PHARMACEUTICAL: RUSSIA

RISK ASSESSMENT: HIGH

HIGHLIGHTS AND OUTLOOK

The Russian drug market ranks 14th globally, according to a Deloitte report on Russian Pharmaceutical Market Trends in 2018. The commercial market represents 73% in value and 85% in volume, with the government procurement market (secured with state money either through reimbursable drug coverage or hospital purchases) constitutes the rest. The global market is comprised of 64% of generics and of 36% of original drugs in value terms (2017, DSM), respectively 88% and 12% in volume. Prescription drugs represent 64% in value, but only 43% in terms of volume. In the state procurement segment alone, they represent 94% in money terms. In pharmacy chains, they constitute 50% of sales in value and 32% in volume.

There is preferential provision of drugs to certain categories of citizens through different programmes. The Federal Drug Reimbursement Programme provides free access to over 350 products for 20 million people.

Medical drug distribution developed intensively prior to the start of the local economic crisis in 2013, with many companies growing exponentially in size. Despite some consolidation over the following years, competition within the market remains high, restricting margins.

Distributors are confronted with slow domestic market growth, a weak rouble impacting import prices, counter-sanctions limiting imports, competition inside their segment and from independent pharmacy chains, state intervention (especially on pricing), and the sheer size of the country. These challenges have harmed their financial results and, unexpectedly, put a halt to consolidation. As a consequence, they are diversifying into manufacturing and retailing, striking deals with general retailers, and using franchising to bolster their presence throughout Russian territory.

The presence of individuals and entities (both private and public) close to the authorities (either federal or regional) can complicate the business, at times.

These hardships will not disappear – at least, not in the short term. Russian economic growth is set to remain lacklustre, weighing on household consumption. Public consumption will be subject to reinforced fiscal austerity, which will affect public procurement. The pharmaceutical market is thus expected to grow by a mere 1% in physical terms and 3% in rouble terms in 2018.

Strengths

- Further potential of market development linked to the lag behind advanced markets, as well as to the important and aging population
- Extension of digitalization down to retailing

Weaknesses

- Slow consumption growth, impact on OTC drugs sales
- Heavy state intervention
- Recurrent rubble depreciation and high dependence on imports
- Immensity of Russian territory making business logistics difficult

Key Players

- **Protek:** 18.1% market share, a publicly-owned company that owns the n° 3 Rigla pharmacy chain
- **Katren:** 17.6% market share, owns the n° 13 Melodiya Zdorovya pharmacy chain (privately-owned)
- **Puls:** 12.4% market share, owns Apteka Forte pharmacy chain (privately-owned)
- **Farmkomplekt:** 5.2% market share, owns the Farmani pharmacy chain (privately-owned)

Sources: annual reports

Regional Risk Assessments: Agri-food

ASIA	LOW
CENTRAL & EAST. EUROPE	LOW
LATIN AMERICA	MEDIUM
M. EAST & TURKEY	MEDIUM
NORTH AMERICA	LOW
WESTERN EUROPE	LOW

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PHARMACEUTICAL: RUSSIA

SECTOR ECONOMIC INSIGHTS

In 2017, the Russian pharmaceutical market increased by 8% to 1.6 trillion roubles, and by 6% in physical terms (respectively by 6.5% and 3.5% for sales through pharmacy networks). After two years of decline due to the sharp depreciation of the rouble, sales expressed in foreign currencies (euro or US dollar) also rose. It could progress by 3% in value terms and by 1% in volume in 2018, according to DSM and RNC forecasting. This will undoubtedly be below last year's performance, and its market value expressed in either euros or US dollars is again going to fall after the latest rouble depreciation. Market deceleration has been on the menu since 2013.

In the long term, the aging Russian population (the number of people over 60 will increase from 22 million to 33 million between 2015 and 2030, according to the United Nations) should benefit the pharmaceutical sector, despite a shrinking general population. Nevertheless, longer trends in pharma consumption will remain marked by government policy, given that expensive medicine, often linked to old age pathologies, is predominantly sold via the government procurement system.

Most (80%) pharmaceutical sales, both to hospitals and the public, depend on distributors. Their dominance is particularly high for imported drugs. Some distributors conduct both wholesaling to independent pharmacy chains and hospitals, and retailing through their own pharmacy networks.

The Russian pharmaceutical market is highly dependent on imports: 70% in value terms and 38% in volume. The discrepancy indicates that most advanced drugs are imported. Economic downturn (from 2013) and counter-sanctions (from 2014) have given Russian government impetus to push through legislation, named Pharma 2020, to progressively substitute imported pharmaceuticals and give more self-sufficiency to the Russian pharmaceutical market. Adopted as early as in 2011, Pharma 2020 aims to reduce import dependence to 50% in 2020, especially for expensive drugs, by introducing restrictions on setting prices for imported drugs. In 2017, 80% of imports came from Europe (primarily from Germany, 21%, France, 9% and Italy, 6%, with Sanofi, Novartis, Bayer as the main suppliers), and 13% from the USA. Russian counter-sanctions apply to pharmaceuticals that can be replaced with local products. However, this has often resulted into shortages. Moreover, there is a quality gap and drugs manufactured locally are still mostly made from imported substances. Finally, import substitution mostly works in state procurement segment. This can be explained by the ban on their access to public procurements introduced in 2018. As a consequence of this policy, both Russian and foreign labs are investing in new additional production sites in Russia. In Russia, there are 600 Russian-based drug manufacturers producing 2270 drugs. There are also 700 foreign-owned manufacturers who locally produce 3950 drugs.

Federal state has been introducing legislation in the sector for some years. 50% of the pharmaceutical market, both in money and volume terms, is under price regulation. This share comprises the so-called list of vital and essential drugs. Drugs from this list prevail in the state procurement segment, where they represent 80% of this market. Conversely, in pharmacies, drugs not included in this list prevail, representing 65% in value. Control of prices in state purchases of drugs for beneficiaries of free medicine will become more efficient from 2018 with automatic blockage in case of excessive prices. Electronic prescription, electronic patient cards, and a unified state healthcare information system will become obligatory over 2018-2019. Cash registers for pharmaceutical retails became compulsory as of July 2018. There is also a draft bill on online pharmacy retail, which would legalize the distance trade of over-the-counter (OTC) medicines. Distributors and pharmacy chains are getting ready by signing agreements with general or specialised e-commerce companies (Ulmart, Erkapharm, Ozon, Apteka, Zhikiva, etc.) to enable customers to withdraw their orders from stores.

Another bill is being drafted, which would authorize the sale of OTC drugs in grocery stores. Originally, only licensed pharmacies located in these stores would have been able to sell them. Pharmacy chains, where 95% of these drugs are sold, have said it would kill them – prescription sales would not be enough to keep them afloat. Amendments to the law on circulation of medicines made in 2017 for a 2020 introduction impose bar code labelling and entering medicine information into the state system to make tracking and tracing easier and reduce the prevalence of counterfeit drugs; which is harming manufacturers.

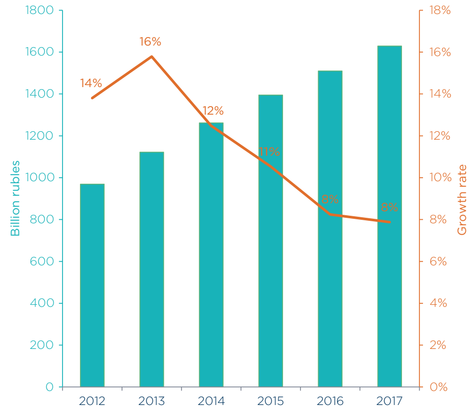
In the distribution segment, the top 10 and the top 3 represent, respectively, 72% and 47% of the market in value terms, compared with 79% and 40% in 2014. Concentration decreased in recent years, as big businesses lost their market share and were confronted with financial difficulties: it is now back to the 2009 level. Some big players disappeared in the last years. Rosta, which held 8% of the market in 2016, went into bankruptcy in 2017 and saw its assets dispersed. The market leader, Protek – which owns the Rigla, Bud Dzorov! and Zhivika pharmacy chains, has an 18% market share, and is the only publicly-owned actor – has been recording a mere 1-2% EBITDA* for several years. This evolution correlates with low market growth, as well as mounting barriers in logistics, warehousing, and finances, linked with geographic diversification and the immense size of Russia. To confront these challenges and resist independent pharmacy chains (which are developing direct contracts with manufacturers), distributors have been developing franchising in remote regions, e-retail, warehousing facilities, retail pharmacy networks, and striking alliances with general retailers and drug manufacturers.

Contrary to the distribution segment, consolidation and growth processes in pharmacies (i.e. retail) have intensified. The top 3 and top 10 respective market shares went up from respectively 8% and 18% in 2014 to 23% and 41% in 2017. ASNA, an association of independent pharmacies, represents over 13% of the market, which puts the group well ahead of the other chains. This type of grouping is a way for pharmacy retail chains, some of which are already owned by distributors, to keep their independence and resist pressure from distributors and general retailers.

Pharmacy retail chains and distributors, both suffering from strong competition since the pre-2013 boom in an overheated market, have been harmed by the slowing market, the rouble's depreciation, the counter-sanctions, and the credit slowdown. Despite the majority of drugs being imported, the depreciated rouble has not transposed into a rise in retail pharmaceutical prices, which did not budge in 2017. This can be explained by the slow recovery in household consumption, which deterred the sector to pass on higher import prices, government control on half of the prices, and acceleration in the shift to generics and local products. According to a poll from DSM, 66% of households say they try to save on medications, 33% don't buy the prescription, and 61% buy cheaper generics. This means that pharmaceutical companies must bear the cost of the rouble's depreciation through a decrease in their margins. As a result, only a few distributors are earning healthily, with pharmacy chain payments eventually getting slower, and their overdue periods longer.

**Earnings before interest, taxes, depreciation and amortization*

Russian Pharmaceuticals Market in Rubles terms (Amount and Variation)



Sources: DSM Group, Rosstat

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