs800mn, Rs226mn and $5mn respectively in the company.
- These investors were given exits in 2017, when the promoter bought back 69% stake in the company, increasing its shareholding above 90%. The promoter borrowed Rs7,500mn from Goldman Sachs and Edelweiss to buy out this stake.
- In 2019, Premji Invest invested in the company buying 22% stake in the company for Rs3,660mn.
- In 2021, Warbug Pincus bought a 25% stake in the company for Rs6.5bn. Premji Invest further invested Rs220mn in this round.

Exhibit 1: Pre-IPO shareholding structure

Shareholders	% of shareholding
Warbug Pincus	25%
PremjiInvest	22%
Promoter - Lone Furrow	15%
Promoter – Agilemed	14%
Promoter - Gangadi Madhukar	14%
Others	10%

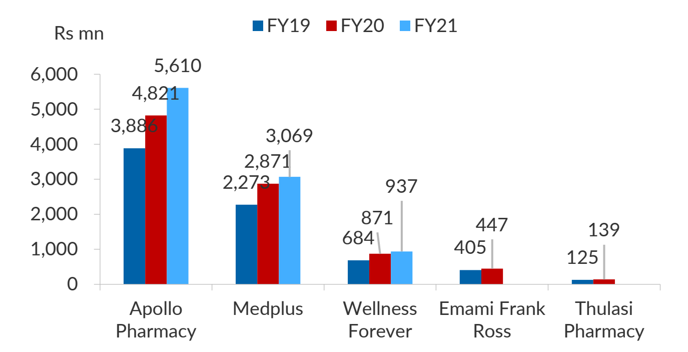
Growth plans

- Company is planning to roll out 2-hour delivery services in cities like Chennai and Mumbai. It plans to follow the strategy similar to DMart's and saturate its existing markets with a cluster-based approach.

Key Risks/Concerns

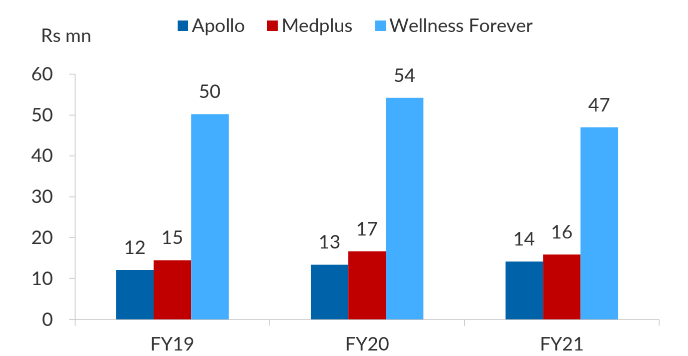
- Company is not planning to venture in the consultations and diagnostics space, which is an evolving concept and can be a risk over a longer term
- Discounts offered by e-pharmacy players are much higher and can impact the sales and margins of MedPlus.

Exhibit 2: Revenue Trajectory for MedPlus Vs Peers



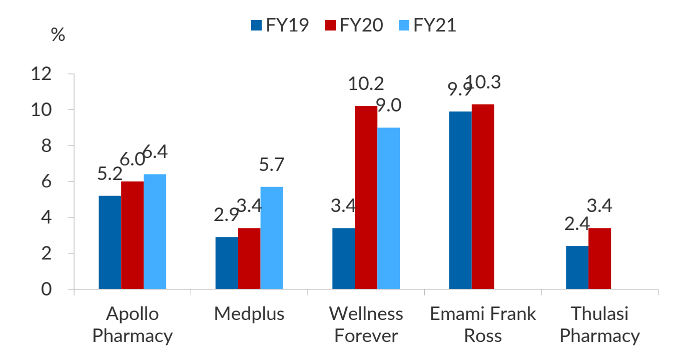
Source: Company, YES Sec

Exhibit 3: Average Revenue per store comparison with peers



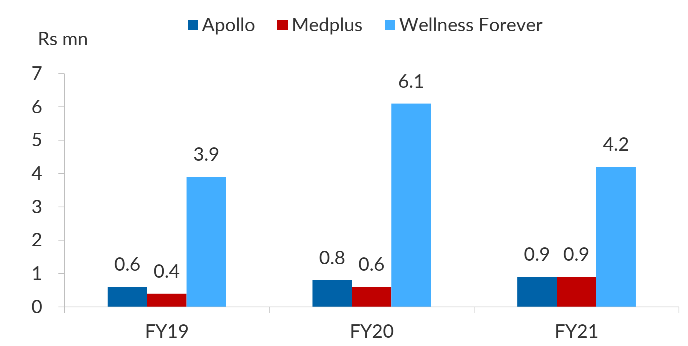
Source: Company, YES Sec

Exhibit 4: Operating margin for MedPlus Vs Peers



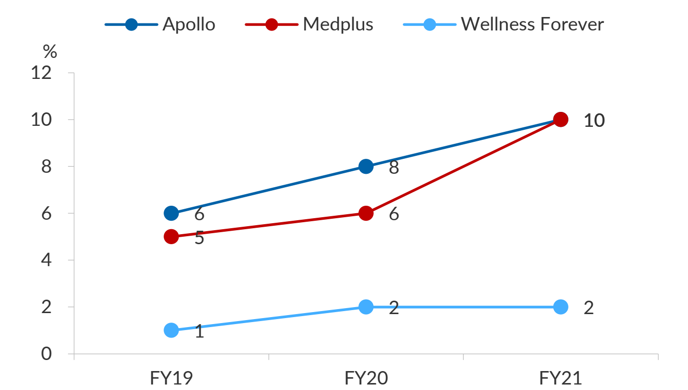
Source: Company, YES Sec

Exhibit 5: Operating EBITDA per store comparison with peers



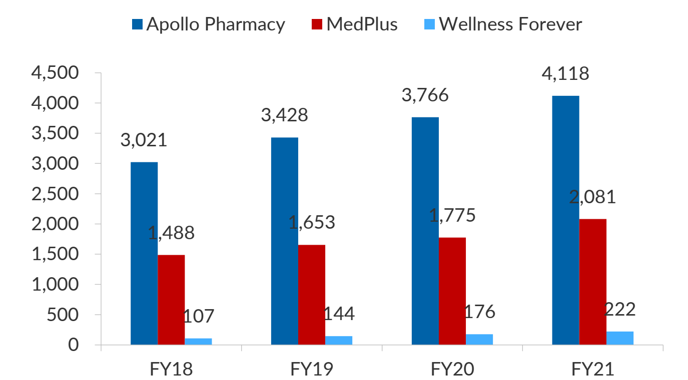
Source: Company, YES Sec

Exhibit 6: Increasing share of private label products



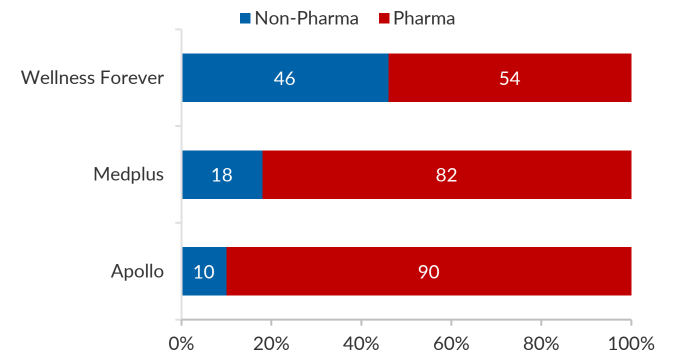
Source: Company, YES Sec

Exhibit 7: Store count of established players



Source: Company, YES Sec

Exhibit 8: Share of Retail Sales (FY21)



Source: Company, YES Sec

Exhibit 9: Sales from online channel

	Omnichannel Started in Year	Contribution to Sales in FY20	Contribution to Sales in FY21
Apollo Pharmacy	2019	1-2%	2-5%
MedPlus	2015	7%	9%
Wellness Forever	2016	9.5%	11.7%

Source: Company, YES Sec

PRE-IPO MEET TAKEAWAYS

Operations:

- Pharmacy Retail is the fastest growing sector among retail segments and is expected to continue to grow at faster rates than others.
- Penetration in smaller towns (Tier 1 and 2) is around 6-7% and presents a huge opportunity. MedPlus has 47% of its stores in Tier 2, 3 and 4 cities.
- Better fill rate with most of the products available across stores. This is because stores are well connected with warehouse with proper inventory management.
- Scale allows MedPlus to buy at a small discount than others. Also sharing of data with companies regarding what is selling where helps to create uniqueness in comparison to mom and pop stores.
- In short trying to create a DMart version of pharmacy retail.
- 40% of medicines sold are for acute needs and this is where B&M plays an important role in comparison to online. Also, these customers are least price conscious and is more profitable than drugs sold at higher discounts. This is where omnichannel works better than online channel.
- Online orders in a radius of 3-4km of a store can be serviced within an hour or two from the store itself and is a huge benefit of being omnichannel.
- Ranking: Bangalore and Chennai - 1 and Kolkata and Hyderabad – 2.
- Not too much of discounts + a small fee charged for online deliveries. Planning to grow this profitably in the clusters where company has strong presence.
- All IT operations are in-house and no money paid to IT companies. Allows a lot of flexibility.
- 60-70 store additions per month is the current run rate.
- Competition from big guys is not a problem as the unorganized market is ~90% and huge unpenetrated market left for growth. For a player to come and set up a network of MedPlus' size will take a lot of time.
- Most stores have an in-house delivery guy.
- Earlier when the company was started 4-5 distributors were appointed. Currently 90% of products come from company owned distributors or company directly and rest 10% comes from 3rd party distributors. Because of the scale, not losing much when bought from 3rd party distributors also.
- If the customer is unable to upload prescription, he/she can select click and pick model where they can go to the nearest store and get the drugs ordered physically after showing the prescription.

Financials:

- 8.3% SSSG for FY19-21, Sales per store is 15.9mn which is higher than Apollo.
- 60% of stores breakeven in 3 months. 75% of stores are reaching breakeven within 6 months. Even stores not breaking even do not lose out much money (20k-30k per month max) after 3 months.
- Out of 2300 stores, 65-66 stores are owned by franchisees in smaller towns but don't want to expand in this model as margins are already low and don't want to share with people.
- Below Rs200 order value, no discount. Rs200-1000: 10% discount and above Rs1000: 20% discount.
- Topline shift is happening from COVID related drugs to drugs which were subdued during COVID so topline should not suffer with outset of COVID.

- Average discounts have ranged between 15-16%.
- Composition of private label is increasing and 1% increase in private label will increase the margins by 0.5%.
- 26-30 lacs investment per store. 10% EBITDA by 2-2.5 years mark.
- Not trying to associate with hospitals or get in those kinds of business as receivable days are currently 0 and would like to keep the it the same way.
- 45 days of inventory in mature store. 22-25 days of inventory at warehouse. 20 days is payable. Net 50 days of working capital in stores and planning to bring it down.
- 18 lacs of inventory in new store. 6 lacs of sales. 90 days of inventory.
- Currently catering to 40% of Indian population with the network and aiming to make a 15-20% market share in this Rs850-900bn market.

FINANCIALS

Exhibit 10: Balance sheet

Y/e 31 Mar (Rs mn)	FY19	FY20	FY21	H1 FY22
Equity capital	2	2	4	64
Reserves	2,911	5,276	7,301	7945
Net worth	**2,913**	**5,278**	**7,305**	**8009**
Minority Interest	0	13	6	0
Debt	2,948	3,384	4,197	4812
Def.tax liability	0	0	0	0
Total liabilities	**5,861**	**8,675**	**11,508**	**12,821**
Goodwill	415	415	415	415
Fixed assets	3,372	3,830	4,813	5,847
Investments	444	528	692	785
Def. tax assets	657	558	505	541
Net working capital	**973**	**3,344**	**5,083**	**5,236**
Inventories	3,941	6,436	7,500	8,100
Sundry debtors	88	64	54	72
Cash	499	1,406	1,186	961
Other current assets	171	249	492	745
Sundry creditors	(1,581)	(2,342)	(1,481)	(2,235)
Other current liabilities	(2,145)	(2,469)	(2,668)	(2,407)
Total assets	**5,861**	**8,675**	**11,508**	**12,821**

Source: Company, YES Sec

Exhibit 11: Income statement

Y/e 31 Mar (Rs mn)	FY19	FY20	FY21	H1 FY22
Revenue	22,727	28,706	30,693	18,799
Operating profit	**1,190**	**1,659**	**2,166**	**1,587**
Depreciation	(586)	(748)	(883)	(548)
Interest expense	(500)	(468)	(548)	(313)
Other income	122	173	215	110
Profit before tax	**226**	**616**	**950**	**836**
Taxes	(108)	(276)	(320)	(172)
Adj. profit	**118**	**340**	**630**	**664**
MI + exceptional	-	(323)	-	-
Net profit	**118**	**17**	**630**	**664**

Source: Company, YES Sec

MedPlus Health Services IPO

DISCLAIMER

Investments in securities market are subject to market risks, read all the related documents carefully before investing.

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