August 30, 2022

Kwality Pharmaceuticals Ltd.: Ratings reaffirmed

Summary of rating action

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

**Instrument details are provided in Annexure-I*

Rationale

The reaffirmation of ratings takes into account Kwality Pharmaceuticals Ltd.'s (KPL) established track record of operations in the pharmaceutical formulations industry spanning more than three decades. ICRA notes the experience of KPL's promoters and its comfortable financial profile characterised by a healthy capital structure and debt coverage indicators. The company reported a strong year-on-year (YoY) revenue growth of 74% in FY2022 with revenue of Rs. 456.2 crore vis-à-vis FY2021 revenue of Rs. 262 crore, led by sales of drugs for Covid-19 treatment. The ratings also factor in KPL's wide product portfolio with a diversified geographical presence.

The ratings are, however, constrained by the company's moderate scale of operations that limit its economies of scale. 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, the company remains exposed to adverse changes in Government policies related to price control, similar risks in the semi and unregulated export markets as well as the intense competition in the industry. The rating also factors in risks associated with KPL's ongoing capital expenditure and plan to launch new products. With the subsiding of pandemic waves, KPL's ability to achieve healthy performance in its regular non-Covid portfolio and new launches remains to be seen.

The Stable outlook on the [ICRA]BBB rating reflects ICRA's opinion that the company will benefit from its expanded manufacturing capabilities and approvals received from new semi-regulated markets.

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 as well as product profile, diversified geographical presence – 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. However, there was a one-time surge in revenues in H1 FY2022 due to high sales of products like Remdesivir and Propofol for their efficacy in treating Covid-19, leading to a skewed product and revenue mix. As of now, however, most of the sales are routed through distributors. Nevertheless, KPL's end-customer base and geographical presence remain diversified with exports to semi-regulated markets in Latin America, Africa and South East Asia. The company received new product approvals from countries like Tanzania in FY2022.

Healthy financial profile characterised by low indebtedness and healthy coverage metrics – KPL's capital structure remains comfortable, with gearing of 0.3 time as on March 31, 2022. The coverage indicators witnessed significant improvement and remained comfortable as reflected by an interest cover of 58.8 times in FY2022, TD/OPBDITA of 0.2 time and NCA/Debt of ~240% as on March 31, 2022. However, with the withdrawal of the pandemic wave and increased vaccine coverage, the credit metrics of KPL are set to moderate in FY2023 as contributions from Covid-specific drugs, which fetched very high margins, are expected to be minimal.

Credit challenges

Moderate scale of operations –The company remains a moderate sized player in the formulations industry, with an operating income (OI) of Rs. 456 crore in FY2022, aided heavily by the proceeds from sale of Remdesivir during the global pandemic. Revenue and margins are set to moderate in FY2023, as illustrated by the results of Q1 FY2023. However, increased focus on complex injectables especially in the oncology segment augurs well for the business prospects of KPL. With the subsiding of pandemic waves, KPL's ability to achieve healthy performance in its regular non-Covid portfolio and new launches, and a resultant improved product mix remains to be seen.

Exposure to regulatory changes and intense competition – As is prevalent in this industry, KPL's 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. 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.

Susceptibility to fluctuations in raw material prices and foreign exchange – 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 an extent. Also, the absence of adequate hedging mechanism exposes KPL to risks pertaining to adverse currency movement.

Risks associated with ongoing capex – KPL's ongoing capital expenditure exposes the company to risks associated with timely project implementation and subsequent ramp-up in sales, post commercialisation of operations. In FY2022, KPL spent ~Rs. 55 crore on replacement of old machinery and addition of capacity, which was partly debt-funded. It is further adding capacity, primarily in complex injectables segment in the current fiscal. Also, ICRA notes that the company has been making efforts towards developing new products. The ability to achieve healthy demand and capacity utilisation for these products remains to be seen.

Liquidity position: Adequate

KPL's liquidity is adequate, evidenced by its cash and liquid investments aggregating to approximately Rs. 13 crore as of March 31, 2022 and undrawn working capital limits. Despite the expectation of moderate cash flows from operations in the near-term due to the withdrawal of Covid-19 pandemic, the liquidity would be sufficient for covering the repayment liabilities over the near-term.

Rating sensitivities

Positive factors – ICRA could upgrade KPL's ratings if the company strengthens its market position characterised by expanding product basket, better product mix and overall scale of operations while maintaining comfortable credit metrics.

Negative factors – Negative pressure on KPL's ratings could arise if there is a significant deterioration in its credit profile. A specific credit metric that could lead to a downgrade of KPL's ratings is if Total Debt/EBIDTA is above 3 times 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 consolidated financials of KPL as enlisted in Annexure-2.

About the company

KPL was incorporated in 1983 as a private limited company, promoted by Mr. Ramesh Arora. The company was reconstituted to a closely held public limited company in 1993 and got listed on the SME platform of the Bombay Stock Exchange in July 2016 and subsequently migrated to main board of BSE Limited in June 2022. It manufactures pharmaceutical formulations in the form of injectables, tablets, capsules, and syrups. It has two units each in Amritsar (Punjab) and Kangra (Himachal Pradesh); the Kangra unit commenced production in October 2008.

In Q1 FY2023, KPL achieved PAT of Rs.10.5 crore on an operating income of Rs. 70.2 crore as compared to PAT of Rs. 34.3 crore and operating income of Rs. 120.2 crore respectively in Q1 FY2022.

Key financial indicators (audited)

KPL Consolidated	FY2021	FY2022
Operating income	262.0	456.2
PAT	14.9	119.9
OPBDIT/OI	11.0%	37.6%
PAT/OI	5.7%	26.3%
Total outside liabilities/Tangible net worth (times)	1.8	0.9
Total debt/OPBDIT (times)	1.4	0.3
Interest coverage (times)	10.8	58.8

PAT: Profit after tax; OPBDITA: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

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 as of Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Aug 30, 2022	May 21, 2021		
1	**Fund-based – Term Loan**	Long-term	22.00	31.76	**[ICRA]BBB (Stable)**	**[ICRA]BBB (Stable)**	-	-
2	**Fund Based Working Capital**	Long-term	24.08	-	**[ICRA]BBB (Stable)**	**[ICRA]BBB (Stable)**	-	-
3	**Non-fund Based Working Capital**	Short-term	9.00	-	**[ICRA]A3+**	**[ICRA]A3+**	-	-
4	**Unallocated**	Long-term/ Short-term	9.92	-	**[ICRA]BBB (Stable)/ [ICRA]A3+**	**[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	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 I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Term Loan-I**	July 2020	NA	March 2023	2.00	[ICRA]BBB (Stable)
NA	**Term Loan-II**	July 2020	NA	March 2023	4.00	[ICRA]BBB (Stable)
NA	**Term Loan-III**	July 2020	NA	March 2023	4.00	[ICRA]BBB (Stable)
NA	**Term Loan-IV**	July 2020	NA	March 2023	4.00	[ICRA]BBB (Stable)
NA	**Term Loan – V**	July 2020	NA	July 2025	8.00	[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 II: 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 FY2021 and audited financial results for FY2022

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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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