Research

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Booster shot for pharma from exports, costs

Domestic business stutters a touch in the first half

Chartbook | January 2021

India's formulation and bulk drug exports improved 18% and 9% on-year (in constant currency) during the first half of this fiscal, compared with 11% and -1%, respectively (in constant currency) for the whole of fiscal 2020.

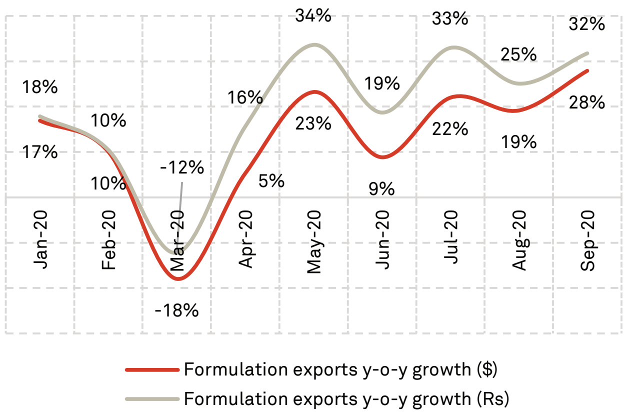
A spike in demand for pharma products, induced by the Covid-19 pandemic, and hoarding of supplies by some nations in the wake of production disruptions, have boosted exports.

Further, increasing customer diversification away from China with respect to bulk drug policy, coupled with some countries adopting a 'China plus one' policy, has led to increased demand for active pharmaceutical ingredients (APIs) from India.

Robust demand from most economies boosted India's exports in the first half

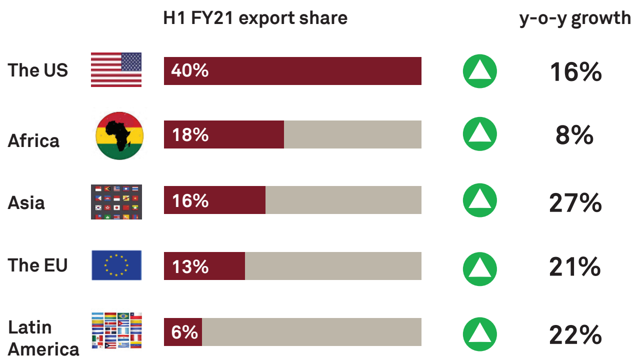
Major regions such as the US and Europe brought good exports growth due to increased demand for drugs — especially antivirals and antibiotics for treatment of Covid-19. For example, several Indian players have inked agreements with Gilead Sciences to manufacture and export Remdesivir.

Formulation exports see robust growth in H1 FY21



Source: DGCIS
Note: % y-o-y growth mentioned

Formulation exports rise across top regions

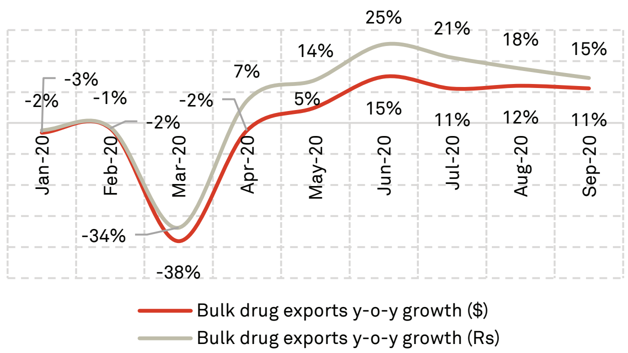


Source: DGCIS
Note: Above growth is in constant currency

Global de-risking of supply chain bodes well for Indian bulk drug exports

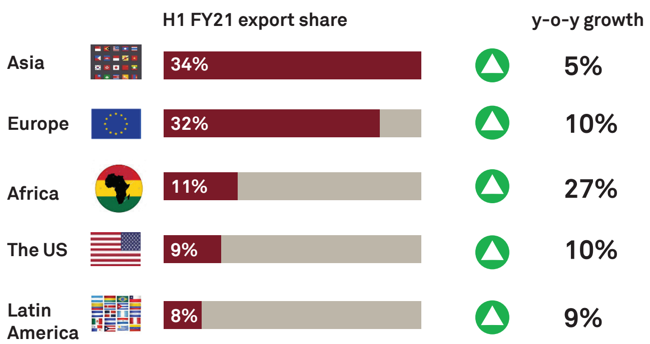
Chinese supply disruptions in early 2020 and persistent quality issues provide opportunities for Indian players as customers look at India as an alternative supplier of bulk drugs. Further, Indian API exporters have been able to garner good realisations on their exports during the first half of this fiscal.

Strong demand boost Bulk drug exports as well



Source: DGCIS
Note: % y-o-y growth mentioned

Bulk drug exports rise across top regions



Source: DGCIS
Note: Above growth is in constant currency

Domestic market fell 2.5% in the first half; sequential improvement visible

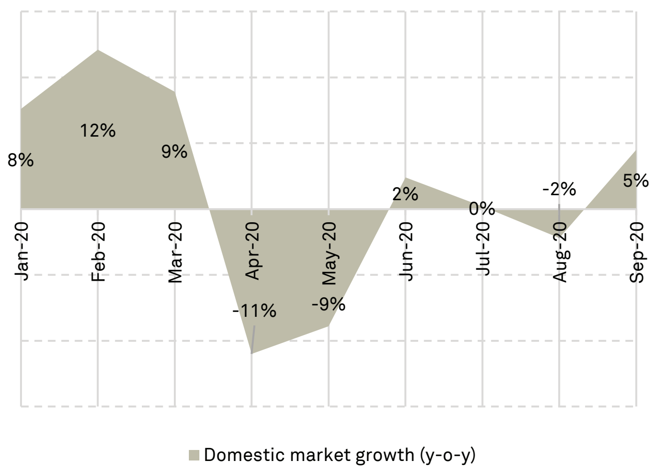
Given the lockdown in April and May, the domestic pharma market logged a 6% decline in growth in the first quarter of this fiscal. Closure of smaller clinics and hospital OPDs and postponement of surgeries resulted in slower sales of drugs in the domestic market, although some support was provided by an increase in sales of chronic therapies such as cardiac and anti-diabetics.

Growth in the domestic market remained muted in the second quarter, leading to an overall decline of 2.4% for the first half. Key acute therapies logged a 4% decline in the first half, led by anti-infectives (9% y-o-y decline) and Gastro-intestinals (3% y-o-y decline), while key chronic therapies grew ~6%, led by cardiac and anti-diabetic therapies (12% and 6% y-o-y growth, respectively).

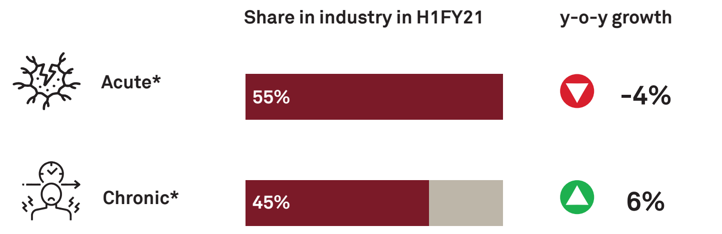
The domestic market is expected to bounce back in the second half of the fiscal as demand disruptions ease, as is evident from a 9.6% on-year growth logged in October.

All the same, the slowdown in the domestic market would result in a moderation in overall pharma market growth this fiscal, as shown in the graph below.

Domestic growth falters due to Covid-led disruptions



Lower hospital consultations restrict growth in Acute therapies



**Key acute therapies (Anti-infectives, Gastro Intestinal, Vitamins/minerals/nutrients, Pain Analgesics, Derma); *Key chronic therapies (Cardiac, Anti-Diabetic, Respiratory, Neuro)*

Source: Industry, CRISIL Research

Pharma revenues to continue uptrend this fiscal

Robust exports growth in both formulations and bulk drugs is likely to help players maintain 7-8% (in Rs terms) on-year growth this fiscal.

Gradual easing of lockdown restrictions, coupled with demand for pharma products and bulk drugs in both exports and domestic markets, will aid revenue growth. Indeed, a ramp-up in specialty products and biosimilar exports, along with strong domestic sales, will aid revenue growth next fiscal, too.

As expenses came off, margins expanded in the first half

Lower travel and marketing costs on account of the lockdown, together with a favourable business mix, led to an improvement in margins for formulation and bulk drug players by ~280 basis points (bps) on-year in the first half of this fiscal. Operating expenses reduced due to a fall in movement of medical representatives and other cost cuts, along with rationalisation of manpower.

Raw material costs remained flat in the first quarter, but increased ~7% on-year in the second, largely led by demand. In the second half, the cost of raw materials is likely to be higher, putting pressure on margins.

With the benefit of lower expenses waning in the second half and the cost of raw materials trending up, players are likely to see a 100-200 bps improvement in margins this fiscal.

Selling and marketing expenses among lowest in first half of fiscal 2021, as compared with past quarters

Note:31 companies in the set including bulk drugs and formulation players
Color code for raw material costs, staff costs and selling expenses: Green denotes a fall in costs, amber for moderate growth, red for high costs. All in relation to revenue growth in corresponding quarters
Source: Company reports, CRISIL Research

On the other hand, the withdrawal of the Merchandise Exports from India Scheme (MEIS) will have some impact on the margins of export-oriented players. The government has announced the withdrawal of the MEIS scheme by December 31, 2020, to be replaced by the Remission of Duty or Taxes on Export Products (RoDTEP) scheme. Further, incentives under MEIS have been capped at Rs 20 million per exporter. With incentives under the MEIS scheme accounting for ~2% of revenue for most players in fiscal 2020, large exporters will thus lose much of these tax incentives for fiscal 2021.

Analytical contacts

Isha Chaudhary
Director
CRISIL Limited
isha.chaudhary@crisil.com

Sehul Bhatt
Associate Director
CRISIL Limited
sehul.bhatt@crisil.com

Nidhi Shetty
Analyst
CRISIL Limited
nidhi.shetty@crisil.com

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