July 10, 2017

Natco Pharma Limited

Summary of Rated Instruments

Instrument*	Rated Amount (in crore)	Rating Action
Term Loans	300.00	[ICRA]AA (Stable) / outstanding
Long-Term Fund based limits	421.00	[ICRA]AA (Stable) / outstanding
LT / ST - Fund based/Non Fund Based	61.50	[ICRA]AA (Stable) / [ICRA]A1+ / outstanding
Short-Term Non-fund based limits	59.00	[ICRA]A1+/ outstanding
LT/ST Proposed	59.40	[ICRA]AA (Stable) / [ICRA]A1+ / outstanding
Commercial Paper	200.00 (Enhanced from 100.00)	[ICRA]A1+/ assigned
Total	**1100.90**	

*Instrument Details are provided in Annexure-1

Rating Action

ICRA has assigned short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs.200.00 crore (enhanced from Rs.100.00 crore) commercial paper programme of Natco Pharma Limited (NPL / the company). ICRA also has a long-term rating of [ICRA]AA (pronounced ICRA double A) outstanding on the Rs.300.00 crore term loans and Rs.421.00 long-term fund based limits and short-term rating of [ICRA]A1+(pronounced as ICRA A one plus) outstanding on the Rs.59.00 crore non-fund based limits of NPL. ICRA also has ratings of ICRA]AA / [ICRA]A1+ outstanding on the Rs.61.50 crore LT/ST fund based / non fund based interchangeable limits and Rs.59.4 crore proposed facilities of the company.

Rationale

The assigned rating takes into account improvement in NPL's financial profile characterized by robust revenue growth of 82.1% (YoY), improvement in operating margins to 33.5% during FY2017 from 24.9% in FY2016 and comfortable capitalization and coverage indicators (TD/OPBDITA of 0.3x as on March 31, 2017 and interest coverage of 37.7x during FY2017). Launch of the generic version of Tamiflu (previously marketed by Hoffman La-Roche Inc.) in the USA during December 2016 resulted in substantial increase in revenues, margins and cash accruals (Rs.394.3 crore). The company received its profit share from its marketing partner, Alvogen which witnessed healthy sales of the generic version during the exclusivity period. The ratings also continue to factor NPL's strong market position in the domestic oncology formulations segment with leading volume share for its key drugs, its focused strategy on expanding presence in regulated markets driven by a portfolio of niche and complex molecules and its backward integration in Active Pharmaceutical Ingredients (APIs). While the company derived majority of its revenues from oncology earlier, with healthy revenue expansion in the gastroenterology segment (Hep-C drug portfolio) in the recent past, the company has achieved improved therapeutic diversity.

The ratings continue to factor intense competition in the domestic oncology segment leading to pricing pressure, dependence on few brands and limited presence in some of the fast-growing lifestyle related therapy areas as compared to other ICRA-rated entities. Also, increasing regulatory interference and potential price erosion upon inclusion of oncology segment under National List of Essential Medicines (NLEM) could result in pressure on earnings from domestic formulations business over the near-to-medium term. Further, intense competition and pricing pressures in the US generic market will also play an important role in both revenue and margin trajectory of the company. ICRA also notes that with growing product portfolio and increasing focus on markets outside India, NPL's working capital requirements will consistently expand going forward. Further, increasing regulatory scrutiny by the US FDA, compliance costs and risks associated with the same will be a key rating sensitivity going forward. NPL's ability to maintain its revenue growth momentum and its stable financial risk profile through the planned capital expenditure programme will also remain key credit monitorables.

Key rating drivers

Credit Strengths

- Leading player in the domestic oncology segment within its key products
- Domestic market position further strengthened by healthy market share under the gastroenterology segment with launch of Hepatitis C drug portfolio during CY2015
- Healthy sales of Natco's generic version of Tamiflu supported company's robust EBITDA during FY2017
- Strong Research & Development (R&d) capabilities and track record of building a product pipeline of complex and difficult-to-develop molecules for regulated markets with focus on U.S. generics; presence in niche APIs, Abbreviated New Drug Application (ANDA) programs reflects company's strategy to develop sustainable and high-value business streams
- Tie-up with leading generic players for the U.S. market mitigates the risk associated with potential litigation challenges associated with Para IV filings or at-risk launches
- Pipeline of ANDAs provides strong growth potential over the medium to long term; however, visibility of monetizing the ANDAs held, consistently over a period of time remains dependent on outcome of patent litigations and approvals on existing product pipeline considering the strong focus on Para IV/FTF filings for complex drugs
- Strengthening manufacturing capabilities, supported by adequate backward integration into manufacturing of active pharmaceutical ingredients (APIs) and regulatory market approvals
- Financial risk profile characterised by robust revenue growth, healthy profitability indicators and comfortable capitalization and coverage indicators

Credit Weakness

- Growing competition in the domestic market could pose concerns in maintaining growth momentum and pricing in the domestic market; however, healthy market share and proposed new drug launches in oncology and gastroenterology segments likely aid revenues
- Pricing pressures and intense competition in the US generic market will play an important role in both revenue and margin trajectory of the company
- Increasing working capital cycle with increasing share of international business
- Ongoing and planned debt-funded capital expenditure likely to impact margins (till capacities are at optimum utilization levels) and capitalization indicators over the near-to-medium term

Description of key rating drivers highlighted above:

NPL is a mid-size pharmaceutical company with presence across R&D, manufacturing and marketing of formulations and bulk drugs/APIs in India as well as international markets. The sales mix of the company has witnessed some volatility over the last two fiscals, owing to the modest performance of API exports coupled with the sharp growth in domestic branded formulations under both oncology and gastroenterology segments.

For business and geographic diversification and to leverage its strong R&D capabilities, NPL has been investing in developing a portfolio of ANDAs with Para IV filings on niche and complex molecules for the USA market. Despite a considerable portion of NPL's portfolio pending approvals in the USA, its focus and consistent track record of developing complex molecules demonstrates its strong R&D skills. The focused research and product development initiatives have aided NPL in building a wide product portfolio with increasing number of new drug filings across markets, where its ability to identify and develop complex and difficult-to-develop molecules, successfully file dossiers and tie-up contracts with leading generic majors remains a critical component for driving future growth. NPL follows a relatively de-risked business model, particularly in the US market, wherein it develops and files ANDAs and enters into agreements with leading generic players to manage the patent litigation risk and also for marketing and distribution activities. With pricing pressures witnessed across business segments, NPL's formulation exports driven by new drug launches both in regulated and emerging markets., is expected to be the key growth driver.

While a healthy ANDA pipeline is expected to support revenue growth of the company going forward, increasing share of revenues from international business is expected to increase the working capital requirements of the company. Further, the company also plans to expand its capacities and R&D infrastructure by investing Rs.300-350 crore per annum over the next 2-3 fiscals. The company plans to fund this capital expenditure with a mix of internal accruals and term loans of Rs.300 crore (out of which Rs.250 crore has already been tied up with various banks). While the aforementioned capital expenditure is expected to provide a boost to the company's manufacturing capabilities, it is likely to impact NPL's margins (till capacities are at optimum utilization levels) and capitalization indicators over the near-to-medium term.

Analytical approach: For arriving at the ratings, ICRA has taken a consolidated view of NPL and its subsidiaries.

Links to applicable Criteria
Corporate Credit Rating Methodology
Rating Methodology for Pharmaceutical Industry

About the Company:
A medium-sized pharmaceutical company, Natco Pharma Limited (NPL), develops, manufactures and markets formulations and active pharmaceutical ingredients (APIs). Founded in 1981 by Mr. V.C. Nannapaneni, NPL began manufacturing formulations as a private limited company – NPL Fine Pharmaceuticals Private Limited in Andhra Pradesh. Since then, NPL has emerged as an established pharmaceutical company with presence in formulations, APIs and retail pharmacy business. The company owns seven manufacturing facilities, including five formulations and two facilities for APIs in India, and a Natco Research Centre for R&D in Hyderabad. The formulation unit in Kothur and API facility at Mekaguda are approved by authorities of regulated markets including US FDA. The company's R&D activities are focused on a) synthetic chemistry, b) novel drug delivery mechanism and c) development of new chemical entities.

By virtue of being an early entrant and with strong R&D capabilities, NPL has established itself as a leading player in the oncology segment in India. In addition, it also generates sizeable proportion of its formulations business from exports with presence in generics business in regulated markets of North America and Europe and branded generics in RoW.

Besides manufacturing formulations and APIs, NPL also operated retail pharmacy business in the U.S., which it started by acquiring three stores over FY2006. However, the business became financially unviable with two of its stores getting impacted by cuts payments to health programmes. Eventually, the company divested this business during FY2016.

The company raised Rs.341 crore through Qualified Institutional Placement (QIP) to fund its capital expenditure and bring down its debt levels during FY2016.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable
Rating History for last three years:

Table: Rating History

S.No	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. Crore)	Month-year & Rating in FY2018	Month-year & Rating in FY2017	Month- year & Rating in FY2016	Month- year & Rating in FY2015
				July 2017	February 2017	December 2015	February 2015
1	Fund based facilities	Long Term	421.00	[ICRA] AA (Stable)	[ICRA] AA (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)
2	Term Loans	Long Term	300.00	[ICRA] AA (Stable)	[ICRA] AA (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)
3	Fund based/ Non-fund based limits	Long Term /Short Term	61.50	[ICRA] AA (Stable)/ [ICRA] A1+	[ICRA] AA (Stable)/ [ICRA] A1+	-	-
4	Non-fund based limits	Short Term	59.00	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+
5	Commercial Paper	Short Term	200.00	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+
6	Proposed Limits	Long Term /Short Term	59.40	[ICRA] AA (Stable)/ [ICRA] A1+	[ICRA] AA (Stable)/ [ICRA] A1+	[ICRA] AA (Stable)/ [ICRA] A1+	-

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

Details of Instrument

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Cash Credit/EPC/BD	-	-	-	421.00	[ICRA] AA (Stable)
Term Loans	-	-	5 years from drawdown	300.00	[ICRA] AA (Stable)
Fund based/ Non-fund based limits	-	-	-	61.50	[ICRA] AA (Stable) / [ICRA] A1+
LC/BG	-	-	-	59.00	[ICRA] A1+
Commercial Paper	-	-	-	200.00	[ICRA] A1+
Proposed Limits	-	-	-	59.40	[ICRA] AA (Stable) / [ICRA] A1+

Source: Natco Pharma Limited

Name and Contact Details of the Rating Analyst(s):

Analyst Contacts

Subrata Ray
+91 22 2433 1086
subrata@icraindia.com

Pavethra Ponniah
+91 44 4596 4314
pavethrap@icraindia.com

Mythri Macherla
+91 80 4332 6407
mythri.macherla@icraindia.com

Name and Contact Details of Relationship Contacts:

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

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.
For more information, visit **www.icra.in**

Registered Office
ICRA Limited
1105, Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel: +91-11-23357940-50, Fax: +91-11-23357014

Corporate Office
Mr. Vivek Mathur
Mobile: +**91 9871221122**
Email: vivek@icraindia.com

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122002
Ph: +91-124-4545310 (D), 4545300 / 4545800 (B) Fax; +91- 124-4050424

Mumbai **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 3rd Floor, Electric Mansion Appasaheb Marathe Marg, Prabhadevi Mumbai—400025, Board : +91-22-61796300; Fax: +91-22-24331390	**Kolkata** **Mr. Jayanta Roy** Mobile: **+91 9903394664** Email: jayanta@icraindia.com A-10 & 11, 3rd Floor, FMC Fortuna 234/3A, A.J.C. Bose Road Kolkata—700020 Tel +91-33-22876617/8839 22800008/22831411, Fax +91-33-22870728
Chennai **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 5th Floor, Karumuttu Centre 634 Anna Salai, Nandanam Chennai—600035 Tel: +91-44-45964300; Fax: +91-44 24343663	**Bangalore** **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 'The Millenia' Tower B, Unit No. 1004,10th Floor, Level 2 12-14, 1 & 2, Murphy Road, Bangalore 560 008 Tel: +91-80-43326400; Fax: +91-80-43326409
Ahmedabad **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 907 & 908 Sakar -II, Ellisbridge, Ahmedabad- 380006 Tel: +91-79-26585049, 26585494, 26584924; Fax: +91-79-25569231	**Pune** **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 5A, 5th Floor, Symphony, S.No. 210, CTS 3202, Range Hills Road, Shivajinagar,Pune-411 020 Tel: + 91-20-25561194-25560196; Fax: +91-20-25561231
Hyderabad **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 4th Floor, Shobhan, 6-3-927/A&B. Somajiguda, Raj Bhavan Road, Hyderabad—500083 Tel:- +91-40-40676500	