Pharmaceuticals – sector report United Kingdom

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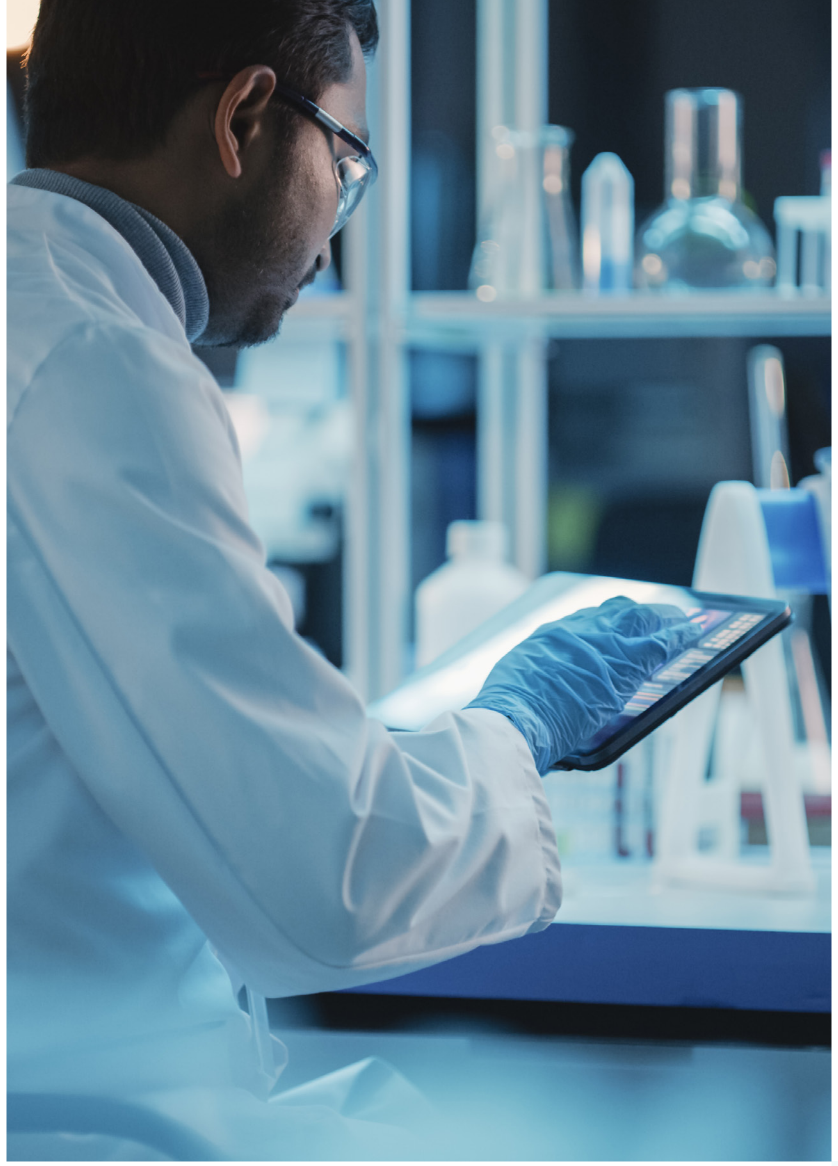
The five-year pricing agreement has provided a steady revenue stream for pharmaceutical manufacturers, including both branded and generic products. As branded products come off licence, generic manufacturers will expand, prompting branded manufacturers to innovate new blockbuster drugs. Liquidity for investment is ample in both sectors, with low risk of insolvency. Wholesale distributors face escalating pressure due to more brands coming off licence, leading to cheaper generic alternatives and reduced revenue. Sustained margin pressure will continue due to high stock levels among wholesalers, increased interest and fuel costs, and the predominant use of invoice finance for funding.



Sector rating (global): Low Risk
Sector rating (United Kingdom): Low Risk

Strengths	Weaknesses
High barriers to entry Established enterprises in the field are shielded against new entrants by the high barriers to entry, which are a result of strict regulatory standards and substantial expenditure in research and development.	**Highly supervised and controlled** Extensive regulations can restrict operational adaptability, escalate compliance expenses, and slow down the timely introduction of new drugs. In this environment, companies must constantly navigate through intricate regulatory landscapes.
Low fragmentation The sector derives advantages from economies of scale and diminished competition, as it is dominated by major players. Large companies are capable of managing costs and resources with greater efficiency, which may result in increased profits and market stability.	**Generics and biosimilar drug producers** The rapid expansion of generics and biosimilars present a considerable obstacle, particularly with the expiration of patents. This may result in decreased prices and a decline in market share for the original drug manufacturers, which can have a negative impact on their profitability.
Pricing power Established companies possess the ability to set higher prices due to their possession of patented drugs and distinct treatments. This power is particularly strong for drugs without generic equivalents or for life-saving medications.	

Key trends and challenges that will shape the industry:

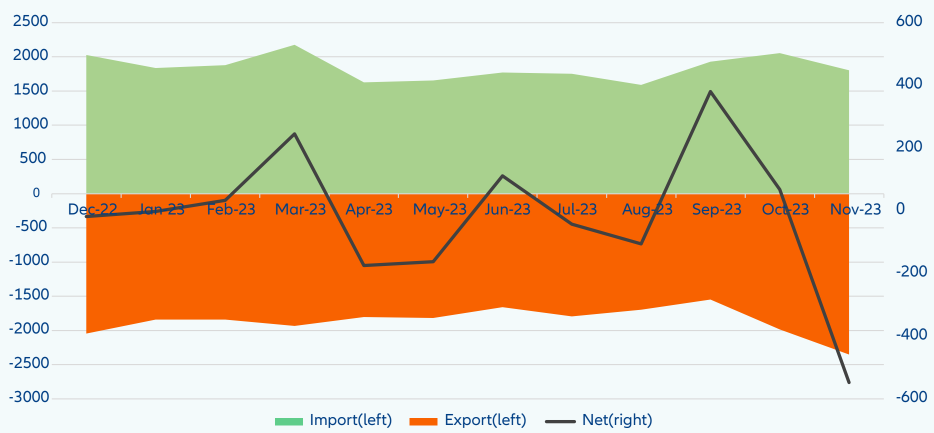
1. **Technology and innovation:** The integration of artificial intelligence (AI) in clinical data management is a major trend. AI, which encompasses machine learning and deep learning, is being employed in activities, such as writing protocols, risk assessments, and streamlining medical coding review processes. The incorporation of this technology enhances the effectiveness and excellence of data management.
2. **Economic and financial factors:** Post-COVID developments, inflation, and geopolitical situations are significant challenges. These economic constraints are forcing the pharmaceutical sector to re-evaluate long-term sourcing, production, and supply chain optimisation decisions.
3. **Market dynamics:** Big pharma companies are doing more research in-house, while smaller biotech firms are growing more reliant on specialised or boutique Contract Research Organisations (CROs).
4. **Aging and growing population:** Healthcare and new treatments for age-related disorders are in demand as the world population ages (life expectancy 75.6y for women and 70.8y for men). The global population is 8bn and is expected to reach 8.5bn in 2030. Population growth drives pharmaceutical and healthcare demand. This expansion increases pharmaceutical consumption and the need for innovative and diversified therapies.
5. **Generic drug-makers:** The competition with manufacturers of generic drugs escalated in 2023 due to a greater number of patents reaching their expiration date, surpassing the levels observed in 2021-2022. With generic drugs becoming accessible in the market, it is anticipated that it will reduce the revenue of the branded drug by approximately 70-80%.
6. **Policy:** EU regulations, which are designed to address shortages, enhance medication security, and combat anti-microbial resistance, may lead to a modification in the protected production period of drugs. Consequently, unbranded competitors may be able to join the market at a faster pace. Also, changes in medication security in Europe may restrict exports from the UK if new standards are not met.

Sector Overview:

In 2023, the UK pharmaceutical sector continued to play a critical role in the economy and healthcare. Marked by a strong research and development focus, it remained at the forefront of biomedical innovation. Despite variations, the sector saw a trade surplus, indicating a robust demand for UK pharmaceutical products internationally.

This excess implies UK pharmaceuticals are competitive globally. The year-round trade surpluses and deficits suggest seasonal demand or strategic product launches. Overall surplus benefits the UK economy and trade balance. However, the year's volatility implies that patent expirations, global health trends, and regulatory changes may be affecting trade patterns. The UK pharmaceutical sector's trade surplus shows stability and market presence, but monthly changes show a dynamic market that responds to many complicated factors.

Figure 1: UK Import and Export of Pharmaceutical products (£m)



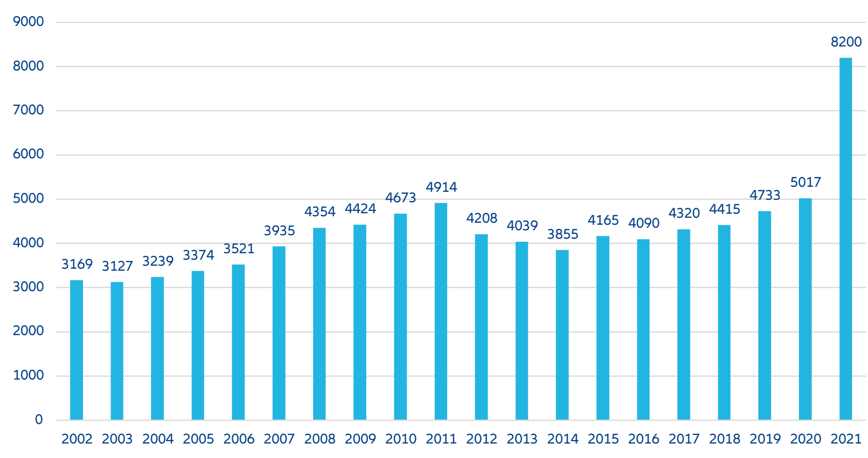
Source: Statista, Allianz Research

Main Trends:

The data shows that the expenditure on research and development for pharmaceuticals in the UK increased significantly between 2002 to 2021, with a considerable increase to £8.2bn in 2021. This increase is in line with the increased spending of the National Health Service (NHS) and the five-year pricing policy that the UK government implemented with the Association of British Pharmaceutical Industry, which have freed up funding for research and development. These investments contribute to the substantial liquidity of the sector as well as the low risk of insolvency that it faces (there have been no more than 6 annual insolvencies in England & Wales per year over the past 10 years).

Conversely, the pricing policy has resulted in wholesale distributors seeking generic alternatives which are cheaper, but also substantially reduce their revenues and put their own margins under pressure. However, some issues arise as a result of the trend of economic and scientific activity transferring from Europe to the United States and rising economies such as China and Korea. When it comes to global pharmaceutical innovation, Europe's position has been deteriorating, with China coming close to equal Europe's output of new compounds in 2022, while the United States continues to command the lead. This move has the potential to refocus the research and development base of the pharmaceutical industry towards emerging economies.

Figure 2: UK Research and Development Expenditure(in million GBP)

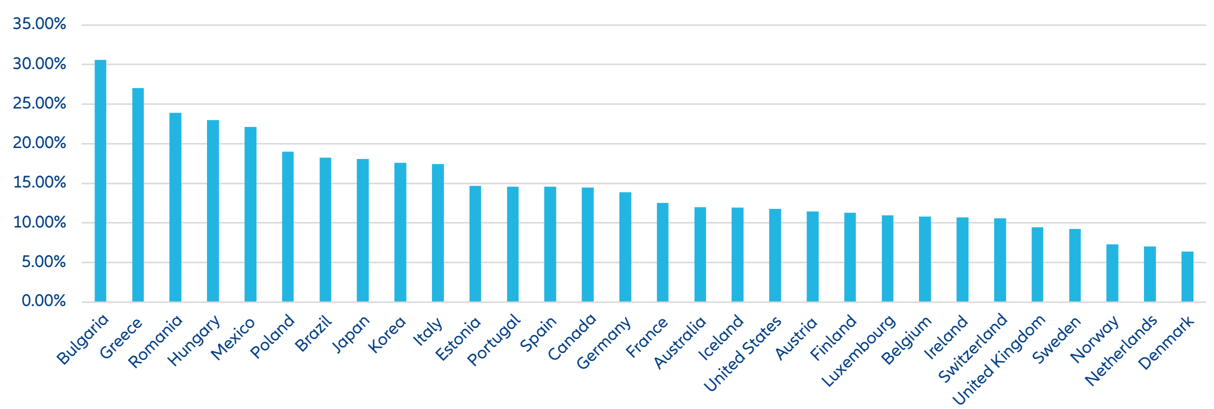


Source: Statista, Allianz Research

*The data also includes chemicals and refers to business R&D performed in the UK irrespective of the residence of the ultimate owner.

There was substantial variation in pharmaceutical spending as a proportion of overall health expenditure among different nations in 2022. The UK stands at 9.5%, which is low when compared to nations like as Bulgaria, Greece, and Romania, where expenditure surpasses 23%. This implies that the UK places lesser importance on allocating funds towards pharmaceuticals compared to other countries, or indicates effective implementation of cost-containment measures. Countries with high percentages are seeing a rise in medicine prices or a higher demand for drugs.

Figure 3: Pharmaceutical spending as % of total health spending, 2022

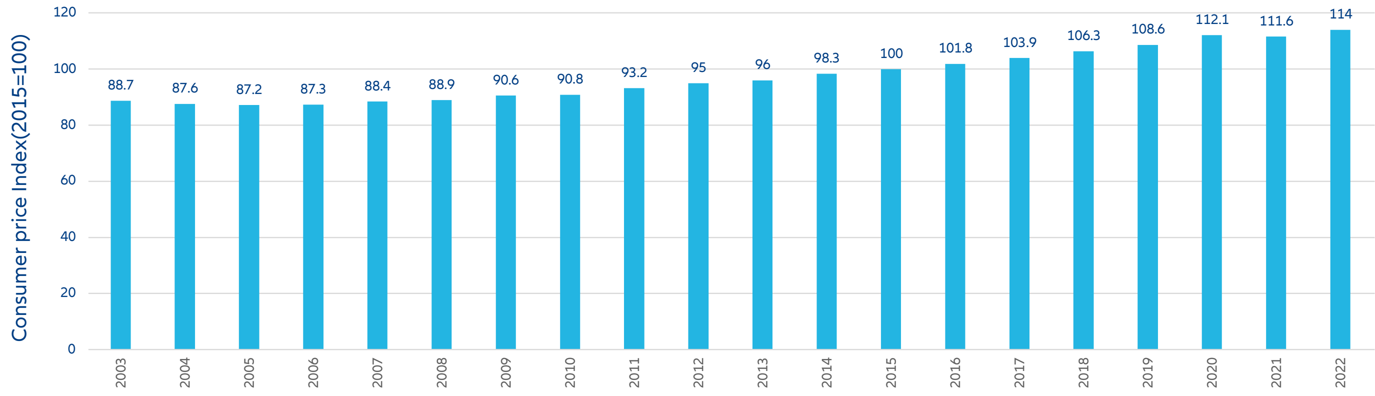


Source: OECD, Allianz Research

Consumer Price Index (CPI):

We see a gradual upward trend in prices over the nearly two-decade period. The CPI value begins below the baseline of 100, indicating prices lower than the 2015 base year, and steadily increases year after year, eventually surpassing the baseline around 2015. As of 2022, the CPI for pharmaceutical products has risen to 114, reflecting a 14% price hike since the base year of 2015. The increase in prices can be attributed to the overall inflation in the economy and the rising expenses related to pharmaceutical products. These higher costs may be a result of advancements in medical technology, the introduction of new drugs, and stricter regulations that impact production expenses.

Figure 4: Consumer price index (CPI) of pharmaceutical products annually in the United Kingdom (UK) from 2003 to 2022

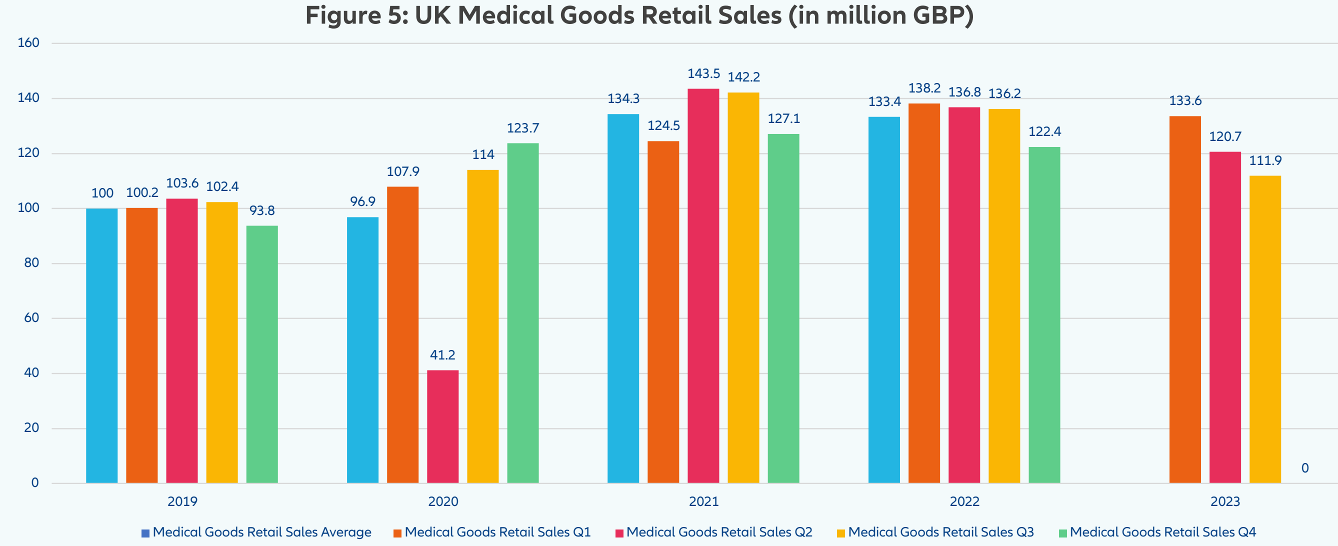


Source: Statista, Allianz Research

Medical Goods Retail Sales:

From 2019 to the third quarter of 2023, the retail sales of medical goods in the United Kingdom exhibit a growing tendency that reaches its high in 2021. On the other hand, there is a significant drop from the fourth quarter of 2022 until the year 2023. The peak in 2021 could be linked to increased spending on healthcare during the later phases of the pandemic. In 2023, the drop reflects a stabilisation that occurred after COVID-19 or the impact of steps taken to reduce fiscal spending. The decline in 2023 may also be an indication of the difficulties that the pharmaceutical retail sector in the United Kingdom is facing as a result of Brexit and other global economic challenges.

Figure 5: UK Medical Goods Retail Sales (in million GBP)



Source: Office for National Statistics (ONS), Allianz Research

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