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Drug firms on outsourcing high

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An increase in the number of outsourcing deals between domestic drug companies and pharmaceutical multinationals (MNCs) has triggered huge capacity expansion programmes in the drug manufacturing sector.

According to data put together by Business Standard, the country's top 30 drug makers are investing over Rs 5,500 crore in expanding capacity, partly to meet outsourcing calls, while the next rung of companies have lined up investments of around Rs 5,000 crore.

Apart from riding a steady growth of over 12 per cent in the domestic market, it is estimated that the companies are adding capacity through 50-60 manufacturing plants of global standards.

During the current financial year, top firms like Dr Reddy's, Lupin, Cipla, Zydus Cadila and Aurobindo are each investing between Rs 400 crore and Rs 600 crore in export-focused special economic zones (SEZ). The rules mandate that facilities in SEZ export majority of their produce and can only sell in the domestic tariff area on payment of customs and other duties.

The mid-rung companies such as Surya Pharmaceuticals (Rs 400 crore), JB Chem (Rs 60 crore), Elder Pharma (Rs 125 crore) and Biocon (Rs 100 crore) have also lined up large capacity expansions. Even smaller players like Indian Immunological Labs, DRS, Kemwell, Advanced Enzymes and MSN Labs do not want to be left behind and are investing between Rs 40 crore and Rs 150 crore to expand capacity. What has triggered the expansion is the possibility of more deals like Aurobindo-Pfizer, Dr Reddy's-GSK, Pfizer-Claris Life Sciences agreements, where the multinational corporations have agreed to source a broad range of medicines from their Indian partners for global supplies, said industry analysts.

"The rationale for these huge investments is the expected steady income from outsourcing contracts. For capacity addition, completion of a greenfield project would take nine months to one year. The industry does not want to lose out on a huge outsourcing contract just because it has no spare capacity," said Ranjit Kapadia, vice-president (institutional research) at HDFC Securities.

A McKinsey report estimates that the Indian pharmaceutical market will undergo a major transformation and become \$20 billion (around Rs 90,000 crore) by 2015 from Rs 65,000 crore now. The total market, including outsourcing, is expected to rise to a value of approximately \$50 billion (Rs 225,000 crore) by 2020, according to an estimate by PricewaterhouseCoopers (PwC).

"We have just begun supplies to Pfizer. Product registrations are on and by 2012, we expect Pfizer supplies alone to contribute over Rs 2,300 crore to our revenues," said Aurobindo Pharma Chairman and Managing

Director Ramaprasad Reddy.

The company is ready with a new production facility in an SEZ in Andhra Pradesh to meet future demand. “Our capacity expansion programme is almost complete. The plant is ready. It will begin production as and when required,” Reddy said.

Cipla, which is on the final leg of its three-year capex programme, estimated at over Rs 1,300 crore, is expected to spend about Rs 600 crore to add production capacities during the year. The company is in touch with global majors for product supply agreements and anticipates huge upside from such contracts. “Cipla’s current year’s growth will be driven by its export revenues and supply agreements with large MNCs will play a key role during 2010-11,” Motilal Oswal, a Mumbai-based brokerage, said in a recent report.

Cipla, which invested Rs 300 crore in a new pharma project in Sikkim, is setting up a formulation unit in an Indore SEZ at an estimated cost of over Rs 750 crore. It is also setting up an active pharmaceutical ingredients production facility at Bangalore and expanding its API units in Vikhroli and Patalganga in Maharashtra.

Nilesh Gupta, group president, Lupin, said the company will have an annual capex of Rs 450-500 crore this financial year, as done in the past two years. However, it’s not outsourcing opportunity that drives Lupin’s capacity expansion programme, but its US, Japan and emerging markets. In the domestic market, the company is growing at over 25 per cent.