Pharma Players' FY23 Profitability Margins May See 200-250 bps Dip

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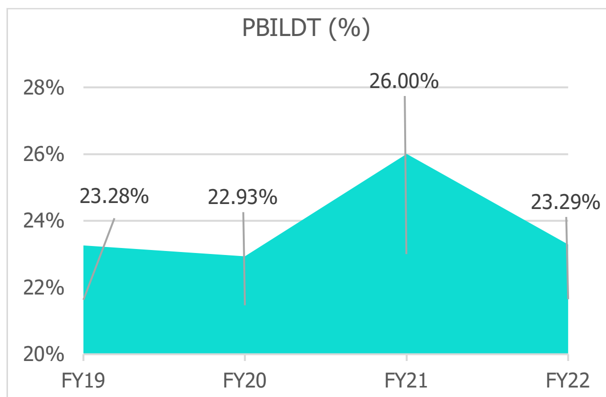
Overview

With a market size of around USD 47-49 billion in FY22 (April 1 to March 31), the Indian pharmaceutical industry globally ranks third in terms of volume and thirteenth in terms of value. The industry has exhibited compounded annual growth rate (CAGR) of 8-9% during last five years i.e. FY17-FY22 while registering a y-o-y growth of 5-7% in FY22, largely driven by higher domestic consumption, even as the exports value was stable at USD 24.60 billion in FY22. The United States of America (US) continued to be the prime export destination for the industry, constituting nearly 34% of total exports during FY22, which registered a growth of 2% in USD terms while export to the Rest of the World (ROW) witnessed a decline of 7%. Based on industry aggregates that represent over 85% of the overall pharma market, the operating profitability has remained stable at about 23% during the last 4 years (FY21 being the exception). However, with various factors affecting the Indian pharma entities, CareEdge expects operating profitability to taper by 200-250 bps in FY23 and the factors leading to the same are delineated below.

Factors behind the Rise and Fall of PBILDT Margin from FY20 to FY22

Pharma sector had witnessed a significant jump in its operating profitability (PBILDT) margin in FY21 over FY20 on account of sharp reduction in marketing, travelling and conveyance expenses in the backdrop of Covid-19 pandemic restrictions. The profitability was also supported by Covid-led sales opportunities. However, with the normalisation of above-mentioned expenses along with waning sales opportunity of Covid-related drugs, the industry suffered a decline in its PBILDT margin during FY22 over FY21. This apart, US generic market saw a steep rise in competition and consequent price erosion, which also impacted the profitability of Indian Pharma Industry during FY22. However, the negative impact of price erosion on profitability was partly offset by the depreciation of INR against USD.

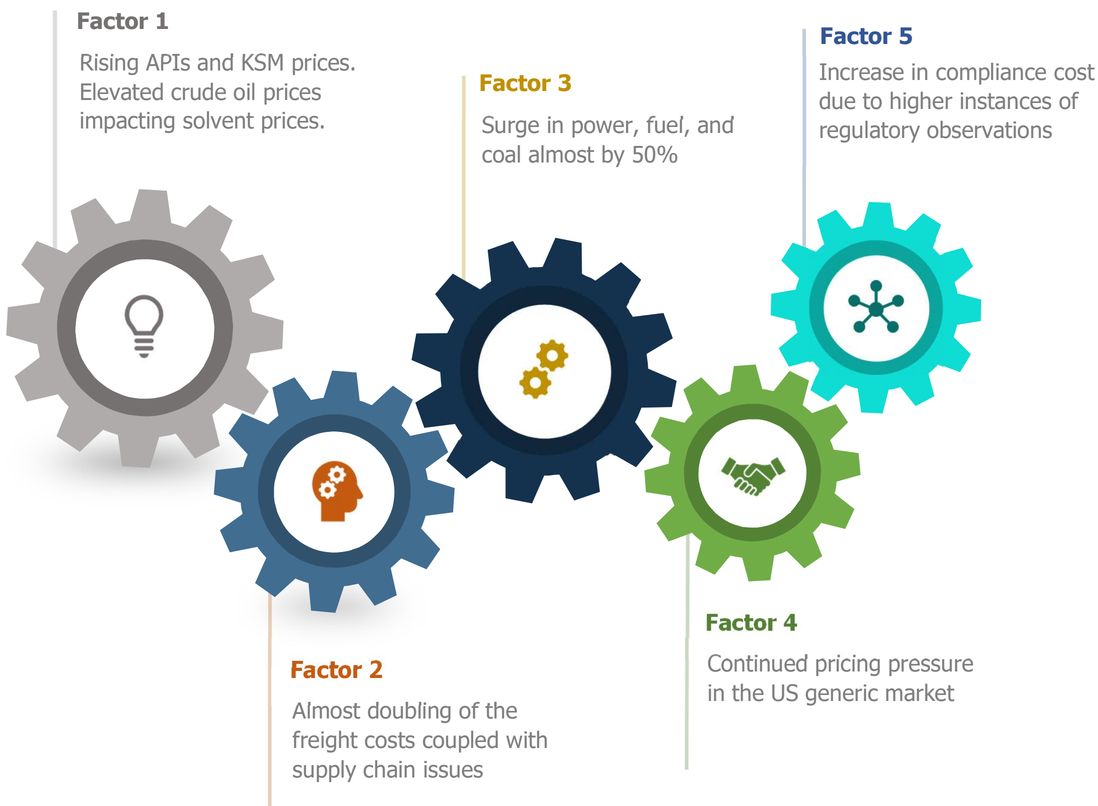


Source: Ace Equity; Industry aggregates of over 165 Indian pharma companies compiled by CareEdge. These companies represent more than 85% of the overall pharma market.

Headwinds Envisaged to Taper Down PBILDT Margin in FY23 despite Offsetting Factors

Presently, the Indian Pharma Industry is witnessing multiple challenges such as rising prices of active pharmaceutical ingredients (APIs) and key starting materials (KSM), the surge in solvent prices, rise in freight and energy cost and continued pricing pressure in the US generic market. Due to supply chain disruptions and prevailing lockdown in China, the prices of some APIs/ KSM have increased between 25% to 120% while prices of excipients have risen between 15%-200% during the last 12-18 months. Apart from the cost of raw material, the cost of packing material also saw an upward movement of 25-100% during the past 12-18 months. The cost of power, fuel and coal witnessed a rise of more than 50% during the last one year while the cost of freight saw a jump of more than 2 times.

With the easing of travel restrictions, the US Food and Drug Administration (USFDA) has ramped up its regulatory inspection rates of pharmaceutical manufacturing facilities. During the past six months (January to June 2022), it has been observed that many Indian pharma companies have received Form 483 observations on their manufacturing facilities. Rising instances of audit observation by USFDA impacts the compliance cost and in turn hurts the profitability of the pharma sector. Any adverse observations from the regulatory authorities can also lead to a delay in the launching of new products or may even impact the current revenue stream, thus denting its prospects at least for the medium term. The ability of the Indian pharma companies to successfully sail through the inspections carried out by the regulatory authorities would be critical in determining their future growth plans and profitability margins.

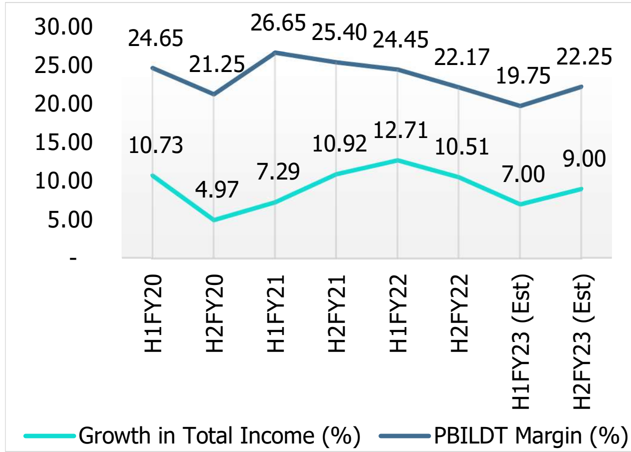


Recently, India's drug pricing authority allowed a price hike of 10.7% for scheduled drugs which are under price control, considering the rise in the cost of production. This is the highest price hike allowed by it during the past many years which is expected to support the profitability of the pharma sector to an extent. Further, the pace of price erosion in the US market is likely to reduce to the mid-single digit in FY23. Furthermore, the recent sharp depreciation of INR against USD is also expected to support the profitability of the sector considering it is a net exporter. From April 01, 2022, to June 30, 2022, the Indian rupee has depreciated by more than 4%.

Conclusion

CareEdge expects the PBILDT margin of the Indian pharmaceutical sector to decline both on Y-o-Y basis and Q-o-Q basis to 19-20% during H1FY23 due to an increase in the cost of APIs and 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. Despite expected moderation in operating profitability in near to medium term, the credit profile of pharmaceutical companies is expected to remain strong due to their low reliance on external debt.

Y-o-Y Growth in Total Income (%) and PBILDT



Source: Ace Equity; Compiled by CareEdge

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