

## Generics still the game changer

19 February 2014 | News | By BioSpectrum Bureau

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The near-term outlook for the Indian pharma industry continues to be principally supported patent expiration wave in the US, strong product pipeline of Indian companies and favorable foreign exchange environment has been noted in ICRA latest update on Indian Pharmaceutical Industry. While growth in the Indian market was muted in first half of the year due to inventory cuts by trade channels and impact of new pricing policy (we expect an average price cut of 17-20% for drugs under NLEM), it is expected to recover gradually.

As far as emerging markets are concerned, while the long-term growth prospects remain intact, certain regulatory developments in some of the markets have hinder the growth momentum for few quarters.

Particularly, the delays in product approvals and pricing pressure in Brazil and efforts to encourage domestic companies in Russia are some of the key challenges that Indian pharma companies face at present.

Overall the performance of individual companies would continue to vary depending on the quality of product pipeline in regulated markets, especially the US, geographic diversification, and in-organic investment driven strategies.

Companies with growing portfolio comprising of niche or complex products in regulated markets and strong & established brands in branded generic markets are likely to be better positioned to manage industry challenges, says ICRA.

Conferring to ICRA study on 22 leading pharma companies much of the growth has been driven by the strong US generic business where Indian pharma continues to leverage on limited competition launches, scale-up in product portfolio and market share gains. These companies have reported a steady growth of 14% in revenues and stable EBITDA margins in the 23.5-24% range during H1 2013-14 despite headwinds building up in the domestic as well as emerging markets.

The growth trajectory has however started showings signs of sluggishness in emerging markets as frequently evolving regulatory developments is impacting the pace of new product approvals, drug pricing and competitive landscape.

While these factors have impacted performance of individual companies during the past few quarters, the relatively low penetration of Indian companies in emerging markets and their growing product portfolio augurs well for the long-term, says ICRA in the report.

According to ICRA analysis, companies strong product pipeline in the US, well diversified presence across emerging markets and strong chronic focus in India have continued to perform better. These factors along with favorable growth prospects for generic drug launches in the US and other developed markets will continue to support earnings of Indian companies.

The key sensitivity to our view would continue to be the expectation of increasing competition in the US due to relatively lower proportion of blockbuster drugs going off patent over the next few years and possibilities of further increase in R&D spending.

ICRA expects the foreign exchange environment is likely to be positive for companies that do not have significant US\$ denominated liabilities in their balance sheets or limited revenue hedges.

However, companies with significant forex borrowings or derivative contracts (not covered adequately by export receivables) could see MTM losses during periods of rupee depreciation. ICRA analyzed 45 pharma companies with aggregate debt of Rs. 173 billion (as on March 2013) to judge the extent of their exposure to forex risk.

Around 46% of the debt of these entities was denominated in foreign currency and 56% was unhedged. While these indicators suggest high vulnerability to INR depreciation, we believe that most of it is offset by higher realization of revenues from international markets.