Medplus Health Services Limited

November 10, 2023

The Listing Department
BSE Limited
Phiroze Jeejebhoy Towers
Dalal Street, Fort,
Mumbai – 400001
Scrip code: 543427

The Listing Department
National Stock Exchange of India Limited
Exchange Plaza , 5th Floor
Plot No. C/1, G Block,
Bandra - Kurla Complex
Bandra (East), Mumbai - 400051
Symbol: MEDPLUS

Dear Sir/ Madam,

Sub: Submission of earning call Transcripts for the quarter & half year ended September 30, 2023.

Pursuant to Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, we enclose herewith transcript of the earnings calls held on November 8, 2023 for the quarter & half year ended September 30, 2023.

Kindly take the same on record. The same is available on Company's website at www.medplusindia.com

For MedPlus Health Services Limited

MANOJ KUMAR SRIVASTAVA
Digitally signed by MANOJ KUMAR SRIVASTAVA

Manoj Kumar Srivastava
Company Secretary & Compliance Officer
FCS 7460

“MedPlus Health Services Limited Q2 FY'24 Earnings Conference Call”

November 08, 2023

MANAGEMENT: **MR. MADHUKAR REDDY GANGADI – MANAGING DIRECTOR & CHIEF EXECUTIVE OFFICER, MEDPLUS HEALTH SERVICES LIMITED.**
MR. SUJIT MAHATO – CHIEF FINANCIAL OFFICER, MEDPLUS HEALTH SERVICES LIMITED.
MR. CHETAN DIKSHIT – CHIEF STRATEGY OFFICER, MEDPLUS HEALTH SERVICES LIMITED.
MR. PRASAD REDDY – MEDPLUS HEALTH SERVICES LIMITED.

Moderator: Ladies and gentlemen, good evening and a warm welcome to the MedPlus Health Services Limited Q2 FY24 Earnings Conference Call.

As a reminder, all participant lines will be in the listen only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Prasad Reddy from MedPlus. Thank you. And over to you, sir.

Prasad Reddy: Good evening everyone. On behalf of MedPlus, it's my utmost pleasure to welcome you all to the MedPlus Q2 FY24 Earnings Conference Call to discuss the financial results of MedPlus for the Second Quarter of Financial Year 24 which were announced earlier today. We have with us today the Senior Management team, represented by Mr. Madhukar Reddy Gangadi – Chief Executive Officer and Managing Director; Mr. Sujit Mahato – CFO and Mr. Chetan Dikshit – CSO.

Before we begin, I would like to mention that some of the statements made in today's discussion may be forward looking in nature and may involve risks and uncertainties. Please note the disclaimer mentioning these risks and uncertainties are on Slide #1 of the Investor Presentation shared with all of you earlier. Documents relating to our financial performance have been circulated earlier and these have also been posted on our corporate website.

I will now handover the call to Mr. Madhukar. Thank you. And over to you Madhukar.

Madhukar Reddy: Today I would like to talk to you about the four main features of the Indian Pharmacy retail industry as we see it and the opportunities these features actually present to us.

i) The industry itself is extremely fragmented.

ii) It is a big resilient, small and medium sized set of operators out there who still have nearly 85% of the overall market.

iii) The other factor would be the active involvement of government in promoting low cost generics.

iv) Marked absence of store brands in the country, you know like in U.S. and UK and all where Walgreens and CBS and all have their own store brands.

Just to come back to the main points out here, the Indian pharma retail industry as I said has over 900,000 retailers serving a population of 1.4 billion people. To put that into perspective Indian market has roughly 20 times as many pharmacies as in U.S. while our population is only four times that of U.S. The U.S. market has roughly 45,000 to 48,000 stores catering to their over 350,000 million people.

So, 900,000 retailers for a market that is less than 200,000 crores makes the average per store slightly over Rs. 20 lakhs per year, that's the average sales. This by any normal business standard should be considered extremely low throughput and as a result unviable actually. The reason it still works in India is because of the prevalence of high margin trade generics. Some of the lower throughput stores have a 50% or more share of trade generics where often the margins are above 70%. This makes even a store that sells Rs. 20 lakhs per year viable with an average margin of 50% which takes care of the fixed cost and makes a salary level wage for the operator.

Then if trade generics is how the small operators survive the reason for the resilience of the mid to large size independent retailers is not really much different. As you all know the retailer and distributor margins in India are 20 and 10 for drugs not under DPCO and only 16 and 8 for those under price control.

Most retailers who don't have the advantage of a large operator like MedPlus which actually enjoys both retail and distributor margins actually get a margin of around 20% or 21%. Despite this we see them competing with us and with the other large key pharmacy guys with a 20% discount. We have seen this happening in most South Indian markets, and we have seen them actually mushrooming, some of these stores.

What we have seen and what we have actually observed when we have shopped in this stores and what we have from industry knowledge is that most of these operators, a large number of them at least do substitution for the prescription which they get with trade generics. So, an average bill of Rs. 1500 if 20% of it is substituted for a trade generic product, that they would still make Rs. 150 at least on that. The trade generic of Rs. 300 basically fetching them at least Rs. 150, 50% margin, which still makes an overall 10%, and which is how most people today seem to be competing.

So, in a super competitive scenario where online players are willing to lose money, and whereas large retailers like us are using our buying power to actually give, choose discounts we actually see a lot of the small operators still continuing to give the same discount and still continuing to actually compete with us.

While the first two factors depend on selling trade generics at full price the other third big factor on the list has the potential of changing the industry in the opposite direction: selling generics at hugely discounted price. Government has introduced Jan Aushadhi Stores a while back and the fact that they are even selling anything despite them not being located in the best places and not carrying the full assortment is proof of the fact that the Indian consumer has started realizing that 80% of the drugs sold in the market are only variations of a limited set of actual formulations.

While the effect of these stores on the sales of regular pharmacy retail is not big as of now, if things were not to change then the effect will actually continue to grow should not be in any doubt. The recent NMC notification, although it was withdrawn after a short while asking all doctors to write only the generic name in the prescription is one more step in the direction of a generics market. This we can be sure will come in some form or fashion back to take the branded generics out.

Another key feature or lack of, I would say, in the Indian Pharma retail market is the absence of store brands. In U.S. for example customers get to buy either the innovator product and if the innovator product is not longer on patent or if it comes off patent, the store brand. So, customers could still continue to buy the innovator product even if it is off patent for a slightly lesser cost. Or they would buy the store brand which would either be by Walgreens, Rite Aid or CBS there is nothing in-between.

Indian market on the other hand does not have this, largely because till now there was no large chain that had a trusted brand that customers could buy. Or no large chain that had the scale to get a full assortment of drugs manufacturing. You require a certain number of stores to be able to get the MOQ manufactured for, the large set of drugs. And you could perhaps get away with maybe the Top 50 or Top 100 but to actually get the Top 500 drugs or the Top 800 it would require substantial scale and till now there was no one actually there in the Indian market.

This has led to a proliferation of a large number of me-too branded generics resulting in pharmacies being forced to carry several thousand SKUs to cover the prescription while essentially stocking a few hundred actual therapeutic types only. So, all the above-mentioned four resulted in us taking our next step in our path to becoming the largest pharma retailer.

End June 2023 MedPlus launched over 400 drugs in Hyderabad and these drugs which could potentially provide substitutes for over 55% of the medicine needs of our customers. We launched them with a discount of 50% to 80% on the MRP and the MRP Maximum Retail Price itself was tagged to the price of the marked leader for the corresponding drug composition.

We were able to do this because we obviously do not have any marketing cost, that we own the channel, and we are able to pass on all the sales to the customer. And we were also able to convince the customer of the value proposition. Our aim in doing so was to take advantage of the fact that the Indian market has matured and has become knowledgeable of the fact that 80% of the drug sold in the market are off patent and their generic substitutes which work just as well as the innovator product as long as they are manufactured in a good factory.

This is also aimed at bringing in customers who otherwise shop at Jan Aushadhi Stores and their like. And our aim was not just to get these customers but also anyone who understood the fact that all the drugs are generic in nature, but who was looking for slightly better, I would say better quality manufacturing than what was available in the market. So, to these customers also, our appeal actually worked well.

MedPlus making MedPlus Store brand available at 50% to 80% below MRP also makes it difficult for small stores to sell at full price trade generics. And if they are not able to sell it, as I said, stores which otherwise sell Rs. 20 lakhs a year or Rs. 1.5 lakhs a month or Rs. 1.6 lakhs a month, if there access to the margin which is afforded by trade generics is taken away they actually become unviable and we expect that will be one of the ways in which the market will consolidate as small operators basically stop doing this.

MedPlus also in future, plans to make trade generics from companies like Cipla, Alchem, Zydus and the likes available at the same price as MedPlus Store brands. This will now make it tougher for stores that are substituting promoted brands with trade generics to compete with us and to offer the 20% discount which we actually give on branded products.

This approach not only positions MedPlus as a cost-effective choice, but also enables the company to capture a significant portion of the market that was previously dominated by at least was populated by I would say a large number of smaller, independent players. Thanks to our comprehensive control over the entire supply chain MedPlus can strategically adjust pricing and discounts, thereby optimizing profitability. This grants the company a competitive advantage in effectively managing its profit margins in achieve a favorable financial position in the market.

Additionally, as more and more customers take to our products, we expect our inventory cost to come down significantly. As the cost of stocking MedPlus brands is only a 5th of the cost of stocking branded generics. We also expect fill rates to get much better in our stores for customers who have adopted the MedPlus brand. Needless to say, it is much more easier to stock 500 to 600 products in sufficient quantities versus stocking 47,000 SKUs that we now stock across our network.

MedPlus products were introduced in Hyderabad and the rest of Telangana at the end of June 2023 followed by their launch in Andhra Pradesh in 2023. Notably Hyderabad's revenue witnessed a substantial 15% increase in September compared to June, a growth 3 times higher than that observed in Bangalore and Chennai. Out of the 15% portion a large portion 9% has been contributed by the MedPlus Store brands. Furthermore, the regions outside of Hyderabad and Telangana and Andhra Pradesh have experienced remarkable growth than compared to similar territories in Karnataka and Tamil Nadu.

We are happy with the way the customers have taken to our brands and we have now launched them across all the states in October.

We will of course update you on what happens in this quarter, in the coming quarter's month and meanwhile I will now hand it over to Mr. Sujit to give our quarterly updates.

Sujit Mahato: Good evening, everyone. As of September 30th, we have been serving the Healthcare and Household needs of our community in 599 cities across 9 states through our extensive network of 4089 pharmacy stores. During the current quarter, we have successfully expanded our presence to 18 additional cities. In addition to our pharmacy operations in Hyderabad, MedPlus operates four full service diagnostic centers, seven Level-II centers and 120 collection centers. These facilities play a crucial role in our commitment to providing affordable diagnostic service to our customers.

An update on the network, our store expansion program remains on track as we continue to balance growth and profitability. Over the past 12 months, we have added a net total of 761 stores to which 139 stores opened in Q2. Notably West Bengal and Karnataka saw the highest number of store addition with 32 and 26 outlets respectively.

Of the store openings in Q2 48% were in Tier-II cities and beyond, reflecting our strategic focus on these markets. Currently out of our 4089 stores around 1819 stores reflecting 44% are located in Tier-II cities and beyond. We recognize the potential of these markets and aim to further expand due to the maturity of our operations and robust supply chain capability. During Q2 we experienced 25 store closures. Considering both openings and closures we achieved a net addition of 114 stores in Q2 compared to 153 stores in Q1.

In terms of the age of our store network approximately 21% of our store are less than a year old. Around 26% of our stores are in their second year of operation and the remaining 53% of our stores have been operating for two years and beyond. It's important to note that all stores in the less than two years age bracket are still in their ramp up stage. From a financial perspective they continue to have a negative impact on our operating EBITDA. However, as these stores mature we anticipate them contributing positively to our profitability.

We closely monitor the time it takes for our new stores to breakeven. For stores open between October 2022 and March 2023 approximately 54% of them achieved breakeven within six months of operations. Additionally, as a cohort all the stores combined achieved breakeven in just five months.

In terms of the network store size, as at the end of the quarter, our network has growth to 4089 stores. We are 2.1 million plus square feet compared to 3320 stores and 1.8 million square feet at the end of September 2022. The average store size is 538 square feet. To give you a sense of spread in store sizes, we have 2958 stores that are less than 600 square feet and 1131 stores that are greater than 600 square feet.

In terms of the revenue mix with our expanded scale, we have strategically positioned to enhance our revenue share from private label products. Our private label range is designed to offer customers high quality product at affordable prices. Currently MedPlus offers around 1400 thoughtfully curetted SKUs spanning across pharmaceutical and non-pharmaceutical category. Private label sales accounted for around 14% of our total revenue. Furthermore, our expanding presence in Tier-II cities and beyond is making a significant impact on our revenue mix. Sales from these markets accounted for 34% of our pharmacy revenues in the current quarter demonstrating an increase from 31% in the same period last year.

Financial numbers - Quarter's Performance:

Consolidated Revenues

Our Consolidated revenue was Rs. 14,086 million with growth of 25.7% year-on-year and 9.7% sequential basis quarter-on-quarter. Our consolidated operating EBITDA stood at Rs. 410 million representing 2.9%.

Pharmacy

Around 99% of our revenues is from our pharmacy operations. The pharmacy operating EBITDA stood at Rs. 440 million representing 3.2% of sales. Our store's performance I would like to update on our store older than 12 months, revenues from these stores in Quarter 2 was Rs. 12,520 million or 91% of pharmacy revenue. These stores had a store level EBITDA margin of 9%. The store level ROCE of these stores stood at 50.6%, a word here on the store level EBITDA margin by vintage.

While stores greater than 12 months had a margin of 9% this was 9.8% for stores greater than 24 months and 6.5% for stores in the 13 months to 24 months age bracket. If the allocated non-store related cost than the operating EBITDA of stores greater than 12 months would be Rs. 530 million which translates to a margin of 4.2%.

Diagnostics

Our diagnostic numbers, Diagnostic revenues has grown to Rs. 182 million in Quarter 2 compared to Rs. 58 million in Quarter 2 FY23 which is primarily due to launch of the new centers in Hyderabad. Diagnostic segment recorded an operating EBITDA loss of Rs. 29 million compared to a loss of Rs. 53 million in Q2.

Working Capital

Our networking capital for Q2 was 64 days. The inventory in our warehouse was 37 days. As you are aware because of the sales trajectory of new stores, their inventory turnover is lower in the first year. In Q2 the inventory level of our first year stores was 110 days. In comparison for our stores older than 12 months, the inventory was 41 days.

Now I request Chetan to update on our Diagnostic business. Over to you Chetan.

Chetan Dikshit: Good evening, everyone. To recap what Sujit has already said, in our pilot market of Hyderabad we have four full-service diagnostic centers, eight Level-II centers and 120 plus collection centers. In July 2023 we had increased the price of our plans by Rs. 150. This was a 15% increase. On earlier occasions we had modified prices but at the test level. So, this was our first instance at testing price increase at scale and it has not affected the offtake of our plans. This is positive.

In July we sold 348 gross plans per day. In August and September this was 381 and 408 respectively. As on 30th June, we had 105,000 active plans and 186,000 underlying lives covered under our plans. As of 30th September we have 117,000 active plans and 207,000 underlying lives. Our current observed on-time renewal rate is 15%, but in 6 months post-expiry we have observed the renewal rate to be 40%.

That's our update on Diagnostics.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Tanmay Gandhi from Investec. Please go ahead.

Tanmay Gandhi: My first question is on profitability, so if we look at the operating matrices for this quarter, so we have probably the best quarter in last 8 quarters right, in terms of store aging. So, we have only 20% of the stores less than 12 months; in terms of private labels, we are very close to all time high of 14.1% or 14.2%, right. And still in terms of operating EBITDA margins we are nowhere close to the recent peak of 5%. So, what exactly is dragging our EBITDA margins?

Madhukar Reddy: In terms of, in the Investor Presentation we have guided on the second last slide that the drag from the new stores and the stores which were opened in the last 12 to 24 months, they are still a drag on our P&L and on a matured state basis we should see those inching northwards.

Tanmay Gandhi: But even if we look at the EBITDA margins for stores which are more than 12 months old and within that also we have a very favorable mix in terms of stores which are more than two years old. Still, it is only 4.2% versus the 5% which we had seen. And we have a very high contribution coming from gross margins, what exactly is dragging our margins even in case of older stores?

Madhukar Reddy: Tanmay for us the overall maturity is only at the level of 24 months and more, 24 to 30 is when we actually hit the 10% gross margin. And below that then we have the, a portion of cost of the corporate and warehousing and all and that's what lands it at 5%. So, I don't think we are quite there, the mix is not quite there. So, it's just that we definitely need these to come to the level of that Rs. 15 lakh odd sales per month, per store kind of number for it to actually get to that number.

Tanmay Gandhi: No sir actually my question was --

Madhukar Reddy: But we are going in the right direction.

Tanmay Gandhi: -- More than two-year-old stores are at 53% which is 5 quarter highs and still we are not 5 quarter high in terms of margins. But anyways I understand. And secondly in terms of store additions, we had initially guided for 1000 plus stores and now I think we are at 800 to 1000 stores, so just wanted to understand that do you want to adjust your guidance given that we have only added about 260 stores in the first two quarters of the year.

Madhukar Reddy: So, in the beginning of the year we said 800 to 1000, we were looking more at 800 stores. I really don't want to adjust the guidance and all right now. We think we will actually be able to ramp up in the Q4. We may be somewhere close to that but if there is any need for us to adjust the number, we shall do it next quarter, but I don't think it is necessary.

Tanmay Gandhi: So, have we seen any, are we facing any challenges in terms of store opening, maybe some regulatory challenges or some bandwidth related challenges because in last two quarters it has meaningfully come down. And again, this coincides with our new initiatives of diagnostics, of generic or rather MedPlus branded generic side. So, are there any constraints in terms of bandwidth or these are just timing issues in terms of regulatory approvals.

Madhukar Reddy: No, definitely nothing in terms of bandwidth, that's not a bandwidth related issue at all. There have been some regulatory issues here and there, those we expect are normal. While we should have basically had something like 400 stores, we are at some 260. But these numbers are usually adjusted towards the end of the overall year anyway. Last four years our Q4 has been the best and so we expect that we will continue to ramp up going forward. Definitely not a bandwidth issue. Yes, we are going into some new states, that is taking us a little bit of time. Kerala, Madhya Pradesh and Chhattisgarh but that is to be expected. I would say whatever adjustment we have made is mainly to make sure that we can just get to the guided number of 800 odd stores, that's all.

Tanmay Gandhi: Last question from my end, so we have recently obtained an enabling resolution for QIP and as of September 2023, we already have about Rs. 220 crores of cash on books. And anyways our quarterly store additions have come down. So, can you give us some color on where will you deploy such kind of funds? And what is the exact number of fundraise you are looking at in the near term?

Madhukar Reddy: No, as you said this is mainly an enabling resolution only. If we do decide to basically go get the money then it will be only to bolster the overall balance sheet and we will use the money in the best way, but yes, I would say at this point it is just being ready to raise if necessary.

And again just to clarify, if at all we end up actually doing a raise then it will be for growing the pharmacy faster, I would say one. And second definitely on the diagnostic side. And of course we will require some money for working capital as we go forward.

Moderator: Thank you. The next question is from the line of Harith Ahamed from Avendus Spark. Please go ahead.

Harith Ahamed: Can you talk a little bit about the seasonality in the business, the second half versus the first half? When I look at our quarterly margins for the pharmacy retail segment, last year second half was much stronger. So, should we expect a similar trend this year as well?

Madhukar Reddy: So, there is definitely a little bit of seasonality, not sure if extends all the way to the second, third and fourth quarters and all, but first quarter typically we have seen a softening normally during the peak summer months and if especially the summer month gets extended then you definitely see a dip in the overall pharmacy chains. And it's just largely because people obviously tend to fall less sick because of infections and all or at least lack of, right. Other than that, we don't see too much seasonality on this, Harith. There is always the festival factor which comes in during the extended Dusshera, Diwali periods and all and the vacations period, that is not a time in which people typically tend to go to hospitals or to doctors and all, nothing elective gets done during those days. Doctors themselves are on vacations and all. So, we see a small dip during those times, but otherwise there is not much I would say.

Harith Ahamed: Couple of questions on the MedPlus branded private label that we have launched. So, when I look at the contribution of private label pharma, it's at 7.9% of our revenues this quarter. And it has come down by roughly 100 basis points. I know it's the impact of the higher discounts that's probably leading to this lower share. But we were also expecting the higher volumes to kind of offset the impact of discounts, right. So, how should we look at the contribution from private label pharma, should it inch back to the previous level of close to 9% that we saw in the September quarter FY23?

And second one on the same foray would be on our plans to expand beyond Hyderabad and rest of AP, Telangana into our other key markets?

Madhukar Reddy: Obviously the second part of the question answers the first one. We have seen a significant increase in volumes where we have introduced private label on the 50% to 80% discount. In Hyderabad, rest of Telangana and in Andhra where we did it successively, we started in Hyderabad in end of June then after that in July, we did it in rest of Telangana and in September we did it in Andhra. We have actually seen on a GMV basis close to 15% pharma private label in these states. So, if we have not seen the overall thing, it is because Hyderabad and rest of Telangana are a portion of the entire country. But we are now going to the reporting on a GMV basis all our sales, on this overall to show you the effect of the overall private label and all. And you will see a significant increase in these.

Just to give you an idea here Harith, one second, so we introduced roughly around 433 products in the end of June in Hyderabad. Those account for 55% of all the medicine needs which we have, which is you know if we say that 80% of all my sales are medicines and out of that 55% that's 44% of overall sales. We had substituted 44% of the medicines which we sold. What we saw at the end of the quarter was that 15% of our sales now are coming from these discounted products. So, which means 15% out of 44%, which is a third of whatever we offered, was coming in from sales of private label products in Hyderabad and rest of Telangana, and slightly higher in rest of Telangana and Andhra actually.

Harith Ahamed: And then our preparedness to go beyond Hyderabad and AP, Telangana with this --?

Madhukar Reddy: So, we have now launched except in Karnataka and Maharashtra where we had a little bit of hurdle but otherwise, we have launched across the rest of the country. And probably we will be doing that also in those two states also, shortly but yes. So, as of at least now, as of November 1st at least you can assume that we are there across the country with our private label, in all the states in which we are working, that is, with our private label offering.

Moderator: Thank you. The next question is from the line of Vilina Jain from Perpetuity Ventures. Please go ahead.

Vilina Jain: So, firstly on the pharmacy business, there were 14 store closures for which in the presentation you have mentioned that the reason is others. So, what is basically involved in this?

Madhukar Reddy: So, for us the others are mainly due to various reasons it could have been lease which has expired or we have changed it because of location problems or whatever which have come up in the middle. So, as we can see, the age of the other store is also 5.6, the average age is 5.6, so they are not stores which we just took and made a mistake and had to move, these are stores which where we found better locations to actually move to, so that would largely be the cost. I can get back to you with the exact details after the call though. But the fact that the average age of these stores is 5.5 years should tell you that these were regular stores which we had to move for other reasons.

Vilina Jain: Secondly on the diagnostic business when do we expect the business to breakeven? And what are the target active subscriptions by the end of FY'24?

Chetan Dikshit: Vilina, we want to take advantage of Q3 and Q4, Q4 tends to be slightly strong seasonally. But at this stage we are not giving firm guidance. And on the second part of your question was in terms of what are the active plans goals that we have set, see we kind of look at the active plans as well as the active lives the target that we are currently looking at is 250,000 lives, we expect to close the year below 150,000 plans sold, active plans. Again we are not in a position to give guidance at this stage.

Vilina Jain: Any plans to take the diagnostics business to other cities or states?

Chetan Dikshit: Well at this stage we do, see we do have residual legacy diagnostics business in few cities. These are legacy from our earlier phase. What we talk about as the current experiment that is being carried out in Hyderabad, there is no plans to go outside of Hyderabad as of now.

Vilina Jain: Lastly of the active subscriptions that is 117,000 currently, how much of this is renewed and how much of this is new subscription base?

Madhukar Reddy: Of this roughly 20,000 of those which have gotten renewed.

Moderator: Thank you. The next question is from the line of Lokesh Manik from Vallum Capital. Please go ahead.

Lokesh Manik: My question first was a clarification in the DRHP it is given store payback period is 3 years, maturity is 4 years. In your presentation you are reporting numbers at 2 years plus. Today's presentation shows stores greater than 12 months are operating at 8.89% that is the margin. So, I am just confused as to what is the exact or common average and what is the maturity period for a store that you consider?

Madhukar Reddy: So, the maturity period continues to be the same which is around 24 to 30 months or so. The payback period is 3 years, is what we say. If we are getting stores more than one year at 8.9% EBITDA, that's just a mix of all the stores which we have in the basket right now.

Lokesh Manik: Yes, but ideally wouldn't that be maturity, 8.99%?

Madhukar Reddy: No, but that's a full basket, I don't think that's only the stores which are more than one year. I don't think the stores just above one year are at 8.9% EBITDA at the store level. Anyway, just to walk you through that, we expect our stores to breakeven anywhere from three to six months, which is when they have 0% EBITDA. At the one-year timeframe they probably have around 3% to 4%. And at the end of two years, they should have roughly around 7% to 8% or 10% and that could go on up to being a 30-month thing, in which they are around 10% EBITDA at the store level for an average.

Lokesh Manik: My second question was on store closures, what we have ideally seen in the retail industry is the store closures, the age of these stores is usually younger. In our case these are older. And what is happening is that stores with an average age of six years will get closing, means significantly impacting our return matrix given these are maybe 60%, 80% according to the ROC generating higher EBITDA margins stores, greater throughput stores. Given that we are operating on thin margins so what are the steps we have taken to avoid this? As far as my understanding store closure is 5% of the number of the stores, roughly get closed every year. And these are in the higher 5, 6 years age bracket. So, just your view on what we are doing to avoid this?

Madhukar Reddy: So, it is not as high as 5% but we will get back to you on that. The reasons for store closures for us are the average lease for us is around 9 years. So, if we feel or at the 9-year period if you see that the landlord is not renewing the lease, for various reasons or we are not happy with the location, we could tend to move so there in that case, we will probably move. And those movements which happen because of landlord not renewing or we not being happy with the rent and all, they could significantly increase the overall age of the store closure rate that's one.

Second, for us unlike most store, we open at the rate of around 50 to 100 stores a month, sometimes, right. So, what that means for us is --. So, in the way we do it and largely because of the way the economics of the store are structured. We set up a store at roughly around Rs. 25 lakhs to Rs. 30 lakh cost, out of which Rs. 2 lakhs to Rs. 3 lakh goes towards the rental deposit and Rs. 6 lakhs to Rs. 7 lakh goes towards the build of the cost store and rest is all inventory. So, for us we don't necessarily need the best of the best locations for us to start, because of the fact that we have great availability in our stores, and we have the best value pricing for the customers we are confident that we could actually go into any market in which there is a reasonable density and even if there is competition, we could actually grab business from those guys.

So, hence we go location by location, market by market and set up the store in the best available location at that time. And we constantly look to upgrade the location as our business increases or as new locations open up in the same market. And the reason we do this is because inventory, store deposit and everything, all of those are completely recoverable. 80% to 90% of the cost of our fit-out is modular furniture and the stuff which can be moved from one store to another. So, we actually loose less than Rs. 2 lakhs when we move the location. So, we don't really consider it a big, let us say a problem if we have to move the store, especially when we come across a location which is better than what we currently have.

Lokesh Manik: So, in the DRHP it is mentioned the attrition rate was about 20% to 30%, DRHP is about 21%, so are we seeing the drop from there now at that attrition level?

Madhukar Reddy: See most of the people are working at minimum wage, I don't think the attrition is going to come down anytime soon. We are figuring out different ways of solving this problem, but yes we would be happy to solve it, no, attrition has not come down.

Lokesh Manik: You did because of competitive intensity, or they are opening up their own after getting --?

Madhukar Reddy: Neither, see obviously there is always different kinds of things out there. It is definitely not competition. Some of the people, after coming to Hyderabad to setup or to any other big cities to actually work with us for a few years, may end up going to the small towns to go setup a store. That is completely possible but that's also not the large this thing. It is neither this nor that, it is just that, people today definitely are --. Seeing retail is almost like the first step for most people who come in from small towns into big cities. They come in, get some experience and then try to move on to better jobs as they go forward. We also expect that they work with us only for two to three years we don't really expect them to work for longer than that.

Lokesh Manik: In diagnostics business, when do you plan to breakeven, if I am not mistaken we have invested over the last few years about Rs. 200 crores in terms of CAPEX --

Madhukar Reddy: No, I don't think so, we have invested only around Rs. 110 crore odd, you probably are seeing some other lease old things out there as capitalized expense. So, our investment is only Rs. 110 crore. We are now more or less breaking even at all the central level I would say. At the company level we don't want to give you guidance on this right now. We are not yet ready to give you guidance on the exact time of breaking even. But our sales continue to grow up and our losses continue to go down. And we are seeing a huge uptick by all the, I would say citizens of Hyderabad, we expect that if the value proposition of what we have is really good and we are seeing a really good uptake. So, we feel confident about the prospect of the old business.

Lokesh Manik: On the strategy you are getting operational leverage through scale, so if I understand correctly a fixed cost is about 2%, so there is not much fixed cost left to create operating leverage. So, then are you then looking at expansion of gross margin because the chain that you are competing with that is a retailing distributor, gross margin level is about 28% to 35%. We are at 21.4% so then is that where you are expecting operating levels to kick in closing to that gap?

Madhukar Reddy: No, I still think operating leverage is possible as we move forward and automate our warehouses and all, that has taken us slightly longer than what we expected, but that will happen. So, today 3% of the cost goes towards warehousing and 2% on corporate. As we grow from Rs. 4,500 crores to whatever number it is this year and the year after, I really don't expect that our corporate cost or the warehousing cost will grow in tandem with that. There is still a lot of room for leverage out there, I think.

Gross margin, definitely but that is going to come on the back of better adoption by customers or at least higher penetration of private label among our customers for us. So, private label is where we expect even on the discounted private label model which we have today, we still expect margins to be better as we go forward.

Moderator: Thank you. The next question is from the line of Saion Mukherjee from Nomura. Please go ahead.

Saion Mukherjee: I wanted to understand the growth rate that you mentioned in the 12 month plus at around 15%. So, for older stores let's say which are two years or more, if you can give some detail as to how those stores are growing?

Madhukar Reddy: Saion, we are currently not sharing those numbers whatever is there in the presentation is what it is. We expect the older stores to grow slightly slower than this obviously. But given the fact that we now have two levels out there private label in non-pharma products which will continue to gain traction, second, our own private label which is now going to go at that 50% to 80% discount, we expect growth is going to be much higher than inflation, much higher than the cost which increase every year for us. Well, I can't give the actual numbers here.

Saion Mukherjee: On this experience on generic, Hyderabad you have launched it in June and there is some month of experience. So, let's say if you are doing Rs. 100 of EBITDA in Hyderabad, where it stands now with the kind of transition, you know is it more than 100, how much more than 100 or less than 100 if you can provide some color on that. And how we should think this number going forward?

Madhukar Reddy: So, I will you a longish answer for this. I explained the four main kind of features of our Indian industry and all, and I also said how we are going to go and take more top-line. I expect our EBITDA to grow both as a result of higher HSG as we go forward as we take market share from the smaller independent retailers and all (1).

And 2) also as the private label grows from the current 15% pharma which is in Hyderabad to 20% and above. We have already seen a pretty significant growth in the overall top-line and I expect that to continue. The margin growth though, will take a little while, because although the private label is more profitable than the branded generic, it has also in the first stage replaced the slightly more profitable, full cost private label which we had earlier. So, right now what we have is a MedPlus brand but earlier to that we had a MedPlus subsidiary brand which we used to sell at full price. So, cannibalization of that has resulted in a slight degrowth of I would say of a margin of there, what has been more than made up by the increase of overall sales, and by the increase from 8% to 15%. So, for us is Hyderabad trending at a better EBITDA, definitely, compared to earlier. The exact numbers, I think you will probably be able to see it as we go forward in the next quarter, when we give the results for the full country.

Saion Mukherjee: And finally one question is the plans that you have, is there any scope for acquisition both at the distributor level or at the retail level, is that something which make sense given the plan for expansion that you have at this point?

Madhukar Reddy: We are always willing to look at acquisitions out there. But as of now we have nothing in mind. We are not really seeing any great targets for acquisition. But I'm pretty sure at some point we will continue to evaluate as they say and if there is a good deal out there on table we will take it. But as of now we don’t have anything.

Saion Mukherjee: But you would pursue, I mean this is mainly because of valuation --

Madhukar Reddy: Absolutely**.**

Saion Mukherjee: So, the issue is valuation because if the industry is consolidating, I would assume that you would have target which we would like to consolidate with the largest player. And you could then add value. So, I was wondering if something which we can see in the near term.

Madhukar Reddy: See there are couple of things 1) Valuation, definitely, but 2) also the kind of models, right. If there business philosophy is completely different and the way they actually go about getting their customers and their value proposition to customers is completely different than it may not really blend very well with our own model. Then the only way in which we could basically run it is have two independent brands supplied by the same backend. And that could be one possible thing, but we have not really seen any I would say immediate opportunity out there. But yes, if we see a huge synergistic thing, definitely we don’t see anything out there. We have to now look for complimentary models we obviously work at, we are a value player and we basically do discounting and everything else but there could be someone out there who caters to a different audience and who is profitable and which can be acquired at a decent price, we could perhaps look at it, at that time.

Moderator: Thank you. The next question is from the line of Madhav Marda from FIL. Please go ahead.

Madhav Marda: My question basically was that as we see this mix of private labels, new private label which we have launched, the MedPlus Store Brand Generics I think if I picked up right, you are saying gross margins are better. And we are seeing higher volumes in the stores where we have launched them which means there should be better operating leverage. Is it fair to understand as we go ahead the EBITDA that we make per store should structurally improve because we get better gross margin and operating leverage? I am taking like a slightly longer view if you could think from like a one- or two-year view. Do you think that's how it should play out?

Madhukar Reddy: 100%, as I said earlier, the reason why we have so many stores out there is because a lot of them depend on trade generics for their viability. Store which does Rs. 5000 and Rs. 10000 per days is selling 30%, 40%, 50% of its overall thing making around 50% to 60% margin. Now that we are in the market basically saying that if it is not something which a doctor has written, if it's not a promoted brand, then we are there with a 50% to 80% discount on that. And in Hyderabad and rest of Telangana we are also selling trade generics at the same price. And we are testing out to see how this works. You know if trade generics are available at that number, at 50% to 80% discount that automatically means lot of the smaller stores will find it very difficult to sell it at that full price. And if they tried to sell, at a price which matches with us, the low throughput will not allow them to actually survive. We will see a consolidation, we will see the benefit of that coming to us, that is for sure. And again, as I said the Indian consumer is also getting, I would say more knowledgeable about the overall medicines and all, we are also seeing a bunch of people saying it's not a big deal, we know MedPlus, we know all these brands are same, now that you guys have something to offer, we are more than happy to actually take it and save money. So, we are seeing a lot of those people come too. So, between both, between some of the stores not giving up and sending their customers over to us and people switching to our thing, both in terms of top-line and on the margins, I expect we will see a positive outcome as we go forward.

Madhav Marda: So, payback period for store that we introduced obviously just mathematically should come down right, over the period of time as these unit economics of a store increases, our sort of ROIC profile I mean I am just 1+1 but that should happen, I would assume?

Madhukar Reddy: No, long run definitely, mainly because of this, the cost of private label is 1/5th of what it cost for us to buy a brand. So, at the sale of Rs. 18 out of Rs. 30 lakhs basically go into inventory for us. As the inventory cost comes down, as our overall investment in the store comes down definitely the ROCEs will improve. And as we continue right, today we are making let us say after all the discounts which we give and after all the incentives which we give our employees for selling our private label, we still make at least I would say 75% to a 100% more than what we make on branded generics after all the discounts.

Now this number where it is can only go up from here, because today the average discount in Hyderabad is roughly around 58% to 59% or even 60% on the MedPlus private label. This need not always be that number, it can easily move anywhere from 60% to 55% or even 56%, so that's one lever which we have and that will actually improve our overall margin.

And the normal inflation which the government allows every year of 10% right on the drug price, that will also, some of it we will pass to the customer, because you know that 10% does get passed on us, 50% to 55% discount to the customer, but rest would come to us, because I don't expect that the price of manufacturing it will go up as much.

Moderator: Thank you. The last question of today is from the line of Sayantan Maji from UBS. Please go ahead.

Sayantan Maji: My question is regarding the private label portfolio. So, if I look at the private label portfolio and considering that there would have been some cannibalization to the earlier trade generics that we were selling. So, is it fair to assume that say if I just look at the 14% portfolio, 14% revenues that are coming from private labels to the gross margins sequentially could have come down and considering that the pharmacy gross margin has increased so in the branded pharma business probably the gross margins would have increased quarter-on-quarter and hence the average discounting levels would have come down? Is that a fair assumption or something is not correct?

Madhukar Reddy: No, so you are saying our margins because of the cannibalization of our earlier higher margin private label will have come down that is right. Earlier in Hyderabad we had roughly around 7% to 7.5% of private label now it's standing at 15%. So, we assume that all 7.5% has been let's say substituted by this, then we would have lost roughly around 2% on that. But the additional 7% which we actually got here would have basically secured another I would say another 1% would have basically been made up by the extra private label which we sold and that would have replaced the regular branded generic. Now what we are also not seeing is the fact that our sales also grew significantly because of this. So, a growth of even 10% extra at a 20% margin more than makes up for all this. And we expect that we will continue to grow as we go forward. From now on, I would say in Hyderabad whatever margins we have lost because of merging both the old and new ones that effect is long gone, so we will continue to grow from here.

In the other states though, in Karnataka and all these other places, we have now, till now kept these separate so we continue to operate the old private label as it is. We are seeing some cannibalization but not complete so to that extent we will see some loss, but overall since the private label is growing out there we expect to make more money out of that.

Sayantan Maji: Another question related to private label is when you had chosen 400 SKUs which cater to 55% of the customers. So, are these the ones who have probably the sale base were lower earlier or are these top selling SKUs that you see in branded pharma. And the 15% which is as you explained 1/3rd of the addressable market that you were able to convert. So, do these customers had higher awareness or is there some below the line activity which has been done to create awareness which led to this uptick in private labels?

Madhukar Reddy: Two things, everyone is aware because the private labels was sold only to people who had MedPlus membership and MedPlus membership was sold at some price, super discounted price, original price which we thought of was Rs. 499 but we ended up selling it for Rs. 49 as initial sell. But they had to actually become a member, pay that money to actually obtain this discount. So, they were told. And in the stores when they came in and we also had some marketing material which went outside we also did a little bit of advertisement and all. We talked about only this, that 80% of all the drugs in the country are off patent, all these are just branded generics or generics only. And we basically just said that MedPlus with a 4000-store network and a Rs. 4500 crores as of last year as the size and capability of getting these drugs manufactured in the same places and to the same level of quality as any other larger brands. And given that we did not have any marketing cost and all and we made it very clear that the discount was coming to them because we didn't have any channel cost and we didn't have any marketing cost. And so customers bought that and a significant portion of them ended up actually buying as I said a 3rd of whatever we put out on offer basically got taken up. And these are fast moving products by the way, these are not products in which the fill rate is a problem or anything like that, these are the, the fastest moving products.

Sayantan Maji: So, that is substitution, which is happening, it's not that probably a patient is coming and you were able to fulfill 8 out of 10 and the 2 was the gap and you had introduced only to, so it's not the case, so it's probably the ones which would any were selling and you have a substitute now available for the customer.

Madhukar Reddy: Exactly yes.

Sayantan Maji: So, your CAPEX if I just do a CAPEX per store it comes to around Rs. 1.4 million which is Rs. 14 lakhs so we have fit out cost of Rs. 6 lakhs, Rs. 2 lakhs to Rs. 3 lakhs of deposit, so where is the remaining Rs. 5 lakhs to Rs. 6 lakhs coming from assuming that none of the CAPEX is going into diagnostics for this quarter?

Madhukar Reddy: I don't think, we will try and come back to you. I am not sure if it's --; capitalized or something like that, I don't think the CAPEX for a store goes beyond Rs. 6 lakh to Rs. 8 lakh. Maybe a little bit of a maintenance, we actually did tell the investors last time that we are going to refurbish I would say refit roughly around 1000 stores to accommodate the private label products, non-pharma private label products. which would now start going from being shelved from behind the counter to in front of the counter. So, maybe a little bit of that but I don't think it is going to be, it should have change it so much. Happy to come back to you with more details on this please reach out to us after this.

Moderator: Thank you. Ladies and gentlemen, that was our last question for today. I now hand the conference back to the management for their closing remarks. Thank you. And over to you.

Madhukar Reddy: Thank you everyone for the call.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of MedPlus Health Services Limited that concludes this conference. Thank you for joining us today and you may now disconnect your lines.