

June 02, 2017

Discovery Laboratories Private Limited

Summary of rated instruments

Instrument*	Rated Amount (in crore)	Rating Action
Fund-based – Cash Credit	6.25	[ICRA]B (Stable); Reaffirmed
Total	6.25	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]B (pronounced ICRA B)¹ assigned to the Rs. 6.25 crore² fund-based bank facilities of Discovery Laboratories Private Limited (DLPL). The outlook on the long term is stable.

Rationale

The reaffirmation of the rating is constrained by the company's small scale of operations in pharmaceuticals industry; drop in turnover from Rs. 42.74 crore in FY2016 to Rs. 38.63 crore in FY2017 due to lower sales and job work income from Mylan Laboratories; and high customer concentration risk with top five customers accounting for ~90% of the total sales. The rating is also constrained by the project execution risk with the company increasing the capacity from 100 kilo liters to 180 kilo liters coupled with ~85% of the project cost yet to be incurred and adverse impact on the cash flows and coverage metrics in the near term; tight liquidity profile of the company as reflected from high working capital limits utilization in the past twelve months; and highly fragmented and competitive nature of the industry which limits the pricing flexibility. The rating, however, positively considers long experience of promoters' in Active Pharmaceutical Ingredient (API) manufacturing industry and the diverse product portfolio of the company which includes various intermediates used in API manufacturing; ICRA also notes the company's strategic partnership with reputed pharmaceutical companies such as Dr. Reddy's Laboratories and Mylan Laboratories which supports company's revenues to an extent.

Going forward, the firm's ability to timely complete the capex without cost overruns while effectively managing its working capital cycle shall be the key credit rating sensitivity.

Key rating drivers

Credit strengths

- Long experience of the promoters in the pharmaceutical intermediates manufacturing industry
- Strategic partnership with reputed clientele like Dr. Reddy's Laboratories Limited (DRL), Mylan Laboratories Limited
- Product portfolio includes intermediates used for manufacturing widely used bulk drugs ensuring a stable demand

¹ For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

² 100 lakh = 1 crore = 10 million

Credit weaknesses

- Substantial debt funded capex to be incurred over the next 18 months is expected to affect the leverage and coverage metrics adversely; further project is vulnerable to cost and time overruns given that 87% of the project cost is yet to be incurred as on March 31, 2017
- Drop in turnover from Rs. 42.74 crore in FY2016 to Rs. 38.63 crore in FY2017 due to lower sales to Mylan Laboratories Ltd
- Highly fragmented and competitive nature of the API industry limits pricing flexibility
- High customer concentration risk given that top-5 customers account for ~ 90% of the total revenues in the last 2 years
- Tight liquidity profile of the company in the last 12 months as reflected by ~90% utilization of working capital limits owing to high inventory and debtor levels
- Modest scale of operations with turnover of less than Rs. 40 crore for FY2017

Description of key rating drivers:

DLPL is involved in manufacturing of APIs used in the manufacturing of drugs. DLPL was incorporated in 2004 and is being managed by Mr. Prashanth Manne who has more than a decade experience in pharmaceutical industry. The company sells its products primarily to Mylan Labs and DRL and has a strategic partnership with these companies for manufacturing APIs under various therapeutic segments. Further, the company also manufactures intermediates used for manufacturing widely used bulk drugs ensuring a stable demand.

The company is currently undertaking a capacity expansion to increase the total reactor capacity to 180 kilo liters from 100 kilo liters besides adding a pilot plant facility to manufacture new range of intermediates across different therapeutic segments. The estimated cost to be incurred is about Rs 20.97 crore funded by Rs. 5.04 crore promoters' funds (24%), Rs. 3.38 crore internal accruals (16%), and Rs. 12.62 crore term loan from Telangana State Financial Corporation Ltd (60%). The company has incurred a cost of Rs. 2.70 crore till March 31, 2017 which translates to 13% of the total project cost. Hence the project is vulnerable to time and cost overruns. Further, the company's financial performance in FY2017 was modest with turnover dropping to Rs. 38.67 crore in FY2017 from Rs. 42.74 crore in FY2016 due to lower sales to Mylan Laboratories while the liquidity profile remained tight owing to high inventory and debtor levels.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[Corporate Credit Rating Methodology](#)

[Rating Methodology for Pharmaceutical companies](#)

About the firm:

Incorporated in 2004, Discovery Laboratories Private Limited (DLPL) is engaged in the manufacturing of pharmaceutical intermediates. The name of the company changed from Discovery Intermediates Private Limited to DLPL in January 2017. The company manufactures various types of intermediates and supplies to bulk drug manufacturers in Hyderabad. The company is promoted by Mr. M.V. Sekhara Rao and his son Mr. Prashanth Manne. The company's manufacturing facility is based in Hyderabad (Andhra Pradesh) and the commercial production for the unit commenced in 2006.

As per provisional financials for FY2017, the company reported a profit before tax of Rs. 1.73 crore on an operating income of Rs. 38.63 crore, as against a net profit of Rs. 1.36 crore on an operating income of Rs. 42.74 crore in the previous year.

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:

Table:

S. No.	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. Crore)	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2016	Date & Rating in FY2015
				June 2017	Jun 2016	Mar 2015	-
1	Cash Credit	Long Term	6.25	[ICRA]B (Stable)	[ICRA]B	[ICRA]B-	-

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1
Instrument Details

Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Crore)	Current Rating and Outlook
Cash Credit	-	-	-	6.25	[ICRA]B (Stable)

Source: DLPL

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About ICRA Limited:

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