Covalent Laboratories Private Limited

Instrument	Amount In Rs. Crore	Rating Action
Long term fund based limits	219.59 (revised from 230.06)	[ICRA]BBB+ (Stable); reaffirmed
Short Term Fund Based limits	10.00	[ICRA]A2; reaffirmed
Short term non-fund based limits	90.00	[ICRA]A2; reaffirmed
Long term non-fund based limits	3.00	[ICRA]BBB+ (Stable); reaffirmed
Unallocated	10.47	[ICRA]BBB+ (Stable); assigned

ICRA has reaffirmed the long-term rating at [ICRA]BBB+ (pronounced ICRA triple B plus) and short-term rating at [ICRA]A2 (pronounced ICRA A two) assigned to Rs 333.06 crore[1] bank facilities of Covalent Laboratories Private Limited (CLPL)[2]. The outlook on the long term rating is Stable.

The rating reaffirmation factors in stabilisation of CLPL's manufacturing capacities for its flagship product – Cefixime, post temporary disruption during FY2016; as well as ramp up of sales in its relatively new Sterile division which is expected to strengthen company's business profile going forward. Sales volumes for Cefixime declined by 19% during FY2016 owing to production disruption caused by ongoing changes for USFDA and EQDM approvals in CLPL's manufacturing facility. Though this resulted in a decline in company's profitability levels during FY2016, the company has witnessed recovery in the sales volumes during H1FY2017 post restoration of the production facility. Receipt of USFDA approval for its manufacturing facility along with EQDM approval for two of its major revenue contributors - Axetile and Cefixime, is likely to support growth for CLPL by facilitating entry into regulated markets as well as aid its profitability margins going forward. Further, ramp-up in sales volumes of Steriles during FY2016 has further strengthened CLPL's presence in cephalosporins segment.Ratings also continue to factor in long standing experience of promoters in the pharmaceutical industry in manufacturing and marketing of mature molecules; and the financial flexibility available by virtue of being part of the established Virchow group. Around 35-40% of CLPL's total raw material requirement (and 90% of GCLE requirement) is being met by the group company - Virchow Petrochemicals Private Limited (VPPL, rated: [ICRA]A-/A2+), which besides ensuring steady and timely raw material supply, enables the company to receive extended credit period, particularly in times of short-term cash flows mismatches.

The ratings, however, continue to remain constrained on account of vulnerability of profitability to fluctuations in the raw material prices owing to complete dependence on single therapeutic segment with mature and commoditized products (four cephalosporin based APIs –Cefixime, Axetile, Proxetile and Cefdinir) with intense price based competition in the bulk drug segment. This is also reflected in the fact that the company reported a consistent decline in profitability margins over the past few years from a peak of ~14-15% in FY2012 to ~6.8% In FY2016. ICRA notes that the company is also exposed to foreign exchange fluctuations with sizeable imports, though partly mitigated by natural hedge provided by exports. Continued large capex during FY2016 resulted in an increase in overall indebtedness of the company. Increased debt levels coupled with drop in profitability has resulted in weakening of coverage indicators for FY2016. Nevertheless, these continued to remain comfortable. Further, the company has been working on improving yields, waste recovery and reducing power costs, which coupled with ramp up in production volumes has resulted in some improvement in company's profitability margins during H1 FY2017. With receipt of USFDA and EQDM approvals, CLPL is likely to enter regulated markets, which together with commencement of captive power generation during XX is expected to further support company's profitability margins going forward. In ICRA's view, the company's ability to improve its profitability margins while expanding its market share for oral and sterile APIs in regulated markets would remain key rating sensitivities. While the company does not †For complete rating scale and definitions please refer to ICRA's website www.icra.in or other ICRA Rating Publications I C R A Limited An Associate of Moody's Investors Service have any sizeable capex plans for the next few years as yet, timing and scale of CLPL's next round of expansion along with the mode of financing and its impact on capital structure and overall financial profile will be the key monitorables.

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[1] 100 lakh = 1 crore = 10 million

[2] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications.

Company Profile
Incorporated in September 2002 by Mr. Madireddy Narayana Reddy and his associates, Covalent Laboratories Private Limited s is an ISO 9001:2000 accredited pharmaceutical company which is WHO GMP certified for all its products and specializes in the manufacturing of Active Pharmaceutical Ingredients (APIs) and intermediates for cephalosporins in the therapeutic segment of beta-lactamase anti biotic. The key products of CLPL are four cephalosporin based APIs (Cefixime, Axetile, Proxetile and Cefdinir). Further, the company also forayed into sterile cephalosporin APIs (Ceftriaxone, Cefuroxime Sodium, Cefotaxime) in Feb'14. CLPL has a single manufacturing facility located at Gundla Machnoor Village in Medak District (Hyderabad, Telangana) with an installed capacity of 1080 metric tonne per annum (MTPA) for oral APIs. The facility is also certified by ISO 14001-2004. CLPL belongs to Hyderabad-based Virchow group promoted by Dr. N Venkata Reddy, Mr. M Narayana Reddy, Mr. L V Subba Reddy, Mr. Ravindra Reddy and their families. Emmennar Pharma Private Limited (EPPL, [ICRA]BBB/A3+), Virchow Petrochemicals Private Limited (VPPL, rated [ICRA] A(Stable)/A1), Virchow Laboratories Limited (VLL, rated [ICRA]A+(Stable)/A1+), Andhra Organics Limited (AOL, rated [ICRA]A+ (Stable)/A1+) and Saraca Laboratories Limited (SLL) are some of the entities belonging to the group.

Recent Results
As per the unaudited results of FY16 the company recorded revenues of Rs 753.32 crore and PAT of Rs 0.79 crore against audited OI of Rs. 786.60 crore and PAT of Rs 20.51 crore in FY15.

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