April 30, 2024

Natco Pharma Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term - Fund Based Working Capital Limits	866.50	0.00	-
Long-term/short-term - Fund Based Working Capital Limits	-	930.00	[ICRA]AA (Stable)/[ICRA]A1+; reaffirmed
Short-term - Non-Fund Based Working Capital Limits	85.00	0.00	-
Long Term/Short Term - Non-Fund Based Working Capital Limits	-	120.00	[ICRA]AA (Stable)/[ICRA]A1+; reaffirmed
Long Term/Short Term - Fund based/Non-Fund Based	155.00	0.00	-
Long Term/Short Term – Unallocated Limits	43.50	100.00	[ICRA]AA (Stable)/[ICRA]A1+; reaffirmed
Commercial Paper	400.00	400.00	[ICRA]A1+; reaffirmed
Total	**1,550.00**	**1,550.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings reaffirmation considers Natco Pharma Limited's (Natco/company) healthy abbreviated new drug application (ANDA) portfolio in the complex generics space in the US market, complemented by its strong research and development (R&D) capabilities. Further, notable market position in the domestic oncology formulations segment and robust financial profile continue to support the ratings. The company witnessed revenue growth of 39.2% in FY2023, backed by substantial profit share contribution from gRevlimid and gCopaxone and improvement in performance of its Canadian and Brazilian subsidiaries. In 9M FY2024, the company witnessed robust YoY revenue growth of 62.0% driven by growth across segments and specially on the back of higher gRevlimid sales in the US, healthy revenue growth of its Brazilian and Canadian subsidiaries and its agri business. While the company continues to witness competition-induced pricing pressures in the domestic and US markets, it is mitigating the same through new product launches to support its revenue growth. The operating profit margins (OPM) improved substantially to 34.8% in FY2023 from 13.5% in FY2022, mainly on the back of healthy profit share received from gRevlimid and gCopaxone. During 9M FY2024, OPM further expanded to 42.8%, primarily supported by improved scale of operations in addition to continued healthy profit share from gRevlimid and gCopaxone. Going forward, Natco's revenues and margins are expected to remain rangebound over the near term, supported by the contribution from the product launches in the last two years. The ratings also continue to factor in the extensive experience of the promoters along with the backward-integrated nature of its operations with strong capabilities in API.

The ratings consider the high product concentration with a few molecules driving the company's US formulations business (particularly gRevlimid and gCopaxone in FY2023 and 9M FY2024) and its top-five products accounting for ~35% of its domestic formulations business. The ratings also consider the intense competition in the domestic formulation business leading to material price erosion. Natco's working capital intensity remains high with a growing product portfolio and increasing focus on international markets. Further, the company holds higher-than-required inventory to mitigate supply-chain challenges for few of the products with high lead time. The company has received a warning letter from the US FDA[1] for its Kothur facility.

[1] *US FDA - U.S. Food and Drug Administration*

However, ICRA does not expect the same to impact the operations of the company materially in the near term as Natco can continue to manufacture and sell the products from Kothur and also since majority of its supplies to the US market including gRevlimid and other key products are currently being done from Natco's Vizag plant. However, given that approvals for new products filed from Kothur will be delayed till the warning letter is resolved, timely resolution of the warning letter remains a key monitorable.

Additionally, increasing scrutiny by the US FDA, compliance costs and risks associated with the same on the company's operations along with its exposure to potential adverse outcomes on any product litigation will be key rating sensitivities, going forward. In the US market, the company has tie-ups with front-end players for a profit share contribution to launch its complex generic products or Para IV filing. Further, the company has also incorporated its own subsidiaries in Brazil and Canada to set up frontend presence in those markets and has also acquired Dash Pharmaceuticals LLC (now renamed as Natco Pharma USA LLC) to creates its own frontend presence in the US. Thereby, the company remains exposed to potential litigation risks. ICRA will continue to monitor the impact of any adverse outcome of such litigations on the credit profile of the company.

The company has been exploring inorganic expansion opportunities and any significant debt-funded acquisition impacting its credit metrics, remains an event risk and would be evaluated on a case-by-case basis.

ICRA also notes that the company completed buyback of ~34 lakh equity shares through the open market route. The buyback was completed on May 12, 2023. The total cash outflow for the same was ~Rs. 260 crore including transaction costs and taxes on buyback.

The Stable outlook on the rating reflects ICRA's opinion that Natco will continue benefiting from its strong market position and track record of R&D capabilities and healthy financial profile.

Key rating drivers and their description

Credit strengths

Healthy ANDA portfolio in the complex generics space continues to support business prospects – The company has predominantly focused on complex products with high barriers to entry in the US. The launch of gRevlimid in the US during March 2022 (with the sale volume expected to increase steadily post launch every year), supported substantial ramp up of Natco's revenues and profit margins in FY2023 and 9M FY2024. In the past, the launch of the complex generic version of gCopaxone (40 mg), supported the company's revenues and margins in the US market. Further, Natco had a pipeline of 23 Para IV filings (15 are approved) as on December 31, 2023, with a few significant launches (few of which are subject to approval/litigation) in the medium term.

Strong R&D capabilities – Natco continues to invest a high single-digit percentage of its revenues in R&D every year, except for FY2022 where it incurred 11.7% of revenues as R&D expenses, thereby supporting its strong capabilities to develop limited competition and difficult-to-develop molecules for the regulated markets. Strong manufacturing capabilities in addition to backward integration into API manufacturing continue to support the company's revenue

Notable market position in domestic oncology segment – Being an early entrant with regular product introductions and competitive pricing, Natco has managed to establish a strong presence in the domestic formulations market with a healthy market share in the domestic oncology segment. The company continues to be one of the leading players in the domestic oncology segment, despite facing intense competition that leads to pricing pressures. The company is also increasing its sales force coverage in the cardiology, pharma and diabetology division (C&D) and is focusing on new product launches in gastro and anti-infectives, which is expected to diversify its revenue profile in the domestic formulations business. Further, the company witnessed substantial revenue contribution from the agrochemical segment with the launch of Chlorantraniliprole (CTPR) in October 2022; the profitability from this division is expected to improve going forward, supported by ramp-up in scale of operations along with new product launches.

Financial profile characterised by robust debt metrics and strong liquidity position – Natco's financial risk profile is characterised by robust debt protection metrics on the back of low debt availed by the company (nil gearing and TD/OPBDITA of 0.1x as on September 30, 2023). The TD/OPBITDA improved to 0.2x and 0.1x as on March 31, 2023, and September 30, 2023, respectively, against 1.6x as on March 31, 2022, backed by substantial improvement in margins. The company continued to maintain its negative net-debt position with strong cash and cash equivalents of Rs. 1,800 crore (approx) at consolidated level as on March 31, 2024. Backed by strong accruals and stable capital expenditure levels, the company is expected to maintain its negative net-debt position, going forward.

Credit challenges

High product concentration – The company derives majority of its US formulation revenues from gRevlimid, gCopaxone, gFosrenol, gTykerb, gTamiflu, gDoxil, gAfinitor and gZortress. Going forward, the product concentration risk is expected to remain high with the substantial revenue contribution expected from gRevlimid in the US in the near term. However, once the patent for gRevlimid expires in FY2026, the revenues and margins of the company are expected to significantly decline. Consequently, resolution of the warning letter in Kothur and timely approval and launch of other key Para IV products will be key to the company's business prospects post FY2026. In the domestic formulations business, the top-five products accounted for ~35% of the company's revenues. While the concentration has reduced over the years, the same continues to be high. Going forward, it is expected to ease gradually with new launches in the oncology, C&D and anti-viral segments.

High working capital intensity – As Natco expands its product portfolio, it needs to maintain a certain level of inventory to optimise its production schedule and minimise switchover costs at plants which manufacture multiple APIs or formulations. The company carries relatively higher inventory to mitigate supply-chain challenges for few of the products with high lead time. This led to high inventory days of 193 as on September 30, 2023, which is in line with the past trend. However, with a growing product portfolio (which requires higher level of inventory to be maintained) and increasing focus on markets like Brazil, Canada, Southeast Asia, and China (which generally have a higher receivables period than the domestic segment), Natco's working capital requirements will remain high, going forward.

Increasing competition in key markets – High competitive intensity leading to pricing pressures along with relatively high base of Covid-led supplies during FY2022, led to contraction in Natco's revenues from the domestic market in FY2023; however, the growth revived in 9M FY2024 backed by new product launches. Going forward, the competitive intensity and quantum of price erosion for gRevlimid in FY2025 and FY2026 and other Para IV products in general will continue to have a bearing on the company revenues and margins.

Exposure to regulatory risks and litigations; outstanding warning letter on its Kothur facility – Natco is exposed to increasing regulatory scrutiny, compliance costs and risks associated with the same in line with other industry players. The company has received a warning letter from the US FDA[2] for its Kothur facility. However, ICRA does not expect the same to impact the operations of the company materially since it can continue to manufacture and sell products and also majority of the manufacturing for gRevlimid and other key products is currently being done from the company's Vizag plant. However, timely resolution of the warning letter will be a key rating monitorable. Further, in view of the risks associated with product litigations, ICRA will continue to monitor the impact of any adverse outcome of such litigations on the credit profile of the company.

ESG related comments

Environmental considerations: Natco does not face any major physical climate risk. However, it remains exposed to tightening environmental regulations regarding breach of the waste and pollution norms, which can lead to an increase in operating costs

[2] *US FDA - U.S. Food and Drug Administration*

and new capacity installation costs. This can also require continued capital investments to update/upgrade its effluent treatment infrastructure to reduce the carbon footprint and waste generation.

The company has been undertaking initiatives that are expected to have environmental benefits and improve the organisation's sustainability. This includes utilisation of renewable energy, which contributes 27.5% to its energy consumption, thereby reducing carbon emissions. It practices water conservation by increasing its usage of recycled water. It also ensures that the waste generated during the manufacturing process is appropriately disposed.

Social considerations: The industry faces social risks related to product safety and the associated litigation risks, access to qualified personnel for R&D and process engineering, and maintenance of high manufacturing compliance standards. Further, Government intervention related to price caps/control also remains a social risk faced by entities in the pharmaceutical industry.

Liquidity position: Strong

The company's liquidity position is strong, characterised by consolidated cash and cash equivalents of Rs 1,800 crore (approx) as on March 31, 2024. In addition, the company's working capital utilisation remained low at ~17% for last 12 months. Further, the company is expected to generate positive fund flow from operations supported by healthy cash accruals over the near term. There are no long-term debt obligations as on date. Natco is expected to incur Rs. 300-400 crore per annum on maintenance capex and expansion, going forward. ICRA expects Natco to meet its capital commitments through existing cash reserves and internal cash accruals.

Rating sensitivities

Positive factors – A significant improvement in the company's product diversification, given its focus on a few critical molecules, and a scale-up in its revenues with continued robust debt protection metrics and liquidity would be a positive trigger.

Negative factors – Pressure on Natco's ratings could arise if there is a deterioration in the margins or if debt-funded capex or acquisitions or regulatory measures lead to the weakening of the company's credit profile with Net Debt/OPBDITA>1.25x, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for entities in pharmaceuticals
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financial statement of Natco.

About the company

Natco is a medium-sized pharmaceutical company, which develops, manufactures and markets formulations and APIs. Founded in 1981, Natco has emerged as an established pharmaceutical company with a presence in formulations and APIs in both the domestic and export markets. The company owns seven manufacturing facilities and the Natco Research Centre in Hyderabad. Its formulations units in Kothur (Telangana) and Visakhapatnam (Andhra Pradesh) and API facilities in Chennai and Mekaguda (Telangana)are approved by the authorities of regulated markets, including the US FDA. The company had also set up an agrochemical's facility for API's/technicals and formulations in Attivaram Industrial Area, Nellore (Andhra Pradesh) to diversify its portfolio.

As an early entrant with strong R&D capabilities, Natco has established itself as a leading player in the oncology segment in India. In addition, it generates a sizeable proportion of its formulations business from exports. It is present in the generics business in the regulated markets of North America and Europe and branded generics in the rest of the world (RoW). As on December 31, 2023, 49.71% 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)

Natco Consolidated	FY2022	FY2023	9M FY2024*
Operating income	1,944.8	2,707.1	2,930.5
PAT	170.0	715.3	1,002.0
OPBDIT/OI	13.5%	34.8%	42.8%
PAT/OI	8.7%	26.4%	34.2%
Total outside liabilities/Tangible net worth (times)	0.2	0.2	NA
Total debt/OPBDIT (times)	1.6	0.2	NA
Interest coverage (times)	14.9	64.9	NA

*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*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2025)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Dec 31, 2023 (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022
					Apr 30, 2024	Apr 28, 2023	Apr28, 2022	Apr 29, 2021
1	Fund Based Working Capital Limits	Long term	0.00	-	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Fund Based Working Capital Limits	Long term and short term	930.00	-	[ICRA]AA (Stable)/[ICRA]A1+	-	-	-
3	Non-Fund Based Working Capital Limits	Short term	0.00	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Non-Fund Based Working Capital Limits	Long term and short term	120.00	-	[ICRA]AA (Stable)/[ICRA]A1+	-	-	-
5	Fund based/Non-	Long term and	0.00	-	-	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+

	Fund Based Limits	short term						
6	**Unallocated Limits**	Long term and short term	100.00	-	**[ICRA]AA (Stable)/[ICRA]A1+**	**[ICRA]AA (Stable)/ [ICRA]A1+**	**[ICRA]AA (Stable)/ [ICRA]A1+**	**[ICRA]AA (Stable)/ [ICRA]A1+**
7	**Commercial Paper**	Short term	400.00	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term/Short Term - Fund Based Working Capital Limits	Simple
Long Term/Short Term - Non-Fund Based Working Capital Limits	Very Simple
Long Term/Short Term – Unallocated Limits	Not Applicable
Commercial Paper	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	Long Term/Short Term - Fund Based Working Capital Limits	NA	NA	NA	930.00	[ICRA]AA (Stable)/[ICRA]A1+
NA	Long Term/Short Term - Non-Fund Based Working Capital Limits	NA	NA	NA	120.00	[ICRA]AA (Stable)/[ICRA]A1+
NA	Long Term/Short Term – Unallocated Limits	NA	NA	NA	100.00	[ICRA]AA (Stable)/[ICRA]A1+
Not Placed	Commercial Paper	NA	NA	NA	400.00	[ICRA]A1+

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Company Name	Natco Ownership	Consolidation Approach
NATCO Pharma Limited	100.00%	Full Consolidation
NATCO Pharma Inc., United States of America ('USA'	100.00%	Full Consolidation
NATCO Pharma USA LLC, USA (Formerly known as Dash Pharmaceuticals LLC, USA - name changed w.e.f. 12 April 2023) (Subsidiary of NATCO Pharma Inc.)	100.00%	Full Consolidation
Time Cap Overseas Limited, Mauritius ('TCOL')	100.00%	Full Consolidation
NatcoFarma do Brasil Ltda., Brazil (Subsidiary of TCOL)	100.00%	Full Consolidation
NATCO Pharma (Canada) Inc., Canada	100.00%	Full Consolidation
NATCO Pharma Asia Pie. Ltd., Singapore	100.00%	Full Consolidation
NATCO Pharma Australia Pty Ltd., Australia	100.00%	Full Consolidation
NATCO Lifesciences Philippines Inc., Philippines	100.00%	Full Consolidation
NATCO Pharma UK Limited, United Kingdom (incorporated on 04 September 2023)	100.00%	Full Consolidation
PT. NATCO Lotus Farma, Indonesia (incorporated on 28 August 2023)	100.00%	Full Consolidation

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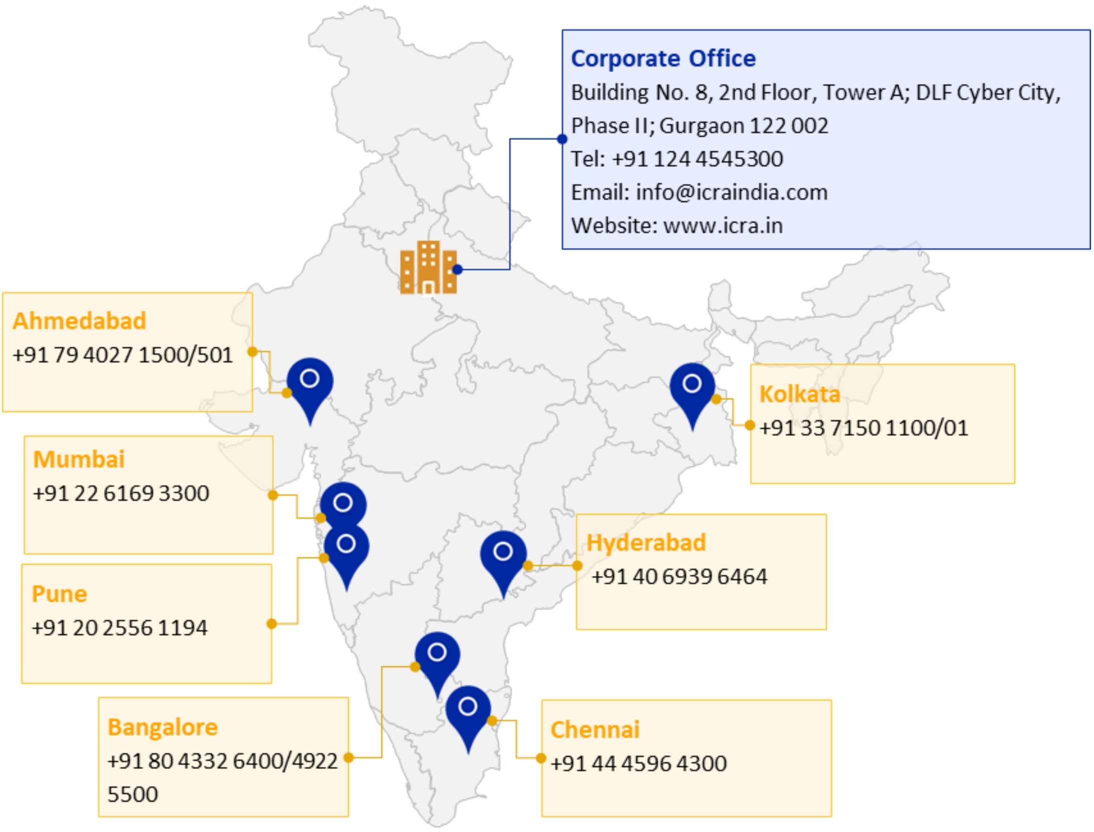

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