Optival Health Solutions Private Limited

November 20, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating1	Rating Action
Long term Bank Facilities	175.00	CARE A-; Stable(Single A Minus; Outlook: Stable)	Revised from CARE BBB+; Stable (Triple B Plus; Outlook: Stable)
Total Facilities	175.00 (One Hundred and Seventy Five crore only		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in rating assigned to the long term bank facility of Optival Health Solutions Private Limited (Optival) is primarily on account of improved financial performance during FY20 (refers to the period April 1 to March 31) and H1-FY21 and comfortable liquidity position. The rating continue to derive strength from experienced promoters, market position of the group, geographically diversified stores and revenue stream, stable operating cycle and benefits derived by the company from its group companies and favorable industry prospects. Further, the ratings also derive strength from investment of PI Opportunity in the holding company i.e. MedPlus Health Services Private Limited (MedPlus) which in turn has invested in Optival during Q1FY20, comfortable debt coverage metrics during FY20. The rating, however, are constrained by highly fragmented industry with competition from existing organized and unorganized players.

Rating Sensitivities

Positive Factors

- Ability of the group to increase the scale of operations thereby increasing the PBILDT margins beyond 8% on sustained basis.

Negative Factors

- Decline in PBILDT margins to less than 4.00% on sustained basis.
- Elongation of working capital cycle beyond 100 days.
- Company undertaking any aggressive debt funded capex for expanding the number of outlets leading to deterioration in overall gearing beyond 1.50x.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced and resourceful Promoters

The key promoter of Optival; Dr. Madhukar Reddy, is a doctor by profession and had done master's in business administration from Wharton School of Business. Dr. Reddy is the chief mentor for the MedPlus group companies in their strategic planning and decision making. He has more than two decades of experience in various fields of business and functions like launching and growing IT outsourcing organizations, sales, marketing, fundraising and recruitment. Mr. Murali Krishna is another director of Medplus group who has more than a decade and half years of experience in different fields of retail and wholesale businesses. He handles day-to-day operations at corporate and store level. Further, during FY20, PI Opportunity (Promoted by Mr.Azim Premji) has invested Rs.204.49 crore in MedPlus by way of equity capital amounting to Rs.0.66 crore and compulsorily convertible preference shares of Rs.203.83 crore (including security premium of Rs.203.77 crore). Post to that MedPlus has in turn invested around Rs.187 crore in Optival by way of fresh issue of equity (including security premium of Rs.160.28 crores) during FY20.

Synergy derived on account of backward integration in pharmacy retailing value chain

MedPlus, is the holding company of the MedPlus group. MedPlus at standalone level is into pathlab business and has 30 collection centers and about 146 patient service centers as on September 30, 2020 at various locations. The company has its own pathology centers located within its subsidiary stores. MedPlus's basic business model is based upon adding large volumes of customers through Optival's pharmacy operations and then cross-selling the pathology services to those customers. The group has nine subsidiary companies which are into distribution business and supply its products to the

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

Optival. This helps the group to enhance its penetration by providing discounts and reaching directly to manufacturers which provide superior margins.

One of the leading market players in pharma retail chain with geographically diversified stores and revenue stream

Optival has over 1,700 pharmacy outlets and 29 optical stores as on March 31, 2020. Majority of the stores of the company are located in urban areas. The company strategically positions its stores in prime commercial areas to create better brand awareness. However, the prime locations have higher lease rentals and fierce competition from other organised and unorganised players.

Healthy growth in total operating income and stable profitability margins

Optival registered a significant Y-o-Y growth of 26.87% in total operating income during FY20 amounting to Rs.2,864.66 crore (6.89% during FY19). The increase was led by improvement in the business from existing outlets, increase in the revenue from newly added outlets (244 outlets) and revised discount structures. The online sales contributed to 14.48% during FY20 as against 18.22% during FY19. During FY20, there is a significant improvement in revenues and the same was due to discount structure changes. The improvement in revenues and profitability continued even during H1-FY21. The company during half year ended September 30, 2020 has achieved PBILDT margins of 7.93% (5.04% during FY20).

The PBILDT margins improved significantly from 1.61% to 5.04% due to adoption of IND AS 116 where the interest on lease liability and amortisation of ROU assets are given affect after PBILDT level unlike the earlier years where the lease payments are charged to P&L account as operational expense. However the adjusted PBILDT margins remained stable with marginal improvement from 1.61% to 1.65% and PAT margins of the company improved by 21 bps to 0.47% in FY20 from 0.26% in FY19. The GCA of the company improved from Rs.31.36 crore during FY19 to Rs.47.98 crore during FY20. The overall cash accruals have improved due to the increase in volume, stable margins and fixed interest and depreciation costs

Growing scale of operations with improvement in operational efficiency

Over the years (FY15-20), the number of outlets as well the revenue per outlet has been increasing. The average revenue per store has increased significantly from Rs.109.70 lakh in FY15 to Rs.161.39 lakh in FY20 reflecting the improvement in the operational efficiency of the retail stores. Further average revenue is about Rs.44,200/- per day per store during FY20 against Rs.30,000/- per day during FY15.

Sourcing arrangement; terms with supplier and return policy on expiry drugs

The company has been procuring traded goods from distributors, C&F agents and directly from reputed pharmaceutical companies in India for more than a decade and has established long term relations with them. Optival procures the goods in bulk quantities state wise and stores them in the warehouses at each state and distributes the material from central warehouse to the individual retail stores. Further, by virtue of procuring bulk quantities from them, the company was able to avail additional discount from the suppliers. Apart from that as part of contract terms, the company can replace the near-to-expiry products and expired products from the suppliers.

Significant improvement in liquidity position

The liquidity position of the company is comfortable as indicated by current ratio of 1.56x as on March 31, 2020 (1.29x as on March 31, 2019). Out of the total funds infused by Medplus of Rs.187 crore in Optival during FY20, the company paid off the interest bearing unsecured loans from the promoters to the extent of Rs.28.50 crore, utilized significant amount in building up of inventory and balance funds of Rs.98.40 crore is available in the form of cash and bank balance as on March 31, 2020. Further the reliance of the company on the bank borrowings for working capital is moderate with utilization of about 44% during 12 months ending July 2020. The company during FY20 has added 244 stores which were funded primarily through internal cash accruals and inventory recovered from the closed store.

Moderate financial risk profile

The debt profile of the company includes working capital borrowing and lease liability. The overall gearing of Optival deteriorated to 1.09x as on March 31, 2020 from 0.41x as on March 31, 2019. The deterioration is majorly on account of recognition of lease liability as a part of debt amounting to Rs.364.79 crore during FY20 as result of adoption of IND AS 116. However, adjusting the lease liability, the adj. overall gearing would improve to 0.24x as on March 31, 2020 from 0.41x as on March 31, 2019. Further, the debt coverage of the company represented by Total debt/GCA ratio deteriorated from 3.20x during FY19 to 4.45x during FY20 on account of increase in total debt due to lease liability. PBILDT interest coverage improved to 3.15 times during FY20, from 2.40 during FY19.

Stable operating cycle of the company

Optival has a satisfactory operating cycle despite its operation in working capital intensive business. Given the company's presence in retail and wholesale industry, it has to maintain relatively large stock of pharmaceutical products to cater to various retail businesses. Nevertheless, the operating cycle has been between 1-1.5 months on an average and stood at 42 days in FY20 (as against 39 days in FY19) backed by satisfactory inventory period. Further, the average working capital utilization has been comfortable at around 44% during the 12 month period ended July 2020.

Negligible impact of COVID-19 pandemic on the operations of the company

The impact of COVID-19 on the business operation was not significant. As retail pharmacy business comes under essential services, it was operational during the lock down period also. However, there were minor impacts on the business as follows:-

- The company has faced with logistic issues in initial lock down days. Especially manpower shortage in godown and outlets, whereas the same was resolved in few days.
- There was reduction of sales seen in the month of April 2020 and May 2020. However, the same slightly picked up in the month of June 2020 and came to normal level from the month of July 2020.

Stable industry outlook

The operations of pharma industry being considered necessary came under the ambit of essential manufacturing during the lockdown induced by Covid-19. This had kept production activities at many pharma companies largely unaffected. Also easing of restrictions in different phases of lockdown is believed to have supported the operations of pharma companies. During this period, while the domestic market for antibiotics, cold and cough gained traction, demand from segments like women healthcare and orthopaedic were impacted as the treatment for such ailments were believed to be kept on hold. Also, inbound logistics constraints restricted the movement in exports to an extent during lockdown. With relief in various restrictions, the industry is expected to see pent up demand for treatments that were postponed which will support the demand for drugs. Moreover, the demand for medicines will increase during the monsoon season as the distributors and retailers normally stock drugs for the season. These parameters will augur well for pharma industry. In addition to this, the industry will continue to see demand from the domestic as well as international markets for some of the antivirals, antimalarials and antibiotics given the spread of Covid-19..

Key Rating Weaknesses

Highly fragmented industry

The Indian pharmacy market continues to be highly fragmented in nature due to the overwhelming presence of unorganized pharmacies, with organized sector estimated to account for only 3-5% of the total business.

Liquidity: Adequate

Liquidity is marked by adequate accruals of Rs.47.98 crore against nil repayment obligations (except for lease liability which is already charged to P&L) during FY20 with liquid investments to the tune of Rs.98.40 crore as on March 31st, 2020. As on September 30, 2020 the company holds cash and bank balance to the tune of Rs.62.70 crore. The adjusted overall gearing stood at 0.24 times as of March 31, 2020 and the issuer has sufficient gearing headroom, to raise additional debt for future working capital or capex requirement. The average working capital utilization during 12 months ending July 2020 is comfortable at 44.00% with adequate bank lines to meet its incremental working capital needs over the next one year. Further the company did not avail moratorium provided as a part of RBI COVID-19 regulatory package.

Analytical approach: Standalone

Applicable Criteria

[Criteria on assigning Outlook and Credit watch to Credit Ratings]
[CARE's Policy on Default Recognition]
[Liquidity Analysis of Non-Financial Sector Entities]
[CARE's Methodology for Wholesale Trading]
[Financial Ratios- Non- Financial Sector]
[CARE's methodology for Organised Retailing]

About the Company

Optival Health Solutions Private Limited (Optival) was incorporated in July 2005. Optival is a subsidiary of MedPlus Health Services Private limited (MedPlus), promoted by Dr. Madhukar Gangadi. At group level, MedPlus is operating over 1,700 pharma stores under ‘MedPlus’ brand and 29 optical stores. Further, MedPlus is India’s second largest pharmacy retail chain.
Optival operates in various businesses including retail sale of pharma products, FMCG and private label products. MedPlus at standalone level is into Pathological laboratories (Pathlabs) business and the major retail business of the group is operated by its subsidiary company viz, Optival Health Solutions Private Limited (Optival). During FY20, PI Opportunity (Promoted by Mr.Azim Premji) has invested Rs.204.49 crore in MedPlus by way of equity capital amounting to Rs.0.66 crore and compulsorily convertible preference shares of Rs.203.83 crore (including security premium of Rs.203.77 crore). Post to that MedPlus has in turn invested around Rs.187 crore in Optival by way of fresh issue of equity (including security premium of Rs.160.28 crores) during FY20

Brief Financials (Rs. crore)	FY19 (A)	FY20 (Provisional)
Total operating income	2257.90	2864.66
PBILDT	36.38	144.49
PAT	5.78	13.43
Overall gearing (times)	0.41	1.09

Interest coverage (times)	2.40	3.15

A: Audited

Status of non-cooperation with previous CRA: Not Applicable
Any other information: Not Applicable
Rating History for last three years: Please refer Annexure-2
Covenants of rated instrument / facility: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3
Complexity level of various instruments rated for this company: Annexure 4

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	175.00	CARE A-; Stable

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Cash Credit	LT	175.00	CARE A-; Stable	-	1)CARE BBB+; Stable (23-Aug-19)	1)CARE BBB+; Stable (28-Dec-18)	1)CARE BBB+; Stable (28-Mar-18) 2)CARE BBB+; Stable (13-Mar-18)

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities- NA

Annexure 4: Complexity level of various instruments rated for this company

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Cash Credit	Simple

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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