

Neutral impact for pharma sector: Experts

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The impact of the rupee depreciation is likely to be largely neutral for the Indian pharmaceutical sector, say industry insiders, as the benefits may be offset by rising input costs.

India's pharmaceutical sector exported drugs worth ₹1.8 trillion (\$22.5 billion at INR-USD rate of 80) in 2021-22, according to the Ministry of Commerce. This was flat over the previous year. In 2020-21, however, the exports had clocked an 18 per cent year-on-year (YoY) growth. On the other hand, India also imports active pharmaceutical ingredients (APIs) and other raw materials needed to manufacture drugs, and industry points out that bulk of these imports is from China, and in dollar denomination.

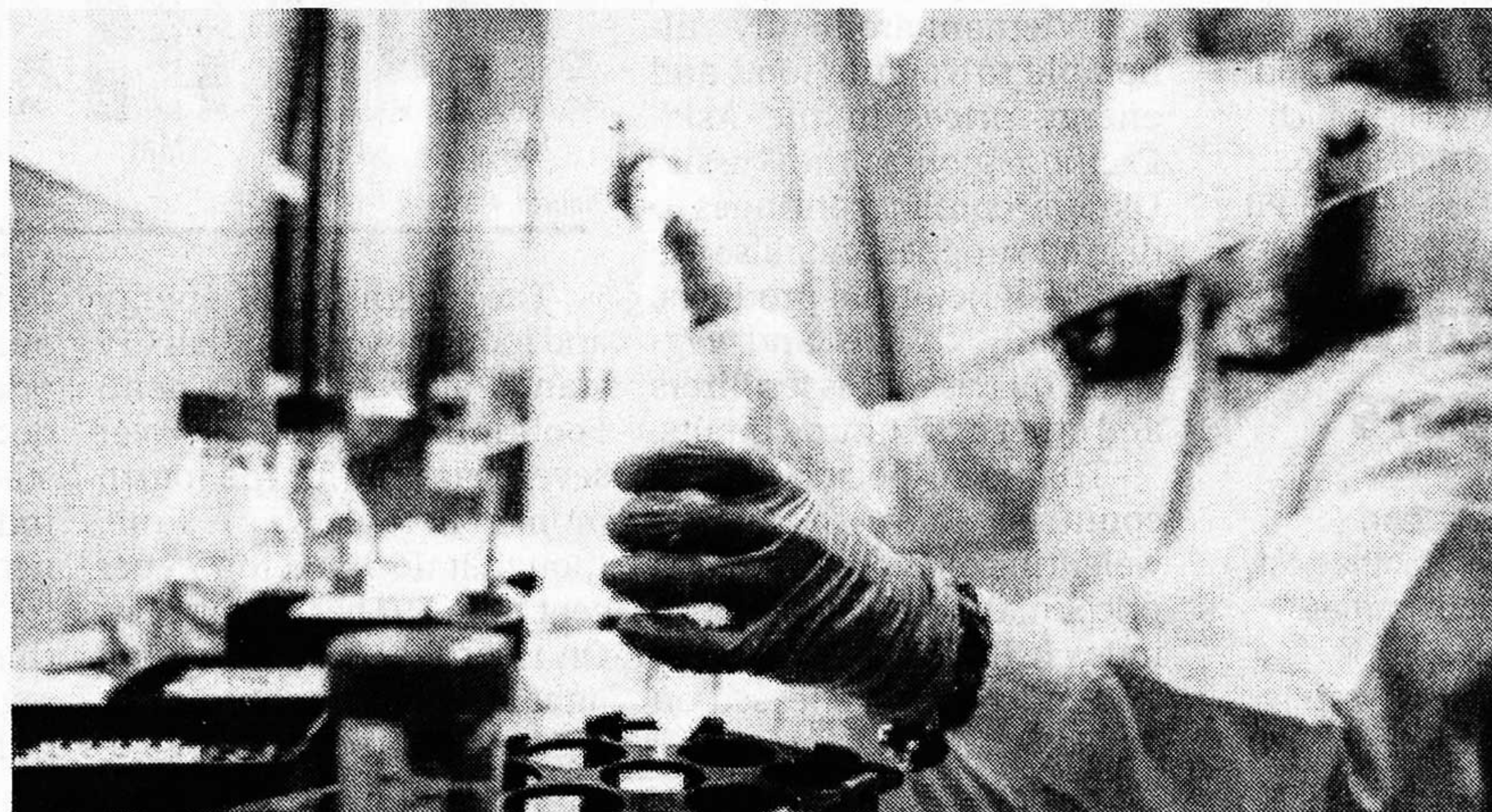
India roughly imports APIs worth ₹30,000 crore, and other chemicals and raw materials to the tune of ₹32,000 crore (total ₹62,000 crore; \$7.75 billion). On top of this, there has been a rise in freight, and power costs in recent months. Prices of key APIs have risen in the range of 30-140 per cent, varying across products.

Kunal Randeria, analyst with Edelweiss Securities said that the rupee depreciation is a slight positive for US-focused companies like Dr Reddy's Laboratories, Aurobindo, Divi's Laboratories, etc. "However, this will be blunted by input cost rise impact," he said.

According to Bloomberg, companies that draw the highest share of revenues from the US are Strides Pharma (78.7 per cent), Granules India (62.93 per cent), Aurobindo (47.6 per cent), Zydus (46.6 per cent), Biocon (36.5 per cent) among others. However, exports are mostly in US dollar denominations apart from some countries like Russia.

Managing Director and Chief Executive Officer, Syngene International, Jonathan Hunt explains: "The vast majority of our work or rather our revenue is dollar-denominated. We price our contracts in dollars. So when we repatriate that back into rupees, clearly we're getting a benefit there and that in some ways helps us offset some of the local natural rupee inflationary pressure."

"Where we are sourcing locally, so we source in India when we can; plus, the labour cost. So there's a little bit of an offset



TOP 10 GAINERS IN NIFTY PHARMA

(As on July 18)	CMP (₹)	Change % 1-mth	3-mth	YTD
Granules India	308.5	27.3	3.6	-8.2
Ipca Laboratories	998.1	15.2	-2.4	-7.9
Sun Pharma	882.8	11.3	-4.8	4.4
Strides Pharma Science	343.7	11.2	-3.1	-23.1
Abbott India	19,867.4	10.9	14.6	2.0
Torrent Pharmaceuticals	1,506.1	9.2	6.1	-7.6
Lupin	645.4	8.0	-16.2	-32.1
Laurus Labs	505.4	7.9	-15.5	-6.2
Dr Reddy's Laboratories	4,466.1	7.7	4.2	-9.0
Divi's Laboratories	3,740.0	7.4	-17.3	-20.1
NSE Nifty Pharma	12,713.5	7.7	-7.3	-10.6

CMP: Current market price; YTD: Year-to-date; Source: Bloomberg, exchange

Compiled by BS Research Bureau

in the P&L because there's a natural hedge between having a revenue US dollar-dominated and lots of our operating costs in the rupee. But in general, I think like most industries, everybody's seeing inflation, it's something that for many of us around the world, we've not seen at this level for decades if not longer. And we have to learn to cope," Hunt adds.

Analysts agree that operating costs and hedging undertaken by companies may offset most of the gains arising from a weaker rupee.

"Most of the companies have hedged their dollar exposure. Dollar impact comes in two forms — one is topline, but also in the middle-line (like paying salaries, which is done on the spot prices). Sales are

planned, and at times hedged by the buyer, but there are spot costs for the pharma companies," said a senior analyst who did not wish to be named.

When foreign buyers see that dollar value is rising vis-à-vis the rupee, they usually seek discounts from the Indian companies, said an industry insider. "The pharma companies give discounts, but they also encash on the situation by asking for larger contracts, or longer term contracts," the person explained.

Smaller companies, however, are likely to be negatively impacted as they do not have long-term import contracts for APIs and intermediates. "These companies do not carry a lot of stock, and they have to do some spot deals. They may have a negative

impact due to dollar rising," said one Gujarat based formulation maker.

On the whole, the pharma industry feels that the impact will be neutral. A senior executive of a pharma lobby group said, "Dollar gains will be neutralised by price erosion, and rise in input costs. Therefore, the gains will be offset."

Rating agency CareEdge said that the US generic market saw a steep rise in competition and consequent price erosion, which also impacted the profitability of the Indian pharma industry during 2021-22. However, the negative impact of price erosion on profitability was partly offset by the depreciation of INR against USD.

CareEdge expects the profit before interest, lease rentals, depreciation and taxes (PBILDT) margin of the Indian pharma sector to decline both on YoY basis and sequential basis to 19-20 per cent during the first six months of 2022-23 due to an increase in the cost of APIs and key starting materials (KSMs) apart from increase in the cost of packing material, freight and compliance cost.

"It is expected that the PBILDT margin should rebound in H2FY23. CareEdge expects rupee depreciation to have a positive impact of nearly 100-150 bps on the PBILDT margin during FY23. On a full year basis, CareEdge expects the PBILDT margin to shrink by 200-250 bps during FY23 over FY22 after considering the positive impact of rupee depreciation," it says in a recent note.

Based on industry aggregates that represent over 85 per cent of the overall pharma market, the operating profitability had remained stable at about 23 per cent during the last 4 years (except for the pandemic year of 2020-21), the rating agency said.

As for the medical devices sector, most of India's imports are from China, and the industry says there would not be much benefit by cutting down imports. "The 5-6 per cent depreciation of rupee vs USD should help exports and theoretically discourage imports. But in reality, the imports are usually not discouraged in most cases as China is the dominant exporter of medical devices to India and also lost 6 per cent to USD, so yuan versus rupee (there is) hardly any change," said Rajiv Nath of the Association of Indian Medical Devices Industry.