Pharma sector growth to moderate at 7-9% CAGR for FY 2018-21

23 October 2018 | News

Low base for domestic business supported healthy Q1FY2019 growth.

The growth trajectory for the Indian pharmaceutical industry is likely to be moderate at 7-9% over FY2018 to FY2021, on the back of healthy demand from the domestic market given increasing spend on healthcare along with improving access though constrained by regulatory interventions and slowing growth from the US given the relatively moderate growth prospects. According to an ICRA report covering a sample of 21 firms in the industry the concerns in the domestic market pertain to price control and mandatory genericisation whereas US concerns pertain to relatively moderate proportion of large size drugs going off patent, increased competition leading to price erosion albeit at moderate pace, generic adoption reaching saturation levels and; regulatory overhang along with base effect catching up.

According to **Gaurav Jain, Vice President & Co-Head, ICRA**, *"The revenue growth from US remained sluggish during Q1FY2019 at 1.5% compared to 4.0% in FY2017 and -13.1% in FY2018 despite consolidation benefits. The growth momentum for US business is likely to remain in low single digit for FY2019, led by limited near term first to file (FTF) generic opportunities, pricing pressures and product rationalization for US base business. The base business in US continuing to face high single digit price erosion (compared to low double digit earlier) and regulatory overhang for select companies."*

Aggregate revenues of sample grew at 15.4% in Q1FY2019 vis-à-vis the prior year as against FY2018 growth of 0.1%. The year on year revenue growth for Q1FY2019 reflect low base for domestic business. The first quarter's growth last year was incrementally impacted by domestic trade channel de-stocking in view of GST implementation leading to loss of 20-25 days of sales in addition to US generic business facing steep pricing pressure. The aggregate domestic growth was 27.2% in Q1FY2019 compared to 4.6% in FY2018 and -8.8% in Q1 FY2018. Besides low base, growth during Q1FY2019 was also supported by volume growth and new product launches. The growth during Q1FY2019 was also supported by 3.4% WPI linked price increase on National List of Essential Medicines (NLEM) portfolio. Growth from European markets benefitted from higher tender wins, new product introduction in B2B segments and low base effect though healthcare reforms resulting in price cuts continue to pose challenge.

Unlike in the past, when several Indian pharma companies ramped up their R&D spend, targeting pipeline of specialty drugs, niche molecules and complex therapies, this time around companies are optimising their R&D spend. This is led by challenging US market conditions characterized by steep pricing pressures, high competitive intensity led by faster ANDA approvals and lower than expected revenue growth. Also with competitive pressures expected to sustain in the near to medium term, companies are exiting product development of easy to manufacture, simple generics with multiple players and focusing on complex generics and specialty products.

The aggregate R&D spends of top few domestic companies which had increased from 5.9% of sales in FY2011 to close to 9.0% in FY2017, moderated to 8.8% during FY2018 and further to 8.6% in Q1FY2019. ICRA expects R&D budgets to remain at 8.6%-8.8% given the growing focus both on regulated markets and complex molecules/therapy segments such as injectables, inhalers, dermatology, controlled-release substances and biosimilars. Indian companies have gained adequate scale and drug development capabilities over last decade of growth which will keep them in good stead to capture new opportunities in the developed market.

As for industry's profitability, the same has moderated over the last few years with aggregate EBITDA margins at 19.7% for Q1FY2019 (vis-a-vis 22.9% FY2017 and 20.1% FY2018). This is due to growth pressures along with sustained R&D and compliance related investments. Though margins remain healthy, the lower margins are due to pricing pressures for the US base generics business and lack of limited competition products. Higher share of domestic business and operational efficiencies has however provided overall cushion to margins.

Concludes Jain, *"The credit metrics of leading pharma companies are expected to remain stable in view of future growth prospects in regulated markets and relatively strong balance sheets. The capital structure and coverage indicators are expected to remain strong despite pressure on profitability and marginal rise in debt levels given inorganic investments. The key sensitivity to ICRA's view remains productivity of R&D expenditure, increasing competition in the U.S. generics space and operational risk related to increased level of due diligence by regulatory agencies."*