April 28, 2022

Natco Pharma Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. Crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based Working Capital	866.50	866.50	[ICRA]AA (Stable); reaffirmed
Long Term/ Short Term – Fund based /Non-fund Based Working Capital	155.00	155.00	[ICRA]AA (Stable)/[ICRA]A1+; reaffirmed
Short-term Non-Fund Based Working Capital	85.00	85.00	[ICRA]A1+; reaffirmed
Long-term/ Short-term Unallocated	43.50	43.50	[ICRA]AA(Stable)/[ICRA]A1+; reaffirmed
Commercial Paper	400.00	400.00	[ICRA]A1+; reaffirmed
Total	**1,550.00**	**1,550.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation considers Natco Pharma Limited's (Natco/the company) strong position in the domestic formulations segment with market leading presence in the oncology segment, its healthy abbreviated new drug applications (ANDA) pipeline complemented by its strong research and development (R&D) and manufacturing capabilities, and its healthy financial profile characterised by robust debt coverage metrics and strong liquidity position. While the company witnessed YoY revenue growth of 7.2% in FY2021 on the back of strong sales in the active pharmaceutical ingredient (API) segment and one-time settlement income for gRevlimid in Canada, it witnessed revenue degrowth of 21.7% in 9M FY2022 due to the high base of 9M FY2021, which included Covid-led supplies, and adverse impact of competition induced pricing pressures. Despite strong recovery in the domestic formulation segment in Q1 FY2022 (YoY revenue growth of 60%) backed by higher sales of its Covid-19 portfolio during the second wave of the pandemic, sales remained muted from Q2 FY2022. Also, the operating profit margins (OPM) contracted to 20.9% in 9M FY2022 from 30.8% in 9M FY2021 primarily due to sequentially lower revenues, impact of pricing pressures, and quarterly operational loss of ~Rs. 10-12 crore in the agrochemical segment. However, the healthy performance of the subsidiaries (mainly Brazil and Canada) and one-time licencing income offset the revenue degrowth to a certain extent. Going forward, the revenues and margins in the export formulation segment are expected to ramp up significantly in FY2023 and likely to sustain for the next two years, on the back of the recent launch of gRevlimid in the US in March 2022, in addition to launch of gZortress and gAfinitor in the US, and gRevlimid in Canada. The ratings also continue to factor in the extensive experience of the promoters, Natco's strategy to leverage its complex molecule portfolio, along with the backward-integrated nature of its operations with strong capabilities in API.

The ratings consider the high product concentration with a few molecules mainly driving the company's US formulations business and its top five products accounting for ~50% of its domestic formulations business. The ratings also consider the intense competition in Natco's formulation business, leading to price erosion and decline in revenues and margins in 9M FY2022. While Natco's oncology business was impacted by pricing pressures, the Hep C segment witnessed overall market size reduction. Natco's working capital intensity remains high with a growing product portfolio and increasing focus on the international market. Further, the company has built-up significant inventory for its Covid-19 portfolio and chlorantraniliprole (CTPR; wherein the launch was delayed due to patent related litigation) in the recent past.

Also, ICRA notes that there is a possibility of inventory provisioning in the near term. Additionally, increasing scrutiny by the US FDA[1], compliance costs and risks associated with the same on the company's operations will be key rating sensitivities, going forward.

The company is exploring inorganic expansion opportunities over the near to medium term. Any significant debt-funded acquisition impacting its credit metrics, remains an event risk and would be evaluated on a case-by-case basis. The Stable outlook on the rating reflects ICRA's opinion that Natco will continue benefiting from its strong market position, the significant experience of its promoters, strong track record of R&D capabilities and healthy financial profile.

Key rating drivers and their description

Credit strengths

Strong market position in domestic oncology segment – As an early entrant with regular product introductions and competitive pricing, Natco has managed to establish a strong presence in the domestic formulations market with a significant market share in the domestic oncology segment. The company continues to be one of the market leaders in the domestic oncology segment, despite facing intense competition that leads to pricing pressures. However, revenues from the Hep C segment witnessed significant reduction in revenues over the last few years due to shrinking market size. While the company has been witnessing losses in the agrochemical segment, the segment is expected to improve with the estimated launch of CTPR in the near term. The company has also forayed into the cardiology and diabetology division (C&D), which is expected to diversify its revenue profile in the domestic formulations business over the long-term.

Healthy ANDA pipeline lends visibility to revenues; launch of gRevlimid to aid growth – The company has predominantly focused on complex products with high barriers to entry in the US. The launch of the complex generic version of Copaxone (40 mg) in October 2017 and the steady gain in market share (more than 30% share) by its marketing partner, Mylan, has supported the company's revenues and margins from the US market. The volume-limited launch of gRevlimid in the US during March 2022 with the sale volume expected to increase steadily every year, shall support significant ramp up of Natco's revenues and profit margins, going forward. Further, the company has a strong pipeline of 19 Para IVs as on December 31, 2021 with a few significant launches (some are subject to approval/litigation) in the near to medium term (gPomalyst, gKyprolis, gNexavar, etc). Also, Natco's strategy of leveraging its limited competition and complex molecule portfolio in newer geographies like Brazil, Canada, Australia, and other south-east Asian countries is expected to support its revenues, going forward.

Strong R&D and manufacturing capabilities – Natco continues to invest a high single-digit percentage of its revenues in R&D every year (FY2021: 7.8%), thereby supporting its strong capabilities to develop limited competition and difficult-to-develop molecules for the regulated markets. Strong manufacturing capabilities in addition to backward integration into API manufacturing continue to support the company's revenue. Further, tie-ups with leading generic players for the US market mitigate the risks associated with potential litigation challenges in case of Para IV filings or at-risk complex generic launches. However, with its acquisition of Dash Pharmaceuticals LLC in January 2022, Natco expects to have a front-end presence in the US market for its plain vanilla generics, to support better margins.

Healthy financial profile – Natco's financial risk profile is characterised by robust debt protection metrics (gearing of 0.1x and TD/OPBDITA of 1.0x as on September 30, 2021). The company continued to maintain its negative net debt position with strong cash and cash equivalents of ~Rs 800 crore at consolidated level as on March 31, 2022. While the company witnessed decline in revenues and margins in 9M FY2022, the launch of gRevlimid in the US along with some new launches (gAfinitor, gZortress in the US and gRevlimid in Canada) is expected to buttress the margins, going forward.

[1] US FDA - U.S. Food and Drug Administration

Credit challenges

High product concentration – The company derived majority of its US formulation revenues from gCopaxone, gDoxil, gFosrenol, gTykerb, gAfinitor and gZortress (launched in Q3 FY2022) in FY2022. Going forward, the product concentration risk is expected to continue with the latest launch of gRevlimid in the US during March 2022. The top five products accounted for ~50% of the company's domestic formulations business. While the concentration has reduced over the years, the same continues to remain high. Going forward, it is expected to ease gradually with new launches in the oncology / C&D segments.

Increasing competition in key markets – The increasing competition, impact of price controls along with adverse impact of the pandemic led to contraction in Natco's revenues from the domestic market in 9M FY2022. While the company derived significant revenues from gTamiflu in the past in the international formulations segment, the US retail market is no longer a meaningful opportunity for the company with the entry of many generics leading to significant price erosion. Further, at least three generic players would enter the gRevlimid market (current market size of ~$8.5-9 billion) in the US, which would lead to price erosion, thereby impacting the overall market size of the drug. New entrants, pricing pressure and intense competition in the company's Para IV portfolio are expected to have a bearing on its revenues and margins going forward.

High working capital intensity – As Natco expands its product portfolio, it needs to maintain a certain level of inventory to optimise its production schedule and minimise switchover costs at plants which manufacture multiple APIs or formulations. The company has significant inventory stocked for Covid-19 portfolio and CTPR, which increased the inventory days to 275 days as on September 30, 2021 from ~200 days in the past. While CTPR inventory is expected to be liquidated post its estimated launch, Natco is expected to write-off the Covid-19 related inventory in the near term. With a growing product portfolio (which requires higher level of inventory to be maintained) and increasing focus on markets like Brazil, Canada, South East Asia and China (which generally have a higher receivables period than the domestic segment), Natco's working capital requirements will remain high, going forward.

Exposure to regulatory risks – Akin to other industry players, Natco is exposed to increasing regulatory scrutiny, compliance costs and risks associated with the same. However, ICRA notes that there has been no significant impact on the company in the past due to regulatory risks and it has launched complex generics with high entry barriers in the US market.

Liquidity position: Strong

The company's liquidity position is **strong,** characterised by consolidated cash and cash equivalents of ~Rs 800 crore as on March 31, 2022. In addition, the company had undrawn working capital limits of Rs. 372.2 crore as on February 28, 2022. There are no long-term debt obligations as on date. Natco is expected to incur capex of ~Rs. 200 crore per annum on maintenance capex and expansion, going forward. ICRA expects Natco to meet its capital commitments through existing cash reserves and internal cash accruals. Any significant debt-funded acquisition impacting its liquidity position remains an event risk and would be evaluated on a case-by-case basis.

Rating sensitivities

Positive factors – A significant improvement in the company's product diversification, given its focus on a few critical molecules, and a scale-up in its revenues with continued robust debt protection metrics and liquidity would be a positive trigger.

Negative factors – Pressure on Natco's ratings could arise if there is a deterioration in the margins or if debt-funded capex or acquisitions or regulatory measures lead to the weakening of the company's credit profile with Net Debt/OPBDITA>1.25x on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Pharmaceutical Industry
Parent/Group Support	NA
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financial statement of Natco.

About the company

Natco is a medium-sized pharmaceutical company, which develops, manufactures and markets formulations and APIs. Founded in 1981, Natco has emerged as an established pharmaceutical company with a presence in formulations and APIs in both domestic and export markets. The company owns eight manufacturing facilities and the Natco Research Centre in Hyderabad. Its formulations units in Kothur (Telangana) and Visakhapatnam (Andhra Pradesh) and API facilities in Chennai and Mekaguda (Telangana)are approved by the authorities of regulated markets, including the US FDA. The company had also set up an agrochemicals facility in Nellore (Andhra Pradesh) to diversify its portfolio. As an early entrant with strong R&D capabilities, Natco has established itself as a leading player in the oncology segment in India. In addition, it generates a sizeable proportion of its formulations business from exports. It enjoys a presence in the generics business in the regulated markets of North America and Europe and branded generics in the rest of the world (RoW). As on December 31, 2021, 48.86% of the company's shareholding was held by the promoter group, with the rest held by various institutions and the public.

Key financial indicators (audited)

Natco Consolidated	FY2020	FY2021	9M FY2022*
Operating Income (Rs. crore)	1,915.0	2,052.1	1,348.0
PAT (Rs. crore)	458.1	442.4	220.5
OPBDITA/OI (%)	30.4%	29.5%	20.9%
PAT/OI (%)	23.9%	21.6%	16.4%
Total Outside Liabilities/Tangible Net Worth (times)	0.2	0.2	NA
Total Debt/OPBDITA (times)	0.6	0.5	0.8
Interest Coverage (times)	27.1	45.6	25.6

**Provisional; NA: Not Available; PAT: Profit after Tax; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation; All ratios are as per ICRA calculations*

Source: Company and ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Dec 31, 2021 (Rs. crore)	Date & Rating	Date & Rating In FY2022	Date & Rating In FY2021	Date & Rating in FY2020	
					April 28, 2022	April 29, 2021	-	Mar 23, 2020	Apr 04, 2019
1	Fund Based Limits	Long Term	866.50	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Fund Based/ Non-fund Based Limits	Long Term /Short Term	155.00	-	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	-	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+
3	Non-fund Based Limits	Short Term	85.00	-	[ICRA]A1+	[ICRA]A1+	-	[ICRA]A1+	[ICRA]A1+
4	Unallocated Limits	Long Term /Short Term	43.50	-	[ICRA]AA (Stable) / [ICRA]A1+	[ICRA]AA (Stable) / [ICRA]A1+	-	[ICRA]AA (Stable) / [ICRA]A1+	[ICRA]AA (Stable) / [ICRA]A1+
5	Commercial Paper	Short Term	400.00	-	[ICRA]A1+	[ICRA]A1+	-	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund Based Limits	Simple
Fund Based/ Non-fund Based Limits	Simple
Non-fund Based Limits	Very Simple
Unallocated Limits	Simple
Commercial Paper	Very 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 are available on ICRA’s 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	Long-term Fund-based Working Capital	NA	NA	NA	866.50	[ICRA]AA(Stable)
NA	Long Term/Short Term – Fund-based/Non-fund Based Working Capital	NA	NA	NA	155.00	[ICRA]AA(Stable)/[ICRA]A1+
NA	Short-term Non-Fund Based Working Capital	NA	NA	NA	85.00	[ICRA]A1+
NA	Long-term/ Short-term Unallocated	NA	NA	NA	43.50	[ICRA]AA(Stable)/[ICRA]A1+
Not placed	Commercial Paper	NA	NA	NA	400.00	[ICRA]A1+

Source: *Company*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
NATCO Pharma, Inc.	100.00%	Full Consolidation
Time Cap Overseas Limited	100.00%	Full Consolidation
NATCO Farmo Do Brazil Ltda	100.00%	Full Consolidation
NATCO Pharma (Canada), Inc.	99.04%	Full Consolidation
NATCO Pharma Asia Pte. Ltd.	100.00%	Full Consolidation
NATCO Pharma Australia PTY Ltd.	100.00%	Full Consolidation
NATCO Lifesciences Philippines Inc	100.00%	Full Consolidation

Source: *Company annual report; As on March 31, 2021*

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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.

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.

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