August 29, 2024

Theon Pharmaceuticals Ltd: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term / Short-term – Fund-based limits – Cash Credit	31.00	31.00	[ICRA]A- (Positive)/[ICRA]A2+; reaffirmed
Long-term / Short-term – Non-fund based limits	14.00	14.00	[ICRA]A- (Positive)/[ICRA]A2+; reaffirmed
Total	**45.00**	**45.00**	

**Instrument details are provided in Annexure-I*

Rationale

To arrive at the ratings of Theon Pharmaceuticals Ltd. (TPL), ICRA has considered the consolidated financial profile of TPL and its wholly-owned subsidiary, Theon Lifesciences Private Limited (TLPL), given their common management and operational and financial linkages between them.

The ratings reaffirmation and continuation of the Positive outlook on the long-term rating factor in the improvement in the company's financial performance in FY2024, as marked by a healthy revenue growth and an increase in the operating margins, and ICRA's expectations of sustenance of the same over the near-to-medium term. TLPL is in the process of setting up a greenfield manufacturing facility for injectables, which are expected to improve portfolio diversity and margin profile over the medium term. Thus, timely commissioning and ramp-up of capacity utilisation in this facility will remain a key monitorable.

Additionally, the ratings continue to factor in TPL's established track record as a leading contract manufacturer for its customers, which include reputed pharmaceutical companies in the domestic market. This apart, the company is also involved in supplying branded formulations to several pharmaceutical institutions and public sector undertakings in the domestic, export markets and its group companies, which leads to revenue diversity. The ratings also draw comfort from TPL's comfortable financial risk profile, characterised by healthy revenue growth, positive cash flow generation and low debt, resulting in a comfortable capital structure and debt protection metrics. Further, the customer concentration risk remains low as TPL enjoys established relationships with various pharmaceutical majors.

The ratings are, however, constrained by TPL's moderate scale of operations with high dependence on a single therapeutic segment of anti-bacterials. However, the company's upcoming injectables facility and planned product launches are expected to improve portfolio diversity over the medium term. Further, TPL's profitability is exposed to highly competitive and fragmented nature of the industry with inherent regulatory risks, with limited ability to fully pass on any increase in raw material prices to its customers, especially in the institutional segment. The ratings are also constrained by the relatively higher receivables cycle as a significant share of the business comes from government tenders and exports, which have a high collection period.

Key rating drivers and their description

Credit strengths

Diversified business across private pharmaceutical players, institutional tenders, sales through group companies and exports – TPL's operations are fairly diversified across its clientele, end-user segments and geographies. It undertakes contract manufacturing of formulations for domestic pharmaceutical companies on a principal-to-principal (P2P) basis (which contributed 40% to its revenues in FY2024) and exports own branded generic formulations in semi-regulated markets (28%).

Further, it derives revenues from government tenders and institutional clients (23%) along with sales of generic branded formulations through its group entities, IVA Healthcare Pvt. Ltd. and Theogen Pvt. Ltd. (8%).

Low customer concentration risk and track record of supplying to pharmaceutical majors – TPL has an established track record of contract manufacturing for various established Indian pharmaceutical majors including Hetero Healthcare Ltd., Torrent Pharmaceuticals Ltd., Alkem Laboratories Ltd., Marksans Pharma Ltd. and Aristo Pharmaceuticals Pvt. Ltd., among others. It also supplies to various public sector undertakings. This results in low customer concentration risk for the company with its top five clients accounting for less than 25% of its revenues in the recent years. Additionally, the healthy credit profile of its corporate customers reduces the counterparty credit risk.

Planned injectable capex to support product diversity and margin profile, going forward – The company is setting up a liquid injectables manufacturing facility in Dera Bassi, Mohali, which is expected to improve product diversity and augment scale and accrual generation over the medium term. The facility is expected to be commercialised in FY2025 and initially cater to existing customers in the domestic and semi-regulated export market. However, the management plans to foray into new geographies after obtaining required regulatory approvals over the medium term, which is expected to be further margin accretive.

Comfortable financial risk profile, led by low indebtedness – TPL's financial risk profile continues to remain comfortable, characterised by relatively lower debt levels, healthy cash accrual generation and an adequate liquidity position. This coupled with a sizeable net worth position of Rs. 291.7 crore as on March 31, 2024 has resulted in a comfortable gearing of 0.2 times as on March 31, 2024. TPL reported a healthy YoY growth of 31% in FY2024, supported by healthy demand for antibiotics, increasing export and institutional sales. Moreover, higher operating leverage coupled with a change in the product mix led to an improvement in the operating profit margin (OPM) to 8.7% in FY2024 against 3.7% in FY2023. Notwithstanding some likely moderation in FY2025 due to balance spend on sizeable, planned capex of Rs. 140 crore (incurred cumulatively over FY2024-FY2025), the debt protection metrics are expected to remain comfortable.

Credit challenges

Moderate scale of operations with high dependence on a single therapeutic segment; new product launches to improve portfolio diversity – TPL's scale of operations remains moderate with 50-60% of its revenues derived from a single therapeutic segment of antibiotics. However, to diversify its product portfolio, the company has launched new products in anti-diabetes and cardiovascular segments and is also in the process of setting up a greenfield injectable manufacturing facility.

High competition intensity; raw material price volatility constrains profitability for institutional tender business – As TPL is a major manufacturer of generic drugs, its profitability remains exposed to intense competition from various players in the industry, leading to pricing pressure. Moreover, the company's margins are vulnerable to volatility in raw material prices as it cannot fully pass on the same to end-consumers, particularly in the institutional segment. Moreover, TPL is exposed to inherent regulatory risks, with respect to its products manufactured as well as inspections of its manufacturing facilities carried out by regulatory agencies.

High collection period, led by institutional and exports businesses – TPL's receivable levels remain high due to sizeable revenue generation from exports and institutional business (primarily public sector undertakings). TPL's receivable days increased to 130 in FY2024 from 119 in FY2023 due to a considerable rise in export revenues and some delay in payments from the institutional clients. Elevated funding requirements led to increased reliance on working capital debt over the past year. While the company is witnessing a gradual recovery in receivables in the current fiscal, any significant delay in recovery of the same could impact its liquidity position and thus remains a monitorable.

Liquidity position: Adequate

TPL has an **adequate** liquidity profile, supported by ~Rs. 20 crore of unencumbered cash balances and liquid investments and undrawn bank lines of ~Rs. 35 crore as on June 30, 2024. TPL is in the process of incurring sizeable capex of ~Rs. 140 crore over FY2024 and FY2025 for setting up a new manufacturing facility. This is being funded largely through surplus liquidity and internal accruals and the balance through debt (Rs. 25 crore), which has already been sanctioned. It has debt repayment liability of ~Rs. 5 crore p.a. over FY2026 and FY2027, which is expected to be adequately funded from its internal accruals.

Rating sensitivities

Positive factors – ICRA could upgrade the ratings if the company demonstrates a sustained improvement in scale and diversification across therapeutic segments while maintaining its operating profitability and adequate liquidity position. Specific resulting in core ROCE being higher than 18% on a sustained basis.

Negative factors – Negative pressure on the ratings would arise in case of a sustained deterioration in the earnings of the company and/ or a significant weakening in the credit metrics with TD/OPBITDA higher than 2.0x on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Pharmaceuticals Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on consolidated financials of TPL and its Group company, TLPL.

About the company

Incorporated in 2005, TPL started commercial operations from April 2007 with the manufacturing and selling of pharmaceutical formulations. TPL undertakes contract manufacturing of formulations for domestic pharmaceutical companies (on P2P[1] basis) and sells its formulations through Government tenders (on open contract basis). The company also sells its own branded generic formulations and generics through group companies, Iva Healthcare Private Limited and Theogen Private Limited. Apart from the domestic market, TPL supplies its formulations to both unregulated (African markets) and semi-regulated destinations (South Asian markets). The company currently operates from its single manufacturing facility in Nalagarh, Solan (Himachal Pradesh).

Key financial indicators

TPL	FY2023	FY2024*
Operating income	459.6	601.8
PAT	10.4	32.6
OPBDIT/OI	3.7%	8.7%
PAT/OI	2.3%	5.4%
Total outside liabilities/Tangible net worth (times)	0.6	0.8
Total debt/OPBDIT (times)	0.0	1.0
Interest coverage (times)	15.4	16.7

*Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. Crore; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation*

[1] *P2P: Marketed by (brand owner) and manufactured at contract manufacturer's site*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Current (FY2025)			Chronology of rating history for the past 3 years					
	FY2025			FY2024		FY2023		FY2022	
Instrument	Type	Amount Rated (Rs Crore)	Aug 29, 2024	Date	Rating	Date	Rating	Date	Rating
Long term / short term-others-non fund based	Long Term/Short Term	14.00	**[ICRA]A-(Positive)/[ICRA]A2+**	25-MAY-2023	[ICRA]A-(Positive)/[ICRA]A2+	13-JUL-2022	[ICRA]A-(Stable)/[ICRA]A2+ ISSUER NOT COOPERATING	14-JUN-2021	[ICRA]A-(Stable)/[ICRA]A2+
				-	-	30-SEP-2022	[ICRA]A-(Positive)/[ICRA]A2+	-	-
Long term / short term-cash credit-fund based	Long Term/Short Term	31.00	**[ICRA]A-(Positive)/[ICRA]A2+**	25-MAY-2023	[ICRA]A-(Positive)/[ICRA]A2+	13-JUL-2022	[ICRA]A-(Stable)/[ICRA]A2+ ISSUER NOT COOPERATING	14-JUN-2021	[ICRA]A-(Stable)/[ICRA]A2+
				-	-	30-SEP-2022	[ICRA]A-(Positive)/[ICRA]A2+	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term/ Short-term: Fund-based Limits	Simple
Long-term/ Short-term: 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 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 Limits**	NA	NA	NA	31.00	[ICRA]A- (Positive)/[ICRA] A2+
NA	**Non-fund Based Limits**	NA	NA	NA	14.00	[ICRA]A- (Positive)/[ICRA] A2+

Source: Company

Annexure II: List of entities considered for consolidated analysis

Company Name	TPL's Ownership	Consolidation Approach
Theon Lifesciences Private Limited	100.00%	Full Consolidation

Source: Company

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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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