

Pharmaceuticals in Russia: a high-growth market mainly benefiting Western laboratories (until now)

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Executive summary

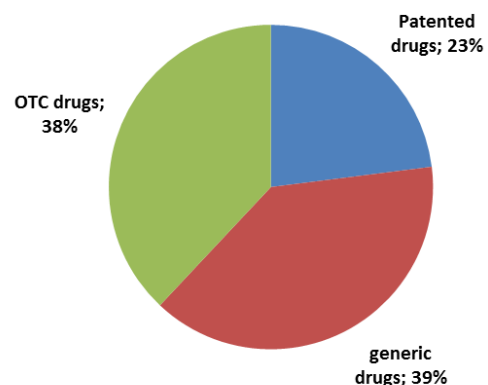
- Russian domestic market was estimated at USD 24 billion in 2013 and is poised to become one of the 10 largest in the world.
- For the time being the market is dominated by sales of cheap drugs (75% of them are generic or over the counter (OTC)).
- Vigorous growth since 2010, boosted by reform of the legal framework governing healthcare and by the country's entry into the WTO. Above all, this has benefited Western laboratories, whose exports to Russia have more than doubled since 2006.
- More moderate prospects for the market out to 2020 (+7% per year on average versus +18% between 2010 and 2014), but which should still outpace the global market (+4%), along with national laboratories that might enjoy more public support.

Russian market valued at USD 24 billion in 2013, dominated by sales of generic and OTC drugs

Like many emerging countries, Russia favors cheap drugs at the national level. As shown by chart 1, drugs that are generic or OTC (over-the-counter, i.e. not necessarily requiring prescription from a doctor) account for 75% of the Russian pharmaceutical market. Patented drugs which are sold at a higher price and require a doctor's prescription to buy at a pharmacy or hospital, make up the rest.

A difficulty with the Russian market is that it is not easy in practice to distinguish between prescription drugs and OTC drugs.

Chart 1 : Russian pharmaceutical market by type of medicines sold



Sources : BMI, Euler Hermes estimations

High-potential market poised to rise from 14th largest in the world in 2007 to 8th by 2017

Table 2 shows the historic predominance of the United States as the largest pharmaceutical market in the world, ahead of Japan. It is often forgotten that despite its highly-aged population, Japan is considered to second place and will soon be third behind China as a result of a highly protectionist healthcare policy. The (North) American market remains highly prized by the laboratories, as its patent protection regime rewards medicinal innovation handsomely. The most recent commercialized drugs command the highest sales price in the United States. The problem is that these drugs are very often out of the reach of Russian patients' insufficient purchasing power.

Nevertheless, Russia (like Brazil) is set to jump six places in the global ranking of pharmaceutical markets. This expected gain stems from a much lower level of per capita drug spending than in mature markets, as shown by chart 3. It also results from the Russian government's ease in financing its public health insurance spending thanks to the considerable financial windfall from energy and more particularly gas.

Table 4 shows that the proportion of healthcare spending at the individual patient's expense in Russia amounts to only 38% of the total. This is all the more desirable as 94% of the Russian population has wealth of no more than US\$ 10,000 according to statistics calculated by Credit Suisse yearly. That means that access among the Russian middle class to the most recent -and therefore the most expensive- pharmaceutical innovations could still take some time.

That said, the Russian pharmaceutical market offers significant potential for growth in the long run as a result of course of the size of its population (more than 140 million people, making it the eight most populous country in the world) but also the many illnesses likely to affect it. Like several other countries, Russia is not immune to the harmful effects of higher than average consumption of (hard) liquor and tobacco: respiratory problems, cardiovascular problems, cancer, etc.

High pace of growth this decade -three times global growth- with a combination of positive factors at the outset

The Russian pharmaceutical market is forecast to grow at an average annual pace of around 13% during the decade 2010-2020. This rate of growth is three times higher than that of the global pharmaceutical market, forecast to grow by 4%.

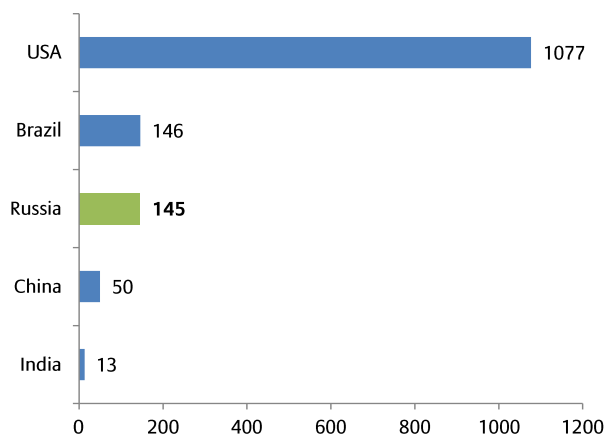
This pace of growth of the Russian market masks two separate stages: euphoric growth in the first half of the decade, with an average annual growth rate of +18%, followed by what promises to be a more moderate growth rate of around "only" +7% between 2015 and 2020.

Table 2: Rank of countries according to their pharmaceutical expenditures

Country	Rank 2007	Rank 2012	Rank 2017 (f)
USA	1	1	1
Japan	2	2	3
France	3	5	6
Brazil	10	6	4
Russia	14	11	8

Source: IMS

Chart 3: drugs spending per capita (in US\$), 2011 figures



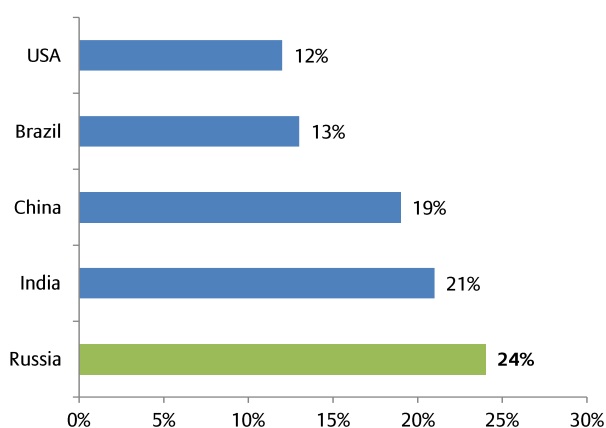
Sources: IFPMA, Euler Hermes

Table 4: Private healthcare spending and average net of assets (2012 figures)

Country	Private share of healthcare expenditures	Population with net assets of US\$10,000 or less
Russia	38%	94%
China	44%	58%
Brazil	53%	67%
USA	54%	31%
India	67%	94%

Sources: PwC, Crédit Suisse, Euler Hermes

Chart 5: Part of drugs spending in global healthcare expenditures (in %, 2011 figures)



Sources: IFPMA, Euler Hermes

In fact, the initial dynamism was the result of no less than three positive factors: first, health reforms implemented from 2010 (including the "Zdorovye" plan), which, in 2012, culminated in a law being passed on the "key principles of public health in the Russian Federation"; second, the process of distributing drugs throughout the country was streamlined; and third, Russia joined the WTO in 2011.

This initial thrust has since lost its steam, and the "slowdown" could last several years. First, it is a result of the persistent difficulties felt by laboratories in complying with Russian drug price law and, especially, in gaining approval for drugs in the national market. The slowdown could also be exacerbated by a few recent political decisions in Russia that have met with international opprobrium and could affect many of its trade relationships with third countries. Notwithstanding the windfall from its successful hosting of the Sochi Winter Olympic Games, Russia is not immune to the possibility of future trade setbacks as a result of its controversial management of its conflict with Ukraine.

Russian pharmaceutical sector caught between its deteriorating trade balance and the government's desire for more national laboratories to emerge

Historically, the major global laboratories have always preferred to import their drugs into Russia due to its previously unsettled healthcare regulatory framework. And Russia's entry into the WTO in 2011 has not put an end to these imports. On the contrary, by paving the way for a reduction in customs duties on drug imports from 15% to 6% - and for medical equipment from 5% to 3% - Russia's entry into the WTO has contributed significantly to a fresh surge in imports since the turn of the decade. Given the market's growing demand, laboratories without local plants have continued to fuel the increase in Russia's trade deficit in pharmaceutical products (see Chart 8) and the market share of imported drugs in Russia has remained predominant (as high as 85% according to DSM).

It is not certain that this state of affairs will continue in light of (i) the lobbying by some national laboratories for government favors at the expense of foreign competition, (ii) the growing size of Russia's public health insurance scheme, and (iii) the government's desire to favor companies that produce drugs locally. Apart from the (small) share of very costly hospital drugs - which are therefore manufactured abroad - the nine largest laboratories in the Russian drug market now prefer to invest locally to capture the root of the market's growth.

The Servier laboratory stands out for its very early decision (2008) to build a plant in Russia: it is now ahead of the pack along with the number two in the Russian market, Pharmstandart, which appears highly profitable: in 2012 it posted revenue of USD 1.7 billion for an operating margin of 24%, i.e. more than double that of all its competitors!

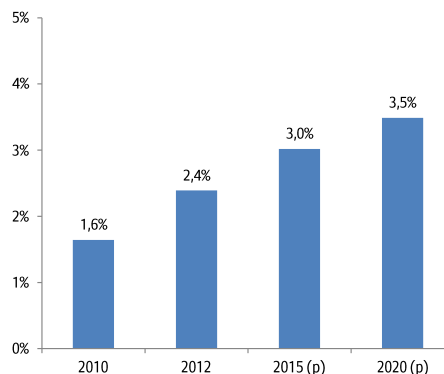
More generally, however, it is very difficult to obtain data on the market share - let alone profitability - of

Table 6 : Russian drugs spending in comparison to worldwide pharmaceutical expenditures

Pharmaceutical market (US\$ Bn)	2010	2012	2015 (f)	2020 (f)
Russia	14	22	32	45
World	852	920	1060	1290

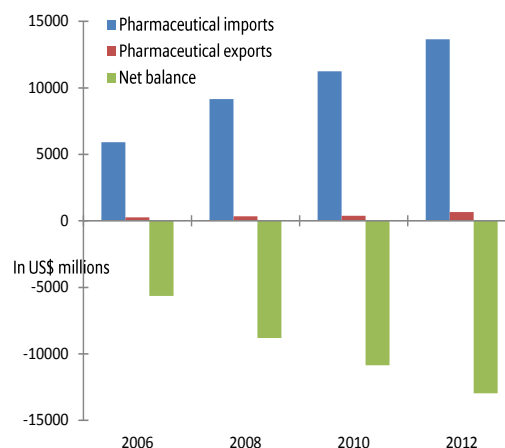
Sources: IMS, PwC, Euler Hermes forecasts

Chart 7: Market share of Russia in worldwide pharmaceutical expenditures (in %)



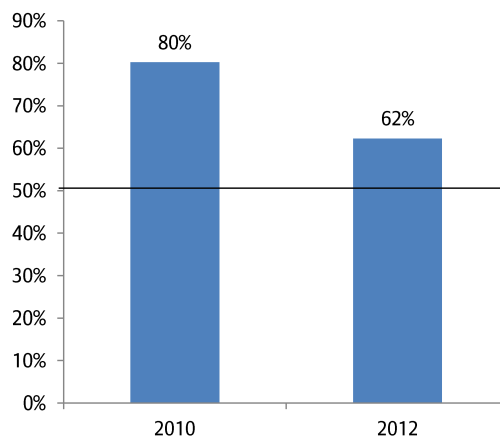
Sources: IMS, PwC, Euler Hermes forecasts

Chart 8: Trade balance evolution in Russian pharmaceuticals



Sources: Chelem, Euler Hermes

Chart 9: Ratio Imports / national drugs spending



Sources: Chelem, IMS, PwC, Euler Hermes

each of the players in the Russian market because these laboratories are either family-owned and therefore do not publish their accounts (such as the Servier or Menarini groups) or are subsidiaries of large global laboratories and refuse to report their revenue by country (such as Bayer, Sanofi or Takeda). We estimate the annual revenue in Russia for each of its nine largest players at between USD 1 and 2 billion (see Table 10).

Table 10 : main pharmaceutical actors in Russia market

Rank	Drug manufacturer	Major shareholder	Nationality
1	Zentiva	Sanofi	France
2	Pharmstandart	-	Russia
3	Bayer	-	Germany
4	Biogaran	Servier	France
5	Lek / Sandoz	Novartis	Switzerland
6	Nycomed	Takeda	Japan
7	Berlin Chemie	Menarini	Italia
8	Gedeon Richter	-	Hungary
9	Teva	-	Israël

Sources : AIPM, Bloomberg

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