

November 25, 2021

## Unichem Laboratories Limited: Rating reaffirmed; outlook revised to Negative

### 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	176.0	176.0	[ICRA]A reaffirmed; Outlook revised to Negative from Stable.
<b>Total</b>	<b>176.00</b>	<b>176.00</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The revision in outlook to Negative factors in the pressure on Unichem Laboratories Limited's (Unichem) margins in the current fiscal as evident from the sharp dip in profitability levels in H1 FY2022 due to pricing pressures in its key export market (US) leading to net losses on a consolidated basis. The losses at the standalone level remains higher, given the high fixed cost manufacturing base compared to its subsidiaries. For H1 FY2022, the company's (consolidated) operating income (OI) declined by 7.3% to Rs. 588.6 crore compared to H1 FY2021, with a negative net margin (-4.1%) against a positive margin of 1.8% for the same period last year. Given the sharp drop in margins as well as incremental long-term borrowings availed in the current year for capex, the coverage indicators are likely to moderate in FY2022 from ICRA's earlier estimates. Though the operating margin has seen sequential recovery in Q2 FY2022 compared to the first quarter, material recovery in the near term will remain a monitorable. ICRA notes that the company is in the midst of sizeable capex programme and have undertaken capex to the tune of ~Rs. 670 crore during the last two fiscals. It is planning to undertake close to Rs. 182-crore capex in FY2022. Nevertheless, the capex has been mainly funded from its internal accruals, and is likely to commercialise by FY2022 end. Commensurate returns from the same in terms of top-line growth and profits remains the key for its credit profile going forward. It is also to be noted that with operationalisation of its Ghaziabad plant, the inventory levels have gone up in FY2021 end. The same remained elevated in H1 FY2022, leading to high working capital intensity of operations. ICRA, however, draws comfort from adequate liquidity position as characterised by free cash and liquid investments to the tune of Rs. 205.7 crore as on September 30, 2021, which moderated from Rs. 313.9 crore as on March 31, 2021 on account of capex, incremental working capital and funding of loss requirements. The liquidity is also supported by buffer available in working capital limits.

After having off its core business of domestic formulations, which drove ~55% of its consolidated revenues in FY2017, Unichem has focused on the US market, supported by the ongoing capacity expansions of its manufacturing facilities. Most of its facilities are approved by the United States Food and Drug Administration (USFDA), and its growing number of Abbreviated New Drug Application (ANDA) filings. The rating also factors in Unichem's backward-integrated capabilities, which have been enhanced over the past couple of years and provide a competitive advantage. ICRA favourably notes its clean track record with respect to regulatory inspections. Despite increased leverage and reduction in liquidity, its net debt position is still comfortable.

ICRA also notes that Unichem's appeal 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.

### Key rating drivers and their description

#### Credit strengths

**Promoter's proven experience of over seven decades in pharmaceutical sector** – Unichem is an integrated pharmaceutical company, headed by Dr. Prakash Mody, which was founded by his father, the Late Amrut Mody, in 1944. The promoters currently hold a 50.9% stake in the company. Unichem's operations are overseen by its Chairman and Managing Director, Dr. Prakash Amrut Mody, who is a post graduate from University of Mumbai and is also an Alumni of Harvard Business School. The

promoters have over seven decades of experience in the pharmaceutical sector spanning across formulations as well as active pharmaceutical ingredient (API) business. After hiving 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 USFDA, and its growing number of ANDA filings.

**Adequate liquidity position** – On a consolidated basis, Unichem had free cash and bank balance and liquid investments of ~Rs. 205.7 crore and a relatively low gross debt of ~Rs. 257.5 crore, as on September 30, 2021 (excluding lease liability). While the company's liquidity position is likely to moderate from the current levels on account of its significant capex plans, ICRA expects the current liquidity position to be adequate for meeting its near-term funding requirements, 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 in the US, which has been growing at a healthy rate over the past few years, albeit on a low base. Unichem's extensive experience in APIs and formulations as well as its cost advantage due to backward integration is a positive factor. Accordingly, the company has been investing in capacity expansion of its API facilities for sufficient in-house capacities to support its expected ramp-up in formulations. Furthermore, in FY2019, it invested ~Rs. 120 crore in two Hyderabad-based API manufacturers to gain access to their USFDA-approved API facilities. ICRA also notes the company's clean track record with respect to regulatory inspections.

## Credit challenges

**Pricing pressures witnessed in the export market in the current fiscal, leading to losses in H1FY22 at net level and subsequent deterioration in credit metrics** – The company reported net losses, on a consolidated basis, on account of a sharp dip in margins due to pricing pressures in its key generics market in the US, which command a sizeable revenue share. The consolidated top line in H1 FY2022 declined by 7.3% to Rs. 588.6 crore compared to H1 FY2021. Coupled with moderation in margin, Unichem is looking at incremental long-term borrowings to the tune of Rs. 120 crore in the current fiscal, out of which Rs. 62 crore was drawn in H1 FY2022. Hence, the same is likely to moderate the debt metrics in FY2022 compared to ICRA's earlier estimates. Though the operating margin has seen some sequential recovery in Q2 FY2022 compared to the first quarter, material recovery in the near term will remain a monitorable.

**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. Unichem has incurred a cumulative capex of ~Rs. 670 crore over FY2020, FY2021 and expects to incur an additional capex of ~Rs. 182 crore in FY2022. It has already incurred a capex of ~Rs. 60 crore in H1 FY2022. The capex has been mainly funded by its internal accruals, and the facilities are expected to commercialise by FY2022 end. Its ability to efficiently manage and generate adequate returns from such high investments by profitably scaling up its operations on the back of successful product launches remains to be seen.

**Working capital-intensive nature of operations** – The company's business remains working capital intensive, given the elongated receivable days as well as high raw material inventory requirements in the business. The working capital intensity as reflected by (NWC/OI) has been over 60% during the last three fiscals and stood at 61.8% as of FY2021 end (consolidated). On a consolidated level, the inventory days increased to 219 days in FY2021 period from 162 days in FY2020, due to inventory build-up at its newly operationalised Ghaziabad plant. The inventory levels remained elevated in the current fiscal, leading to increased short-term borrowings (consolidated) to Rs. 208.3 crore as on September 30, 2021 from Rs. 100.6 crore as on March 31, 2021.

## Liquidity position: Adequate

The company had a comfortable liquidity position with investments and free cash and equivalents of ~Rs. 205.7 crore as on September 30, 2021, on a consolidated basis. It also has cushion available in the form of undrawn working capital limits of ~Rs. 211 crore on its overall ~Rs. 236-crore fungible sanctioned limits as on September 30, 2021 at the standalone level. Though the liquidity is likely to moderate in the near term, given the ongoing capex requirements, the same is expected to remain adequate for working capital needs as well as from a debt repayment perspective.

## Rating sensitivities

**Positive factors** – The rating is unlikely to be upgraded in the near term given the Negative outlook. The outlook can be revised to Stable if there is material improvement in profitability, while maintaining an adequate liquidity position and improvement in scale of operations.

**Negative factors** – The rating can be downgraded if there is a dip in scale or pressure on profitability continues with no material recovery is witnessed in the near term. 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> <a href="#">Rating Methodology for Entities in the Pharmaceutical Industry</a>
Parent/Group Support	Not Applicable
Consolidation/Standalone	The rating is based on consolidated financial profile of the company. As on September 30, 2021, 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 September 30, 2020, the promoters held a 50.9% 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, it 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, the company 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)

Consolidated	FY2020*	FY2021*
Operating Income (Rs. crore)	1103.7	1235.1
PAT (Rs. crore)	-61.0	34.7
OPBDIT/OI (%)	-4.5%	7.4%
PAT/OI (%)	-5.5%	2.8%
Total Outside Liabilities/Tangible Net Worth (times)	0.2	0.2
Total Debt/OPBDIT (times)^	NM	1.3
Interest Coverage (times)	NM	17.9

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ^Includes Lease Liability; \*as per INDAS;

NM-Not Meaningful

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

### Rating history for past three years

Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years					
	Type	Amount Rated (Rs. crore)	Amount Outstanding as of Feb 29, 2020 (Rs. crore)	Date & Rating in	Date & Rating in FY2021		Date & Rating in FY2020	Date & Rating in FY2019		
					Nov 25, 2021	Jan 22, 2021 Jan 07, 2021		Jul 06, 2020	Sep 18, 2018	June 20, 2018
1 Fund Based/ Non Fund Based	Long-term	176.0	-	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Negative)	[ICRA]A (Negative)	[ICRA]A+ (Stable)	-	
2 Commercial Paper Programme	Short term	-	-	-	-	[ICRA]A1; withdrawn	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	

### Complexity level of the rated instrument

Instrument	Complexity Indicator
Long Term Fund based/Non-fund Based facilities	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: [Click Here](#)

**Annexure-1: Instrument details**

ISIN No	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	176.0	[ICRA]A(Negative)

Source: Company

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

Company Name	Unichem 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 September 30, 2021

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