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Pharma outlook stable despite intensifying profitability headwinds

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Ind-Ra expects the Indian pharmaceutical sector's operating profitability to remain subdued in FY19.

India Ratings and Research (Ind-Ra) has maintained a stable outlook for the pharmaceutical sector for the rest of FY19.

The domestic pharmaceutical market growth is likely to remain robust, largely supported by various measures adopted by the government of India to improve access to medicines. Steady investment in research and development is likely to support companies focused on regulated markets, such as Europe and the US, to sustain healthy product pipelines.

Ind-Ra expects the Indian pharmaceutical sector's operating profitability to remain subdued in FY19 on account of the twin headwinds of input price inflation and elevated pricing erosion in key target markets. The implementation of strict environmental regulations by the Chinese authorities has adversely affected the manufacturers of active pharmaceutical ingredients and intermediates. The Indian pharmaceutical industry is heavily dependent on China for various active pharmaceutical ingredients and key starting materials.

Pricing erosion in the US generic drug market continues to remain elevated for most Indian pharmaceutical companies, as the progress made by them to expand their portfolios of difficult-to-manufacture, chemically complex drugs has been slow. Complex generic drugs generally have more defensible margins than immediate-release oral solid dosages. While the measures taken by the US Food and Drug Administration to usher in more clarity on regulatory pathways for the approval of complex generics and address the strategies of large innovator companies to delay the market entry of generic drugs can benefit generic drug makers, the benefits are not likely to be seen in FY19.

Consequent to constrained EBITDA generation, operational cash flow generation is likely to soften in FY19 and keep free cash flow generation moderately negative. The sector's net leverage is likely to deteriorate marginally but it would still remain comfortable at the FY18 level of about 2.0x.