November 26, 2021

Virchow Petrochemicals Private Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based limits	15.00	15.00	[ICRA]A+(Stable); reaffirmed
Non-fund based limits	2.00	2.00	[ICRA]A+(Stable); reaffirmed
Total	**17.00**	**17.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating action factors in Virchow Petrochemicals Private Limited's (VPPL) strong performance in FY2021 and 5M FY2022, marked by steady growth, healthy accrual generation and a strong financial profile supported by its leadership position in GCLE market (intermediate for cephalosporins). A healthy demand, long-term relationships with domestic players and a growing export presence also worked in favour of the rating. VPPL's operating income (OI) grew by 12.3% YoY in FY2021 and 30.3% YoY in 5M FY2022, driven by healthy volume offtake and increase in realisations. Going forward, the revenue growth is expected to be driven by healthy utilisation of existing capacities and higher realisations led by an increase in raw material prices. ICRA notes the introduction of a new intermediate - 7ACCA - in FY2021, enabling product diversification, though a meaningful scale-up of the installed capacities remains to be seen. VPPL is also in the process of commercialising a greenfield unit in the medium term which is expected to drive future revenues and enable product diversification. The financial profile is expected to remain healthy supported by healthy accruals and low reliance on external long-term debt in the near term.
The rating considers the financial flexibility enjoyed by VPPL as part of the Virchow Group, which primarily manufactures active pharmaceutical ingredients (APIs) and intermediates. Nearly 50% of VPPL's total sales are typically made to group company Covalent Laboratories Private Limited (CLPL)[1], ensuring an assured offtake of GCLE for VPPL. VPPL supplies 100% of its GCLE requirement at an extended credit period.

The company's profitability remains vulnerable to the fluctuations in raw material prices and the foreign currency exchange rate. This is also demonstrated by a decline in VPPL's operating margin to 26.6% in FY2021 from 29.3% in FY2020. Moreover, as most of the raw material requirement is being met from China, the company remains vulnerable to the disruptions in sourcing and the associated price volatility witnessed in recent months from China. While VPPL is expected to largely pass on the same with some lag, some moderation in profit margins is likely in the near term.

The rating is also constrained by VPPL's revenue dependence on a single product, though it is diversifying its portfolio to include other intermediates for cephalosporin antibiotics. VPPL has a high customer concentration with its top three customers accounting for 72.7% of the revenues over FY2019-FY2021. Moreover, the working capital intensity of the business remains high, primarily due to the extended credit period provided to a group company and sizeable inventory levels required to be maintained to prevent any production disruptions as most of the raw material is imported.

The Stable outlook reflects ICRA's opinion that VPPL will continue to derive financial flexibility as a part of the Virchow Group, its sizeable market share, the large manufacturing capabilities of GCLE and a sustained healthy financial profile. Healthy accruals and low reliance on external long-term debt are expected to maintain a robust financial profile.

1 Rated [ICRA] A- (stable)/A2+

Key rating drivers and their description

Credit strengths

Established position in GCLE-based cephalosporin drugs in domestic and export segments - VPPL undertakes commercial production of GCLE, a drug intermediate used to manufacture cephalosporins, with a sizeable market share of ~80-90% in the global market. The large production capacities of 3,000 metric tonnes per annum (MTPA) make VPPL the largest producer of GCLE globally. The company has long-term relationships with domestic players and a growing export presence with multiple companies in the Chinese markets. Its established presence is expected to remain supported by the management's focus on exports and continued dominant position in the domestic market.

Financial flexibility as part of the Virchow Group - VPPL is a part of the Virchow Group, which has a track record of manufacturing and marketing APIs for various classes of antibiotics, and it also maintains a leadership position in the respective product categories. Nearly 50% of VPPL's total sales (48.4% of sales in FY2021) are typically made to CLPL, a dominant player in GCLE-based cephalosporin manufacturing, ensuring an assured offtake of GCLE for VPPL. VPPL, therefore, serves as a backward-integrated unit for CLPL supplying 100% of its GCLE requirement at an extended credit period.

Healthy revenue growth prospects driven by increase in volumes and realisations – A healthy ramp-up in production levels, driven by rising domestic and export demand for GCLE, increased the OI at 5.4% CAGR during FY2017 to FY2021. The OI grew by 12.3% YoY in FY2021, led by higher export volumes, overall increase in realisations and the new product introduction of 7ACCA. In 5M FY2022, the OI grew by 30.3% YoY on healthy domestic demand and increase in realisations. The robust growth in OI is because of a low base effect in the corresponding period last year given the onset of the pandemic. Going forward, the revenue growth is expected to be spurred by higher utilisation of existing capacities for GCLE and 7ACCA and increase in realisations led by a subsequent increase in raw material prices. During FY2023-FY2024, growth is expected to be led by gradual commercialisation of VPPL's greenfield unit and diversification of the product portfolio.

Healthy financial profile characterised by strong capitalisation and coverage indicators – VPPL's gearing was 0.04 times as on March 31, 2021 compared to 0.2 times as on March 31, 2020. The TD/OPBITDA and interest coverage was recorded at 0.14 times and of 146.6 times, respectively, in FY2021 compared to TD/OPBITDA and interest coverage of 0.5 times and 96.2 times, respectively, in FY2020. The long-term debt comprises unsecured loans from promoters that will be repaid by the company on availability of surplus cash flows. Its financial profile improved because of a reduction in debt levels in FY2021 despite the decline in OPM to 26.6% in FY2021 from 29.3% in FY2020. The financial profile is expected to remain healthy supported by healthy accruals and low reliance on external long-term debt in the near term.

Credit challenges

High product and customer concentration risks – The company is largely reliant on a single product, GCLE, that exposes it to adverse event risks and demand fluctuations. It is diversifying its product portfolio by introducing 7ACCA in FY2021, an intermediate for cephalosporins, though a scale-up of the capacities and achieving the desired level of profitability remains a sensitivity. The sales from 7ACCA declined in 5M FY2022 because of reduced demand offtake for the finished product though the management expects demand to recover in H2 FY2022. VPPL is exposed to high customer concentration risk, with the top three customers driving 72.7% of the revenues and CLPL alone accounted for 49.3% of the revenues over FY2019- FY2021.

Geographical concentration risk for raw material – The company imports nearly 65-70% of its key raw material from China. Penicillin-G is the key raw material in manufacturing GCLE and 7ACCA and is entirely procured from China with no alternative sources. As most of the raw material requirement is being met from China, the company remains vulnerable to the disruptions in sourcing and associated price volatility witnessed in recent months from China, leading to significant geographical supply concentration. As a mitigating factor, the company plans to maintain higher levels of raw material inventory to avoid any supply chain disruptions while also passing on increased raw material costs if the prices remain elevated.

High working capital intensity - VPPL's working capital requirement is high on account of sizable inventory levels and extended receivable period from a group company. The key raw material is imported and, therefore, adequate levels are maintained to prevent any production disruptions. The company's receivable period is typically between 135 days and 140 days because of an extended credit period of 120-150 days to its group company, CLPL. VPPL extends 90-120 days credit period to its domestic customers and 45-90 days to its export customers. The working capital intensity (NWC/OI) moderated to 45.3% in FY2021 from 52.5% in FY2020 because of significant raw material purchases in February-March 2021 that resulted in higher outstanding payables as on March 31, 2021 though the same normalised as on August 31, 2021. The NWC/OI is expected to remain at 45-50% going forward.

Profitability exposed to fluctuations in raw material prices and foreign currency rates – The company's profitability is exposed to adverse movements in foreign exchange as ~50% of the revenues in FY2021 are derived from exports. VPPL enjoys a natural hedge through its imports (~65-70% of raw materials in FY2021). However, it remains exposed to adverse movement in foreign currency rates. VPPL's margins remain vulnerable to any adverse movement in raw material prices, though it can be passed onto consumers with a lag, depending on market conditions.

Liquidity position: Adequate

VPPL's liquidity is adequate characterised by healthy accruals and cash flow from operations which is expected to continue going forward. It has low average working capital utilisation of 5.2% of the sanctioned limits for the 12-month period ended August 2021. The liquidity profile is also supported by ~Rs. 11.4 crore as on October 31, 2021. VPPL only has unsecured loans from promoters and no external long-term debt. The capex outlay for FY2022 is expected to be Rs. 80-85 crore, funded completely through internal accruals.

Rating sensitivities

Positive factors – ICRA could upgrade VPPL's rating if the company diversifies its product portfolio thereby reducing its dependence on a single product. A desired scale-up of fresh capacities and maintaining a strong market position in the GCLE-based cephalosporin market will also work in VPPL's favour. VPPL's ability to maintain similar profitability levels as FY2021 and a robust capital structure will be the key towards the upward movement in rating.

Negative factors – Negative pressure on VPPL's rating could arise if the company's RoCE declines below 20% on a sustained basis or if there is a substantial increase in working capital requirements from the current levels. Capital withdrawal without corresponding surpluses, resulting in indebtedness for working capital requirements/capital expenditure, and additional funding or support to the Group company will be the other negative triggers.

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	Standalone

About the company

VPPL, incorporated in 2003, undertakes commercial production of GCLE (7-phenylacetamido-3-chloromethyl cephalosporanic acid p-methoxy benzyl ester), a drug intermediate used to manufacture cephalosporins like Cefixime, Cefdinir and Cefprozil. In FY2021, the company started manufacturing 7ACCA (intermediate for antibiotics) in small quantities, though its contribution to the overall revenue profile remains minimal. At present, it has an installed capacity of 3,000 MTPA for GCLE and 120 MTPA for 7ACCA. VPPL is a part of the Hyderabad-based Virchow Group, which has interests primarily in pharmaceutical businesses.

Key financial indicators

Consolidated	FY2020 (Audited)	FY2021 (Provisional and Unaudited)
Operating Income (Rs. crore)	759.2	852.3
PAT (Rs. crore)	215.4	217.9
OPBDIT/OI (%)	29.3%	26.6%
PAT/OI (%)	21.6%	18.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.3	0.2
Total Debt/OPBDIT (times)	0.5	0.1
Interest Coverage (times)	96.2	146.6

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 (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Nov 26, 2021	Nov 17, 2020	Sept 12, 2019	Sept 24, 2018
1	Fund-based facilities	Long Term	15.00	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	Non-fund based -Bank guarantee	Long Term	2.00	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based limits	Simple
Non-fund based limits	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 analyzing 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: www.icra.in

Annexure-1: Instrument details

Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Fund-based facilities	NA	NA	NA	15.0	[ICRA]A+ (Stable)
NA	Non-fund based facility-Bank guarantee	NA	NA	NA	2.0	[ICRA]A+ (Stable)

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Not applicable

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545328
shamsherd@icraindia.com

Kinjal Shah
+91 022 61143400
kinjal.shah@icraindia.com

Gaurav Jain
+91 020 6606 9922
Gaurav.jain@icraindia.com

Deepak Jotwani
+91 124 4545 870
Deepak.jotwani@icraindia.com

Vanshika Gupta
+91 020 6606 9919
Vanshika.gupta@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

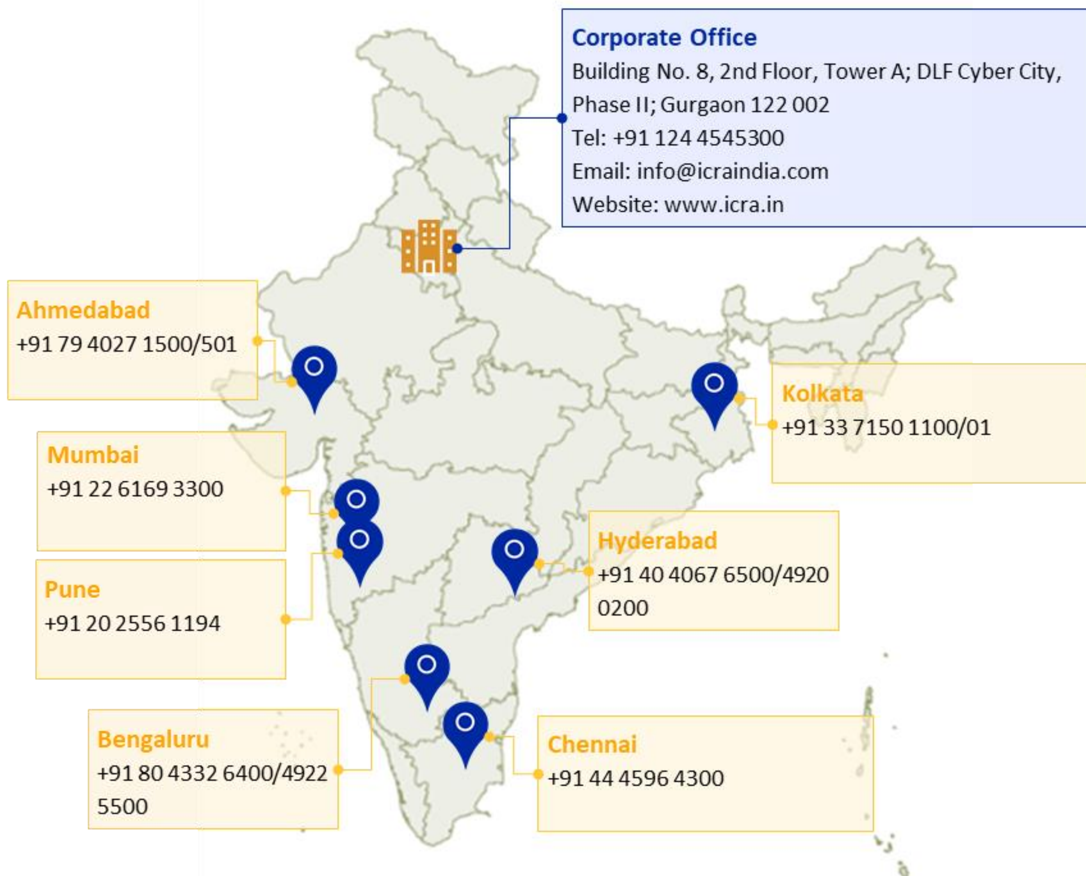
For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches



© Copyright, 2021 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.