Healthcare

Internet usage to buy medicines minuscule yet

Parameter	Data
India pharma market size (INR b)	1,368
Online Pharma market share (%)	3
Approx Online pharma market size (INRb) (a*b)	37
Average purchase per customer (INR)	1,200
Approx No. of purchases per annum	8
Total purchases per annum per customer (INR) (d*e)	9,600
Total Number of customers (mn) (c/f)	**3.8**

Performance of top companies: September 2019)

Company	MAT gr (%)	Sep- 19 (%)
IPM	9.8	11.9
JB chemicals	21.8	28.1
Dr Reddy Labs	12.7	24.0
GSK Pharma	11.8	22.9
AstraZeneca	10.7	19.5
Lupin	15.3	19.3
Torrent Pharma	11.9	17.5
Mankind	13.9	14.5
Alkem	12.7	14.5
Zydus Cadila	10.1	14.4
Abbott	9.6	13.9
Sun Pharma	7.7	13.1
Sanofi	13.0	11.4
Merck	4.5	9.4
Pfizer	7.0	9.4
Glenmark Pharma	9.3	9.3
Ipca Labs	18.6	9.2
Biocon	14.2	7.6
Cipla	9.0	5.9
Ajanta Pharma	7.1	5.7
Natco	8.5	5.2
Alembic Pharma	7.3	0.2

Online Pharmacies – Just a click away!

Re-calibrating growth outlook; Distributor alliance to lower working capital

Launched just a few years ago in India, E-Pharmacies have grown from strength-to strength and have re-hauled the drug-dispensing business in the country. Through this note, we take a deep dive into the Indian pharmaceutical network to understand how online pharmacies have reshaped India's retail medicine-distribution landscape.

- **The Indian pharma trade channel is transforming, thanks to the advent of online pharmacies and consolidation of distribution network, which we believe is a win-win combination for manufacturers and patients. Currently, E-Pharmacies have ~17m registered customers; of this, ~3.8m are already active and making purchases. The number is estimated to grow exponentially in the coming years.**
- **Online pharmacies provide real-time detailed data, which will reduce opaqueness in the current system. Data analytics helps manufacturers to forecast demand more accurately and to understand target customers better.**
- **Further, even distributor consolidation has significant benefits, such as (a) economies of scale driving margin improvement of 80-100bp, and (b) reduction of working capital days by at least 10-12 days.**
- **While this may not alter the demand perspective, it would enable profitability improvement for manufacturers due to improving efficiency in supply-chain management.**

Digital India – To sharply improve tracking system for manufacturers

The current system of analyzing revenue uses secondary sales data and information relayed by medical representatives (MRs). For instance, 50-60% of sales happening in the last week of the month and frequency of sales force visits of ~1-3/month per stockist creates difficulty in differentiating demand between doctor promotions and sales push. Real-time detailed data – in terms of doctors prescribing brands, retail outlets selling the brand and re-ordering by customers – would not only give a strong boost to distributors but would also enhance the quality of demand analysis and better MR productivity.

Chronic business shifting toward online pharmacies

Unlike acute diseases, demand for chronic diseases is not ad-hoc as requirements are not time sensitive; they can be pre-planned. Further, according to estimates, the number of patients falling under the chronic category is set to expand, thanks to changing lifestyles and increasing share of the 25-69 years age category (from ~50% in 2015 to an estimated ~57% by 2035). Therefore, online pharmacies have a strong advantage while dealing with chronic disease patients by way of home deliveries v/s their offline counterparts. However, offline pharmacies are expected to maintain their ground when it comes to delivering medicines for time-sensitive diseases.

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Consolidation of distributors to reduce inventory days

Our interaction with industry experts indicates that inventory days are higher for small distributors (annual sales ~INR200-300m). Small distributors' inventory days typically fall between 35-40 days v/s large distributors' (+INR1b) 20-25 days – this can be attributed to the quantum of business and efficiency of distributors. Also, small distributors have to provide a higher credit period to retailers to gain greater wallet share despite limited product offerings. Further, this effect is intense in metro cities compared to non-metro cities due to steep competition. We believe that distributor consolidation would not only improve working capital management but would also expand product portfolio, leading to better negotiating terms with manufacturers.

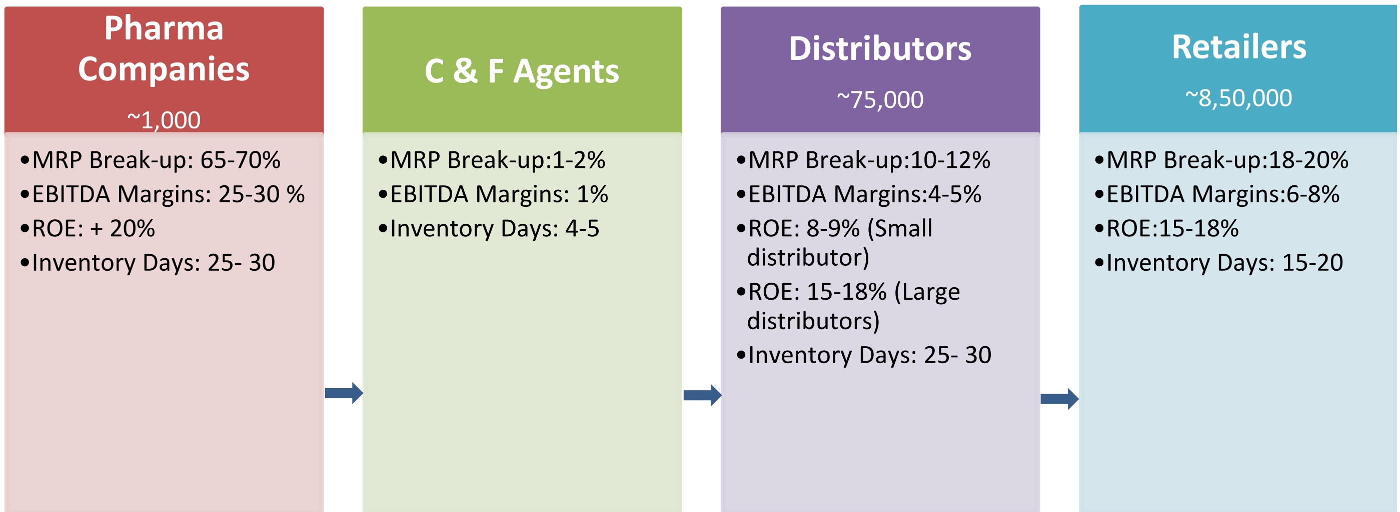
Pharma Trade channel less efficient than FMCG trade channel

The parameters like supply-chain cost (as % of sales) and inventory days of distributors are higher in the case of the pharma trade channel (~95days) v/s that of the FMCG trade channel (~70 days). Also, the process of estimating demand and planning supplies is superior in case of FMCGs. While inherent nature of the business in each category (Pharma/FMCG) may not allow the exact matching on all parameters, there is enough scope to optimize the pharma trade channel to build a better ecosystem.

Profitability to further improve for pharma producers over medium term

While demand parameters remain fairly stable, further improvement in efficiency of medicine distribution, better mapping of doctors (key influencers) prescribing medicines as well as regional analysis would enable optimum utilization of resources (MRs/manufacturing operation efficiency). Subsequently, it would drive profitability for manufacturers over the medium term as more number of patients access online pharmacies.

Exhibit 1: Domestic pharma value chain



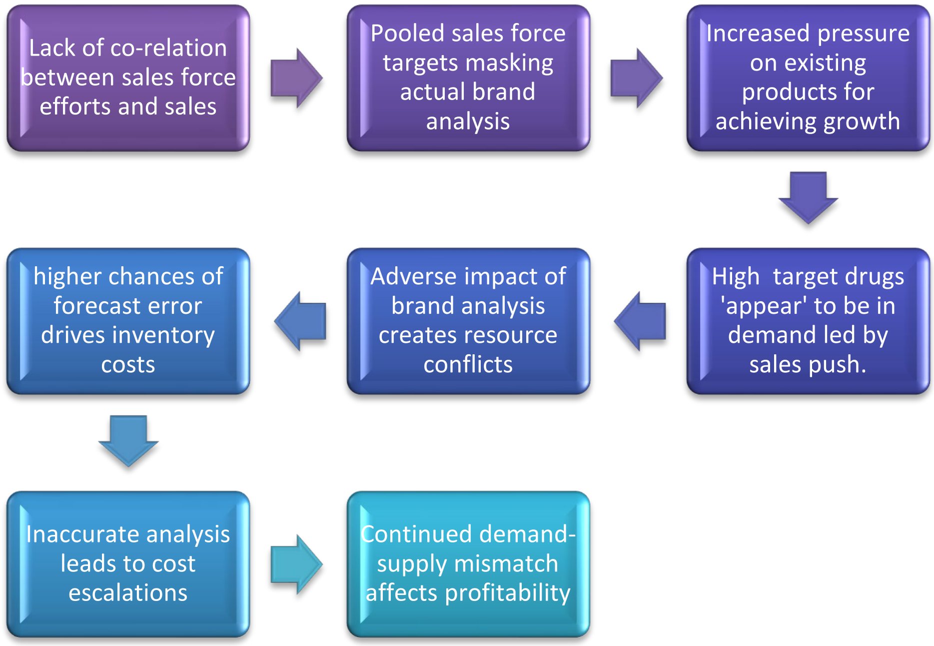
Digital India – To aid tracking system for manufacturers

- **The limited visibility of post C&F supply-chain of pharma manufacturers makes existing sales analysis difficult, and thus, leads to an opaque demand forecast.**
- **A detailed analysis based on data provided by online pharmacies would enable further optimization of resources and improve profitability.**

Lower correlation between marketing effort and actual sales in current structure

Pharma manufacturers/brand owners typically take cues from visits of their sales force to stockists/retailers and through monthly stock & sale statement of stockists. However, as inputs are from a limited number of stockists, it does not provide complete clarity in terms of demand and regional analysis.

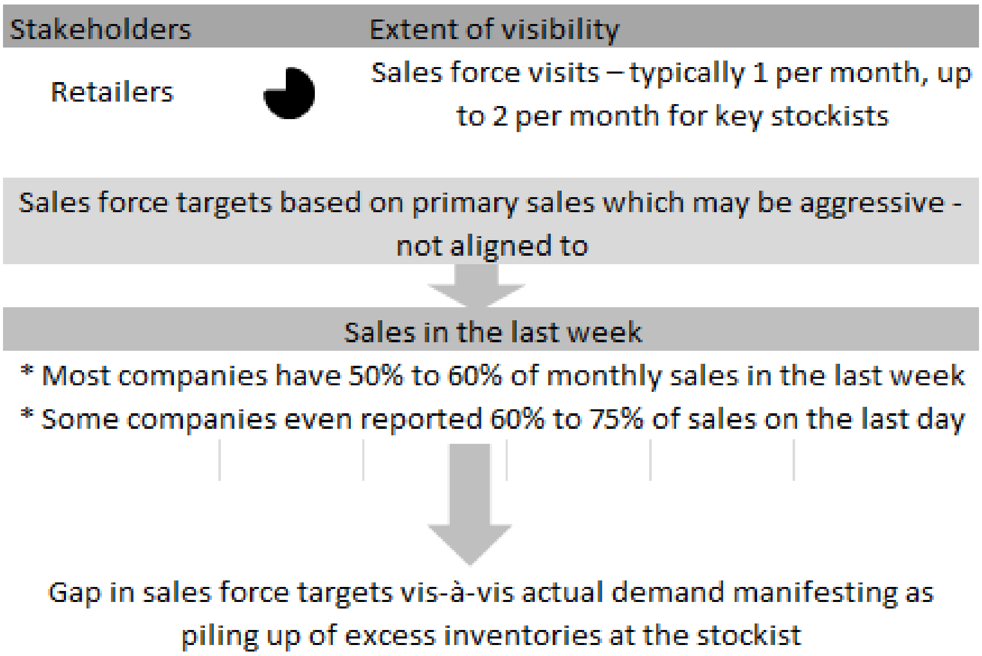
Exhibit 2: The current structure of data flow and interpretation for pharma manufacturers



Source: MOFSL, Industry

While the marketing representatives (MR) continue their efforts in creating brand awareness and recall of high-value brands, there is a distinct disconnect between the doctor prescribing (key influencer in the system) the brand and actual sales from that particular location. Further, there is also the possibility of the sales force resorting to 'pushing stocks' to distributors to fulfill their targets.

Exhibit 3: Sales force target not aligned with actual demand



Source: MOFSL, Industry

This results in the following inappropriate outcomes:

- Difficulty in differentiating demand for products based on doctor promotion and sales push.
- Skewness in sales pattern.
- Diversion of MR resource towards brands with pseudo potential.
- Sub-optimal performance resulting in reduced profitability.

Online pharmacy to plug the gap resulting in resource optimization

As the number of patients using the online platform to procure medicines increases, manufacturers can derive significant value adds from the related data in terms of:

- Better Doctor-MR mapping.
- Understanding patient mindset toward a brand.
- Avoiding conflict while allocating resources for enhancing brand value.
- Lowering chances of error in demand prediction, thereby resulting in better product supply-chain management.

Chronic business shifting toward online pharmacies

- **Sticky requirement in terms of volume as well as brand for chronic diseases makes demand more certain, thus leading to more scope for online pharmacies to cater to this need.**
- **Home delivery and higher discounts further strengthens the case for online pharmacies.**

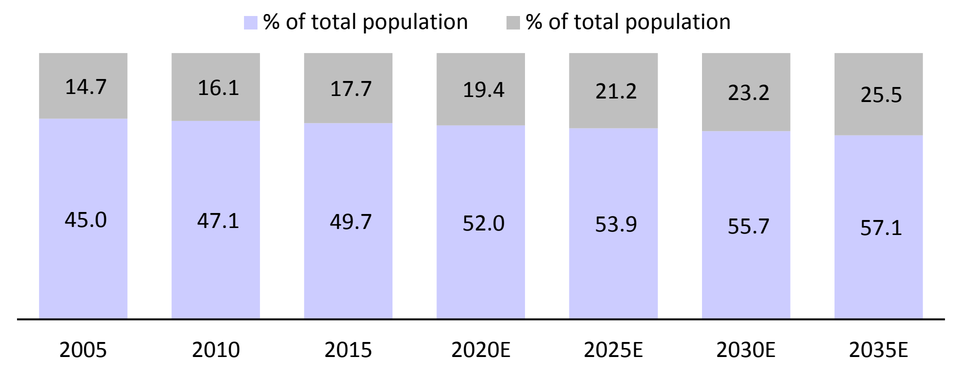
Continued demand by chronic patients to drive e-pharmacy biz over medium term

Given the current size of business, online pharmacies are tapping the chronic patients segment. By doing so, online pharmacies are garnering better visibility for their products and also enabling them to have better operational management.

Aging population base…

The share of population between ages 25-69 is expected to increase to 57% by 2035 v/s ~50% in 2015E. Particularly, share of the 50+ age group is expected to increase 26% by 2035 v/s 18% in 2015. As the ageing population has higher inclination toward chronic diseases, it provides an impetus for improved customer service to online pharmacies.

Exhibit 4: Population profile tilting toward chronic diseases

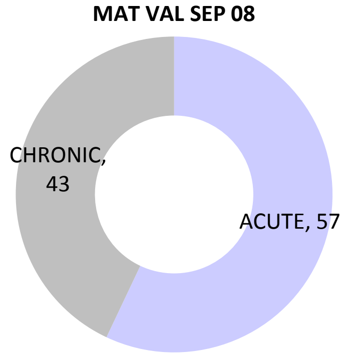


Source: MOFSL, Industry

…and changing lifestyle supports demand for medicines related to chronic diseases

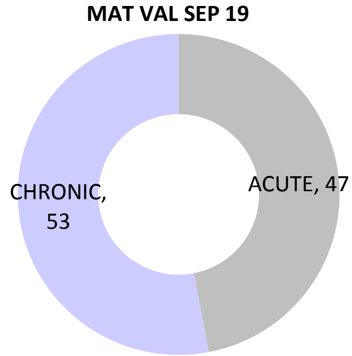
There has been a higher incidence of lifestyle diseases like diabetes and cardiac ailments. Accordingly, the share of chronic diseases has increased from 43% in MAT Sep'08 to 53% in MAT Sep'19. The chronic segment of IPM has witnessed CAGR of 16% over 2008-19.

Exhibit 5: IPM mix shifting toward…



Source: MOFSL, Industry

Exhibit 6: …chronic category



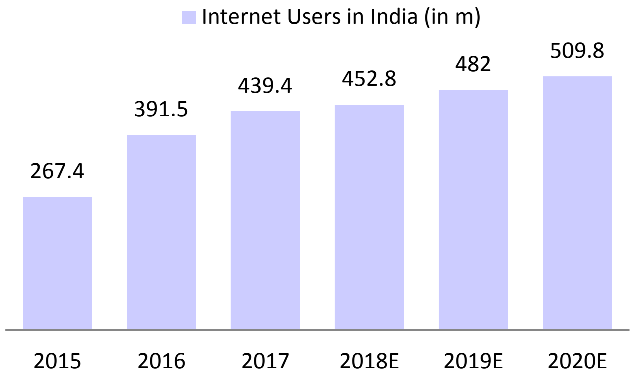
Source: MOFSL, Industry

Improved service and initial discounts create pull for online pharmacy

In addition to door-step service and regular reminders for replenishing medicines provided by online pharmacies, there are considerable discounts on MRP. Thus, these factors compel patients to switch to online pharmacies.

While offline pharmacies also offer discounts on MRP, it is difficult for them to match those offered by their online counterparts. Also, offering very high discounts would lead to sustainability issues as it would raise doubts on the viability of return on investments for offline pharmacies.

Exhibit 7: Rising Internet user trend in India



Source: MOFSL, Industry

Exhibit 8: Internet usage to buy medicines minuscule yet

	Parameter	Data
a	India pharma market size (INR b)	1,368
b	Online Pharma market share (%)	3
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f	Total purchases per annum per customer (INR) (d*e)	9,600
	Total Number of customers (mn) (c/f)	**3.8**

Source: MOFSL, Industry

Huge scope for increase in customer base

Given the number of internet users in India, the number of people using the online medium to buy medicines is very small at ~3.8m. The registered number of users is ~17m (based on number of people who have downloaded apps). We expect the number of people shifting to online procurement of medicine to rise exponentially over the next 4-5 years led by increased off-take from chronic patients.

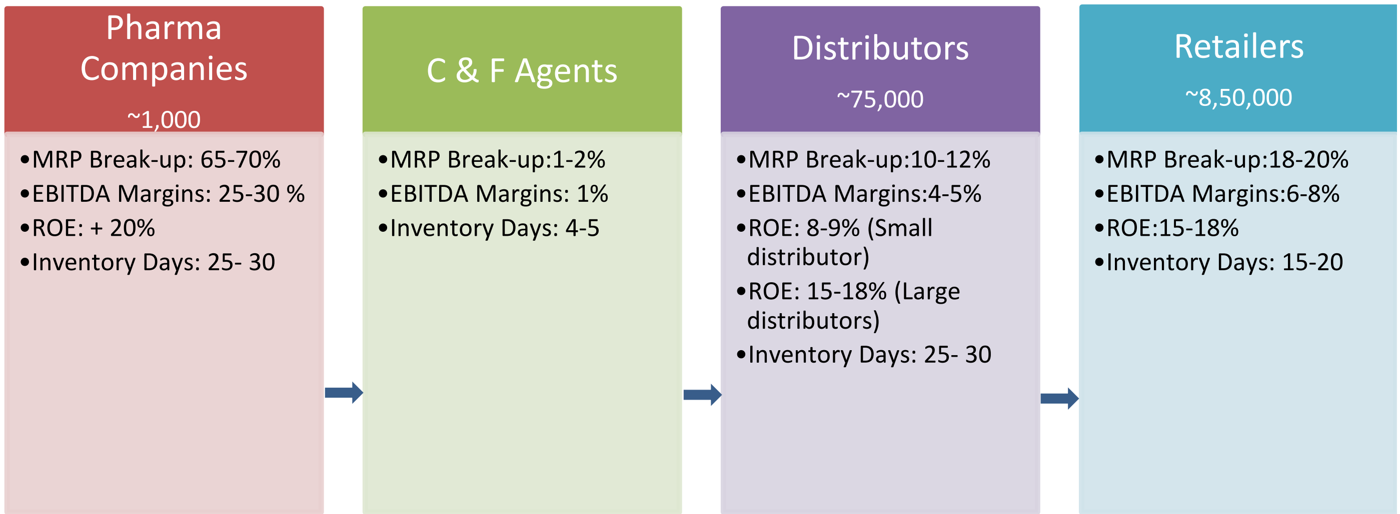
Consolidation of distributors to reduce inventory days

- **Consolidation of distributors would not only enhance product offerings but would also improve working capital management.**
- **It would also increase scope of business and better negotiations to improve return on investment as well.**

Large pool of distributors catering to current needs of the India Pharma market

Currently, there are about 70,000-75,000 distributors channeling drug products from ~1,000 pharma companies (having aggregate ~10,000 manufacturing facilities) to ~8,50,000 retails pharmacies. Further, according to India Pharmacopeia, there are ~0.1m stock keeping units (SKUs) registered with products available for patients.

Exhibit 9: Domestic pharma value chain



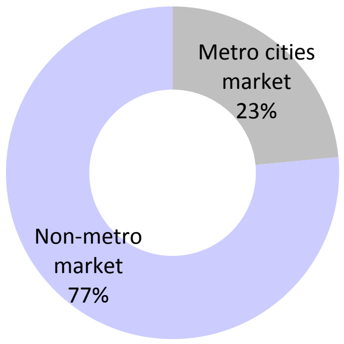
Breaking down the maximum retail price (MRP) in the value chain, 65-70% goes to the manufacturer, 1-2% is with C&F agent, 10-12% is with distributor and 18-20% is with retailer. Further, distributor earns 4-5% EBITDA margin; depending on the size of business, small/large distributors earn 8-9%/15-18% return on investment. Retail pharmacy typically earns 3-5% EBITDA margin and 12-15% return on investment.

Small distributors are at a disadvantage in terms of inventory days/product offering

An interesting feedback from channel checks is that small distributors, at times, arise from existing MRs with entrepreneurial motivation. Based on their service relationship with doctors and sales departments of companies, such small distributors are initially are able to channelize products to pharmacies. However, the portfolio offered by them is narrow as products are generally from a particular division (where they have good relationship for procurement). This creates limitation in terms of product offerings. Also, they need to provide more credit to gain some share of the business from retailers. This in turn increases working capital requirement for the distribution business.

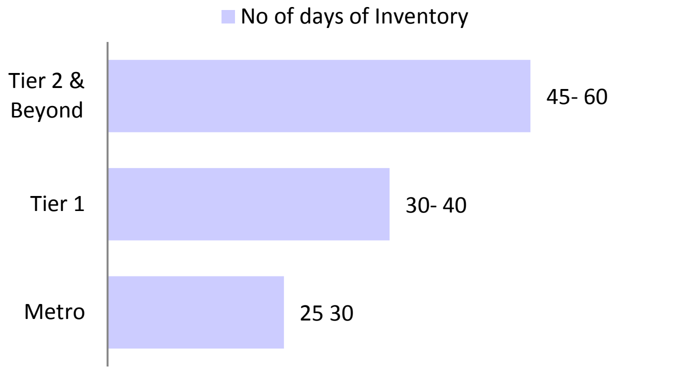
Typically, small distributors have 35-40 days of inventory. This is much higher compared to large distributors that have inventory days of ~20-25 days. This implies enough scope for improvement in working capital on consolidation among distributors and would further result in better return on investment for the distributor.

Exhibit 10: Metro cities form ~23% of IPM



Source: MOFSL, Industry

Exhibit 11: Inventory days differ between cities



Source: MOFSL, Industry

Additionally, there is expansion in the product menu, which can be channeled from manufacturer to retailer, thereby providing better negotiating terms with manufacturers and improving profitability for the distributor. With doctors remaining the key influencers, enhanced MR efforts for better brand recall may provide potential to raise prices to that extent, thereby not impacting profitability of manufacturers.

Consolidation of distributors would also improve the fill-rate for retail pharmacists

Fill-rate is the proportion of patient requirement fulfilled by a retail pharmacy. The fill-rate for Indian retail pharmacy is ~60-65%; of this, 35-40% remains void due to non-availability of products at shelf. With technology, drug inventory and delivery network in place to meet challenges such as packaging, time and location, the fill-rate can be substantially improved, benefiting patients in terms of meeting their maximum requirements.

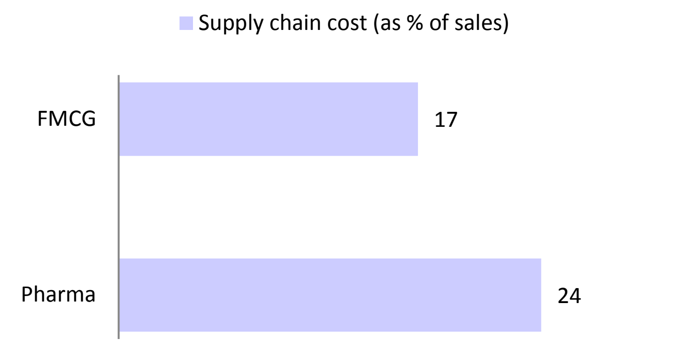
FMCG channel execution better than Pharma channel

- **Compared to the FMCG trade channel, pharma trade channel appears relatively less efficient.**
- **E-Pharmacies and consolidation of distributors can aid reduction in working capital as well as operational cost.**

Pharma supply-chain cost is 1.3x FMCG

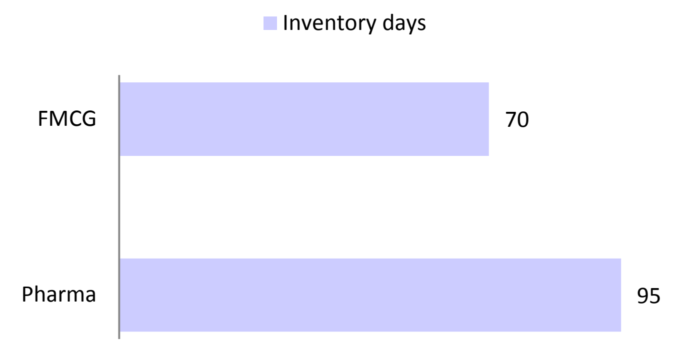
Pharma and FMCG have similarities in terms of wide range of products and customer base; however, there is considerable difference between the two in terms of supply-chain cost as % of sales. For FMCGs, with last mile connect established and usage of advanced technology, the supply-chain cost as % of sales is only ~17%, whereas it stands at 24% in case of Pharma.

Exhibit 12: Higher Supply-chain cost as well as…



Source: MOFSL, Industry

Exhibit 13: …Inventory days



Source: MOFSL, Industry

Further, inventory days in the system are also considerably higher in case of Pharma. Key factors creating such diversion in Pharma compared to FMCG are:

- Lack of process/system to share detailed information with manufacturers, suppliers and distributors.
- Dearth of information transparency and traceability in case of product recall/contamination issues.
- Limited IT tools leveraged to create supply and production plan. This also leads to significant wastage and/or shortage.

Increased share of organized trade channel and better usage of online platform would enable better demand forecast, production planning and optimize inventory requirement in the system. This in turn would improve return on investment for manufacturers, suppliers and distributors as well.

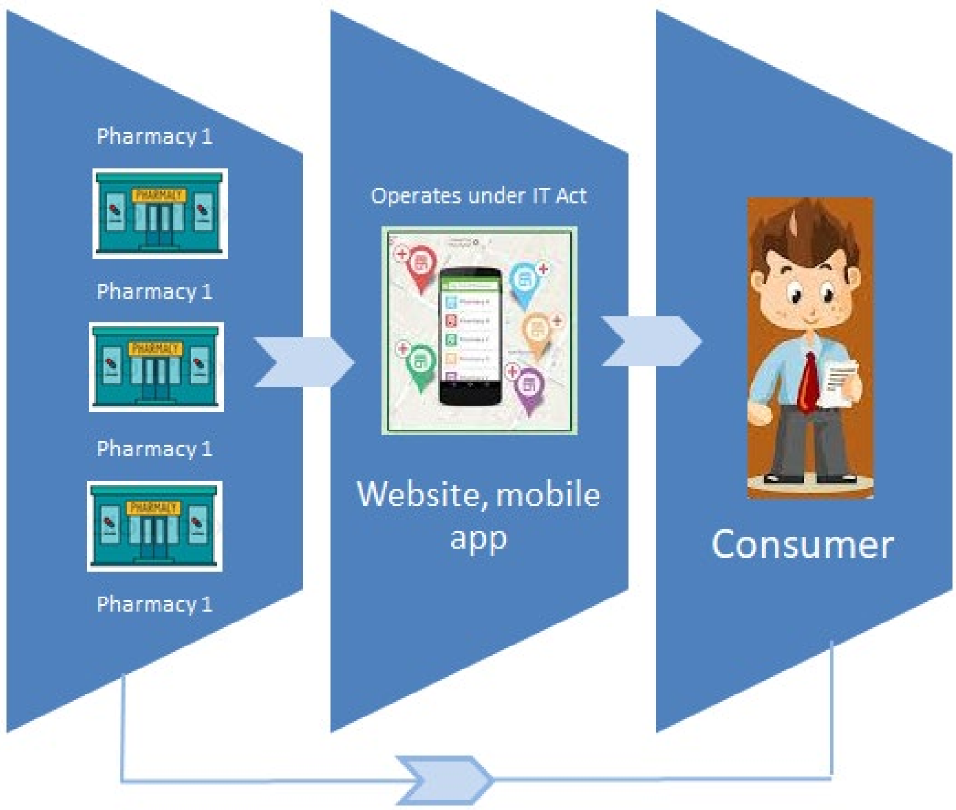
E-Pharmacies enhancing reach/customer awareness

- **In India, E-Pharmacy companies are following the market-place or inventory-based model in order to make the most of the potential opportunity in the segment.**
- **Top E-Pharmacy players have established their presence across India and are in the process of improving product offerings and building a robust supply-chain.**

E-Pharmacies using Inventory-based model than market place-based model

In case of market place-based model, a technology-company acts as a facilitator between buyer (patient) and seller (pharmacist). The e-pharmacy website empanels licensed pharmacies and lists their products. Consumers select the medicines/drugs available on the website/app. The e-prescription/scanned prescription is uploaded on the website/app. The order is then passed on to a licensed pharmacy for verification against the prescription and for order preparation. The orders are cancelled in the absence of a valid prescription. Medicines are then delivered to customers through a courier service. 1MG and Pharmeasy follow a market place-based business model.

Exhibit 14: E-Pharmacies – facilitator in market place-based model

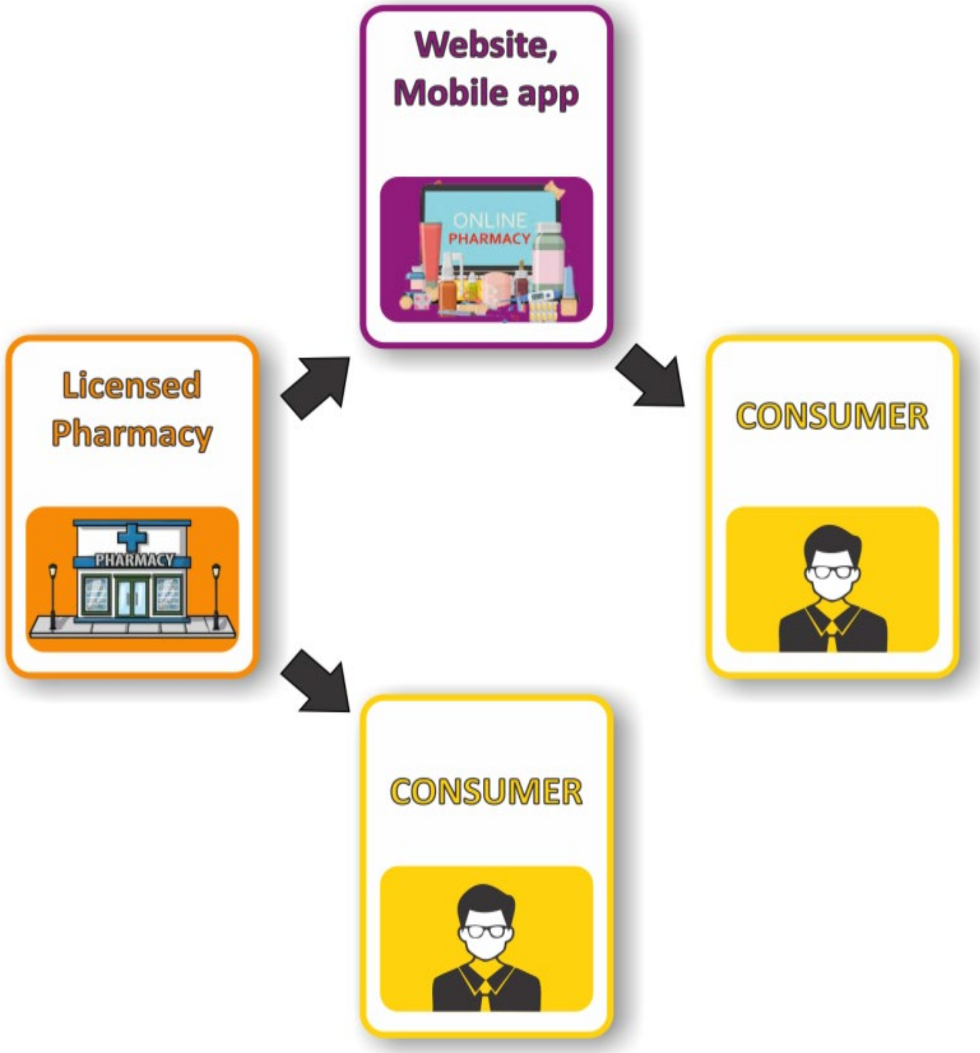


Source: MOFSL, Industry

In case of an inventory-based model, an E-Pharmacy owns the inventory of medicines/drugs that are stored in warehouses/fulfillment centers across geographic locations. Once orders are received on its website/app, they are checked by a registered pharmacist. Orders that require a prescription are checked for a valid e-prescription/scanned prescription uploaded by the consumer on the website.

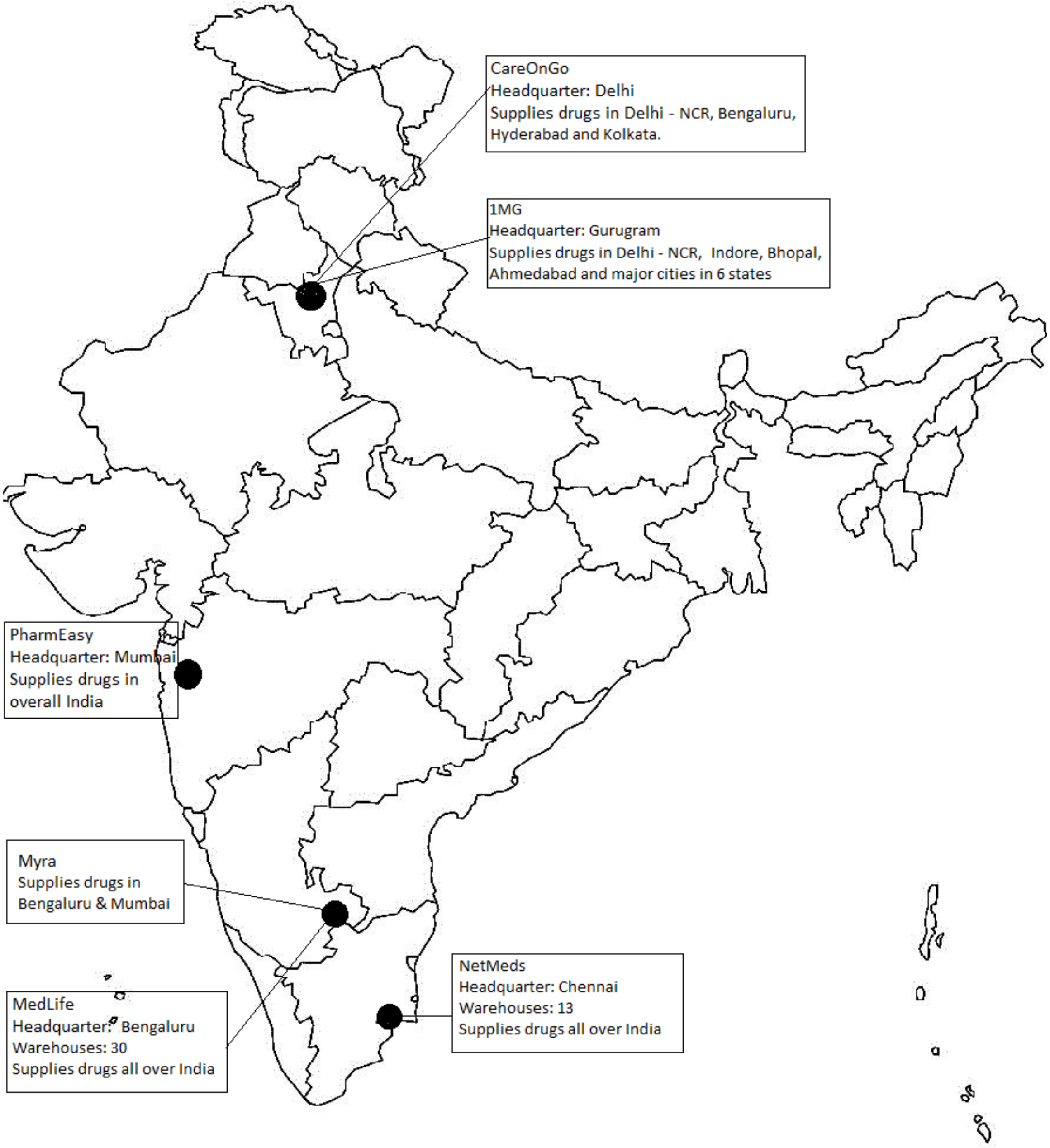
Medicines/drugs are not dispensed without a valid prescription. Registered pharmacists wrap the medicines in a tamperproof pack and deliver them to customers through a courier service. Medlife, Netmeds, CareOnGo, Myra follow an inventory-based model.

Exhibit 15: E-Pharmacies – own inventory/act as facilitators in an inventory-based model



Source: MOFSL, Industry

Exhibit 16: Major players in E-Pharmacies



Source: MOFSL, Industry

Pharmeasy/Medlife/Netmeds have widest geographic reach

Amongst E-Pharmacy companies, Pharmeasy, Medlife and Netmeds have covered 19,000+ pin-codes and supply drugs all over India. 1MG, Myra and CareOnGo are established in a few cities only. Further, Medlife is a leading player in terms of number of warehouses, followed by Pharmeasy/Netmeds.

Value-added service to enhance business

In addition to supply of medicines, few players have started value-added services such as online consultation, tie-ups with diagnostic companies, health blogs to attract more customers, amongst others.

Exhibit 17: Snapshot of fund raised by E-Pharmacies till date

Name	Inception	Founder	Fund raised till Date*
CareOnGo	2015	Ritu Singh, Aditya Kandoi and Yogesh Agarwal	~USD 1m
1MG	2014	Prashant Tandon, Vikas Chauhan, Gaurav Agarwal	USD150m
Pharmeasy	2015	Dharmil Sheth and Dhaval Shah	~USD130m
MedLife	2014	Tushar Kumar and Prashant Singh	USD145m
NetMeds	2012	Pradeep Dadha and Bruce Schwack	USD100m

*As on Oct-18

Source: MOFSL, Industry

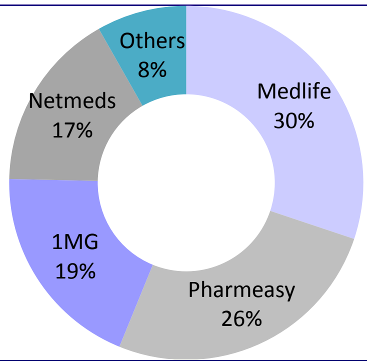
Given the factors favoring the E-Pharmacy business, its size is expected to increase to INR250b by 2022 compared to just INR3.5b in 2018.

Exhibit 18: E-Pharmacy enhancing other services for customers

Value Added Service	MedLife	Pharmeasy	1MG	NetMeds
Online Consultation	✔	✔	✔	✔
Health blog	✔	✔	✔	✔
Tie up with Diagnostic labs	✔	✔	✔	□
Appointments with Doctors /Clinics	✔	□	□	□

Source: MOFSL, Industry

Exhibit 19: Medlife leads in terms of market share



Source: MOFSL, Industry

Multiple formats used by E-Pharmacies to increase customer reach

- E-Pharmacies have used multiple marketing initiatives to increase awareness among customers.
- **PharmEasy** has used multiple media formats like hoardings, billboards, AC bus wraps, non-Ac bus panels and other below-the-line activation, including residential welfare campaigns like health camps, to promote its offerings. Print and radio campaigns explain the ease of using online pharmacy. Social media platforms such as Twitter have also been used. Recently, it has used television media to enhance customer awareness.
- **Netmeds** signed *cricketer MS Dhoni* as brand ambassador for its advertising campaigns. It is also associated with the Asia Cup One Day International Cricket Tournament in Dubai. Additionally, it is also in the process of setting up offline pharmacies to enhance customer cognizance.
- **1MG** has used digital social media such as whatsapp/Facebook. In Sep'17, it launched a new campaign - The Grandmaster Series - that aims to celebrate unsung heroes in the field of medicine.
- **Medlife** is using digital, print as well as television advertising. Particularly, television campaign *'Lafaddu matt bano'* has had significant impact on the company's revenues. Medlife's sales team also has been engaging with doctors and making them aware of the e-pharmacy services and benefits of ordering medicines online.

Beneficial to Pharma manufacturers over medium term

India remains one of the key markets for Pharma companies with strong brand-led business model. Compared to other geographies, this business remains superior in terms of return on investment.

We believe that the emergence of E-Pharmacies will prove complimentary for the business of Pharma manufacturers over the medium term. With better demand forecast/operation optimization, it could lead to further improvement in return ratios from this business.

As volumes build up for E-Pharmacies, there could be risk of trade substitution. Besides, doctors may also start to favor brands pushed by E-Pharmacies. Further, with improvement in E-Pharmacies' market share, there is a possibility that such players would start demanding better margins from pharma manufacturers over the long term. However, it remains to be seen if manufacturers are able to maintain their profitability by lowering their marketing spends on the traditional channel and/or by witnessing better volumes from E-Pharmacies.

NOTES

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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