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ICRA assigns stable outlook for Indian Pharma companies

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Domestic pharma cos expected to grow at a CAGR of around 8-10% between FY2018-2021

ICRA has given a stable outlook on the Indian pharmaceutical industry. The headwinds from pricing pressure in large regulated markets, especially USA, increased cost related to regulatory compliances but are largely offset by growing scale of business, increased focus on specialty/ niche segments and comfortable balance sheet structure. The domestic pharmaceutical industry has gained adequate scale and generic drug development capabilities over a decade of growth which will keep them in good stead to capture bigger opportunities in the regulated market. The FY2018-2021 CAGR is expected to be around 8-10% for domestic Pharmaceutical companies.

The credit metrics of leading pharma companies are likely to remain stable in view of steady growth prospects in regulated markets and limited dependence of Indian pharmaceutical companies on bank borrowings. The OPBITDA/Interest and TD/OPBITDA for ICRA set of 21 entities in Indian pharmaceutical industry has been healthy at 10.2x and 2.3x for FY2018. They are expected to remain in similar range in medium term despite some pressure on profitability and marginal rise in debt levels, given inorganic investments. The key sensitivity to our outlook 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.

The growth from US has come down sharply from 14.4% in FY2016, 4.0% in FY2017 to -13.1% in FY2018. Going forward the growth momentum would face continued headwinds given the relatively moderate proportion of large size drugs going off patent, increased competition, generic adoption reaching saturation levels in the US market along base effect catching up for Indian exporters. Further increased regulatory scrutiny as reflected in increased issuance of warning letters/import alerts and consolidation of supply chain in US market resulting in pricing pressures has impacted competitiveness of Indian pharmaceutical companies.

The profitability for the industry, though expected to remain healthy, faces pressure from rising pricing pressures in US, increased regulatory compliance costs, rising R&D costs and other overheads and currency volatility related challenges in EMs. Overall, company specific factors would continue to play a pivotal role with quality of product pipeline (i.e. higher share of limited competition launches in the U.S.) being the single most differentiating factor. Companies with growing portfolio comprising of niche/complex products in regulated markets, diversified geographic-mix and established brands in EMs would be better placed to manage some of the headwinds.

Over the past few years, pharma companies have increased their R&D budgets significantly in view of their growing focus on regulated markets and complex molecules/therapy segments. With R&D optimization efforts underway, we expect aggregate R&D spend to maintain at current levels despite requirements arising from expanding presence in complex therapy segment such as injectables, inhalers, dermatology, controlled-release substances and even biosimilars.