January 30, 2023

Adcock Ingram Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based Limits – Working Capital#	(30.00)	(30.00)	[ICRA]A+ (Stable); reaffirmed
Long-term Non-fund Based Limits#	(15.0)	(15.0)	[ICRA]A+ (Stable); reaffirmed
Short-term – Fund-based Working Capital	55.00	55.00	[ICRA]A1+; reaffirmed
Short-term Non-fund Based Limits#	(15.0)	(15.0)	[ICRA]A1+; reaffirmed
Total	**55.00**	**55.00**	

**Instrument details are provided in Annexure-I; # Sub-limit of short-term fund-based limits*

Rationale

The reaffirmation of the ratings considers Adcock Ingram Limited's (AIL) long track record, strong contract manufacturing capabilities and robust relationship with its joint venture (JV) investors who have been its customers over the years. The company enjoys strong operational and financial flexibility since it is a JV between its experienced JV investors, Medreich Limited (rated [ICRA]AA- (Stable)/[ICRA]A1+) and Adcock Ingram Holdings Limited (Adcock Holdings). While Medreich has an extensive and proven track record in the contract research and manufacturing (CRAMS) space, Adcock Holdings continues to have a strong position in the South African private healthcare market. AIL's financial profile remains strong, characterised by healthy coverage metrics and liquidity position.

However, the ratings also factor in the relatively moderate scale of AIL's operations, its high customer and geographical concentration with the company deriving most of its revenues from its JV investors. Although its affiliation with Adcock Holdings is a positive and supports business operations, any weakness/adverse regulatory changes or pricing-led competition in the South African pharmaceutical market impacting Adcock Holdings' performance could impact AIL's performance. The ratings also consider the susceptibility of the company's revenues and margins to any adverse forex movements as it derives majority of its revenues from the overseas markets. In FY2022, AIL witnessed moderation in its operating profit margin (OPM) to 19% owing to a sharp increase in raw material prices and delay in passing on the costs to the customers. ICRA also notes that the company is in the midst of a capacity expansion plan for setting up a greenfield facility in Bengaluru to manufacture effervescent. The project cost is estimated at Rs. 150-160 crore and is expected to be funded by mix of debt and internal accruals. While ICRA does not expect this to impact AIL's strong debt protection metrics and liquidity position, the timely commencement, receipt of approvals, and ramp-up of operations at the new facility and the impact of the same on the credit metrics remain key monitorable.

Key rating drivers and their description

Credit strengths

Strong and experienced JV partners, with whom AIL enjoys strong financial and operational flexibility – AIL enjoys strong operational and financial flexibility, given its experienced JV partners. While Medreich (a wholly-owned subsidiary of Meiji Seika Pharma Co. Limited) has an extensive and proven track record in the CRAMS space, Adcock Holdings enjoys a strong brand recall and has a second position in the South African private healthcare market. The company forms an important part of Adcock Holdings' manufacturing set up owing to Adcock Holdings' dependence on AIL for meeting its oral solid manufacturing requirements for over-the-counter (OTC) and public/ Government tender business. Consequently, Adcock

Holdings contributed around 71% to AIL's turnover and supported revenue growth in FY2022 and FY2023 YTD. Hence, by virtue of its strong business relationship with its JV investor, the company has enjoyed an assured revenue stream over the years.

Strong financial profile characterised by healthy credit metrics and sizeable cash balances – The company's credit metrics are healthy, given its healthy cash accruals and limited dependence on debt. Till March 2022, the company was debt free and had taken a foreign currency loan of Rs. 50 crore with a seven-year tenor to fund its greenfield capex in its subsidiary, Adcock Ingram Pharma Private Limited (AIPPL). ICRA expects coverage metrics to remain healthy backed by stable business from JV partners. Also, the company has sizeable cash balances of Rs. 38 crore and unutilised fund-based working capital limits of Rs. 38 crore lending a strong liquidity cushion, supporting the financial profile.

Established track record coupled with strong contract manufacturing ability – The company has an extensive track record in the contract manufacturing space and its facility with an installed capacity of ~470 crore tablets and capsules per annum is certified by various leading regulatory bodies such as the Medicines and Healthcare products Regulatory Agency (MHRA) in the UK, Therapeutic Goods Administration (TGA) in Australia, The National Agency for the Safety of Medicines and Health (ANSM) in France, the South African Health Products Regulatory Authority (SAHPRA), Pharmacy & Poisons Board (PPB) in Kenya, The Tanzania Food and Drugs Authority (TFDA), and the National Agency for Food and Drug Administration and Control (NAFDAC) in Nigeria. The company is setting up a greenfield facility for effervescent drug forms under the new subsidiary at a capex of Rs. 150-160 crore. The new capacity will cater to the manufacturing requirements of Adcock Holdings and is expected to commence from H2 FY2024, subject to timely approvals.

Credit challenges

Moderate scale of operations, timely completion and approvals for new facility critical for further scale up– AIL has an assured revenue stream since it primarily caters to the manufacturing requirements of its JV partners. The company has a relatively moderate scale of operations and its revenues have remained range-bound over the past four to five years. Revenues grew 14% to Rs. 413 crore in FY2022 aided by higher demand from its customers amid the pandemic. While the company is in the midst of setting up a greenfield facility in Bengaluru, which is likely to provide additional revenues, it is yet to go through the regulatory approval process and timely completion of the process is critical for the planned ramp-up.

Exposure to raw material price volatility to an extent – In FY2022, the company witnessed a drop in operating margins to 19% compared to 26% in FY2021 owing to high raw material prices, especially for paracetamol. As the company continues to import around 50-60% of its raw material, the margins are exposed to raw material availability and pricing in key exporters such as China as well as the freight costs. Although AIL has a cost-plus margin arrangement with the parent, Adcock holdings, it is able to pass on raw material price escalations to its parent to a large extent and with some lag. The impact of the fluctuating raw material prices on the company's earnings remains monitorable.

High customer and geographical concentration risk; revenues vulnerable to unfavourable forex movements – AIL derived 90% of its revenues in FY2022 from its top two customers, with significant dependence (~71%) on Adcock Holdings followed by the Australia-based iNova Pharmaceuticals (19%). Consequently, it is exposed to high geographical concentration risk as 80% of its revenues come from the South African market. Therefore, any weakness/adverse regulatory change in the South African market is likely to exert pressure on the company's revenues. ICRA also notes that the company has low therapeutic diversification with a key focus on pain management, contributing almost 70-80% of revenues followed by the multivitamin segment (15-20%). The company has considerable exposure to forex fluctuation as most of its revenues come from exports. Although AIL transacts with the parent in USD to insulate itself from the fluctuation in South African local currency, it faced some currency issues with its African clientele. The company also imports around 50-60% of its raw material in USD, which provides a partial natural hedge.

Regulatory risks as is prevalent in the pharmaceutical sector – Adcock Holdings operates in a highly competitive and fragmented industry with inherent regulatory risks. The South African generic formulation and OTC industry faces stiff competition from numerous multinational corporations (MNCs) as well as established domestic brands. The intense competition could restrict Adcock Holdings's revenue growth and pricing flexibility, which could have a cascading impact on the revenue prospects of AIL. As is prevalent in the industry, the company remains exposed to similar risks in its other end-consumer markets.

Liquidity position: Strong

AIL's liquidity position is strong owing to healthy retained cash flows of Rs. 40-50 crore, free cash balances of Rs. 38 crore and unutilised working capital limits of ~Rs. 38 crore. The company has modest dependence on debt to fund its greenfield capex owing to healthy accruals. It has nil debt repayments in FY2023 and Rs. 2.5 crore of repayment in FY2024.

Rating sensitivities

Positive factors – An upward movement in the rating could happen with a substantial increase in the scale of operations along with improvement in product and customer diversity, as well as an improvement in the earnings and profitability indicators on a sustained basis.

Negative factors – Pressure on the ratings could arise the with weakening of business linkages with the JV partners and a sharp deterioration in the credit profile of the company owing to reasons including debt-funded capex. Additionally, pressure on the ratings could arise due to a significant decline in revenues leading to a deterioration in the profit margins on a 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 standalone financials of AIL.

Note (for analyst reference only):

About the company

Established in 2007, AIL is a JV between the South African firm, Adcock Ingram Holdings Limited and Medreich Limited. AIL was formed with the primary objective of manufacturing pharmaceutical formulations for Adcock Holdings. Medreich holds a 50.07% stake in the company while Adcock Holdings holds the balance.

AIL's facilities are primarily dedicated to manufacturing generic drugs for Adcock Holdings for the South African market. In addition to catering to Adcock Holdings, AIL provides some outsourced formulation manufacturing services to Medreich. In addition to its captive customers (JV partners), the company provides contract manufacturing services (CMS) to some of its external customers. Adcock is currently operating with a manufacturing facility in Bengaluru.

Key financial indicators (audited)

AIL (Consolidated)	FY2021	FY2022	H1 FY2023*
Operating income	361.5	413.5	243.6
PAT	71.7	59.8	52.3
OPBDIT/OI	26.4%	19.5%	24.3%
PAT/OI	19.8%	14.5%	21.5%
Total outside liabilities/Tangible net worth (times)	0.2	0.4	0.1
Total debt/OPBDIT (times)	-	0.6	-
Interest coverage (times)	483.6	422.1	-

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; *Provisional standalone financials*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Jan 30, 2023	Oct 29, 2021	Sep 2, 2020	May 6, 2019
1	**Fund-based working capital#**	Long term	(30.0)	-	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**
2	**Non-fund based limits#**	Long term	(15.0)	--	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**
3	**Fund-based limits – Working capital**	Short term	55.0	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**
4	**Non-fund based limits#**	Short term	(15.0)	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**

 # Sub-limit of short-term fund-based limits

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based Limits – Working Capital #	Simple
Long-term Non-fund Based Limits#	Very Simple
Short-term Fund-based Limits – Working Capital	Simple
Short-term Non-fund Based Limits#	Very Simple

 # Sub-limit of short-term fund-based limits

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#	NA	NA	NA	(30.0)	[ICRA]A+ (Stable)
NA	Non-fund based limits#	NA	NA	NA	(15.0)	[ICRA]A+ (Stable)
NA	Fund-based limits – Working capital	NA	NA	NA	55.0	[ICRA]A1+
NA	Non-fund based limits#	NA	NA	NA	(15.0)	[ICRA]A1+

Source: Company; # Sub-limit of short-term fund-based limits

Annexure II: List of entities considered for consolidated analysis – Not applicable

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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.

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