

Sector Update

Deregulation of non-essential drug prices is a boon for the pharma industry

The government has approved deregulation of drug prices not included in the National Essential Medicines List (NEML), on recommendation of the Ministry of National Health. This is a major shift from the Drug Policy 2018 currently in place (under which pricing was linked to the annual CPI). Prices of medicines, other than essential, will be exempted from the section 12 of Drugs Act, 1976 and grants autonomy to pharmaceutical companies to independently raise prices of non-essential drugs. DRAP will be making amendments to the last Drug Pricing Policy 2018 accordingly.

Under the 2018 Drug Policy, prices of essential and non-essential medicines could be raised by 70% and 100% of the average annual CPI (of the previous year) with a cap of 7% and 10%, respectively. While the same still applies for 464 essential drugs listed in the NEML, price for non-essential medicines can now be raised on a discretionary basis by pharmaceutical companies.

Types of drugs on the essential and non-essential list

There are c. 11,000 actively marketed drugs in Pakistan sold at licensed pharmacies based on prescription. The list of non-essential drugs has expanded significantly in the past few years. They include some antibiotics (like amoxiclav), gastrointestinal (Tramadol), and vitamin/calcium/IV solution categories etc. and exclude such categories as medicines in pediatric (Cefaclor) analgesics (paracetamol, ibuprofen), cardiovascular (Amlodipine), respiratory (Aminophylline), diabetes (insulin injections, metformin) and psychotropic drugs etc. which are categorized as essential drugs.

This has happened before, in 1993 - a similar case can be made

A similar decision was taken in 1993, when the government (led by the PML-N) announced partial deregulation of prices of medicines. Drug prices increased by c. 90% on average in post-deregulation era between 1993 and 2001 (even by over 300% in some cases) according to a WHO Report (2006). Importantly as per SBP data, medicine prices in the CPI basket rose 20-30% YoY during 1993-94 – some of which was reversed in subsequent years given prices exceeded that of neighboring countries. This also resulted in a large shortage of essential medicines in Pakistan as the industry lost the economic incentive to produce such drugs which remained regulated. Ultimately a price moratorium was introduced in 2001-2013 by the Ministry of Health. A similar case, (to that of the 1993-94 price hike), can be made this time around given the PKR has devalued by a cumulative c. 30% in FY23-FY24td, against which pharmaceutical companies have received a c. 14%-20% price hike in May'23 from DRAP.

AGP, HINOON and ABOT among the major beneficiaries; we reiterate Buy on AGP and SEARL

The exact increase in prices, based on today's decision, cannot yet be determined. However, pharma companies with a high proportion of non-essential drugs in their revenue mix (over 50%) stand to benefit the most. AGP, ABOT, HINOON and HALEON will be the key beneficiaries – all of which have over 50% non-essential drugs in their sales mix. GSKCH and SEARL will also benefit, albeit with a lower proportion. We expect a very sharp increase in margins of pharmaceutical companies with AGP to lead the trend. The deregulation may also help the industry quickly neutralize the negative impact of any large PKR-USD depreciation, through more nimble price hikes, in our view.

We have a Buy rating on both AGP and SEARL with a TP of PKR100/sh and PKR90/sh respectively. We will look to revise up earnings as clarity on potential price hikes emerges.

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Ratings Guide*	Criteria
Buy	Total return expectation of $\geq 15\%$ or expected to outperform the KSE-100 index
Neutral	Total return expectation of $> -5\%$ or expected to match the return of KSE-100 index
Sell	Expected downside of more than 5% or expected to underperform the KSE-100 index

*Based on 12 month horizon unless stated otherwise in the report.

Valuation Methodology: We use multiple valuation methodologies in arriving at a Target Price including, but not limited to, Discounted Cash Flow (DCF), Dividend Discount Model (DDM) and relative multiples based valuations.

Risks: (i) Reversal of decision by the Government or courts, (ii) revision in the list of non essential drugs, (iii) rise in black market sales.

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