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Pharma's cost savings may persist; revenue growth could be gradual

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Markets hit six-month high on global support
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The ongoing momentum on cost savings could bolster operating margins in the pharmaceutical sector in the coming quarters. Some of that is already reflected in the sector's June quarter results, which has helped pharma stocks jump 44% in 2020, against a 6% slide in the Nifty 50. However, returns may taper in the future.

Analysts note that the cost-saving efforts could carry on for a quarter or so. Pharma companies' typical expenses for marketing and travelling costs were markedly lower during noted that a part of the costs savings could sustain.

"While the strong margin performance across the board (helped by lower domestic promotional spend and modest R&D spend) was a direct consequence of the lockdown, we believe that a significant part of the operating expense reduction during the quarter could be structural with the current disruption offering an opportunity to companies to re-imagine existing cost structures," said analysts at JM Financial Institutional Equities in a note to the clients.

Revenue growth was encouraging in the first quarter, both domestically and internationally. In the domestic market, growth was steady despite fewer footfalls at hospitals and clinics. Sales of acute therapy products, though, were restrained during the quarter. The chronic therapy segment continued to do well. Large companies should be able to outperform the overall pharma market growth in the coming quarters.

"Secondary sales growth data for July indicates that a broader recovery itself is likely to be a more gradual and protracted phenomenon. A prolonged slowdown in the domestic market and depressed acute sales could pose downside risks in the near term," said the JM Financial report.

Still, the 2% year-on-year (y-o-y) revenue growth in Q1 is considered decent given the disruption in supply chains. Further, analysts say the demand for pharmaceutical products is expected to rise after covid-19, as people become health-conscious, which augurs well for the sector.

The US market's growth was largely above Street's expectations in Q1. While a delay in new launches and ramp-up of existing products were seen, a positive is that the price-erosion in generic products was limited.

Further, categories like the active pharma ingredient segment saw some sharp growth. However, one must note that pharma companies stocked up active pharmaceutical ingredients (APIs) during the quarter on fears of supply disruption. Hence, the coming quarters could see growth taper off in this segment.

Also, note that the recent run-up of pharma stocks increased the sector's valuations considerably.

Even factoring in the recent improvement in profitability, stocks of several companies are quoting above their past historical averages, with several frontline pharma companies trading at 18-24 times FY22 earnings, a few even higher. This is quite high and could cap the sector's gains.

HEALTH FACTOR

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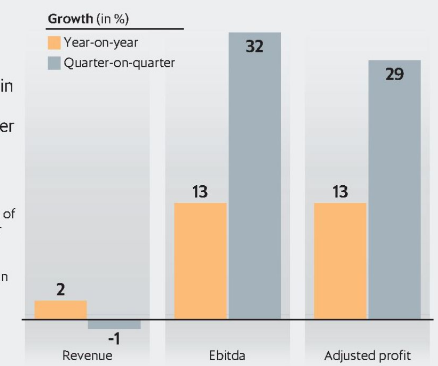
STOCKS of some firms are above their historical averages, which is quite high and could cap gains

THE secondary sales data for July indicates that a broader revival may be a protracted, gradual phenomenon

Profit beat

Several pharma companies showed sharp improvements in their Q1 operating profits, driven by lower costs, part of which may be sustainable, say analysts.



Note: Data includes results of Cadila Healthcare, Cipla, Dr Reddy's Laboratories, Ipca Laboratories, Lupin, Natco Pharma, Strides Pharma, Sun Pharmaceutical Industries, Torrent Pharma.

Source: JM Financial Institutional Equities

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