Market Evolution

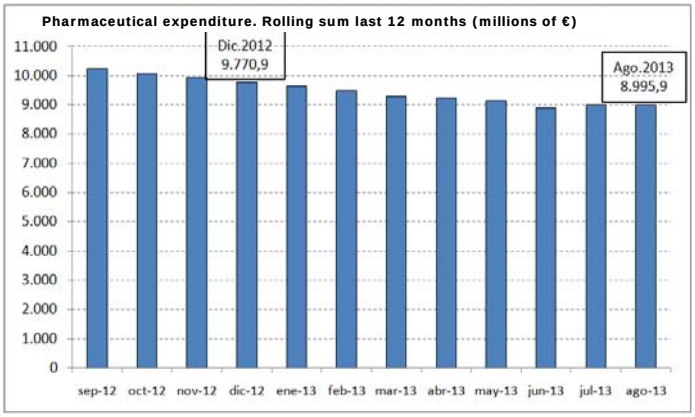
Public Pharmaceutical Expenditure (pharmacies)

	Sept. 2012-Ago. 2013	Sept. 2011-Ago. 2012	% var. 2013/12
Exp. (€ Mill.) *	8.995,9	10.471,2	-14,09%
Prescrip. (Millions)	842,3	965,9	-12,79%
Av. Exp. per. prescription (€) *	10,68	10,84	-1,49%

*Retail price (VAT included).

Data from the Ministry of Health, Social Services and Equality shows that in August 2013, public pharmaceutical expenditure at pharmacies experienced a drop of -14.1%, compared to the same month the previous year. This variation in expenditure is a consequence of a fall in the number of prescriptions (-12.8%) and a drop in the average price per prescription of -1.5%.

The accumulated expenditure in the 12-month period to August 2013 (please see the chart below) is 775 M€ lower than the figure at the end of 2012 and it is foreseeable that this differential will be even greater by the end of this year.

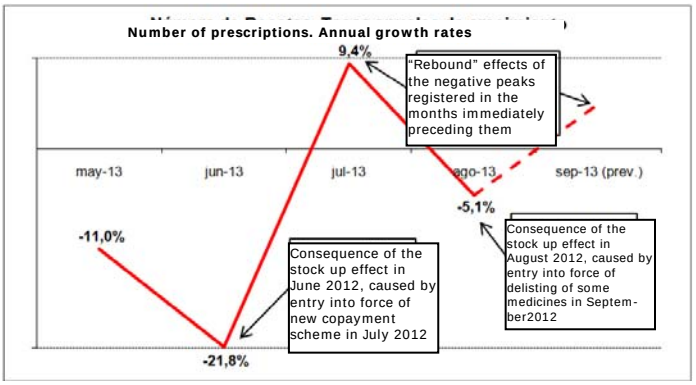


If these forecasts should prove to be correct, public pharmaceutical expenditure on NH prescriptions could reach around 8,800 – 8,900 M€ at the end of this year. This would mean a 4-year period of decrease in public pharma expenditure, a drop of almost 4,000 M€ p/a since its record high of more than 12,700 M€ in May 2010.

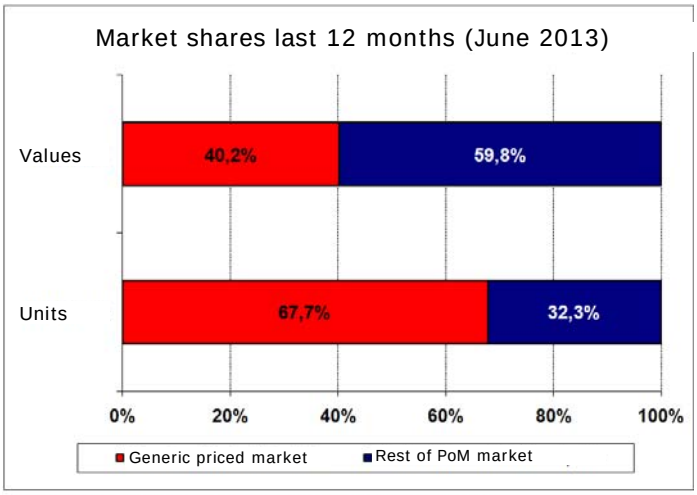
On the other hand, prescription data registered a new low in its annual variation rate in August. As mentioned in our previous bulletin, this registered fall is due to comparing August 2012 with August 2013, and these months were not truly homogenous, given than in August 2012, there was a stocking up of prescriptions of those medicines that would not be financed as from September 2012. So with this in mind, a negative result was to be expected in the annual variation rate this August.

In a similar fashion, we should expect September to show the opposite phenomenon as we will be comparing a "normal" September with a rather low September last year, after the stocking up in August.

The profile of prescription demand over the last few months and what we expect to occur in September is show in the chart below.



Finally, data from the IMS covering the 12-month period ending June 2013 shows that the whole of the medicines market with generic prices reached 67.7% of the total prescription market, in units, in Spain, and 40.2% of said market value.



Source: Farmaindustria estimation from IMS.
Note: Total market net from RDL 8-2010 and 9-2010 RDLs rebates.

R&D in pharmaceutical companies in Spain is taking its toll and they are suffering significant falls in revenues.

By the end of 2013, public pharmaceutical expenditure on NHS prescriptions will have reached a 4-year decline (2010-2013). What public Administration sees as cutting costs, Co's are suffering significant falls in revenues and, given there aren't any clear signs of revenue picking up, Co's need to make adjustments to structural costs to be able to adapt to the new situation of low income and so as not to lose out competitively.

Expenditure in R&D is not one of those items that can be significantly adjusted by the pharma companies in the short-term given that inertia in this type of expenditure (investments planned for the medium and long term) makes the Co's consider costs that are quasi-fixed for short-term planning.

However, if medium and long-term revenues don't improve, then adjustments will also be made to R&D, as a consequence of losing competitiveness in the domestic market.

Diverse studies have empirically shown the link between pharma companies' cash-flow and their investment in R&D. One particular study carried out was based on a Spanish case, in which this relation (cash-flow and investment) was made with the pharma indus-

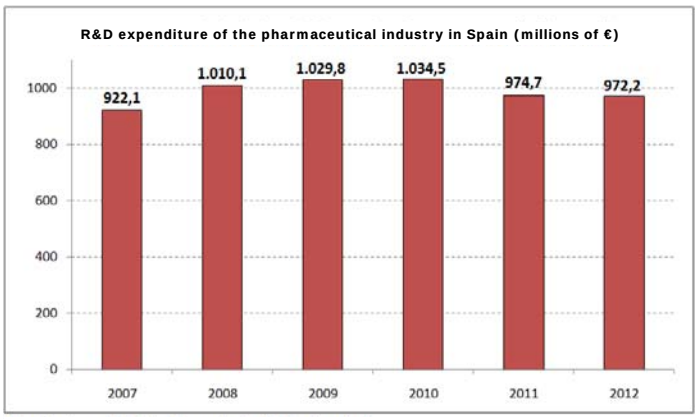
try's Gross Added Value (GAV) as proxy of the business cash-flow.[1]

This study determined that pharma business GAV is one of the main explanatory variables of investment in R&D for laboratories, therefore, a variation in the pharma business GAV, consequently causes a variation in their R&D expenditure (positive elasticity).

In Spain's case, R&D expenditure elasticity to GAV business pharma is +0.35 in the short-term, which would mean, (for example) that a drop of -10% in pharma companies' GAV in Spain would lead to a drop in investment in R&D of -3.5% in the short-term.

In the long-term, once R&D expenditure loses its condition of costs quasi-fixed for the Co., the elasticity is even greater, and in Spain, the elasticity is estimated to be higher than 1. This means that a drop in Spanish business GAV of -10% (for example) consequently causes a fall in business R&D of more than -10%.

The findings of this study are actually becoming a reality. According to Farmaindustria's latest available data on expenditure in R&D [2], pharma companies have experienced two consecutive years of falls (see the chart below) and in 2012, business expenditure in R&D registered its lowest level since 2007, so much so that pharma expenditure ended 2012 at its lowest level since 2005.



Source: Farmaindustria internal survey (several years)

However, R&D data from 2010 to 2012 must be compared to the value that should have been reached in R&D in Spain if the business GAV had evolved according to trends prior to 2010.

In turn, when analising forecasts for 2013, none of the top 10 pharma companies in Spain (by volume in expenditure in R&D) forecast increasing their investment in R&D. This is something that has never happened before and it is going on precisely during the year pharma expenditure falls are the biggest since historic series were available.

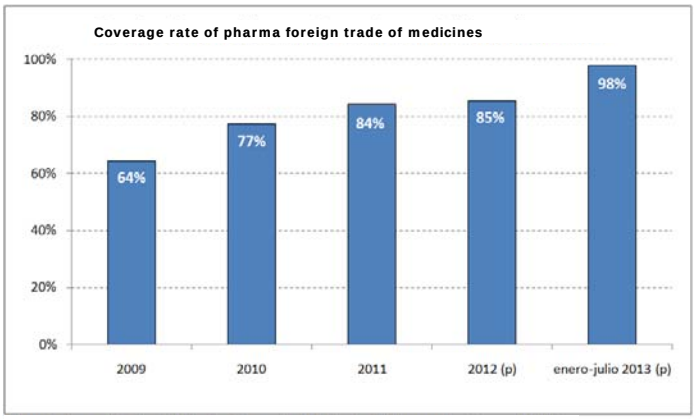
Any government cost containment measures made that affect pharma Co's revenues should also consider the negative impacts they have on the business sector; the leader in industrial R&D in Spain. They should bear in mind that investments are crucial in such a moment as this, so that Spain can get back on track with its economical growth.

Spanish pharmaceutical trade is getting closer to reaching a balance.

Traditionally, the Spanish pharma industrial sector was one of the great dynamic exporters.

However, due to the peculiar characteristics of drugs production (i.e. globalised and made at large factory plants, then exported to whole continents) it also registered significant imports of drugs into our country. In fact, imports have always been bigger than Spanish exports, which implied a deficit balance (import-export) in pharmaceutical trade.

Notwithstanding, and as shown in the following chart, the coverage rate of pharma foreign trade (exports ÷ imports of medicines) has improved considerably in the last few years, going from 64% in 2009 to 77% in 2010, from 84% in 2011 to 85% in 2012 (these figures are still provisional data)



Source: Spanish SS of Trade. Ministry of Economy and Competitiveness
(p) provisional data

Latest figures published by the Secretary of State for Trade corresponding to January - July 2013 indicate a noticeable improvement in Spanish pharma trade balance, which, in fact is very close to going surplus.

According to these provisional figures, in January – July 2013, exports in medicines would have reached 6,101€ (with a growth rate of +21% over the same period in 2012) and imports would have reached 6,228 million € (with an increase of +4% with respect to January – July 2012). This means the trade balance of Spanish pharmaceutical products in the first 7-months of the year would have registered a deficit of -127 million euro, with a covering rate of 98%, very close to the 100 % mark, which is when the difference between deficit and surplus trade is made.

Albeit partial, data from the first 7-months of 2013 shows a trend that, if it continued in the same way through to the end of the year, would be the first time since homogenous data exists, that Spanish pharma trade balance registers a surplus.

[1] NERA Economic Consulting. Impact of economic regulations on R&D of the pharma industry in Spain (2006). Available at: http://www.farmaindustria.es/idc/groups/public/documents/otrosdocumentos/farma_092859.pdf

[2] Available data : http://www.medicamentos-innovadores.org/es/node/188