May 25, 2023

Theon Pharmaceuticals Ltd: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/ Short-term: Fund based Limits	31.00	31.00	[ICRA]A- (Positive)/[ICRA] A2+; reaffirmed
Long-term/ Short-term: Non-fund Based Limits	14.00	14.00	[ICRA]A- (Positive)/[ICRA] A2+; reaffirmed
Total	**45.00**	**45.00**	

**Instrument details are provided in Annexure-I*

Rationale

To arrive at Theon Pharmaceuticals Ltd's (TPL) ratings, ICRA has considered the consolidated financial profile of TPL and its wholly-owned subsidiary, Theon Lifesciences. The positive outlook on the ratings factor in ICRA's expectations that the company's greenfield capacity for injectables, which is being set up in Theon Lifesciences, would improve the company's portfolio diversity and margin profile in the medium term. Moreover, TPL would witness healthy demand recovery in its contract manufacturing segment aided by scale up of new molecules and organic growth in its institutional and export businesses.

The rating reaffirmation factors in TPL's established track record as a leading contract manufacturer for major pharmaceutical companies, apart from its own branded formulations business leading to revenue diversity. Further, the customer concentration risk remains low and the company enjoys established relationships with pharmaceutical majors. The ratings continue to draw comfort from the comfortable balance sheet position as reflected by low debt dependence resulting in strong debt protection metrics.

The ratings are, however, constrained by TPL's high dependence on a single therapeutic segment of anti-bacterials and lower than expected ramp-up of its capacity utilisation for beta-lactam drugs in FY2023. The company's scale of operations has, thus, remained moderate. Further, ICRA factors in the highly competitive and fragmented nature of the industry with its inherent regulatory risks. Along with its limited ability or lag in passing on the increase in raw material prices, especially in the institutional segment, this can impact the margin profile, as witnessed in FY2023. The ratings are also constrained by the high debtor days as a significant share of the business comes from Government tenders and exports, which have a high collection period.

Key rating drivers and their description

Credit strengths

Diversified business across private pharmaceutical players, institutional tenders, sales through group companies and exports – TPL's business is diversified across clientele, end-user segments and geographies. It undertakes contract manufacturing of formulations for domestic pharmaceutical companies on a principal-to-principal (P2P) basis (which contributed to 43% of its revenues in 9M FY2023) and caters to export clients in unregulated markets (21%). Further, it derives institutional business revenues from Government tenders (25%) and also sells its own branded formulations (10%) through its Group entity, IVA Healthcare Pvt. Ltd.

Low customer concentration risk and track record of supplying to pharmaceutical majors – TPL has been supplying to established Indian pharmaceutical majors including Hetero Healthcare Limited, Cadila, and Aristo Pharma. It also acts as a vendor to various state government agencies. The export business and own brand sales further add to the revenue diversity and visibility. Hence the customer concentration risk remains low with TPL's top five clients accounting for less than 14% of its revenues in FY2023 (provisional). Additionally, the healthy credit profile of its corporate customers reduces the counterparty credit risk.

Planned injectable capex to support product diversity and margin profile going forward – The company is planning to set up a liquid injectables plant in Chandigarh, which will improve the company's product diversity, business risk profile and augment margins when it forays into export markets. The construction for the plant has already started and is expected to be completed by March 2024 with commercial production expected to commence from FY2025, subject to regulatory approvals.

Comfortable financial risk profile led by low indebtedness – TPL has remained minimally leveraged over the years. Its capital structure is healthy as reflected by sizable net worth and minimal debt levels as on March 31, 2023. While it has witnessed moderation in operating profit in FY2023 given inflationary trends and softening demand for anti-infectives, TPL's debt protection metrics have remained strong. Further, the company has a sizeable planned capex of Rs. 110 crore cumulatively over FY2024 and FY2025, which is expected to be largely funded through available liquidity and internal accruals with limited dependence of debt.

Credit challenges

Moderate scale of operations with high dependence on single therapeutic segment; new product launches to improve portfolio diversity – TPL's scale of operations remains moderate and almost 60-70% of its revenues are derived from antibiotics. As a result, TPL's revenues in FY2023 declined with moderation in demand for anti-biotics after the Covid-19 pandemic-related surge in demand in FY2022. Apart from the injectables capex, the company is taking initiatives to diversify through new product launches in anti-diabetes and cardiovascular segments and has received approvals for multiple drugs in FY2022 and FY2023.

High competition intensity; raw material price volatility constrains profitability for institutional tender business – As TPL primarily manufactures generic drugs, it remains exposed to competition from various players in the field, leading to pricing pressures. Moreover, the company's margins are vulnerable to volatility in raw material prices as it cannot fully pass on the same to end-consumers, particularly in the institutional segment. Consequently, the increase in the institutional segment's revenue share to 25% in 9M FY2023 (13% in FY2022) resulted in a decline in margins amid elevated raw material prices. Also, as is prevalent in the sector, TPL is exposed to regulatory risks.

High collection period led by institutional and exports businesses – TPL has to provide long credit periods to its customers, especially to its Government clients or public sector undertakings. The debtor days increased in FY2023 to 112 days (as per provisional estimates) due to an increase in Government tender-related receivables. As a result, the working capital intensity increased to 17.3% in FY2023 on a provisional basis from 15.7% in FY2022. As TPL derives around 40-45% of its business from Government tenders and exports, which have a high collection period, any significant delay in realisation could pose an impact on the company's liquidity profile.

Liquidity position: Adequate

TPL has an adequate liquidity profile supported by Rs. 50-55 crore of unencumbered cash balances and liquid investments as on March 31, 2023. Moreover, the company had Rs. 46 crore of unutilised fund-based working capital limits as on March 2023 end. The company is expected to generate healthy cash flow from operations of Rs. 25-30 crore annually and does not have any long-term debt repayments in the near term. However, the company has a planned capex of Rs. 110 crore over FY2024 and FY2025, which will primarily be funded through accruals and cash balances with debt of Rs. 20-25 crore, if needed.

Rating sensitivities

Positive factors – ICRA could upgrade the ratings if the company demonstrates a sustained improvement in scale and diversification across therapeutic segments while maintaining its operating profitability resulting in core ROCE being higher than 18% on a sustained basis.

Negative factors – Negative pressure on the ratings would arise in case of a sustained deterioration in the earnings of the company and/ or a significant weakening in the credit metrics with TD/OPBITDA higher than 2.0x on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Pharmaceuticals
Parent/Group support	Not Applicable
Consolidation/Standalone	Consolidated

About the company

Incorporated in 2005, TPL started commercial operations from April 2007 with the manufacturing and selling of pharmaceutical formulations. TPL undertakes contract manufacturing of formulations for domestic pharmaceutical companies (on P2P[1] basis) and sells its formulations through Government tenders (on open contract basis). The company also sells its own branded generic formulations through Iva Healthcare Private Limited and trade generics through Theogen Private Limited in Jan Aushadi Stores. Apart from the domestic market, TPL also supplies its formulations to both unregulated (African markets) and semi-regulated destinations (South Asian markets) with exports forming 21% of its total revenues in 9M FY2023.

The company operates from its single manufacturing facility in Nalagarh, Solan (Himachal Pradesh), which has four segregated blocks for beta-lactam products (tablets and capsules), cephalosporins (oral solid dosage and dry syrups), non-beta products (tablets and capsules), and dry powder injectables. It is ISO 9001:2008 accredited with WHO GMP certification[2] for all its products, which find application across various therapeutic segments, mainly beta-lactamase antibiotics (anti-bacterial).

Key financial indicators (audited)

TPL Consolidated	FY2021	FY2022	FY2023*
Operating income	398.3	486.0	458.6
PAT	19.0	21.3	15.5
OPBDIT/OI	8.3%	7.0%	6.4%
PAT/OI	4.8%	4.4%	3.4%
Total outside liabilities/Tangible net worth (times)	0.4	0.5	0.5
Total debt/OPBDIT (times)	0.0	-	0.0
Interest coverage (times)	70.2	88.2	34.7

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; *Provisional estimates*

[1] *P2P: Marketed by (brand owner) and manufactured at contract manufacturer's site*

[2] *WHO-GMP: World Health Organisation-Good Manufacturing Practice is a system (and part of quality assurance programme) to ensure that the pharmaceutical products are consistently produced and controlled according to quality standard.*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021
					May 25, 2023	Sep 30, 2022	Jul 13, 2022	Jun 14, 2021	-
1	**Cash Credit – 1**	Long Term and Short Term	23.00	-	**[ICRA]A- (Positive) / [ICRA]A2+**	**[ICRA]A- (Positive) / [ICRA]A2+**	**[ICRA]A- (Stable) / [ICRA]A2+ ISSUER NOT COOPERATING**	**[ICRA]A- (Stable) / [ICRA]A2+**	-
2	**FLC[3] – 1**	Long term and short term	3.00	-	**[ICRA]A- (Positive) / [ICRA]A2+**	**[ICRA]A- (Positive) / [ICRA]A2+**	**[ICRA]A- (Stable) / [ICRA]A2+ ISSUER NOT COOPERATING**	**[ICRA]A- (Stable) / [ICRA]A2+**	-
3	**Cash Credit - 2**	Long Term and Short Term	5.00	-	**[ICRA]A- (Positive) / [ICRA]A2+**	**[ICRA]A- (Positive) / [ICRA]A2+**	**[ICRA]A- (Stable) / [ICRA]A2+ ISSUER NOT COOPERATING**	**[ICRA]A- (Stable) / [ICRA]A2+**	-
4	**BG/FLC Limit – 1**	Long Term and Short Term	9.00	-	**[ICRA]A- (Positive) / [ICRA]A2+**	**[ICRA]A- (Positive) / [ICRA]A2+**	**[ICRA]A- (Stable) / [ICRA]A2+ ISSUER NOT COOPERATING**	**[ICRA]A- (Stable) / [ICRA]A2+**	-
5	**BG/FLC Limit – 2**	Long Term and Short Term	5.00	-	**[ICRA]A- (Positive) / [ICRA]A2+**	**[ICRA]A- (Positive) / [ICRA]A2+**	**[ICRA]A- (Stable) / [ICRA]A2+ ISSUER NOT COOPERATING**	**[ICRA]A- (Stable) / [ICRA]A2+**	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash Credit – 1	Simple
FLC – 1	Simple
Cash Credit – 2	Simple
BG/FLC Limit – 1	Very Simple
BG/FLC Limit – 2	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

[3] *Foreign Letter of Credit*

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Cash Credit – 1**	Jan 2018	NA	NA	23.00	[ICRA]A- (Positive) / [ICRA]A2+
NA	**FLC – 1**	Jan 2018	NA	NA	3.00	[ICRA]A- (Positive) / [ICRA]A2+
NA	**Cash Credit - 2**	Jun 2018	NA	NA	5.00	[ICRA]A- (Positive) / [ICRA]A2+
NA	**BG/FLC Limit – 1**	Jan 2018	NA	NA	9.00	[ICRA]A- (Positive) / [ICRA]A2+
NA	**BG/FLC Limit – 2**	Jun 2018	NA	NA	5.00	[ICRA]A- (Positive) / [ICRA]A2+

Source: Company

Annexure II: List of entities considered for consolidated analysis

Company Name	TPL's Ownership	Consolidation Approach
Theon Pharmaceuticals Ltd (TPL)	100.00% (rated entity)	Full Consolidation
Theon Lifesciences	100.00%	Full Consolidation

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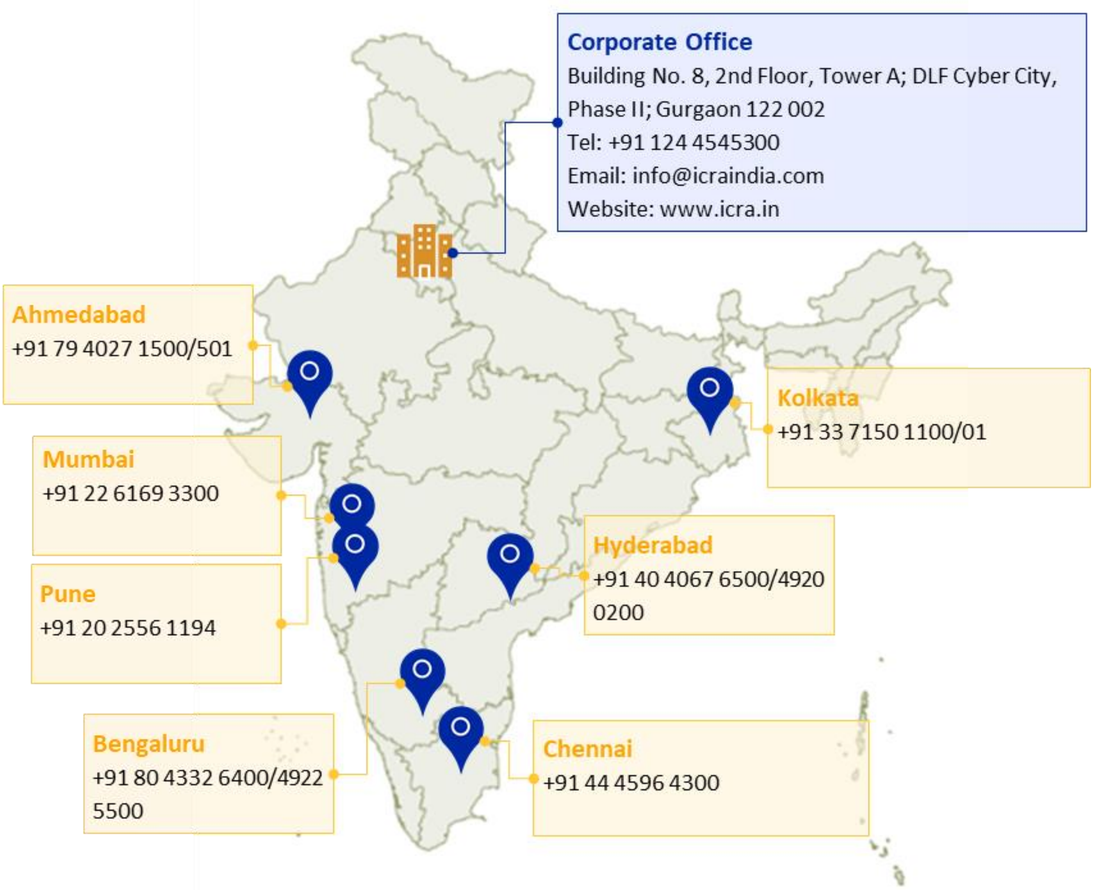

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