

India Ratings and Research maintains a stable outlook on the Indian pharmaceutical sector

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India Ratings and Research (Ind-Ra) has maintained a stable outlook on the Indian pharmaceutical sector due to the expected recovery in margins, improved cash generation on the back of emerging pricing stability in the US generic drug market, and robust growth in the domestic pharmaceutical market. While investment requirements are likely to increase substantially, strong balance sheets and adequate liquidity lend additional support to the outlook.

With the exit of major global companies from select product segments in the US generic drug market and the slim likelihood of buyer consolidation intensifying further, the improvements in the pricing environment might sustain well into FY20. Most large Indian pharmaceutical companies have robust product pipelines, which could support margin recovery. The domestic pharmaceutical sector is likely to maintain its current growth momentum in FY20, with chronic therapies emerging as strong drivers of growth. Considering the government's increasing focus on providing greater access to quality healthcare in the country, this segment would continue to see regulatory interventions, especially in terms of price controls.

Ind-Ra believes the US generic drug market is undergoing a rapid transformation, and over the next decade, Indian pharmaceutical companies would need to possess different product capabilities to remain profitable. Complex generics, such as injectables, long-acting drugs and other alternate dosage forms, will have relatively better margin profiles compared to traditional oral solids, which remains a mainstay for most Indian companies. Biosimilars, as a product category, have gained approval momentum in 2018 and are likely to grow multifold in the medium term. Most large Indian pharmaceutical companies have sizeable pipelines of complex generics and are gradually shifting focus towards specialty drugs. However, the absence in the biosimilar space will remain a glaring gap in the product strategies of most Indian companies. Ind-Ra expects most large issuers to aggressively deploy capital in FY20 towards necessary investments in new product platforms to strengthen their market-readiness for the medium term.

Prices of active pharmaceutical ingredients produced by China have started to soften. However, Ind-Ra believes the prices are likely to settle at higher-than-the-previous-average levels. To implement strict environmental regulations, most Chinese producers had to upgrade facilities, and in some cases, tweak production processes. This has permanently increased the production cost and cycle times, which will act as a floor for price correction. However, most large Indian pharmaceutical companies are pursuing meaningful cost-saving initiatives, including portfolio optimisation, divesting non-core manufacturing facilities and optimising research and development expenditure. This along with currency depreciation could largely offset the increase in input costs.

While the sector is accustomed to acquisition-driven growth, most of the current investments are medium-term plays, wherein the deriving of synergy benefits could take three to five years from the deployment of capital. This could result in a more gradual deleveraging.