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Sector Update

INDIA

Healthcare

DRHP Analysis #4: Deep-dive into Indian pharmacy sector from Medplus prospectus

The key insights for the Indian pharmacy sector from our analysis of Medplus Healthcare Services Ltd. (Medplus) prospectus (DRHP) are 1) Indian retail pharmacy is expected to grow at 10% CAGR over FY20-FY25E with share of organised players increasing from 10% to 20% over this period, implying CAGR of ~25% for organised market, 2) modern pharmacy and hospitals make higher margin of 20-25% in supply chain process, 3) focus on offering OTC and private label FMCG type products to improve scale and profitability, and 4) emergence of omni-channel (offline + online) presence in organised retail pharmacy.

The Indian retail pharmacy sector has been growing at a healthy rate and is expected to grow at CAGR of 10% over FY20-FY25E led by increasing consumer base and rising healthcare expenditure. Apart from selling medicines and OTC products, pharmacy stores also focus on offering margin accretive FMCG & wellness products, consumables, medical devices and private labels products especially by organised players which has improved per unit economics. Apollo Pharmacy is running the largest pharmacy chain in India (4,118 stores in FY21) operating on omni-channel platform.

- **Retail pharmacy likely to grow at 10% CAGR:** In India, unorganised pharmacy comprised ~89% of overall pharmacy business in value terms. The healthy growth witnessed by the Indian pharmacy retail sector over the past few years has primarily been due to an increasing consumer base and rising healthcare expenditure, rising demand for OTC and prescription drugs, wellness products and private label products and the outbreak of covid pandemic. As of FY20, pharmacy retail industry was estimated to be worth ~Rs1,725bn, and is expected to grow at a CAGR of ~10% over FY20-FY25E.
- **Share of organised players to double by FY25:** Traditional retail channels historically constituted a large portion of the pharmacy retail market in India. There has been a recent shift towards modern retail channels with consumers now increasingly inclined to purchase regular prescription drugs and other wellness products from modern organised pharmacy retail outlets. This is driven by better customer experience, wider product range, value-added services like online order and home delivery in short time and discounts. This trend has been accelerated by the outbreak of covid pandemic. Organised players have just 10-11% share but this share is expected to improve to ~20% by FY25E, implying 25% CAGR over next five years vs 10% industry growth.
- **Better unit economics for organised pharmacy:** Led by economies of scale, better cost efficiency, improving sales per square foot and working capital efficiency, organised players are able to command better unit economics. Apart from this, selling margins accretive own private labels leveraging multi-city presence, offering other wellness products, consumables, medical devices further drive better margins.
- **Ecosystem play:** Modern pharmacies are now building up a complete ecosystem of related services in order to acquire customers. They have augmented their proposition by offering a wide range of value-added services like appointments for doctors, online consultation, health blogs, medicine reminders & refills alerts, tie ups with diagnostic centres. Apollo Hospitals, being an integrated player, is able to use its Apollo 24/7 (Apollo Pharmacy) platform better for online consults and consultation bookings besides pharmacy services.

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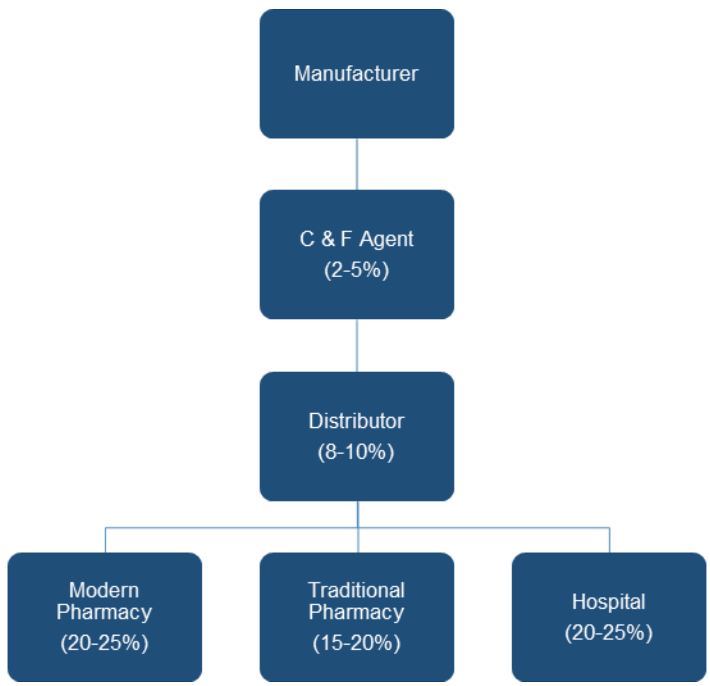
Pharmaceutical supply chain in India

The pharmaceutical supply chain comprises manufacturing plants, intermediary product suppliers, logistics partners and technology partners. The Indian market consists of a large network of >500 medium and large companies (that manufacture/contract manufacture), ~60,000 distributors and ~800,000 pharmacy retail outlets, with more than 100,000 pharmaceutical brands available in the market given it's a branded generics market.

The domestic pharmaceutical supply chain mainly involves a company appointed carry-forward (C&F) agent, responsible for handling, warehousing and transportation of drugs and supplying drugs to distributors who then provide these products to retail pharmacies and hospitals. There are multiple variations to this basic chain where a distributor may also distribute through a sub-distributor, an exclusive distributor may be appointed for a particular channel or customer. In some cases, manufacturers supply their products directly to retailers or through exclusive intermediaries.

Chart 1: Supply-distribution chain with profit margins



Source: Technopak Research, Medplus DRHP

Retail pharmacy in India

Pharmacy in India comprises primarily of pharmaceutical products, including OTC and prescription drugs. In addition, pharmacy stores also sell various FMCG products, wellness products, consumables and medical devices. Indian pharmacy growth over the past few years has primarily been driven by an increasing consumer base and rising healthcare expenditure, rising demand for OTC and prescription drugs, wellness products, private label products and covid pandemic. The pharmacy industry was estimated at ~Rs1,725bn in FY20 and is likely to grow at ~10% CAGR over FY20-25E.

As an essential service, pharmacy retail has performed better than most other sectors during covid pandemic. Domestic market has recovered from the initial loss of business at the onset of lockdowns. However, as a whole, the pandemic is driving incremental growth in the segments such as preventive healthcare and personal hygiene with consumers increasingly purchasing preventive healthcare products such as multivitamins and ayurvedic supplements to boost immunity. Personal hygiene products have also gained prominence.

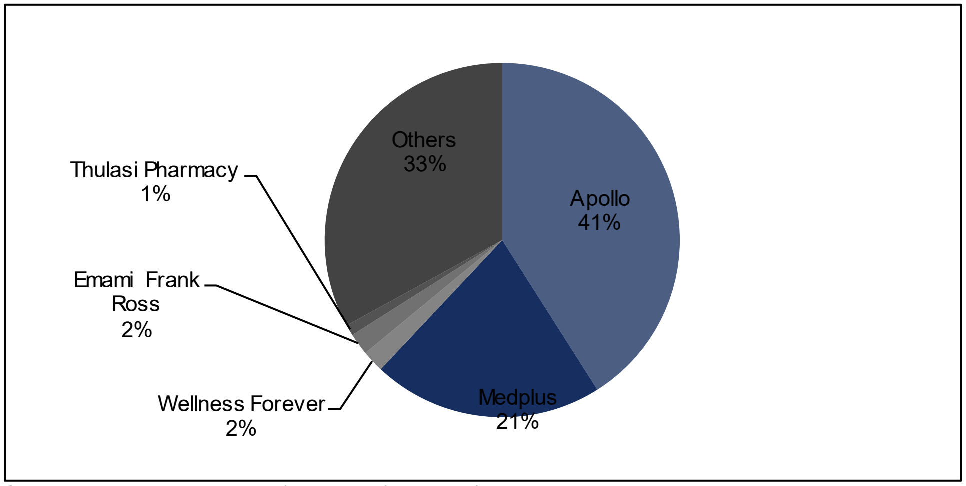
Types of retail pharmacy

Traditional (unorganised) pharmacy is a part of the unorganised Indian pharmacy retail segment predominantly consisting of retail stores operating as family-run medical stores with store size in the range of 150-1,000 square feet. There were ~800,000 such pharmacy stores operating across the country in FY21.

Modern (organised) pharmacy, also known as brick and mortar (B&M) store, is a part of the organised pharmacy segment and primarily comprises B&M stores operated by established players such as Apollo Pharmacy, MedPlus, Wellness Forever and other smaller players. These players continue to drive growth in the organised segment by establishing presence across many cities, primarily through B&M stores and select players also operate an omni-channel platform. These players typically open multiple outlets in a city and a regional warehouse nearby to cater to these outlets.

This model facilitates the implementation of logistics and distribution in a cost-efficient manner, ensuring accurate demand forecast for that region and improved serviceability with consistent availability of products and timely deliveries. Moreover, this model also provides higher profitability and the benefit of economies of scale, with a high store count ensuring low unit logistics costs and better operational efficiency due to distributed and balanced demand.

Chart 2: Share in number of organised pharmacy stores (FY21)



Source: Technopak Analysis (~10000 B&M stores), Medplus DRHP

e-commerce channel

NetMeds, Tata 1mg and PharmEasy operate in e-commerce segment through an online-only model alongside omni-channel platforms of B&M retailers such as Apollo Pharmacy, MedPlus etc. e-commerce channel in pharmacy retail operates through the following models:

- **Inventory-led model**: In an inventory-led model, the inventory of goods and services is owned by the company (and managed through warehouses and fulfilment centres across different locations) and goods and services are sold directly to customers.
- **Hyperlocal model**: This is an inventory-light model where the company only provides online infrastructure and corresponding logistical support. The partner, offline retailer, is responsible for managing the inventory. This model can be implemented with a low seed capital. However, margins are shared with the offline partner retailers which impacts the unit economics.
- **e-commerce marketplace**: Online marketplace platforms like Amazon (and others) are trying to enter this business but may do so gradually given the fluidity in the regulatory environment.

Omni-channel (Online + offline)

B&M stores operating as online + offline model are called omni-channel pharmacies and this model is emerging as a fast growing channel in the pharmacy market. This is primarily due to their multichannel approach to sales through a combination of B&M stores and an online channel, which provides a seamless customer experience to consumers, whether the customer is shopping online or visiting a physical store. The benefits of operating an omni-channel approach are the ability to deliver a consistent brand experience, irrespective of the channel used, to meet customer demand. Omni-channel retail platforms have strong focus on the integration of supply chain, logistics, warehousing, technology and inventory across the channels.

Table 1: SWOT analysis on different types of pharmacies

Therapy segment	B&M Pharmacy	Unorganized Pharmacy	E-Pharmacy
Strength	Improved retail environment and customer experience	Well entrenched	Serviceability
	Assisted selling	Fast inventory churn reduces working capital needs	Wide range of offerings (drug sale, medical equipment and other gadgets, lab consultations)
	Wide SKU range with wellness options	Assisted selling	Convenience
	Transparent discount and lower pricing to customer	Personalised selling	Discounts
	Better availability of brands and prescription fulfilment	Credit to the customer	Personalised
	Payment options		Auto refills
	Loyalty programmes & customer service		
	Higher gross margins due to scale advantage and vertical integration		
Weakness	Limited presence	Poor retail environment	Lack of assisted selling
		Limited assortment due to SKU proliferation (over 100K SKUs sold in Indian market) resulting in lower fill rates	Difficulty in catering acute segment as well as tier 2 and beyond cities due to higher turnaround time
		Limited discounts (based on relationship and negotiation)	Lack of profitability till date
Opportunity	Changing retail preferences in favour of modern retail	Demand bedrocked in traditional retail as it contributes 90% sales of the industry growing at a CAGR of 7%	Acceleration in growth due to covid
	Ability to ensure covid-appropriate behaviour		Growth in internet penetration leading to wider adoption of e-commerce
	Growth in demand for wellness products		Ability to cross sell related products and services
	Greater proliferation of private labels		
	Omni-channel offering		
	Allied offerings like diagnostics		
Threats	Non-tech led companies could mismanage inventory resulting in lower turns and lower fulfilment rate	Covid has posed a serious threat to brick and- mortar retailers	Competition from physical retail stores
	Competition from e-pharmacy		Fluidity in regulatory framework

Source: Technopak Research, Medplus DRHP

Market share of different channels

Unorganised retail channels constitute a large portion of the pharmacy retail market in India. However, there has been a recent shift towards modern retail channels such as e-commerce and B&M stores, with consumers now increasingly inclined to purchase regular prescription drugs and other wellness products from modern organised pharmacy retail outlets amid benefit of an enhanced retail environment, assurance of authentic drugs, transparent discounts and a wide variety of products. This trend has been accelerated by the outbreak of covid pandemic.

Table 2: Format wise revenue share

Market value Rs bn	FY15	FY19	FY20	FY21	FY25	CAGR FY15-20	CAGR FY20-25	CAGR FY21-25	YoY Growth FY21
Total	**1,100**	**1,572**	**1,725**	**1,811**	**2,725**	**9%**	**10%**	**11%**	**5%**
Organised	55	137	173	205	535	26%	25%	27%	19%
E-commerce (including omni-channel)	1	18	38	56	230	106%	44%	42%	50%
Omni-Channel	0	3	4	6	25	223%	48%	43%	71%
Online Only	1	15	34	50	205	103%	43%	42%	48%
B&M	54	112	135	149	305	20%	18%	20%	10%
Unorganised	**1,045**	**1,434**	**1,553**	**1,607**	**2,190**	**8%**	**7%**	**8%**	**3%**
B&M + Omni Channel	**54**	**115**	**139**	**155**	**330**	**21%**	**19%**	**21%**	**12%**

Source: Technopak Research, Medplus DRHP
E-commerce includes digitally (voice and data) enabled sales by Brick chains and sales by online only players

Market segmentation

Penetration of the organised pharmacy retail market at a pan-India level was estimated to be ~11% in FY21. However, the presence of organised pharmacy retail is concentrated in metros and mini metros, with top eight cities contributing close to 32% to the total pharmacy market and 62% to the total organised pharmacy market in India. Penetration of modern pharmacy retail is at ~60-70% in US, ~35-40% in EU, and ~30-40% in China which further indicates the potential for increase in organised pharmacy market growth.

Table 3: Penetration of organised pharmacies in India (FY21)

Rs bn	Overall Pharmacy	Organised	Organized Penetration
Metro & Mini metros	580	126	22%
Tier I	580	41	7%
Tier II & beyond	652	37	6%
Total	**1,811**	**205**	**11%**

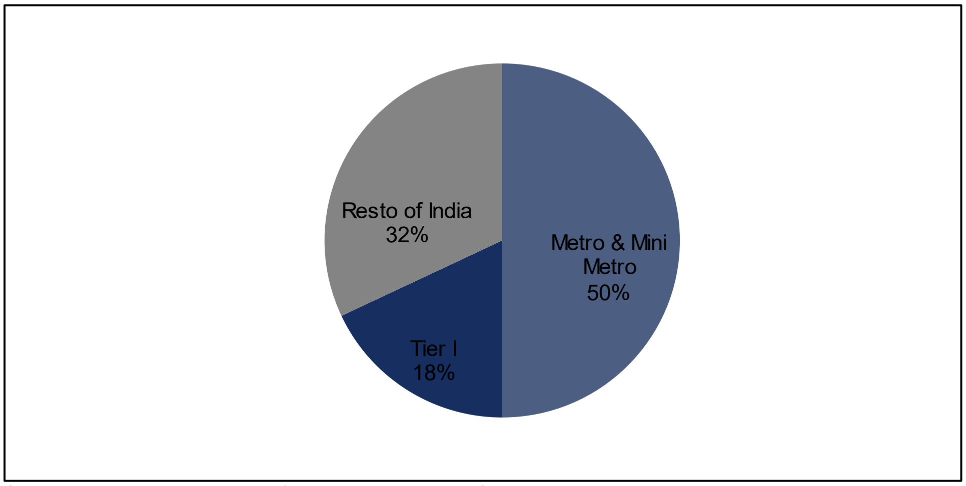
Source: Technopak Analysis, Medplus DRHP

Table 4: Penetration of organised pharmacies in top eight cities in India (FY21)

Rs bn	Overall Pharmacy	Organised	Organized Penetration
Greater Mumbai	126	32	25%
Delhi NCR	136	16	12%
Kolkata	88	16	18%
Chennai	52	18	35%
Hyderabad	47	17	36%
Bangalore	51	18	36%
Ahmedabad	38	4	10%
Pune	41	5	13%
Total	**580**	**126**	**22%**

Source: Technopak Analysis, Medplus DRHP

Chart 3: Share of organised pharmacy retail outlets across country (FY21)



Source: Technopak Analysis (Total:~10000 outlets), Medplus DRHP

Evolving trends in pharmacy sector

Gradual transition towards organised pharmacy: Penetration of organised pharmacy is relatively lower than most other categories except food and grocery. However, organised pharmacy is estimated to grow at a CAGR of 25% with share rising to ~20% by FY25E vs 10% currently.

Rapid development of online channel: The e-commerce and omni-channel retail is expected to grow at a CAGR of 44%, with pharmacy e-commerce expected to be one of the fastest growing segments after food and grocery. B&M stores are in a position to capitalise on this growth with their digitally-enabled platform linked with physical stores and warehouses which will allow them to grow at a faster pace.

Better unit economics in organized pharmacy: Pharmacy retail operates on high inventory turns and can take advantage of economies of scale due to a reduction in the cost of holding, improving sales per square foot and working capital efficiency.

Emergence of nutraceuticals: At present, the US, Japan and Europe account for more than 90% of the total global nutraceutical market, and globally, nutraceuticals have gained importance and become a part of consumer's daily diet, particularly among the aspirational consumer segments across key markets. This is primarily due to the increasing prevalence of lifestyle diseases and conscious shift towards preventive healthcare measures. India accounts for almost 2% of the global nutraceutical market valued at Rs533bn in FY20, and estimated to reach ~Rs1,290bn by FY25E, a growth of 19-20% CAGR.

Cross-selling with FMCG products helps in better margins: FMCG products account for ~15-20% of the overall revenue of organised pharmaceutical stores.

Loyalty programmes aid customer retention: Established market players such as Apollo and MedPlus have developed customer loyalty platforms that enable greater customer acquisition and improved customer retention.

Ecosystem play: Besides dispensing pharmaceutical and FMCG products, modern pharmacies are now building up a complete ecosystem of related services in order to acquire customers. They have augmented their proposition by offering a wide range of value-added services like appointments for doctors, online consultation, health blogs, medicine reminders & refills alerts, tie ups with diagnostic centres.

Table 5: Unit economics of organised vs unorganised pharmacy

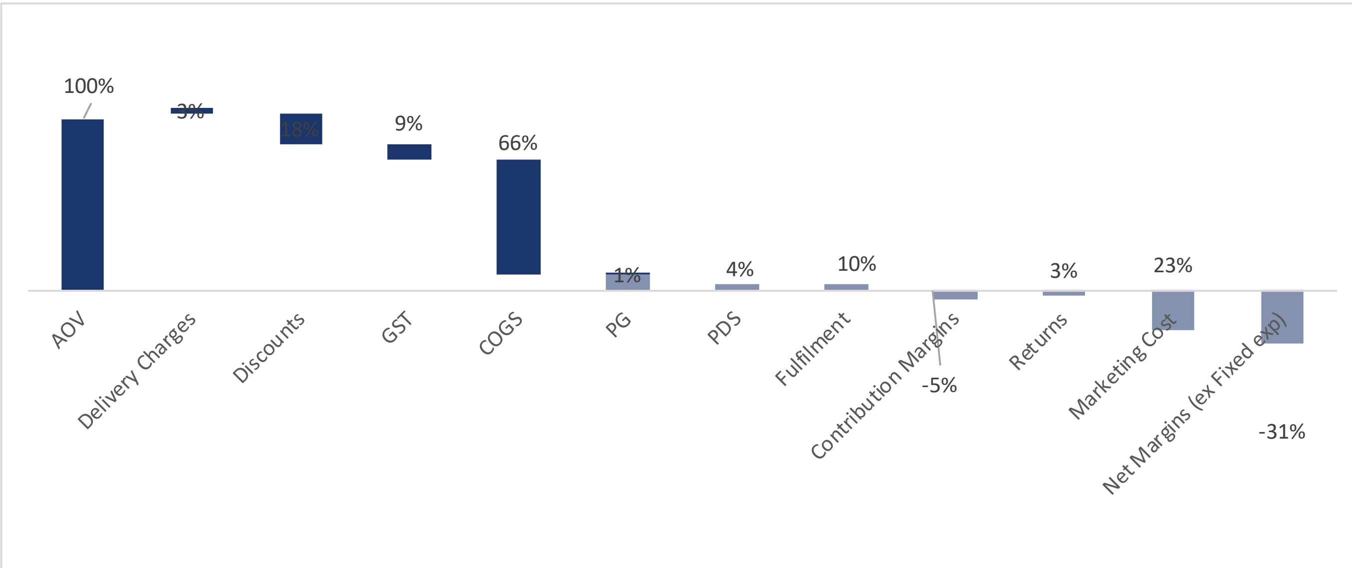
Particulars	Pharmacy led Retail Chains	Independent Pharmacy
Store Size (in sq. ft.)	200-700+	150-500+
Average sales /Day (in Rs)	30,000-50,000	4,000-6,000
SKUs	4,000-10,000	2,000-6,000
COGS	78-83%	86-88%
Gross Margins	17-22%	12-14%
Employee Expense	3-5%	3-5%
Advertisement	0-1%	0-1%
Rent	1-3%	1-3%
Other Store Level Expenses	1-2%	2-4%
Store Level Operating EBITDA	9-12%	3-6%
Retail Discounts (On MRP)	0-20%	0-10%
Capex for Initial Build and Opening (Rs)	4-8 Lacs	1-4 Lacs

Source: Technopak Analysis, Medplus DRHP

Indicative unit economics of online pharmacy

Online pharmacy delivery is in nascent stage in the country and yet to see profitable growth due to high customer acquisition cost and delivery cost which the industry is projected to rationalise in future. A unit sale from online pharmacy provides a contribution margin of (-4) to (-5) % on MRP but has additional costs of returns and customer acquisition.

Chart 4: Indicative unit economics of online pharmacy



Source: Technopak Research, Medplus DRHP
AOV - Average order value for online sales
COGS – Cost of Goods Sold
PG Charge **–** Payment Gateway cost, associated with online transaction for an order
PDS Expenses **–** Packaging, distribution and storage expenses (warehouse costs) associated with handling an online order by a E-pharmacy.
Fulfilment Cost **–** Fulfilment and delivery cost associated with online order, the delivery cost per order is approximately Rs

Store count for top players

Apollo Pharmacy is the largest pharmacy retailer in India with 4,118 stores across the country in FY21.

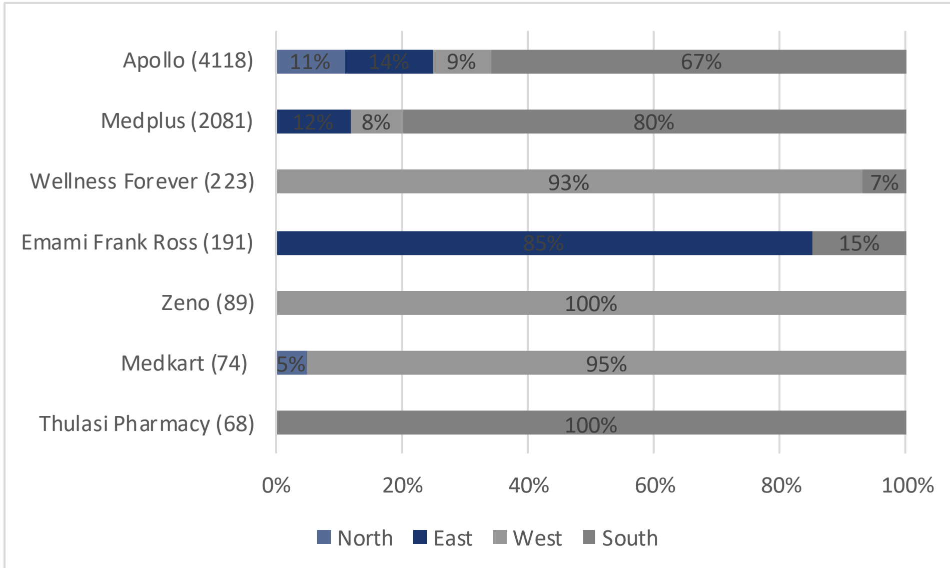
Table 6: No. of stores operated by the three largest players

Players	FY18	FY19	FY20	FY21	CAGR FY18-21	Net Store addition (from FY19-21)
Apollo Pharmacy	3,021	3,428	3,766	4,118	9.6%	690
MedPlus	1,488	1,653	1,775	2,081	12.2%	428
Wellness Forever	107	139	172	223	26.7%	84

Source: Technopak Analysis, Medplus DRHP

Regional presence

Chart 5: Share of organised pharmacy retail outlets across the country; players (no. of stores)



Source: Technopak Analysis, Company filings, Medplus DRHP; data as of FY21

Table 7: Geographical presence (FY21)

States	Apollo Pharmacy	MedPlus	Wellness Forever	Emami Frank Ross
Tamil Nadu	850	447		
Karnataka	604	514	15	28
Andhra Pradesh	634	263		
Telangana	655	435		
West Bengal	425	183		163
Maharashtra	130	166	193	
Orissa	100	73		
Other States	250		15	
Total Stores	**4,118**	**2,081**	**223**	**191**

Source: Technopak Analysis, Company filings, Medplus DRHP

Table 8: Focused regions

Player	Focus States	Focus Cities
Apollo Pharmacy	Tamil Nadu, Telangana, Karnataka, Andhra Pradesh, West Bengal, Delhi	Hyderabad, Bangalore, Chennai, Kolkata, Vizag, Ahmedabad, Delhi - NCR, Mumbai - MMR
MedPlus	Karnataka, Andhra Pradesh, West Bengal, Orissa, Tamil Nadu, Telangana, Maharashtra	Hyderabad, Bangalore, Chennai, Kolkata, Pune, Bhubaneshwar, Vijayawada, Cuttack, Nagpur, Mysore
Wellness Forever	Maharashtra	Mumbai – MMR, Nasik, Pune
Zeno Health	Maharashtra	Mumbai – MMR
Emami Frank Ross	West Bengal	Kolkata
Medkart	Gujarat	Ahmedabad, Vadodara
Thulasi Pharmacy	Tamil Nadu	Coimbatore, Chennai, Tiruchirappalli

Source: Technopak Analysis, Company filings, Medplus DRHP

Table 9: Revenue size of major pharmacy retailers in India

Rs bn	FY19	FY20	FY21	CAGR
Apollo Pharmacy	38.9	48.2	56.1	20.2%
MedPlus	22.7	28.7	30.7	16.2%
Wellness Forever	6.8	8.7	8.9	14.2%
Emami Frank Ross	4.1	4.5	NA	10.4%
Thulasi Pharmacy	1.3	1.4	NA	11.5%

Source: Company Filings, Medplus DRHP
CAGR for Emami Frank Ross and Thulasi Pharmacy computed for FY19-FY20
Apollo Pharmacy FY21 revenues considered without restructuring

Table 10: Average revenue per store

Rs mn	FY19	FY20	FY21	CAGR
Apollo Pharmacy	12.1	13.4	14.2	8.7%
MedPlus	14.5	16.7	15.9	4.9%
Wellness Forever	55.6	56.0	45.2	-9.9%

Source: Technopak Analysis, Company Filings, Medplus DRHP

Table 11: EBITDA and EBITDA margin

Rs mn	FY19	FY20	FY21	CAGR
Apollo Pharmacy	2,020	2,890	3,590	33.3%
Margin	5.2%	6.0%	6.4%	
MedPlus	660	990	1,750	63.2%
Margin	2.9%	3.5%	5.7%	
Wellness Forever	270	330	NA	19.7%
Margin	4.0%	3.7%	NA	
Emami Frank Ross	400	460	NA	15.7%
Margin	9.9%	10.3%	NA	
Thulasi Pharmacy	30.0	47.0	NA	56.7%
Margin	2.4%	3.4%	NA	

Source: Technopak Analysis, Company Filings, Medplus DRHP
CAGR for Wellness Forever, Emami Frank Ross and Thulasi Pharmacy computed for FY19-FY20
Apollo Pharmacy FY21 EBITDA considered without restructuring

Table 12: Average EBITDA per store

Rs mn	FY19	FY20	FY21	CAGR
Apollo Pharmacy	6.26	8.04	9.11	20.6%
MedPlus	4.18	5.78	9.08	47.3%
Wellness Forever	22.11	20.94	NA	~5.3%

Source: Technopak Analysis, Company Filings, Medplus DRHP
CAGR for Wellness Forever computed for FY19-FY20

Table 13: Share of private label sales

%	FY19	FY20	FY21
Apollo Pharmacy	~6%	~8%	~10%
MedPlus	5%	6%	10%
Wellness Forever	~1%	~2%	~2%

Source: Technopak Analysis, Company Filings, Medplus DRHP

Table 14: Omni-channel sales contribution

%	Year of Started Omni-channel	FY20	FY21
Apollo Pharmacy	2019	1-2%	2-5%
MedPlus	2015	7%	9%
Wellness Forever	2016	9-10%	11-12%

Source: Technopak Analysis, Company Filings, Medplus DRHP
Includes digitally (voice and data) enabled sales in Wellness Forever

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