November 29, 2024

Dhanuka Laboratories Limited: 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 Working Capital	91.0	91.0	[ICRA]BBB(Stable)/ [ICRA]A3+; reaffirmed
Short-term, Non-fund Based Working Capital	62.0	62.0	[ICRA]A3+; reaffirmed
Total	**153.0**	**153.0**	

Instrument details are provided in Annexure-I

Rationale

For arriving at the ratings for Dhanuka Laboratories Limited (DLL), ICRA has taken a consolidated view of the financials of DLL (standalone) and Orchid Pharma Limited (OPL), which DLL acquired in March 2020 under the Insolvency and Bankruptcy Code (IBC) process, and currently holds a 69.8% stake in it.

The rating reaffirmation factors in DLL's improving consolidated business profile primarily through continued revival in the business and financial performances of OPL, which has an established presence in regulated markets in the cephalosporin active pharmaceutical ingredients (APIs) segment. This apart, OPL successfully closed its Qualified Institutional Placement (QIP) of ~Rs. 390 crore in FY2024, which resulted in deleveraging with retirement of acquisition related debt and also provided growth capital for the company's planned capex. Further, the ratings continue to draw comfort from DLL's established relationships with the clients in the cephalosporins API segment and the promoters' extensive experience in the said space. The ratings also derive comfort from the track record of financial support from its associate company, Dhanuka Agritech Limited (DAL; rated [ICRA]AA (Stable)/ [ICRA]A1+). The company has undertaken a greenfield facility for manufacturing 7ACA (7-aminocephalosporanic acid), a key raw material for manufacturing cephalosporin antibiotics under OPL's wholly-owned subsidiary, Orchid Biopharma Limited (OBPL) and will also be adding incremental API capacities in OPL's existing Chennai facility for downstream 7ACA processing. The company is expected to realise substantial backward integration benefits from these facilities in the long term. This apart, the company has undertaken another project related to Contract Development and Manufacturing Organisation (CDMO) for Shionogi, a Japanese pharmaceutical company, which is also expected to commence operations in CY2026. Both these projects provide additional revenue visibility in the medium-to-long term. ICRA also notes the recent launch of the company's new product, enmetazobactum, providing further product diversification.

The ratings are, however, constrained by ICRA's expectation that the company will witness a moderation in its return and credit metrics owing to large capex plans related to greenfield and brownfield capacities over the medium term. While a part of the said capex will be funded through QIP proceeds and internal accruals, the company will also be availing sizeable debt, particularly for the 7ACA facility. While the company has already tied up debt for the 7ACA project, the debt of Rs. 150 crore is yet to be tied up for the Shionogi project, resulting in significant funding risk. Owing to the technical complexity and nascent stage of the 7ACA project, there are high project execution risks and the company's ability to successfully commission the plant remains to be seen. While DLL's standalone operating margins improved in FY2024, the same continue to remain volatile on the back of uncertainty over raw material prices amid high dependence on China for its procurement, competitive pressure in semi-regulated markets and forex fluctuations. The business remains working capital intensive, led by a long receivable period and high inventory requirements.

The Stable outlook on the rating reflects ICRA's expectation that the company will benefit from performance improvements led by OPL with improving utilisation across its oral and enhanced sterile capacities. ICRA takes comfort from DLL's access to financial support from its associate concern, DAL, which can be availed to manage cash flow mismatches, if arises.

Key rating drivers and their description

Credit strengths

Leading player in cephalosporin API segment; diversified client portfolio across regulated and semi-regulated markets – The company is a leading manufacturer of cephalosporin APIs and intermediates with a wide portfolio across all five generations of cephalosporin products on consolidated basis. DLL is present in oral cephalosporins, while its subsidiary, OPL, is present in both oral and sterile (injectable) segments. The company has a well-diversified client portfolio across regulated and semi-regulated/unregulated markets. DLL is also present in the non-cephalosporin segment, which contributed around ~12% to its standalone revenues in FY2024.

Benefits for being a part of the Dhanuka Group with record of financial support backed by strong promoters – DLL is a part of the Dhanuka Group. DLL's promoter, Mr. Manish Dhanuka, has extensive experience of 25 years in the pharmaceutical industry, especially in the cephalosporin segment. Under his leadership, DLL successfully acquired OPL and has been able to revive its performance, while having implemented a deleveraging plan through non-core asset sale and equity raise. Moreover, DAL, the flagship company of the Dhanuka Group, has a track record of providing financial support to the company. DAL has extended a credit line of Rs. 50 crore to DLL, which is currently unutilised. With managerial and promoter linkages between DLL and DAL, the former enjoys financial flexibility and comfort with support from DAL.

Improvement in financial risk profile – The financial risk profile of the company, both at the standalone and at the consolidated levels, has improved in FY2024 over FY2023 and is expected to remain comfortable in FY2025. The revenue in FY2024, at the consolidated level (estimated), stood at ~Rs. 1,400 crore, resulting in a YoY growth of ~30%. The operating profit margin (OPM) also improved to over 11% against 9.7% in FY2023. This apart, post the deleveraging, the term debt has been negligible, and the working capital debt stood at Rs. 52 crore as on March 31,1 2024. After including the promoter's loan, the total estimated debt stood at Rs 158.4 crore as on March 31, 2024, thereby resulting in a gearing of 0.1 times and Total debt/OPBDITA of 1 times compared to a gearing of 0.4 times and TD/OPBIDTA of 3.5 times as on March 31, 2023. Going forward, the total debt is expected to increase significantly, resulting in moderation in debt metrics.

7ACA project to provide backward integration benefits – The 7ACA project, which is currently ongoing will provide an avenue for additional revenue and will also be utilised for its captive purposes. While the company will reap the benefits of backward integration, this will also help DLL increase its presence and establish its market position within the cephalosporin segment. This apart, another project for CDMO operations being set up at Shionogi will also enhance DLL's scale at a consolidated level.

Credit challenges

Sizeable project risks primarily for 7ACA project; return and credit metrics to be impacted – The company has announced large capex plans with a combined cost of ~Rs. 780 crore, which includes capex for the greenfield 7ACA project and the brownfield API facility in Alathur (Tamil Nadu) for downstream processing of 7ACA and a CDMO project for the Japanese pharmaceuticals company, Shionogi. The said capex will be incurred primarily over FY2025 and FY2026 and will improve the company's operational profile. For the 7ACA project, the company intends to fund a sizeable portion through debt. DLL's consolidated credit profile might moderate in the medium term with pressure on return and leverage metrics, pending the project's successful implementation and ramp-up. Although the consolidated credit metrics have improved in FY2024 post the sizeable loan repayment from QIP proceeds, the same will weaken from FY2026 with expected fresh term loans for the project. The coverage indicators will weaken once the repayment starts for these sizeable loans. While some part of the loan will come into the books in FY2025, the overall debt profile will remain comfortable. ICRA notes that the debt funding required for the 7ACA project has been secured, while it is yet to be tied up for the Shionogi project, indicating moderate funding risk. The 7ACA project will be eligible for interest subvention, capital subsidy and PLI benefits, which would subsequently benefit DLL. Further, the project is at a very early stage, indicating high project execution risk. Given the technological complexity, the company's ability to timely secure funding and complete within the timelines and budget, remains crucial. ICRA will continue to monitor the project's development as well as its funding mix.

High dependence on imports for raw materials; susceptible to fluctuations in raw material prices and forex rates – The company's operations have high dependence on China for raw material procurement, though through a diversified supplier base. In FY2023, there was a significant increase in raw material cost owing to elevated penicillin prices (a key raw material) and depreciation of the rupee. Raw material prices improved considerably in FY2024, resulting in improvement in DLL's standalone margins as it operates in semi-regulated markets with intense competition. Although the 7ACA project would bring down its import dependence in the long term, DLL's margins would continue to remain vulnerable to raw material price fluctuations as well as forex risk in the near-to-medium term.

High working capital intensity owing to sizeable contribution from exports and high inventory levels – DLL's working capital intensity continues to remain high at 40-45% on a consolidated basis owing to high debtor days, resulting from sizeable exports, and the need to maintain high inventory levels due to high price volatility of the key raw materials. Thus, the company's working capital requirements are expected to be sizeable, as common in this business. ICRA notes that the company has adequate working capital limits both at DLL and OPL to meet working capital requirements.

Liquidity position: Adequate

DLL's liquidity position is adequate, characterised by an expectation of stable consolidated operational cash flows, unutilised working capital limits of ~Rs. 80 crore as of September 2024, on a standalone basis, and unutilised credit line of Rs. 50 crore from DAL. Also, ~Rs. 35 crore of net QIP proceeds are available for general corporate purposes, which could also be used to meet DLL and OPL's funding requirements. Due to prepayment of term loans, mainly in OPL, the company has nominal debt repayment obligations in FY2025 and FY2026, on a consolidated basis. However, there are sizeable project capex plans, which are expected to be funded by a mix of QIP proceeds, internal accruals and debt funding.

Rating sensitivities

Positive factors – A sustained improvement in earnings along with healthy progress in the planned capex, particularly the greenfield 7ACA project, along with funding tie-ups would be favourably considered for ratings upgrade. Specific metrics for ratings upgrade would include consolidated total debt/OPBITDA of lower than 2.5 times on a sustained basis.

Negative factors – A downward rating action could be triggered if there is a decline in earnings or liquidity and weakening of the financial risk profile of the consolidated entity on a sustained basis. Also, higher-than-anticipated debt-funded capex and/or material delays in capex execution, leading to worsening of credit metrics, could result in ratings downgrade. Specific metrics for ratings downgrade would be consolidated total debt/OPBITDA of higher than 3.5 times on a sustained basis. Further, a decline in financial flexibility available to the entity from its associate concern, DAL, would remain a key rating monitorable.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Pharmaceutical
Parent/Group support	The ratings assigned to DLL factor in the moderate likelihood of its associate concern, DAL, extending financial support to it because of the need to protect its reputation from the consequences of a Group entity's distress.
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of DLL. As on March 31, 2024, the company had two subsidiaries, which are enlisted in Annexure-II.

About the company

DLL has been involved in manufacturing and marketing APIs and advanced intermediates of cephalosporin antibiotics since the commencement of its commercial operations in 1998. The company is promoted by the Dhanuka Group, the flagship company of which is Dhanuka Agritech Limited (DAL, rated [ICRA]AA (Stable)/A1+; the ratings stand withdrawn as of September 2024). DLL is a supplier of cephalosporin products to domestic and overseas non-regulated markets such as Pakistan, Bangladesh, Turkey, South Korea, China etc. through its manufacturing facility in Gurgaon (Haryana). The company diversified its portfolio to non-cephalosporin APIs/intermediates through its Keshwana facility in Rajasthan. Apart from operating in the API segment, DLL is present in the formulations segment through Synmedic Laboratories, which was acquired by DLL in 2013. At present, Synmedic operates a manufacturing facility in Faridabad (Haryana) and mainly sells its products to South-east nations such as Vietnam, Philippines, Cambodia etc. Synmedic has also set up another plant in Rajasthan to increase its manufacturing capacity for the formulations.

DLL also has a 69.8% subsidiary, OPL, which is a listed entity and was acquired by DPL in March 2020 under Insolvency and Bankruptcy Code (IBC) process. OPL manufactures cephalosporin APIs and formulations and has significant presence in regulated markets including the US, Europe, Japan etc.

Key financial indicators (audited/estimated)

DLL Consolidated	FY2022	FY2023	FY2024 (estimated)
Operating income	963.2	1083.8	1408.1
PAT	142.6	59.6	109.2
OPBDIT/OI	7.5%	9.7%	11.1%
PAT/OI	14.8%	5.5%	7.8%
Total outside liabilities/Tangible net worth (times)	0.8	0.8	0.4
Total debt/OPBDIT (times)	5.2	3.5	1.0
Interest coverage (times)	1.8	2.9	5.3

Source: Company, All ratios as per ICRA's calculations; Amount in Rs. crore

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current rating (FY2025)				Chronology of rating history for the past 3 years					
	Type	Amount Rated (Rs. crore)	FY2025		FY2024		FY2023		FY2022	
			Date	Rating	Date	Rating	Date	Rating	Date	Rating
Fund-based - Working Capital Facilities	Long / Short-term	91.0	29-Nov-2024	[ICRA]BBB (Stable)/ [ICRA]A3+	31-Aug-2023	[ICRA]BBB (Stable)/ [ICRA]A3+	27-May-2022	[ICRA]BBB (Stable)/ [ICRA]A3+	-	-
Non-fund Based - Working Capital Facilities	Short Term	62.0	29-Nov-2024	[ICRA]A3+	31-Aug-2023	[ICRA]A3+	27-May-2022	[ICRA]A3+	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term and Short Term -Fund based	Simple
Short Term Non-Fund-based	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

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Fund-based - Working Capital Facilities**	NA	NA	NA	91.00	[ICRA]BBB (Stable)/ [ICRA] A3+
NA	**Non-fund Based Working Capital**	NA	NA	NA	62.00	[ICRA] A3+

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Company Name	LTHL Ownership	Consolidation Approach
Orchid Pharma Limited (OPL)	69.80%	Full Consolidation

Source: company

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About ICRA Limited:

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