December 26, 2019

Lincoln Pharmaceuticals Ltd.: Ratings reaffirmed, outlook revised to Positive

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Term Loan	7.70	0.00	-
Fund-based Working Capital Facilities	53.00	53.00	[ICRA]A- reaffirmed; outlook revised to Positive from Stable
Interchangeable Limit	(35.00)	(35.00)	[ICRA]A- reaffirmed; outlook revised to Positive from Stable
Unallocated Limit	0.00	7.70	[ICRA]A- reaffirmed; outlook revised to Positive from Stable
Non-fund Based Letter of Credit (LC)	10.00	10.00	[ICRA]A2+; reaffirmed
Non-fund Based Bank Guarantee (BG)	2.00	2.00	[ICRA]A2+; reaffirmed
Non-fund Based LC/BG	5.00	5.00	[ICRA]A2+; reaffirmed
Total	**77.70**	**77.70**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in outlook takes into account the improvement in the Group's financial risk profile in FY2019 and H1FY2020. While the Group's revenues witnessed a modest growth of 1% in FY2019 and a moderate annualised growth of 14% in H1FY2020, its operating margins grew by 379 bps (to 18.4%) in FY2019 and further by 247 bps (to 20.91%) in H1FY2020. The improvement was aided by increased contribution of higher value-added exports as well as manufacturing sales to its revenue profile. Its operating margin has steadily improved year-on-year to 18.44% in FY2019 and 20.91% in H1FY2020 from 9.5% in FY2014 owing to successful product launches, increased sales of higher value-added products and better profitability on exports. Further, the Group has no long-term debt outstanding as on September 30, 2019 (except for car loans of Rs. 0.94 crore). Healthy profitability and limited capex outgo has improved the coverage indicators and resulted in healthy built of free cash/liquid investments of Rs. 58.11 crore as on September 30, 2019.

The ratings continue to reflect the extensive experience of the promoters, the established track record of the Lincoln Group in the pharmaceutical formulations industry spanning more than three decades and the comfortable financial profile of the Group characterised by sound profitability levels, healthy debt-protection indicators and strong liquidity. The ratings also factor in the Group's established relations with its customers, its geographical diversification with pan - India presence and its continued growth in exports to semi-regulated markets.

The ratings are, however, constrained by the vulnerability of operations to changes in Government policies related to price control as well as the intense competition in the domestic generic formulations industry, which limits the Group's revenue growth in the domestic market and constraints its pricing flexibility. The ratings also consider the high working capital intensity of the Group owing to the long credit period extended to its customers especially in the export markets. ICRA notes that timely product and facility approval/renewal in various semi-regulated markets, in which the Lincoln Group operates, remains critical for growth of exports and retention of profit margins going forward.

The Positive outlook reflects that ICRA expects the Group to sustain its profitability levels and witness improvement in accruals over the near to medium term, while maintaining its debt levels and working capital intensity. The outlook may be revised to Stable if the Group's revenues or margins are lower than expectations; or if the company's liquidity weakens because of elongation in working capital cycle or higher-than-anticipated capex.

Key rating drivers and their description

Credit strengths

Extensive experience of promoters and established customer relationships - The promoters have an extensive experience and the Group has an established track record in the pharmaceutical formulation industry spanning more than three decades. Over the period, the Group has developed an established relationship with its customers, ensuring repeat business.

Diversified product profile and geographical presence - The Group manufactures formulations in various forms such as tablets, capsules, ointments, syrups, dry powder and liquid injections. The product portfolio remains diversified with more than 250 formulations, catering to various therapeutic segments such as antibiotics, analgesics, anti-cold drugs, gynaecology, anti-malarial, and multi-vitamins. The Group was predominately a domestic market player; however, it has been increasing its focus on exports to semi-regulated markets owing to intense competition in the domestic generic formulations industry, which restricts the revenue growth and profitability. The export sales are concentrated, with African regions contributing ~45-55% to the total export sales, whereas in the domestic market the company has a diversified presence in more than 20 states.

Comfortable capital structure and healthy debt protection metrics - The financial risk profile of the Group remains healthy, marked by a comfortable capital structure, as reflected in a low gearing of 0.12 times as on September 30, 2019, strong net-worth base of Rs. 297.33 crore and healthy debt-protection metrics (Interest cover at 35.72 times, Total Debt/OPBDITA at 0.42 times as on September 30, 2019).

Improvement in operating profitability – The Group's profitability improved to 18.44% in FY2019 and 20.91% in H1FY2020 from 14.65% in FY2018 owing to successful product launches, increased sales of higher value-added products and increased contribution of higher value-added exports to semi regulated markets. Exports as a percent of total sales increased to 56% in FY2019 and 57% in H1FY2020 from 35% in FY2018.

Credit challenges

High working capital intensity of operations - The working capital intensity of the Group is high and has witnessed an increase with increased sales to the export market, wherein a higher credit period of up to ~120 days is extended as compared to ~60-90 days extended in the domestic market, coupled with moderate inventory requirements. The same is reflected by a NWC/OI of 44% in FY2018 and 45% in FY2019.

Moderate scale of operations amid intense competition in generic formulations industry - The Group remains a moderate-sized player in the generic formulations industry and reported flat growth in FY2018 and modest growth in FY2019, with an operating income of Rs. 366.20 crore in FY2019 as compared to Rs. 360.91 crore in FY2018. The domestic generic formulation industry faces stiff competition from numerous contract manufacturers, MNCs as well as established domestic brands, with some of these players also having a pan-India presence. The intense competition also restricts the Group's revenue growth and pricing flexibility. The same constrained the revenue growth in FY2018 and FY2019, although, with increased contribution of higher value-added exports, the operating income and profitability witnessed an improvement in H1FY2020.

Operations exposed to regulatory restrictions - The 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 markets, remains critical for the growth of exports going forward.

Liquidity position: Strong

The liquidity position of the Group is strong, supported by healthy estimated cash accruals of ~Rs. 56 crore for FY2020 with no term debt outstanding as on date (except for car loans of Rs. 0.94 crore), free cash/liquid investments of ~Rs.58.00 crore as on September 30, 2019 and minimal requirement of incremental working capital funding. The liquidity is also supported by cushion in working capital limits and absence of any major capital expenditure.

Rating sensitivities

Positive triggers – ICRA could upgrade the ratings if the company demonstrates healthy scaling up of operations, maintains its operating profitability above 17%-18% on a sustained basis and improves its working capital cycle.

Negative triggers – Negative pressure on the Group's ratings could arise if a substantial decline in the scale of operations and profitability results in material deterioration of coverage indicators; or a sizeable capex or increase in working capital cycle adversely impacts the liquidity profile and key credit metrics.

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	**Consolidation** For arriving at the ratings, ICRA has combined the business and financial risk profiles of Lincoln Pharmaceuticals Limited (LPL), its wholly owned subsidiaries Zullinc Healthcare LLP and Savebux Enterprise Private Limited and Lincoln Parenteral Limited (LPPL) (current holding 98.58%) as the entities are owned and managed by the same promoters and are involved in related lines of business.

About the company

Established as a partnership firm in 1979, LPL has been involved in manufacturing and trading of pharmaceutical formulations in the domestic market as well as exports of formulations. LPL was reconstituted as a public limited company in 1995 and is listed on the BSE. The manufacturing plant, located at Kharjat in the Gandhinagar district of Gujarat, has an installed capacity of manufacturing 100-crore tablets, 45-crore capsules and 90-lakh packs of ointments per annum; the unit is ISO 9001, ISO 14001 and OHSAS 18001 certified and WHO, cGMP, MHRA and TGA compliant[1].

The company is a part of the Lincoln Group, which manufactures pharmaceuticals formulations in categories such as generics, anti-malarial, anti-diabetic, gynaecology products, vitamins, minerals and anti-oxidants. LPL's subsidiary Lincoln Parenteral Limited (LPPL) was incorporated in 1991 and is involved in manufacturing formulations in dry powder, liquid injectibles, and syrup variants; LPL has a 98.58% holding in LPPL. LPL has other two wholly owned subsidiaries named

[1] OHSAS: Occupational Health and Safety Management System; MHRA: Medicines and Healthcare products

Regulatory Agency; TGA: Therapeutic Goods Administration

Zullinc Healthcare Limited, which trades and markets pharmaceutical products, and Savebux Enterprises Pvt. Ltd. (erstwhile known as Savebux Finance & Investments Private Limited), which has limited trading operations and is proposed to be liquidated soon. The scheme of amalgamation between Lincoln Parenteral Limited ("Transferor company) and Lincoln Pharmaceuticals Limited (Transferee Company) with the appointed date of the scheme as April 01, 2019 is currently under process.

In H1FY2020, the Group reported a net profit of Rs. 31.60 crore on an operating income of Rs. 209.50 crore compared to Rs. 48.74 crore and Rs. 366.20 crore, respectively, reported in FY2019.

Key financial indicators (audited)

	FY2018	FY2019	H1FY2020*	FY2018	FY2019	H1FY2020*
	Standalone			**Consolidated**		
Operating Income (Rs. crore)	325.04	353.15	205.24	360.91	366.20	209.50
PAT (Rs. crore)	32.76	46.64	30.15	34.65	48.74	31.60
OPBDIT/OI (%)	14.28%	17.19%	19.59%	14.65%	18.44%	20.91%
RoCE (%)	18.30%	21.43%	26.84%	18.98%	22.18%	27.47%
Total Outside Liabilities/Tangible Net Worth (times)	0.26	0.13	0.13	0.27	0.12	0.12
Total Debt/OPBDIT (times)	1.21	0.55	0.46	1.16	0.50	0.42
Interest Coverage (times)	10.89	15.79	33.06	9.77	16.89	35.72
DSCR	6.98	9.54	14.71	3.80	5.89	17.07

**provisional financials*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					26-Dec-2019	7-Jan-2019	7-Feb-2018	16-Jan-2017
1	Cash Credit	Long Term	45.00	-	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)
2	Export Packing Credit-1	Long Term	8.00	-	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)
3	Export Packing Credit-2	Long Term	(35.00)*	-	[ICRA]A- (Positive)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)
4	Unallocated Limits	Long Term	7.70	-	[ICRA]A- (Positive)	-	-	-
5	Letter of Credit (LC)	Short Term	10.00	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
6	Bank Guarantee (BG)	Short Term	2.00	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
7	LC/BG	Short Term	5.00	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+

*Amount in Rs. crore *Sub-limit of Cash Credit*

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

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	45.00	[ICRA]A- (Positive)
NA	Export Packing Credit-1	NA	NA	NA	8.00	[ICRA]A- (Positive)
NA	Export Packing Credit-2	NA	NA	NA	(35.00)*	[ICRA]A- (Positive)
NA	Unallocated Limits	NA	NA	NA	7.70	[ICRA]A- (Positive)
NA	Letter of Credit (LC)	NA	NA	NA	10.00	[ICRA]A2+
NA	Bank Guarantee (BG)	NA	NA	NA	2.00	[ICRA]A2+
NA	LC/BG	NA	NA	NA	5.00	[ICRA]A2+

*Source: Lincoln Pharmaceuticals Limited *Sub-limit of Cash Credit*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Lincoln Parenteral Limited	98.58%	Full Consolidation
Zullinc Healthcare LLP	100%	Full Consolidation
Savebux Enterprise Private Limited	100%	Full Consolidation

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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.

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