Syngene International Limited

July 31, 2018

Summary of rated instruments

Instrument*	Previously Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term loans (External Commercial Borrowings)	660.00	660.00	[ICRA]AA reaffirmed; outlook revised to positive from stable
Long-term unallocated	235.50	235.50	
Long-term/short-term fund based	64.50	64.50	[ICRA]AA and [ICRA]A1+ reaffirmed; outlook on long-term rating revised to positive from stable
Total	**960.00**	**960.00**	

*Instrument details in Annexure – I

Rating action

ICRA has reaffirmed the rating outstanding on the Rs. 660.00 crore term loans (external commercial borrowings) and the Rs. 235.50 crore long-term unallocated facilities of Syngene International Limited (Syngene/the company) at [ICRA]AA (pronounced ICRA double A). ICRA has also reaffirmed the [ICRA]AA (pronounced ICRA double A)/[ICRA]A1+ (pronounced ICRA A one plus) rating outstanding on the Rs.64.50 crore long-term/short-term fund based facilities of the company. The outlook on the long-term rating has been revised to 'positive' from 'stable'.

Rationale

The revision in outlook considers Syngene's strong operating income growth of 18.5% in FY2018 and the company's healthy business prospects over the medium term. Aided by steady growth across segments, Syngene's operating income grew from Rs. 1,200.9 crore in FY2017 to Rs. 1,423.1 crore in FY2018. Further, in FY2018, the company has expanded scope and extended timelines for its dedicated R&D contracts with Amgen, Bristol – Myers Squibb (BMS, until 2026) and Baxter (until 2024), and expanded its client base to include players like GlaxoSmithKline (GSK) and Zoetis. Given the anticipated growth of 10% in the global contract research industry and higher growth in Asia over the medium term, and the new business additions/extensions, the company's revenues are likely to witness double-digit growth on YoY basis over the medium term. While the company already has integrated presence across discovery and development services, the proposed forward integration into commercial scale manufacturing through the upcoming Mangalore facility is likely to diversify Syngene's revenue stream and strengthen the company's position in the 'drug discovery to manufacture' value chain.

Syngene continued to maintain its healthy profit margins, with an operating profit margin (OPM) of 28.1% (adjusted OPM of 31.6% including forex gains) and net margin of 21.4% in FY2018. The company's Return on Capital Employed (RoCE) stood at a healthy 18.0% in FY2018. Syngene's liquidity position also remained strong with cash and liquid investments of Rs. 1,124.2 crore as on March 31, 2018 and the company continued to remain net debt negative as on the said date. Although the company has a total capex of ~Rs. 1,320 crore (USD 200 million) and repayment obligations of about Rs. 700 crore on aggregate basis for FY2019-FY2021, ICRA draws comfort from the anticipated healthy accruals from the business and absence of incremental debt until FY2021. Syngene is likely to remain net debt negative over the medium term.

ICRA notes that Syngene's competition is likely to increase going forward, with several global and domestic players increasing presence in contract research. However, cost advantages compared to overseas players, the company's robust infrastructure/employee skillset and its established client relationships are likely to mitigate competitive threats to a large extent. Also, akin to other industry players, the company is bound by strict regulations for clinical trials for regulated markets; and its revenues and margins are susceptible to unfavourable forex movements, given that about 95% of its revenues are from overseas markets. While historical absence of regulatory issues in clinical trials provides comfort to a large extent in case of the former risk, the hedging mechanism adopted by the company mitigates the forex risk to an extent.

Syngene is a subsidiary of Biocon Limited (Biocon, rated [ICRA]AA+ (Stable)/[ICRA]A1+) and contributed to 48.2% of Biocon's consolidated operating profits in FY2018. Although the company does not require operational or financial support from the parent, Syngene enjoys implicit financial and operational flexibility by virtue of being Biocon's subsidiary.

Outlook: Positive

The 'positive' outlook reflects that ICRA expects Syngene to witness healthy revenue growth and improvement in accruals over the near to medium term. The outlook may be revised to 'stable' if Syngene's margins weaken; or if the company's debt increases significantly, resulting in deterioration in capital structure and coverage metrics.

Key rating drivers

Credit strengths

- **Strong business profile with integrated presence across discovery and development services; forward integration into commercial scale manufacturing in pipeline** – Syngene has presence across discovery and development services for novel molecular entities. The company operates through three verticals, namely – a) dedicated R&D centers for global majors like Bristol – Myers Squibb (BMS), Baxter, Amgen and Herbalife; b) discovery services; and c) development & manufacturing services. Going forward, Syngene plans to commence commercial scale manufacturing of intermediates/APIs, once its upcoming facility in Mangalore is commissioned in FY2020. This is likely to diversify the company's revenue stream and strengthen Syngene's position in the 'drug discovery to manufacture' value chain.

- **Established client relationships; healthy client addition in the last one year** – The company has long-term research contracts with reputed clients like Bristol – Myers Squibb (BMS), Baxter, Amgen and Herbalife. While the BMS and Baxter contracts have been extended till 2026 and 2024 respectively and their scopes were expanded, the scope of the research collaboration for Amgen was also expanded in FY2018. Further, the company has also increased its client base to include large players like GlaxoSmithKline (GSK) for drug discovery projects and Zoetis for development and manufacturing collaboration in the animal heath space. These provide revenue visibility for Syngene over the medium term.

- **Healthy revenue growth in FY2018; likely to continue over the medium term** – Aided by steady growth across segments, Syngene reported strong growth of 18.5% in operating income in FY2018 – from Rs. 1,200.9 crore in FY2017 to Rs. 1,423.1 crore in FY2018. While the growth in the dedicated R&D segment was underpinned by the expansion of services for the four large clients, discovery services grew on the back of strong traction in the discovery biology area; the growth in development and manufacturing services was largely driven by the expansion in chemical development business. The company's revenues are likely to witness double-digit growth on YoY basis over the medium term – given the anticipated growth of 10% in the global contract research industry and higher growth in Asia; and the new business additions.

- **Strong financial profile** – Syngene continued to maintain its profit margins and profitability at healthy levels, with an operating profit margin (OPM) of 28.1% (adjusted OPM of 31.6% including forex gains), net margin of 21.4% and Return on Capital Employed (RoCE) of 18.0% in FY2018. Further, the company's gearing stood at a conservative 0.5 times as on March 31, 2018, while its interest coverage remained strong at 17.6 times for FY2018. ICRA also notes that the company had cash and liquid investments of Rs. 1,124.2 crore as on March 31, 2018; adjusted for this, the company was net debt negative with a cash surplus of Rs. 320.0 crore as on March 31, 2018. Syngene's margins are likely to remain healthy and the company is likely to continue to be net debt negative over the medium term.

- **Strong parentage** – Syngene is a subsidiary of Biocon Limited (rated [ICRA]AA+ (Stable)/[ICRA]A1+). The company has robust infrastructure (with over 3,500 scientists and 1.3 million sq ft of research space) and strong accruals; and thus does not require operational or financial support from the parent. However, Syngene enjoys implicit financial and operational flexibility by virtue of its parentage.

Credit weaknesses

- **Significant capex plans and repayment obligations over the next three years** – The company has a total capex of ~Rs. 1,320 crore (USD 200 million) over the next three years for its upcoming API manufacturing facility in Mangalore and other infrastructure for business expansion. Also, Syngene has repayment obligations of about Rs. 700 crore on aggregate basis for FY2019-FY2021. However, ICRA draws comfort from the anticipated healthy accruals from the business (which are likely to support the capex and repayments) and absence of incremental debt until FY2021.

- **Growing competition in the contract research space** – With the industry poised for healthy growth over the next few years, several global and domestic players are increasing presence in contract research. This is likely to increase competition for Syngene going forward. However, cost advantages compared to overseas players, the company's robust infrastructure/employee skillset and Syngene's established client relationships are likely to mitigate competitive threats to a large extent.

- **Regulatory risks and vulnerability to unfavourable forex movement -** Akin to other industry players, the company is bound by strict regulations for clinical trials for regulated markets. Although any deviation in the same could result in reputational risks and other penalties for the company, historical absence of regulatory issues in clinical trials provides comfort to a large extent. Also, with about 95% of its revenues from overseas markets, the company's revenues and margins are susceptible to risks arising from adverse forex movements including appreciation of INR against USD. However, the hedging mechanisms adopted by the company mitigate the risk to an extent.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below. Also, ICRA has taken a consolidated view of the business and financial risk profiles of Syngene and its parent Biocon Limited, given the significant business linkages.
Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology for Pharmaceutical Industry

About the company:

Syngene International Limited, a subsidiary of Biocon Limited, is a Contract Research Organisations (CRO) providing integrated discovery and development services for novel molecules across multiple platforms, including small molecules, large molecules, antibody drug conjugates and oligonucleotides; the company's strengths include synthetic chemistry and molecular biology. Syngene offers outsourced services to 316 global customers across biotechnology, nutrition, animal health, consumer goods and specialty chemicals including majors such as Bristol-Myers Squibb (BMS), Amgen, Herbalife and Baxter, among others. Syngene has 1.3 million sq ft of R&D infrastructure and about 3,540 scientists currently. Syngene also incorporated a wholly-owned subsidiary, Syngene USA Inc., in the USA in FY2018 for providing marketing services to the company in the region.

Key Financial Indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	1,200.9	1,423.1
PAT (Rs. crore)	287.3	305.1
OPBDIT/ OI (%)	32.0%	28.1%
RoCE (%)	19.6%	18.0%
Total Debt/ TNW (times)	0.6	0.5
Total Debt/ OPBDIT (times)	2.1	2.0
Interest coverage (times)	22.0	17.6

Source: Company, ICRA research; OPBDITA: Operating Profit before Depreciation, Interest and Taxes; PAT: Profit After Tax; RoCE: Return on Capital Employed; TNW: Tangible Net Worth; NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating Jul 2018	Chronology of Rating History for the past 3 years: Date & Rating in FY2018 Apr 2017	Date & Rating in FY2017 Feb 2017	Date & Rating in FY2016 Sep 2015
1	Term loans (ECB)	Long Term	660.00	650.80	[ICRA]AA (Positive)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Long-term unallocated	Long Term	235.50					
3	Long-term/short-term fund based	Long Term/ Short Term	64.50		[ICRA]AA (Positive)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+

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

Annexure-1: Instrument Details

Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Term loans (ECB)	FY2016	Libor + 1.04% - Libor + 1.30%	FY2019 – FY2021	412.80	**[ICRA]AA (Positive)**
Long-term unallocated	NA			235.50	**[ICRA]AA (Positive)/ [ICRA]A1+**
Buyer's credit				64.50	

Source: Syngene International Limited

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About ICRA Limited:

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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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