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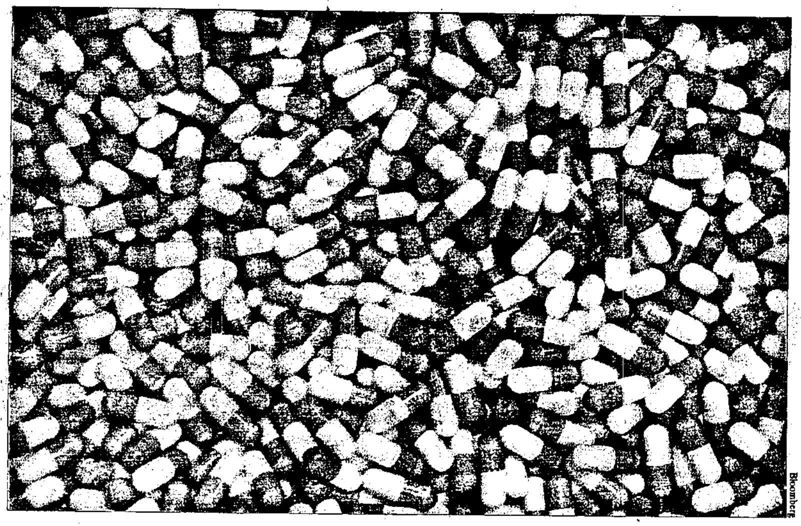
Sector review: Pharmaceuticals

Multiple stimulants

Pharma firms look for big gains from generic and off-patent drugs in India, the US, South Africa and Japan. But the same firms have reported a big jump in fixed costs and marked-to-market foreign exchange losses



Bloomberg

Industry

SHRUTI VERMA KHARE

ON THE back of sustained demand from the US — world's largest drug market — the Indian pharmaceutical companies continue to report strong growth and have beaten analysts' estimates in the results announced for the first quarter for the ongoing financial year. Revenue and operational profit of most pharma companies grew significantly compared with last year.

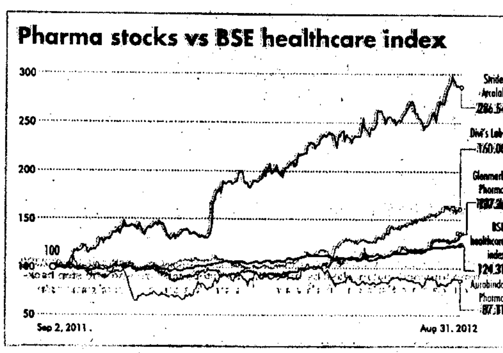
India's largest drugmaker by market capitalisation, Sun Pharma, posted 64 per cent revenue growth in the April-June quarter, largely driven by strong performance in the US and the other emerging markets. Revenue from the US market grew by 148 per cent, while emerging markets contributed 45 per cent to the overall revenue growth.

"Strong operating performance aided by product launches and exceptionally strong growth across the US, India, Japan and South Africa have helped us deliver yet another quarter of sustained growth," said Kamal K Sharma, managing director, Lupin, said in a company statement after the announcement of results. Lupin reported 33 per cent growth in net profit at Rs 280.4 crore for the June ended quarter, against Rs 210 crore in the corresponding period of the previous year on the back of strong sales of its generic drugs in the US, Japan and South Africa.

Placebo effect

Pharma companies have posted good jump in operating profit margins indicating healthy future growth trends. Overall, margins continue to expand by 200-300 basis points (bps) in the first quarter. In April-June quarter this year, Cipla reported 58 per cent growth in net profit at Rs 400 crore, while the operating profit margins expanded by 190 bps to 30.92 per cent.

Lupin's operating margin grew by 55.6 per cent year-on-year (YoY) to 20.6 per cent. However, pharma companies reported sharp jump in fixed costs and mark-to-market (MTM) foreign exchange (forex) losses. For instance, Ranbaxy Laboratories, India's largest drugmaker, has reported loss of Rs 586 crore in April-June, against net profit of Rs 243 crore in the same period a year ago. The company attributed the losses to foreign exchange fluctuations and a weak Indian rupee against the dollar.



Pinaki Paul

Ranbaxy has incurred huge losses notwithstanding net sales increasing by 54.5 per cent to Rs 3,174 crore. Foreign exchange loss in the quarter was Rs 599 crore, against a gain of Rs 111.7 crore posted in same period of the previous year.

Ajay Kumar Sharma, associate director, pharma & biotech, healthcare practice, Frost & Sullivan, South Asia & West Asia, said, "Foreign exchange loss is on a higher side but still Ranbaxy has very strong fundamentals. They have an impressive pipeline of new launches for the US market. Ranbaxy has also sorted its regulatory issue with USFDA and I expect (the company) to come back strongly."

Jubilant Life Sciences reported 93.50 per cent decline in net profit at Rs 5 crore in the first quarter ended June 30, against Rs 77.12 crore in the corresponding period last year. Sharp fall in net profit is due to unrealised mark-to-market forex loss on loans of Rs 104 crore.

Despite the impressive performance at the operating level, the profit of key players weakened on a sharp rise in the interest and depreciation charges and tax. Lupin's tax outgo jumped by 322 per cent to Rs 120 crore in the first quarter of the present financial year, compared with Rs 28 crore in the same period last year.

"A lot of patents in the US set to expire this year will give boost to India's generic producers. Outlook for the next two-three years look strong," said Deepak Malik, senior research analyst, Emkay Global Financial Services.

Progressive care

Growth is driven by shift in focus of the companies towards chronic therapies compared with the acute segment. Under the chronic segment comes lifestyle-related ailment, such as diabetes, high blood pressure and cardiac problems.

Medications for chronic ailments are often life-long, compared with short duration medication for acute ailment. Analysts say chronic illness-focused players such as Sun Pharma, Lupin and Glenmark will continue to report a strong growth trend.

The acute segment includes anti-infectives, pain killers, respiratory drugs, malaria and gastro medication. It also depends on seasonal conditions. For example, inadequate or erratic monsoon many bring down malaria cases.

"Chronic illness-focused players such as Sun Pharma, Cadila, Lupin and Glenmark are major outperformers, while acute-illness-focused players like Ranbaxy, Cipla, Torrent and Dr Reddy's have underperformed," said an Edelweiss report.

For IPCA Labatories, an expected approval from USFDA for its Indore facility will be key for the company. For Glenmark, the US business could be a major driver going forward. Its dermatology and hormones products in pipeline would be the focus.

On Divi's, Motilal Oswal Securities in a note said, "We expect Divi's to be a key beneficiary of increased pharmaceutical outsourcing from India, given its strong relationships with global innovator pharmaceutical companies. It has undertaken large capex at its new SEZ, implying positive prospects for its outsourcing business."

Most companies remain upbeat about revenue guidance (15-20 per cent) for the present year due to strong, new product pipelines, improved utilisation of newly-commissioned facilities and the contribution from the newly acquired entities.

Analysts, however, say that Indian pharma companies will soon have to restructure their domestic business models to factor in a drop in margins as prices begin to fall when the country's new drug pricing policy becomes effective.

The draft policy, unveiled by the department of pharmaceuticals in October 2011, proposes to cap prices of 348 essential medicines and their formulations at the average price of the three best-selling brands. The government's objective is to make essential drugs affordable and accessible to all. However, the health ministry and NGOs have opposed the proposal. It is now pending before a group of ministers.

Stock performance

Small and mid-sized pharma companies have outperformed their larger peers this calendar. Shares such as Shasun Pharma, Piramal Life Sciences, Granules India, Ajanta Pharma and Dishman Pharma have zoomed 244 per cent, 193 per cent, 184 per cent, 182 per cent and 171 per cent, respectively, so far in 2012. Strides Arcolab, Suven Life Sciences, Alembic Pharma and Divi's Labs have soared 106 per cent, 102 per cent, 96 per cent and 48 per cent, respectively. Glenmark, Lupin, Aurobindo Pharma and Pfizer gained 51 per cent, 32 per cent, 30 per cent and 13 per cent, respectively.

"We expect the growth to moderate in the subsequent quarter mainly due to a slower growth in the domestic formulations business (from a relatively higher base) and slower depreciation of the rupee against the dollar (up 11 per cent YoY)," said brokerage Sharekhan in a note. ■

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