March 28, 2017

Windlas Biotech Private Limited

Instrument	Rated Amount	Rating Action
Term Loans	Rs. 33.04 crore (Reduced from Rs. 38.50 crore)	Reaffirmed at [ICRA]A-; Outlook revised to 'Positive'
Cash Credit	Rs. 27.00 crore (Reduced from Rs. 45.00 crore)	Reaffirmed at [ICRA]A-; Outlook revised to 'Positive'
Long Term/Short Term Fund Based Limits	Rs. 23.30 crore	Reaffirmed at [ICRA]A-/[ICRA]A2+; Outlook revised to 'Positive'
Short Term Non-Fund Based Limits	Rs. 2.00 crore	Reaffirmed at [ICRA]A2+
Un-allocated Limits	Rs. 23.46 crore (NIL earlier)	Reaffirmed at [ICRA]A-/[ICRA]A2+; Outlook revised to 'Positive'

Rating Action

ICRA has reaffirmed the long term ratings assigned to the bank facilities of Windlas Biotech Private Limited (WBL / "the company") at [ICRA]A- (pronounced ICRA A minus). The outlook on the long term rating has been revised to 'Positive' from 'Stable'. ICRA has also reaffirmed the short term rating for the company at [ICRA]A2+ (pronounced ICRA A two plus). Total rated amount of the bank facilities is Rs. 108.80 crore.

Rationale

The change in outlook takes into consideration expectations of increase in scale of WBL's contract manufacturing operations driven by new addition of new clients in its portfolio as well as ramp-up new product offerings and ramp-up of its export sales in the medium term. The revised outlook also factors in the healthy financial profile of the company, as supported by a sizeable cash and equivalents in its balance sheet. The company has shelved its plans of setting up a new injectibles unit and has moderate capital expenditure plans in the coming years. Going forward there will be minimal investment from WBL into its wholly-owned subsidiary Windlas Healthcare Limited (WHL), and the management is contemplating a fresh round of equity investment directly into WHL in the near term. WHL is involved in contract manufacturing and contract research requirements of global pharmaceutical players and has filed four Abbreviated New Drug Applications (ANDAs) in the US through US Pharma Windlas LLC (JV with First Time US Generics). It has entered into an exclusive marketing agreement with Granules India to market the product in the US.

During H1 FY 2017, WBL's has reported improved financial performance as reflected by healthy growth of 27% in its operating income and 100 bps improvement in EBITDA margins on account of better capacity utilization and rise in export sales. Most of the production has shifted from Unit 1 to Unit 2 which enjoys excise duty exemption till FY2020 and supports profitability.

The outlook remains favourable as the company has added new clients to its portfolio, including Glenmark Pharmaceuticals which is now one of its major clients. To scale-up its export sales, the company has identified ten key markets in Africa and Southeast Asia where the company will sell directly to the distributors, eliminating the need for a dedicated marketing team. WBL has decided to enter the 'nutra-ceuticals' market to manufacture and market products derived from food sources with extra health benefits. The company expects commercialization in early FY2018.

In March 2016, the Government of India decided to ban 344 fixed dose combination (FDC) products on the context that these products did not have a therapeutic rationale. This led to a sharp contraction in the Indian Pharmaceutical industry's volume growth in Q1 FY2017. However, there was no impact on WBL because it manufactured only five out of the 344 products under consideration. Accordingly, the company's revenues remained insulated from the development as reflected, by growth of 35% in sales during Q1 FY2017 as compared to Q1 FY2016.

The other industry developments that have direct bearing on WBL's business profile include changes in new drugs approval regulations, which have off late become stringent and lengthy. Clinical trials are now necessary for incremental modifications, making the approval process more expensive. This may reduce the rate at which new drugs come into the market and will have a negative impact on pharmaceutical companies including WBL.

The ratings continue to be constrained by the relatively moderate scale of the company's operations, high client concentration and relatively low profit margins. The profit margins weakened in FY2016 due to expansion of its finance team and investment on its MIS system. Further, WBL's wholly-owned subsidiary - WHL is a loss making entity since it is in a gestation period, and it will become profitable once the production introductions in the US market commercialize. Till then the losses would be partially funded by WBL, which acts as a rating constraint.

The company's ability to maintain its financial risk profile, improve its profitability while maintaining healthy growth in revenues, manage incremental investment requirements of its subsidiary WHL towards new drug developments, in a stricter regulatory regime would remain key rating sensitivities going forward.

ICRA will continue to monitor developments related to the investment into WHL and the potential restructuring of WHL's shareholding going forward.

Key Rating Drivers

Credit Strengths

- Established relationships with a number of domestic Pharma players and expanding relationships with MNC Pharma majors; moderate client concentration in spite of relatively smaller scale of operations.
- Most of the production has been shifted to Unit-II which is exempt from paying excise duty till 2019-20
- Entry into the fast growing segment of nutra-ceuticals in the domestic market will help it diversify the product portfolio
- Company is set to ramp up its export sales in Africa and Southeast Asia which will have a positive impact on its profit margins
- Focus on value added generics, combination drugs and change in delivery systems gives a competitive edge
- High focus on quality control and quality assurance procedures limits legal and regulatory risks

Credit Challenges

- The scale of operations remains much lower than other major contract manufacturers resulting in moderate operating margins;
- Two ANDAs, Dronedarone and Lurasidone, need regulatory approvals before commercialization; any delay or adverse court decision will impact the sales and might hamper the fund raising;
- Changes in drug approval process may impact new product development time cycle and hinder growth.

Rating Sensitivities:

- The credit profile and margin improvement will depend on the success of the export plans of the company;
- Exposure to regulatory changes, especially related to pricing of pharmaceutical products (by the National Pharmaceutical Pricing Authority (NPPA)), and events like FDC ban by Government of India may curtail growth of the domestic pharmaceutical market

Description of key ratings drivers highlighted above:

WBL sales grew by 27% in H1 FY2017 vs. H1 FY2016 due to addition of new clients and improvement in the own brand sales. The company added Glenmark to its client base in FY2016 and sales from Glenmark has almost doubled in FY2017 (year to date). Due to the ramp up of operations, the operating profit margin improved from 8% in FY2016 to 9% in H1 FY2017. The working capital utilization has been low and WBL has closed one of its cash credit facilities.

As on February 28, 2017 the company had cash and equivalents worth Rs. 43 crore on their balance sheet of which only limited portion will be invested into WHL in the near-term. Currently WHL is incurring operating losses as the commercialization of the ANDAs is yet to commence. These losses are partly funded by a part of the dossier fee received by WHL from Granules India, while the rest needs to be funded by WBL. The fresh round of investment will bode well for WBL as it will reduce dependence on WBL.

Analytical Approach

"For arriving at the rating, ICRA has considered standalone view of WBL and considered investments in its wholly-owned subsidiary WHL which is currently in gestation phase."

Links to applicable Criteria

Corporate Credit Rating –A Note on Methodology
Rating Methodology for Pharmaceutical Industry

About the Company

Windlas group has two companies – Windlas Biotech Private Limited (WBL) and Windlas Healthcare Limited (WHL). WBL derives its business from two segments viz. - contract manufacturing of formulations for domestic pharmaceutical companies and manufacturing & marketing of branded generic formulations. The contract manufacturing business accounts for a majority of company's total sales, while branded formulations business accounts for the balance. In the contract manufacturing business, WBL undertakes manufacturing of formulations mainly on principal-to-principal (P2P) basis with small contribution from loan licensing arrangements. WHL runs a US-FDA approved plant and provides an array of services including site transfers, contract research for formulations development, small scale to commercial production and regulatory support.

In FY2016, Tano Capital invested Rs. 75 crore in WBL for a 16.4% (on fully diluted basis) equity stake[1]. The funds raised from PE have been partly infused in WHL to meet its expense related to R&D and regulatory costs involved in filing of the ANDAs.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Table: Rating History

S.No	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. Crore)	Month-year & Rating	Month- year & Rating in FY2016	Month- year & Rating in FY2015	Month- year & Rating in FY2014
				Mar 2017	Jan 2016	Nov 2014	Sep 2013
1	Term Loans	Long Term	33.04	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Cash Credit	Long Term	27.00	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
3	Long Term/Short Term Fund Based Limits	Long Term and Short Term	23.30	[ICRA]A- (Positive)/ A2+	[ICRA]A- (Stable)/ A2+	[ICRA]BBB+ (Stable)/ A2+	[ICRA]BBB+ (Stable)/ A2+
4	Non Fund Based Limits	Short Term	2.00	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
5	Un-allocated Limits	Long and Short Term	23.46	[ICRA]A- (Positive)/ A2+	[ICRA]A- (Stable)/ A2+	[ICRA]BBB+ (Stable)/ A2+	[ICRA]BBB+ (Stable)/ A2+

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

[1] Tano Capital has 670,589 equity shares and 294,117 preference shares

Annexure-1

Details of Instrument

Name of the instrument	Size of the issue (Rs. Cr)	Interest Rate	Maturity Date	Current Rating and Outlook
Term Loan 1	3.31	5.15%	FY2019	[ICRA]A- (Positive)
Term Loan 2	4.05	Bank Base rate + 1%	FY2019	[ICRA]A- (Positive)
Term Loan 3	4.34	Bank Base rate + 1%	FY2022	[ICRA]A- (Positive)
Term Loan 4	3.16	6M LIBOR + 45 BPS	FY2020	[ICRA]A- (Positive)
Term Loan 5	1.47	10.25%	FY2020	[ICRA]A- (Positive)
Term Loan 6	16.70	10.0%	FY2022	[ICRA]A- (Positive)
Cash Credit 1	17.00	-	-	[ICRA]A- (Positive)
Cash Credit 2	10.00	-	-	[ICRA]A- (Positive)
Long Term/Short Term Fund Based Limit	23.30	-	-	[ICRA]A- (Positive)/ A2+
Non Fund Based Limit	2.00	-	-	[ICRA]A2+
Un-allocated	23.46	-	-	[ICRA]A- (Positive)/ A2+

Source: Company Data

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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