May 21, 2021

Kwality Pharmaceuticals Ltd.: Ratings assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Term Loan	22.00	[ICRA]BBB (Stable); assigned
Long-term – Fund-based Working Capital	24.08	[ICRA]BBB (Stable); assigned
Short-term – Non-fund based	9.00	[ICRA]A3+; assigned
Long-term/Short-term – Unallocated	9.92	[ICRA]BBB (Stable) [ICRA]A3+; assigned
Total	**65.00**	

**Instrument details are provided in Annexure-1*

Rationale

The assigned ratings take into account Kwality Pharmaceuticals Limited's (KPL's) established track record of operations in the pharmaceutical formulations industry spanning more than three decades, the extensive experience of its promoters and its comfortable financial profile characterised by a healthy capital structure and debt coverage indicators, and its adequate liquidity position. The company continues to focus on gaining incremental business from its key customers in the margin-accretive export segment, which has also supported its revenue growth in the past. The company's revenues from exports increased to Rs. 79.4 crore in FY2020 (including deemed exports) from Rs. 44.7 crore in FY2016. The ratings also factor in KPL's wide product portfolio, which has strengthened its market position in the pharmaceutical industry. The company reported a strong year-on-year (YoY) revenue growth of 65% in H1 FY2021 as a result of product diversification in the recent past. Also, some of the company's products supported the surge in revenues in H1 FY2021 due to their efficacy in treatment of Covid-19.

The ratings are, however, constrained by the company's moderate scale of operations that limit its economies of scale. Furthermore, KPL's exports its products mostly to semi-regulated and unregulated markets with significant share of revenues coming from countries in Africa. This exposes it to credit risk during periods of macro-economic headwinds and geopolitical uncertainties. This risk is, however, partially mitigated by a portion of its sales being backed by letter of credit (LC) or advance payments in some cases. Moreover, since the revenues are mainly export driven and in the absence of an adequate hedging mechanism, any adverse currency fluctuations may have a bearing on the company's profitability. In addition, ICRA notes the vulnerability to changes in Government policies related to price control as well as the intense competition in the industry, which limits the company's revenue growth in the domestic market and constraints its pricing flexibility. ICRA also takes note of KPL's ongoing debt-reliant capital expenditure and significant debt repayments thereon. Its ability to profitably scale up its operations by achieving optimal capacity utilisation levels and generate commensurate returns to support its capitalisation and debt coverage indicators will be critical from the credit perspective.

The Stable outlook on the [ICRA]BBB rating reflects ICRA's opinion that the company will continue to benefit from the extensive experience of its promoters in the pharmaceutical industry and is likely to witness revenue growth in the near to medium term. The revenue growth will be backed by stable demand conditions for its existing products and incremental sales from its new products, supported by enhanced capacities.

Key rating drivers and their description

Credit strengths

Extensive experience of promoters and established track record in pharmaceutical business – KPL has an established track record in the formulations industry. In addition, the promoters have extensive experience in the sector and have established relationships with several of the company's suppliers and customers, thus supporting its operational profile.

Diversified customer base and product profile – Over the past three decades, KPL has developed a diverse portfolio of more than 6,000 drugs in the form of tablets, capsules, small volume liquid injections, liquid syrups, dry syrups, dry injections and suppositories. The company reported a strong YoY revenue growth of 65% in H1 FY2021 as a result of product diversification in the recent past. Also, some of the company's products supported the surge in revenues in H1 FY2021 due to their efficacy in treatment of Covid-19. Furthermore, its customer base remains diversified; its top five customers contributed to 41% of revenues in FY2020 and 64% in H1 FY2021.

Comfortable financial risk profile – KPL demonstrated a compound annual growth rate (CAGR) of ~17% for the four-year period that ended in FY2020. Furthermore, the company reported a strong YoY revenue growth of 65% in H1 FY2021. The capital structure remained comfortable, with gearing of 0.6 times as on September 30, 2020. The coverage indicators witnessed healthy improvement and remained comfortable as reflected by an interest cover of 11.1 times in H1 FY2021, TD/OPBDITA of 1.1 times and NCA/Debt of ~64% as on September 20, 2020.

Credit challenges

Moderate scale of operations amid intense competition in formulations industry – The company remains a moderate-sized player in the formulations industry, with an operating income (OI) of Rs. 142 crore in FY2020. The generic formulation industry faces stiff competition from numerous contract manufacturers, multinational corporations as well as established domestic brands. The intense competition restricts the company's revenue growth and pricing flexibility. However, with increased contribution of higher value-added products, mainly from the critical care segment, the OI improved in H1 FY2021.

Operations exposed to regulatory restrictions – The operations remain exposed to regulatory restrictions in terms of pricing caps in domestic markets and product/facility approvals in export destinations. With increasing focus on exports, ICRA notes that timely product and facility approval/renewal in various semi-regulated/regulated markets will remain critical for the growth of exports going forward. Furthermore, KPL's exports its products mostly to semi-regulated and unregulated markets with significant share of revenues coming from countries in Africa. This exposes the company to credit risk during periods of macro-economic headwinds and geopolitical uncertainties.

Profitability susceptible to volatility in raw material prices and foreign currency exchange rates – With limited control over the prices of its key inputs, the company's profitability remains exposed to volatility in raw material prices. However, in the past, it demonstrated the ability to pass on any increase to its customers, thereby limiting the exposure to some extent. With the company importing a major portion of its raw material requirements, its profitability remains vulnerable to fluctuations in foreign currency exchange rates to the extent unhedged.

Risks associated with ongoing expansion project – KPL's ongoing debt-funded capital expenditure exposes the company to risks associated with timely project implementation and subsequent ramp-up in sales, post commercialisation of operations. The proposed acquirement of bank term loans for the same will moderate the credit metrics in the interim, till commensurate returns from the same start flowing.

Liquidity position: Adequate

KPL's liquidity position is **adequate**, supported by healthy cash flow generation from operations and adequate cushion in working capital limits. Although the scheduled long-term debt repayment obligations are sizeable over the next three years, the company is expected to have sufficient cash accruals to service its debt obligations comfortably.

Rating sensitivities

Positive factors – ICRA could upgrade KPL's rating if it is able to sustain its revenue growth while maintaining stable credit profile on a sustained basis.

Negative factors – Downward pressure on the rating will emerge if the reliance on external borrowings increases, resulting in deterioration in the capital structure, or lack of commensurate and timely returns from the ongoing capex impacts the financial profile and the overall liquidity position. Specific credit metrics that could lead to a downgrade include interest coverage less than 3 times on sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Pharmaceutical Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of KPL as enlisted in Annexure-2.

About the company

KPL was incorporated in 1983 as a private limited company. The company was reconstituted to a closely held public limited company in 1993 and subsequently got listed on the SME platform of the Bombay Stock Exchange in July 2016. It manufactures pharmaceutical formulations in the form of injectables, tablets, capsules, and syrups. It has one unit each in Amritsar (Punjab) and Kangra (Himachal Pradesh); the Kangra unit commenced production in October 2008. Kwality Pharmaceuticals Africa LDA (Mozambique) is a wholly owned subsidiary.

Key financial indicators (audited)

KPL Consolidated	FY2019	FY2020	H1 FY2021
Operating Income (Rs. crore)	166.7	142.3	119.7
PAT (Rs. crore)	7.6	8.2	6.7
OPBDIT/OI (%)	9.6%	12.1%	11.1%
PAT/OI (%)	4.5%	5.8%	5.6%
Total Outside Liabilities/Tangible Net Worth (times)	1.9	2.0	1.7
Total Debt/OPBDIT (times)	1.8	2.0	1.1
Interest Coverage (times)	7.0	6.8	11.1

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA:

The press release of CRISIL Limited dated January 18, 2021 mentions that – 'CRISIL Ratings has been consistently following up with Kwality Pharmaceuticals Limited (KPL) for obtaining information through letters and emails dated December 09, 2020 and December 14, 2020 among others, apart from telephonic communication. However, the issuer has remained non cooperative. The investors, lenders and all other market participants should exercise due caution with reference to the rating assigned/reviewed with the suffix 'ISSUER NOT COOPERATING' as the rating is arrived at without any management interaction and is based on best available or limited or dated information on the company. Such non co-operation by a rated entity may be a result of deterioration in its credit risk profile. These ratings with 'ISSUER NOT COOPERATING' suffix lack a forward looking component.'

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of September 30, 2020 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					May 21, 2021	-	-	-
1	Fund-based – Term Loan	Long-term	22.00	14.7	[ICRA]BBB (Stable)	-	-	-
2	Fund Based Working Capital	Long-term	24.08	-	[ICRA]BBB (Stable)	-	-	-
3	Non-fund Based Working Capital	Short-term	9.00	-	[ICRA]A3+	-	-	-
4	Unallocated	Long-term/ Short-term	9.92	-	[ICRA]BBB (Stable)/ [ICRA]A3+	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Term Loans	Simple
Long-term – Fund Based Working Capital	Simple
Short -term – Non-fund Based	Very Simple
Long-term/ Short -term – Unallocated	Simple^

^ complexity categorization is as per the latest understanding of ICRA and is subject to change once the issuance terms are finalized.

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, is available on ICRA's website: Click Here

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Term Loan-I	July 2020	NA	March 2023	2.0	[ICRA]BBB (Stable)
NA	Term Loan-II	July 2020	NA	March 2023	4.0	[ICRA]BBB (Stable)
NA	Term Loan-III	July 2020	NA	March 2023	4.0	[ICRA]BBB (Stable)
NA	Term Loan-IV	July 2020	NA	March 2023	4.0	[ICRA]BBB (Stable)
NA	Term Loan – V	July 2020	NA	July 2025	8.0	[ICRA]BBB (Stable)
NA	Fund based working capital	-	NA	-	24.08	[ICRA]BBB (Stable)
NA	Non-fund based working capital	-	NA	-	9.00	[ICRA]A3+
NA	Unallocated	-	NA	-	9.92	[ICRA]BBB (Stable)/ [ICRA]A3+

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	KPL Ownership	Consolidation Approach
Kwality Pharmaceuticals Limited	**100.00% (rated entity)**	**Full Consolidation**
Kwality Pharmaceuticals Africa LDA (Mozambique)	100%	Full Consolidation

Source: KPL annual report for FY2020

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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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