

July 06, 2020

## Unichem Laboratories Limited: Rating for commercial paper programme withdrawn

### Summary of rating action

| Instrument*                                       | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action                      |
|---|-----------------------------------|----------------------------------|------------------------------------|
| Long-term, Fund-based / Non-fund Based Facilities | 150.0                             | 150.0                            | [ICRA]A (Negative); outstanding    |
| Commercial Paper Programme                        | 15.0                              | 0.0                              | [ICRA]A1; reaffirmed and withdrawn |
| <b>Total</b>                                      | <b>165.0</b>                      | <b>150.0</b>                     |                                    |

\*Instrument details are provided in Annexure-1

### Rationale

ICRA has withdrawn the [ICRA]A1 (pronounced ICRA A one) rating assigned to the Rs. 15.0-crore commercial paper (CP) programme of Unichem Laboratories Limited (Unichem) as there is no amount outstanding against the instrument. The rating has been withdrawn as per the request of the company and is in accordance with ICRA's policy on withdrawal and suspension.

The rating takes into account Unichem's healthy liquidity position with low debt levels on a consolidated basis. However, the company is expected to continue to report operating losses (post expensing the entire research and development (R&D) spend) in the near term until the international formulations business scales up adequately, in line with its high capital expenditure (capex) and R&D investments. Besides the US market, Unichem's operations in the UK market are yet to turn profitable at operating profit level and its scale in other emerging markets are yet to achieve a meaningful size.

After having off its core business of domestic formulations, which drove ~55% of its consolidated revenues in FY2017, Unichem has enhanced its focus on the US market, supported by the ongoing capacity expansions of its manufacturing facilities, most of which are approved by the United States Food and Drug Administration (USFDA), and its growing number of abbreviated new drug application (ANDA) filings. As on March 31, 2020, the company had 66 ANDA filings, of which 37 have been approved and 28 already launched. The company is expected to continue to ramp up its R&D investments to build a pipeline of complex and niche products.

ICRA notes Unichem's high capex plans of Rs. 518 crore in FY2021 (~Rs. 386 crore in FY2020). Coupled with high R&D spend, this will result in a moderation in the liquidity position of the company in the near term. The ongoing capex spends along with operating losses have resulted in a reduction in the consolidated unencumbered cash and bank balance as well as liquid investments of Unichem to ~Rs. 602 crore as on March 31, 2020<sup>1</sup> from ~Rs. 715 crore as on September 30, 2019.

In FY2020, on a consolidated basis, Unichem registered a YoY revenue growth of ~3% (~44.3% YoY growth in FY2019). The revenue growth in FY2020 was lower primarily due to price reductions in the US business and to some extent on account of impact on operations towards the end of March 2020 because of the Covid-19 induced lockdown, which impacted its production as well as dispatches, due to logistics issues. Although Unichem continued to report an operating

<sup>1</sup> In addition, on a consolidated basis, the company had an encumbered cash and bank balance of ~Rs. 43 crore as on March 31, 2020  
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loss in FY2020, it was lower at ~Rs. 51 crore in FY2020, against ~Rs. 69 crore in FY2019, supported by YoY improvement in its gross margins.

ICRA notes that the appeal of Unichem, against the order of the European Commission imposing a fine of € 13.9 million on the company and its UK subsidiary, was rejected by the General Court of EU in FY2019 and the aforesaid fine was confirmed. Although the company has filed for an appeal before the EU Court of Justice, an unfavourable outcome would impact its financial profile. ICRA will continue to monitor the developments in this regard.

## Key rating drivers and their description

### Credit strengths

**Healthy liquidity position and low debt levels** – On a consolidated basis, Unichem had a sizeable balance of free cash and liquid investments of ~Rs. 602 crore and a relatively low debt of ~Rs. 184 crore, as on March 31, 2020. While the company's liquidity position is expected to moderate on account of its significant capex plans and continued high R&D investments, ICRA expects the current liquidity position to be adequate for meeting its funding requirements in the near term, thus maintaining its strong capital structure.

**Backward integrated capabilities to provide competitive advantage** – Following the sale of its domestic formulations business, the company has enhanced its focus on its international formulations business, especially the US business, which has been growing at a healthy rate over the past few years, albeit on a low base. Unichem's extensive experience in manufacturing active pharmaceutical ingredients (APIs) and formulations as well as its cost advantage due to backward integration is a positive factor. Accordingly, the company has been investing in the capacity expansion of its API facilities for sufficient in-house capacities to support its expected ramp up in formulations. Furthermore, during FY2019, the company made investments of ~Rs. 120 crore in two Hyderabad-based API manufacturers to gain access to their USFDA-approved API facilities.

### Credit challenges

**Capability of the company to efficiently manage and generate returns from enhanced capacities** – The company has been incurring considerable capex to enhance its manufacturing capacities and has been investing in its R&D capabilities to capitalise on certain identified opportunities. Furthermore, there has been an increase in the capex plans of Unichem to ~Rs. 904 crore over FY2020 and FY2021 (of which the company already spent ~Rs. 386 crore in FY2020). The ability of the company to efficiently manage such investments, resulting in breakeven at the operating level, remains to be seen.

**Company to continue to report operating losses in the near term** – Substantial investments in R&D and increased overheads due to ongoing capacity expansions is expected to continue to exert pressure on the profitability of the company. Unichem is expected to continue to report operating losses (post expensing the entire R&D spend) in the near term until the international formulations business scales up adequately, in line with its high capex and R&D investments. Furthermore, with increased salience of the US business, the financial performance of the company remains exposed to regulatory risks, such as increased scrutiny by the USFDA.

**Weak performance of subsidiaries impacts the financial profile of the consolidated entity** – Besides the US market, Unichem's operations in other international markets of Latin America, South Africa and the UK, where it is present through its wholly-owned subsidiaries, are yet to achieve a meaningful size and are making losses at operating level, except its South African subsidiary. This could be attributed to the high cost structure and competitive pressures resulting in thin margins in the EU and lack of adequate product approvals in the Latin American market. Accordingly, the company's ability to turnaround and scale up its businesses in these different geographies remain a key sensitivity.

## Liquidity position: Adequate

The company had a healthy liquidity position with free cash and equivalents of ~Rs. 602 crore as on March 31, 2020, on a consolidated basis. Furthermore, as on March 31, 2020, on a consolidated basis, Unichem did not have any long-term debt besides working capital borrowings of ~Rs. 184 crore. The company is currently in an expansion stage with focus on scaling up its US business. Therefore, its available liquidity is expected to reduce substantially due to the planned capex of Rs. 518 crore in FY2021. Unichem, on a standalone basis, however, also has a cushion available in the form of undrawn working capital limits of ~Rs. 110.9 crore, with the average utilisation of its Rs. 126.1-crore sanctioned fund-based limits standing at Rs. 13.8 crore for the 12-month period ended May 31, 2020.

## Rating sensitivities

**Positive triggers** – The rating is unlikely to be upgraded in the near term unless there is a significant increase in scale and improvement in profitability, while maintaining a healthy liquidity position.

**Negative triggers** – Negative pressure on Unichem’s rating could arise if the company fails to improve its scale and profitability from the current levels. Any debt-funded capex / acquisition leading to weakening credit metrics on a sustained basis, would also pose downward pressure on Unichem’s rating. Any significant deterioration in Unichem’s liquidity will also be a negative trigger. Any adverse observations by any regulatory authorities impacting its revenues and profitability would also be a negative trigger.

## Analytical approach

| Analytical Approach             | Comments   |
|---------------------------------|--|
| Applicable Rating Methodologies | <a href="#">Corporate Credit Rating Methodology</a><br><a href="#">Rating Methodology for Pharmaceutical Industry</a><br><a href="#">ICRA Policy on Withdrawal and Suspension of Credit Rating</a> |
| Parent / Group Support          | Not Applicable   |
| Consolidation / Standalone      | The rating is based on the consolidated financial profile of the company. As on March 31, 2020, Unichem had six subsidiaries, which are enlisted in Annexure-2.                                    |

## About the company

Unichem Laboratories Limited is an integrated pharmaceutical company, headed by Dr. Prakash Mody. It was founded by Dr. Mody’s father, the late Amrut Mody, in 1944. As on March 31, 2020, the promoters held a 50.67% stake in the company. Unichem manufactures and markets a large basket of APIs as well as pharmaceutical formulations as branded and simple generics in several regulated and unregulated markets around the world. The company’s products cater to a diverse range of therapeutic areas, such as cardiology, gastroenterology, diabetology, psychiatry, neurology, anti-bacterial, anti-infective and pain management.

Historically, Unichem was focused on its domestic formulations business, which drove almost 55% of its total consolidated revenues in FY2017. The company took its first major step towards entering the regulated markets in 2002, following its acquisition of a 60% equity stake in Niche Generics Limited, UK. Subsequently, in FY2007, Unichem acquired the balance 40% stake by buying out its partner’s stake. In November 2017, Unichem entered into an agreement for sale of its formulations business in India and Nepal to Torrent Pharmaceuticals Limited by way of a slump sale, for a total consideration of Rs. 3,600 crore. Following the above business sale, Unichem now has formulations manufacturing facilities at Goa, Baddi (Himachal Pradesh) and Ghaziabad (Uttar Pradesh), while its APIs manufacturing facilities are in Roha (Maharashtra), Pithampur (Madhya Pradesh) and Kolhapur (Maharashtra).

## Key financial indicators (audited)

|  | FY2019 | FY2020 |
|--|--------|--------|
| Operating Income (Rs. crore)                         | 1180.0 | 1210.6 |
| PAT (Rs. crore)                                      | -23.9  | -61.0  |
| OPBDIT/OI (%)  | -5.8%  | -4.2%  |
| PAT/OI (%)   | -2.0%  | -5.0%  |
| Total Outside Liabilities/Tangible Net Worth (times) | 0.2    | 0.2    |
| Total Debt/OPBDIT (times)                            | -2.9   | -3.6   |
| Interest Coverage (times)                            | -9.1   | -6.5   |

Source: Company data, ICRA research

OPBDITA: 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 (FY2021) |              |                    | Rating History for the Past 3 Years |                    |                   |             |             |             |             |           |
|---|--|-------------------------|--------------|--------------------|-------------------------------------|--------------------|-------------------|-------------|-------------|-------------|-------------|-----------|
|   |  | Type                    | Amount Rated | Amount Outstanding | Rating                              | FY2020             | FY2019            | FY2018      |             |             |             |           |
|   |  |                         |              |                    | 06-Jul-2020                         | 30-Dec-2019        | 18-Sep-2018       | 20-Jun-2018 | 8-Nov-2017  | 22-Aug-2017 | 17-May-2017 |           |
| 1 | Fund-based / Non-fund Based Facilities | Long-term               | 150.0        | -                  | [ICRA]A (Negative)                  | [ICRA]A (Negative) | [ICRA]A+ (Stable) | -           | -           | -           | -           | -         |
| 2 | Commercial Paper Programme             | Short-term              | 15.0         | 0.0                | [ICRA]A1; withdrawn                 | [ICRA]A1           | [ICRA]A1+         | [ICRA]A1+   | [ICRA]A1+ & | [ICRA]A1+   | [ICRA]A1+   | [ICRA]A1+ |

&: on rating watch with developing implications

Amount in Rs. crore

## 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](http://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   | Long-term, Fund-based / Non-fund Based Facilities | NA                          | NA          | NA            | 150.0                    | [ICRA]A (Negative)         |
| NA   | Commercial Paper Programme                        | NA                          | NA          | NA            | 15.0                     | [ICRA]A1; withdrawn        |

Source: Unichem Laboratories Limited

### Annexure-2: List of entities considered for consolidated analysis

| Company Name                                | Ownership* | Consolidation Approach |
|---|------------|------------------------|
| Niche Generics Ltd, UK                      | 100.00%    | Full Consolidation     |
| Unichem S.A. Proprietary, SA                | 100.00%    | Full Consolidation     |
| Unichem Farmaceutica Do Brasil Ltda, Brazil | 100.00%    | Full Consolidation     |
| Unichem Pharmaceuticals (USA) Inc, USA      | 100.00%    | Full Consolidation     |
| Unichem Laboratories Limited, Ireland       | 100.00%    | Full Consolidation     |
| Unichem (China) Pvt. Ltd.                   | 100.00%    | Full Consolidation     |

Source: Unichem Laboratories Limited; \*as on March 31, 2020

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