

September 16, 2022

## Unichem Laboratories Limited: Rating downgraded; outlook revised to Stable from 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	176.00	176.00	[ICRA]A- (Stable) downgraded from [ICRA] A (Negative); Outlook revised to Stable from Negative
<b>Total</b>	<b>176.00</b>	<b>176.00</b>	

\*Instrument details are provided in Annexure-I

### Rationale

The rating downgrade takes into account the pressure on Unichem Laboratories Limited's (Unichem) margins as evident from the deterioration in profitability levels in FY2022 over FY2021 as well as Q1 FY2023 due to ongoing pricing pressures in its key export market (USA) leading to net losses on a consolidated basis in Q1 FY2023. The losses at the standalone level in FY2022 as well as in Q1 FY2023 remains higher, given the high fixed cost manufacturing base in India compared to its subsidiaries. Given the impact on the profitability levels, the coverage indicators too moderated in FY2022 and are expected to be under pressure in FY2023 as well, owing to continuing pressure on margins and incremental long-term borrowings availed in FY2022 for capex. ICRA also notes that the company is in the midst of a sizeable capex programme and has undertaken capex to the tune of ~Rs. 811.6 crore during the last three fiscals and is expected to further undertake close to Rs. 68-crore capex in FY2023. Though a large part of the capex is expected to commercialise in FY2023 and the rest in FY2024, commensurate returns from the same in terms of scaling up of operations, profits and return on capital employed remain key monitorables for its credit profile, going forward. It is also to be noted that with operationalisation of its Ghaziabad plant, the inventory levels had gone up in FY2021, which remained elevated in FY2022, leading to high working capital intensity of operations. ICRA, however, draws comfort from adequate liquidity profile as characterised by free cash and liquid investments to the tune of Rs. 109.2 crore as on March 31, 2022, which moderated from Rs. 277.5 crore as on March 31, 2021, on account of capex and incremental working capital. The liquidity is also supported by buffer available in working capital limits and the expected inflow of Rs. 270 crore from its stake sale in Optimus Drug Pvt. Ltd. in Q1 FY2023.

After hiving 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.

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, the outcome is still awaited. The same continues to be under contingent liability to the extent of Rs. 118 crore as of end FY2022, and the auditor has qualified its opinion to provision the same as per auditor comments in FY2022. However, as per the management, given the status quo in terms of outcome of the appeal, no such provision was provided. Any unfavourable outcome on this matter remains critical from a credit perspective, given the large value at dispute.

## 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. It was founded by Dr. Mody's 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 postgraduate from the University of Mumbai and an Alumni of Harvard Business School. The promoters have over seven decades of experience in the pharmaceutical sector spanning formulations as well as active pharmaceutical ingredient (API) businesses. 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.

**Backward integrated capabilities to support in-house formulations manufacturing, going forward** – 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. Unichem's extensive experience in APIs and formulations as well as its cost advantage from 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. ICRA also notes the company's clean track record with respect to regulatory inspections.

### Credit challenges

**Pricing pressures on export markets leading to decline in margin and coverage metrics in FY2022; same continues in current fiscal, reflecting near term margin pressure** – The company reported moderation in operating margin to 6.3% in FY2022 from 7.4% in FY2021, on a consolidated basis, due to pricing pressures in its key generics market in the US, which command a sizeable revenue share. The pressure continues in the current fiscal, with sharp dip in margins in Q1 FY2023, leading to losses on a consolidated basis. Coupled with moderation in margin, Unichem also took incremental long-term borrowings to the tune of Rs. 115 crore towards the end of FY2022, which impacted the debt coverage metrics in FY2022 and is likely to keep coverage indicators under check in FY2023 too. Material recovery in margins in the medium term on a sustained basis, to improve the financial profile on an overall basis, will remain a key monitorable.

**Capability to efficiently manage and generate returns from enhanced capacities remains critical from credit perspective** – 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. 811 crore over FY2020–FY2022 and expects to incur an additional capex of ~Rs. 68 crore in FY2023. The capex has been funded by a term loan of Rs. 125 crore and the rest through its internal accruals. Due to these ongoing investments in capacity addition, the return on capital employed has remained subdued at 2.6% and 1.3% in FY2021 and FY2022, respectively. The facilities are expected to be commercialised in FY2023. The company's 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 critical from a credit perspective.

**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 79% as of FY2022 end on a consolidated basis. On a consolidated level, the inventory days increased to 230 days in FY2022 from 219 days in FY2021 and 162 days in FY2020, due to inventory build-up post operationalisation of its Ghaziabad plant. Given large capacities coming online in the current fiscal, inventory levels are expected to remain elevated and will be one of the key monitorables in terms of turnaround, going forward.

## Liquidity position: Adequate

The liquidity position remained adequate with investments and free cash and equivalents of ~Rs. 109 crore as on March 31, 2022, on a consolidated basis. It also had cushion available in the form of undrawn working capital limits, wherein limits of Rs. 207 crore at the standalone level were utilised on an average of 9.91% for the past 15 months ended June 2022. The company has repayment obligations to the tune of ~Rs. 26 crore p.a., which are expected to be adequately covered by the liquidity available on Unichem's books, coupled with cash accruals. It is also expected to receive Rs. 270 crore in the near term from its stake sale in Optimus Drugs Private Limited in Q1 FY2023, which is expected to support its working capital needs and debt repayments, as well as act as a cushion in case of any exigencies.

## Rating sensitivities

**Positive factors** – The rating can be upgraded if there is a significant increase in scale and material improvement in profitability, while maintaining a healthy liquidity position on a sustained basis, leading to sustainable improvement in coverage metrics.

**Negative factors** – Unichem's rating could be further downgraded if the company fails to scale up from present levels and generate adequate returns from the recently concluded large capex, thereby impacting the financial profile. Any significant deterioration in Unichem's liquidity profile or 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 June 30, 2022, 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*	FY2022
Operating income	1103.7	1235.1	1270.0
PAT	-61.0	34.7	34.1
OPBDIT/OI	-4.5%	7.4%	6.3%
PAT/OI	-5.5%	2.8%	2.7%
Total outside liabilities/Tangible net worth (times)	0.2	0.2	0.3
Total debt/OPBDIT (times)^	NM	1.3	4.4
Interest coverage (times)	NM	17.9	13.2

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ^Includes Lease Liability; \*as per INDAS; NM-Not Meaningful, amount Rs in crores

**Status of non-cooperation with previous CRA: Not applicable**

**Any other information: None**

### Rating history for past three years

Instrument	Type	Current Rating (FY2023)		Chronology of Rating History for the past 3 years				
		Amount Rated (Rs. crore)	Amount Outstanding as of Sept 12, 2022 (Rs. crore)	Date & Rating in FY2022		Date & Rating in FY2021		Date & Rating in FY2020
				Sept 16, 2022	Nov 25, 2021	Jan 22, 2021 Jan 07, 2021	Jul 06, 2020	Dec 30, 2019
1 Fund based/ Non fund based	Long-term	176.0	-	[ICRA]A-(Stable)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Negative)	[ICRA]A (Negative)
2 Commercial paper programme	Short term	-	-	-	-	-	[ICRA]A1; withdrawn	[ICRA]A1

### Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term Fund based/Non-fund Based facilities	Simple/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](http://www.icra.in)

### Annexure I: 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-(Stable)

Source: Company

### Annexure II: 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

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