March 24, 2022

Strides Pharma Science Limited: Ratings downgraded; outlook revised to Negative from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. Crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	200.00	193.50	[ICRA]A(Negative); Rating downgraded from [ICRA]A+(Stable)
Long-term Fund-based Facilities	940.00	900.00	
Short-term Non-Fund Based Facilities	480.00	480.00	[ICRA]A2+; Rating downgraded from [ICRA]A1
Unallocated Facilities	180.00	226.50	
Total	**1,800.00**	**1,800.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating action follows the weaker-than-expected performance of Strides Pharma Sciences Limited (Strides/the company) during 9M FY2022, as the company's US business witnessed pricing pressures (as prescription levels remained weak) amid slower pace of new product approvals. With Strides deriving sizeable portion of its US revenues from the oral solids segment in the acute therapies space, the company's performance was severely impacted in 9M FY2022. Overall, Strides witnessed YoY revenue degrowth of 8% in 9M FY2022, despite growth in its other regulated markets (1% YoY) and emerging markets (28% YoY) businesses. The company's operating profit margins reduced to -2.4% in 9M FY2022 from 19.8% in 9M FY2021 owing to substantial price erosions coupled with higher material and logistics costs. Against this backdrop and incremental debt availed for acquisition of Endo, the debt coverage metrics witnessed significant deterioration in 9M FY2022. However, the US business witnessed sequential growth of 13% in Q3 FY2022 on the back of new contract wins. The pace of recovery in the US market and benefits from acquisition of Endo Pharmaceuticals (Endo) remains a key monitorable for the company, going forward. The ratings also take into account the company's significant investment in Stelis Biopharma Private Limited (Stelis) of ~$75 million till date and outstanding corporate guarantee extended to Stelis to the tune of Rs. 627.0 crore as on December 31, 2021. Further, Strides has an option to invest in Stelis' partly paid-up shares to the extent of $14 million. While contract manufacturing operations at Stelis achieved break even at OPBDITA level in Q3 FY2022, commencement of cash flows from the vaccine operations have taken longer than expected. Going forward, revenue from Stelis' vaccine segment will remain dependent on the demand scenario of the Sputnik vaccine across the globe. The vaccine segment's revenues will also remain sensitive to the uncertainties following the ongoing geopolitical tensions in Eastern Europe and Russia to a certain extent.

The ratings also consider the company's high working capital intensity of operations given the high receivables and inventory holding period requirements for its US business. ICRA notes that relatively high competition in the generic pharmaceutical industry has limited the company's pricing flexibility in the recent past. The company has a warning letter issued by the United States Food & Drug Administration (USFDA) to its Puducherry plant in May 2019, which is pending resolution. While ICRA notes that the site has been offered for re-inspection, the same is yet to happen. Also, while ICRA notes that the same has not had a significant impact on the company's revenue growth and that the facility has been successfully inspected by EU GMP and UK MHRA in the recent past, timely resolution of the USFDA warning letter is important.

The ratings also consider the proposed receipt of deferred consideration from Arrotex of AUD 106 million (~Rs. 580 crore) in the near term, which is expected to be utilised for debt prepayment. Further, equity commitment of ~Rs. 88 crore from the promoter group is also likely to support the liquidity. ICRA also notes that the company has plans to divest some of its non-core/low margin assets. The ratings continue to factor in the company's strong business profile with most revenues driven by regulated markets, improving performance in the emerging markets, its long track record of operations and strong management team. Strong manufacturing, and research and development (R&D) capabilities as well as front-end presence in the US market will continue to support the company's revenues and margins, going forward.

As on December 31, 2021, the promoters held 29.3% equity stake in the company, of which around 37.8% was pledged, an increase from 26.0% in September 30, 2021, due to steep decline in the company's share price in the recent past. However, it must be noted that the pledged promoter shareholding has reduced from 40.4% as on December 31, 2020.
The company has a track record of growing and diversifying through strategic acquisitions. Any significant debt-funded acquisition, thereby impacting the company's credit metrics, remains an event risk and would be evaluated on a case-by-case basis.

Key rating drivers and their description

Credit strengths

Diversified business and geographic mix – Strides derives sizeable revenues from the US market (38% of revenues in 9M FY2022). The company sells ~40 products out of its 100-approved abbreviated new drug applications (ANDA). With the acquisition of Endo in October 2021, Strides has further added ~150 approved ANDAs in its product portfolio, mainly under the chronic space, which includes 20 commercialised products. The company derives 36% of its revenues from other regulated markets (the UK, Australia, European Union, Canada, South Africa, etc.). Strides also has a portfolio of products for emerging markets (both branded and institutional businesses accounting for 26% of revenues in 9M FY2022), which further supports its geographic and business diversification. The revenues from the emerging markets portfolio witnessed healthy YoY growth of 28% in 9M FY2022 on the back of strong revenue growth under its institutional business (45% YoY). Going forward, the company's institutional business is expected to witness healthy ramp up in revenues driven by new product launches and ramp-up in Covid-19 product portfolio.

Strong manufacturing and R&D capabilities – The company's strong track record of ANDA filings and its manufacturing capabilities will support its growth prospects. Further, front-end presence across markets is expected to support its revenues and margins, going forward. Its R&D spend was ~Rs. 115 crore during FY2021, accounting for 4.3% of its regulated market revenues, wherein it primarily focused on new formulations and portfolio maximisation, while evaluating its existing product basket for extension to other geographies. R&D spend as a proportion of the company's top line is expected to reduce as scale increases.

Receipt of deferred consideration and equity raise to support cash flows – Strides has deferred consideration of AUD 106 million (~Rs 580 crore) (along with interest) receivable from Arrotex pertaining to the Australia business sale in FY2019. The same is expected to be received in the near term vis-à-vis contracted timeline of December 2022 and is expected to be utilised for debt prepayment. Further, incremental cash flows of ~Rs. 88 crore is also expected to be received by way of equity from the promoter group in a phased manner, within a span of 18 months from the date of shareholders' agreement, which would support the liquidity buffer of the company.

Credit challenges

Significant deterioration in performance in 9M FY2022 leading to moderation in debt coverage metrics; high working capital intensity – The US market is a key geography for Strides, accounting for 38% of its revenues in 9M FY2022 (against 48% revenue contribution in 9M FY2021). The significant price erosions, high impact on acute therapy segment and slowdown in new product approvals, impacted the company's US business adversely. The gross margins of Strides declined to ~51% in 9M FY2022 from ~60% in 9M FY2021, primarily owing to increased material costs and pricing pressures impacting realisations. Further, higher logistics cost also impacted the operating profits to a certain extent. Strides has also completed divestment of its Florida facility in 9M FY2022 and booked net exceptional loss (impairment and disposal loss net of tax credit) of ~Rs 147 crore. This in turn, resulted in net profit margins of -19.8%[1] during 9M FY2022 as against 12.1% in 9M FY2021. The debt coverage metrics have significantly deteriorated in 9M FY2022 owing to operating losses, incremental debt for acquisition and capex, and increase in working capital intensity. While logistics cost reduced by ~Rs 29 crore in Q3 FY2022 on QoQ basis, improvement in the operating leverage will be a key monitorable for the company.

The company's working capital intensity increased to 38% as at September 30, 2021 (28% as at March 31, 2021) given the impact on US business revenues along with relatively high receivables (127 days as at September 31, 2021 and 124 days as at March 31, 2021) and inventory holding period (228 days as at September 30, 2021 and 202 days as at March 31, 2021) requirements of its US business. While ICRA expects the working capital intensity to reduce from H1 FY2022 levels in the near to medium term, the same shall continue to remain elevated.

High competitive intensity – The generic pharmaceutical business in regulated markets is characterised by low entry barriers and high pricing pressures. The intense competitive pressures in the US and corresponding significant price erosions in the recent past has substantially impacted the company's revenues and margins. While contribution from Endo is expected to support the near-term revenue growth, recovery in the US market and stability in the pricing environment remains to be seen.

Significant investments in Stelis – Till date, Strides has made significant investments of ~$75 million in Stelis. Strides has also subscribed to partly paid up shares in Stelis in the last fund-raising round in March 2021, and has an option to invest incremental $14 million, if required in Stelis. In addition, Strides has provided oustanding corporate guarantee to Stelis to the extent of Rs 627.0 crore as at December 31, 2021. Given that Stelis has invested heavily in setting up a vaccine manufacturing facility, timeliness in achieving breakeven of operations and cash flows from the same would be a key credit monitorable. While the contract manufacturing business of Stelis has broken even at OPBDITA level in Q3 FY2022, the commencement of cash flows from vaccine operations have taken longer than expected. The vaccine segment revenues shall also remain sensitive to the uncertainties following the ongoing geopolitical tensions in Eastern Europe and Russia to a certain extent. Strides will have a shareholding of 33% on a fully-diluted basis in Stelis. ICRA notes that Strides plans to divest part/complete stake in Stelis going forward.

Exposure to regulatory risks; warning letter for the Puducherry facility yet to be resolved – Increasing regulatory scrutiny by the USFDA, compliance costs and risks associated with the same will be a key rating sensitivity, going forward. The company has a warning letter issued by the USFDA to its Puducherry plant in May 2019, which is pending resolution. While ICRA notes that the same has not had a significant impact on the company's revenue growth and that the facility has been successfully inspected by EU GMP and UK MHRA in the recent past, timely resolution of the USFDA warning letter is important. Any other regulatory non-compliance issued to Strides for its products and/or manufacturing facilities that impact its product launches and, thus, its revenues and profitability, would be key monitorables.

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[1] *Adjusted for exceptional loss/gain, net profit margins reduced to -12.2% in 9M FY2022 during 9M FY2022 as against 10.3% during 9M FY2021*

Liquidity position: Adequate

The company's liquidity position is **adequate**, supported by cash and liquid investments of ~Rs. 304 crore and undrawn working capital lines of $30 million as on December 31, 2021. In addition, the deferred consideration (AUD 106 million; ~Rs. 580 crore) towards sale of its Australian business in FY2019 is expected to be received in the near term. This will further support the company's liquidity position in the near term.

The company has repayment obligations of Rs. 223.5 crore in FY2023 and Rs. 186.6 crore in FY2024 on the existing term debt. Proceeds from the proposed receipt of deferred consideration from Arrotex of AUD 106 million (~Rs. 580 crore) is expected to be utilised for debt prepayment. In addition, the company expected to spend ~USD 10-12 million per annum on maintenance capital expenditure (capex) and upgradation and has an option to further invest $14 million in Stelis, if required, going forward. ICRA expects Strides to be able to meet its near-term commitments through internal accruals, existing cash reserves and incremental cash flows from equity, deferred consideration and divestments, if any.

Rating sensitivities

Positive factors – ICRA has a negative outlook on the long-term ratings of Strides. Accordingly, key triggers for revision in outlook to stable and subsequently for rating upgrade include significant improvement in the US business resulting in healthy cash flows, margins and debt metrics on a sustained basis.

Negative factors – Negative pressure on Strides' ratings could arise if there is further deterioration in margins/ debt metrics or if debt increases on account of capex/ inorganic transactions/ regulatory changes. Any material financial support to group companies that results in weakening in credit metrics could also exert pressure on the ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Pharmaceutical Industry
Parent/Group Support	NA
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of Strides.

About the company

Incorporated in 1990, Strides Pharma Science Limited is a medium-sized pharmaceutical company that develops, manufactures and exports a wide range of pharmaceutical products. The company has followed both organic and inorganic growth strategy over the years that has led to its foray into new markets and the addition of new businesses, therapy segments and manufacturing infrastructure. The company's product range covers most dosage forms including soft gel capsules, tablets, capsules and semi-solids. It has also acquired a basket of ANDAs and a facility at Chestnut Ridge (US) from Endo in October 2021 for a consideration of $24 million. Currently, its business is broadly classified into regulated market formulations (mainly comprising the US, the UK, Europe and Australia), emerging markets (primarily Africa) and institutional segments (tender-driven business mainly in developing markets). As on December 31, 2021, 29.33% of the company's shareholding was held by the promoter group, with the rest held by various institutions and the public.

Key financial indicators (audited)

Strides Consolidated	FY2020	FY2021	9M FY2022*
Operating Income (Rs. crore)	2,752.0	3,315.9	2,204.2
PAT (Rs. crore)	137.8	353.9	-436.0
OPBDITA/OI (%)	18.9%	18.9%	-2.4%
PAT/OI (%)	5.0%	10.7%	-19.8%
Total Outside Liabilities/Tangible Net Worth (times)	1.3	1.4	NA
Net Debt^/OPBDITA (times)	2.3	2.1	-35.9
Interest Coverage (times)	3.3	4.2	-0.4

**Provisional; ^Net Debt: Adjusted for lease liabilities, cash, liquid investments and deferred consideration; NA: Not Available; PAT: Profit after Tax; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation; All ratios are as per ICRA calculations*

Source: Company and ICRA Research

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 as of Dec 31, 2021 (Rs. crore)	Date & Rating		Date & Rating In FY2021	Date & Rating In FY2020	Date & Rating in FY2019		
					Mar 24, 2022	Nov 18, 2021 Aug 17, 2021 Apr 7, 2021	-	Nov 29, 2019	Feb 07, 2019	May 28, 2018	May 16, 2018
1	Term Loans	Long Term	193.50	193.50	[ICRA]A (Negative)	[ICRA]A+ (Stable)	-	-	[ICRA]A+ &	[ICRA]A+ (Negative)	[ICRA]A+ &
2	Fund-based Facilities	Long Term	900.00	-	[ICRA]A (Negative)	[ICRA]A+ (Stable)	-	[ICRA]A+ (Stable)	-	-	-
3	Non-fund Based Facilities	Short Term	480.00	-	[ICRA]A2+	[ICRA]A1	-	[ICRA]A1	[ICRA]A1 &	[ICRA]A1	[ICRA]A1 &
4	Unallocated Facilities	Short Term	226.50	-	[ICRA]A2+	[ICRA]A1	-	[ICRA]A1	[ICRA]A1 &	[ICRA]A1	[ICRA]A1 &
5	Fund-based Facilities	Short Term	-	-		-	-	-	[ICRA]A1 &	[ICRA]A1	[ICRA]A1 &

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund Based - Term Loans	Simple
Long-term Fund-based Facilities	Simple
Short-term Non-Fund Based Facilities	Very Simple
Unallocated Facilities	Not Applicable

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: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loans	2020	NA	FY2024	193.50	[ICRA]A (Negative)
NA	Fund-based Facilities	2019/2020	NA	NA	900.00	[ICRA]A (Negative)
NA	Non-fund Based Facilities	2019/2020	NA	NA	480.00	[ICRA]A2+
NA	Unallocated Facilities	NA	NA	NA	226.50	[ICRA]A2+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Altima Innovations Inc, USA	100.00%	Full Consolidation
Apollo Life Sciences Holdings Proprietary Limited, South Africa	51.76%	Full Consolidation
Arco Lab Private Limited, India	100.00%	Full Consolidation
Arrow Life Sciences (Malaysia Sdn. Bhd, Malaysia)	100.00%	Full Consolidation
Arrow Pharma (Private) Limited, Sri Lanka	100.00%	Full Consolidation
Arrow Pharma Life Inc, Philippines	100.00%	Full Consolidation
Arrow Pharma Pte Ltd, Singapore	100.00%	Full Consolidation
Beltapharm, S.P.A, Italy	97.94%	Full Consolidation
Eris Pharma GmbH, Germany	70.00%	Full Consolidation
Fairmed Healthcare AG, Switzerland	70.00%	Full Consolidation
Fairmed Healthcare GmbH, Germany	70.00%	Full Consolidation
Generic Partners (Canada) Inc, Canada	100.00%	Full Consolidation
Generic Partners (International) Pte Ltd, Singapore	100.00%	Full Consolidation
Generic Partners Ltd., UK	100.00%	Full Consolidation
Generic Partners (R&D) Pte Ltd., Singapore	100.00%	Full Consolidation
Pharmapar Inc, Canada	80.00%	Full Consolidation
Shasun Pharma Solutions Inc, USA	100.00%	Full Consolidation
Stabilis Pharma Inc, USA	100.00%	Full Consolidation
Stelis Biopharma (Malaysia) Sdn Bhd, Malaysia	100.00%	Full Consolidation
Strides Arcolab International Ltd., UK	100.00%	Full Consolidation
Strides CIS Ltd, Cyprus	100.00%	Full Consolidation
Strides Lifesciences Limited, Nigeria	100.00%	Full Consolidation
Strides Pharma (Cyprus) Ltd, Cyprus	100.00%	Full Consolidation
Strides Netherlands BV	100.00%	Full Consolidation
Strides Nordics Aps, Denmark	100.00%	Full Consolidation
Strides Pharma (SA) Pty Ltd, South Africa	60.00%	Full Consolidation
Strides Pharma Asia Pte. Ltd, Singapore	100.00%	Full Consolidation
Strides Pharma Canada Inc, Canada	100.00%	Full Consolidation
Strides Pharma Global (UK) Ltd, UK	100.00%	Full Consolidation
Strides Pharma Global Pte Limited, Singapore	100.00%	Full Consolidation
Strides Pharma Inc., USA	100.00%	Full Consolidation
Strides Pharma International Limited, Cyprus	100.00%	Full Consolidation
Strides Pharma UK Ltd, UK	100.00%	Full Consolidation
Strides Shasun Latina Sa De CV, Mexico	80.00%	Full Consolidation
SVADS Holdings SA, Switzerland	100.00%	Full Consolidation
Trinity Pharma Proprietary Limited, South Africa	51.76%	Full Consolidation
Universal Corporation Ltd, Kenya	51.00%	Full Consolidation

Company Name	Ownership	Consolidation Approach
Strides Vivimed Pte Ltd, Singapore	100.00%	Full Consolidation
Vensun Pharmaceuticals Inc, USA	100.00%	Full Consolidation
Vivimed Life Sciences Private Limited, India	100.00%	Full Consolidation
Juno OTC Inc	60.00%	Equity Method
Sihuan Strides (HK) Ltd	49.00%	Equity Method
Stelis Biopharma Private Limited, India	47.81%	Equity Method
Stelis Biopharma LLC, USA	47.81%	Equity Method
Stelis Pte. Ltd., Singapore	47.81%	Equity Method
Strides Global Consumer Healthcare Limited, UK	53.64%	Equity Method
Strides Consumer LLC	53.64%	Equity Method
Strides Consumer Private Limited, India	53.64%	Equity Method
Aponia Laboratories Inc., USA	24.00%	Equity Method
Regional Bio Equivalence Centre S.C., Ethiopia	24.98%	Equity Method

Source: *Company annual report; As on March 31, 2021*

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