

## Unichem Laboratories Limited

September 18, 2018

### Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term, Fund-based / Non-fund Based Facilities	-	30.0	[ICRA]A+ (Stable); Assigned
Commercial Paper Programme	15.0	15.0	[ICRA]A1+; Outstanding
<b>Total</b>	<b>15.0</b>	<b>45.0</b>	

\*Instrument details are provided in Annexure-1

### Rating action

ICRA has assigned a long-term rating of [ICRA]A+ (pronounced ICRA A plus)<sup>1</sup> to the Rs. 30.0-crore<sup>2</sup> fund-based / non-fund based facilities of Unichem Laboratories Limited (Unichem or the company). The outlook on the long-term rating is Stable. ICRA also has a short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) outstanding on the Rs. 15.0-crore commercial paper programme of the company.

### Rationale

The assigned rating takes into account the robust liquidity position of the company as characterised by cash and bank balance and liquid investments of Rs. 1,577 crore as on March 31, 2018. This position followed the post-tax cash inflow of Rs. 2,665 crore from the sale and transfer of its formulations business in India and Nepal to Torrent Pharmaceuticals Limited during November 2017. Of this cash inflow, the company has used ~Rs. 886 crore towards buyback of shares in FY2018.

Post having off its core business of domestic formulations, which contributed ~55% to its consolidated revenues in FY2017, Unichem's continuing business now comprises its international formulations, contract research and manufacturing services (CRAMS) and active pharmaceutical ingredients (API) businesses. While the demerger has resulted in a decline in the topline of the company, it is expected to sharpen Unichem's focus on the international formulations business. The cash flows from the sale of the domestic formulations business are expected to fund Unichem's investments in the US markets, which has grown at a healthy rate, albeit on a low base. Unichem has enhanced its focus on the US market, which is supported by the ongoing capacity expansions of its manufacturing facilities, majority of which are approved by the United States Food and Drug Administration (USFDA), and its growing number of abbreviated new drug application (ANDA) filings. The company is also expected to ramp up its research and development (R&D) investments to build a pipeline of complex and niche products, from which it expects to earn relatively higher returns than what it earns from the domestic market.

<sup>1</sup> For complete rating scale and definitions, please refer to ICRA's website [www.icra.in](http://www.icra.in) or other ICRA Rating Publications

<sup>2</sup> 100 lakh = 1 crore = 10 million

Unichem's financial profile is strong at present, with low debt levels on a consolidated basis and robust liquidity. However, the company is expected to continue to report operating losses (post expensing the entire R&D spend) over the next two-three years until the international formulations business scales up, especially amid pricing pressures in the US due to distribution channel consolidation. Besides the US market, Unichem's operations in the emerging markets are yet to achieve a meaningful size. Furthermore, the company has sizeable capital expenditure plan of ~Rs. 500 crore over FY2019 and FY2020. ICRA believes the current robust liquidity should be adequate for funding the company's investments and losses in the near term.

The assigned rating also factors in the ongoing litigation in the European Union (EU) courts, with respect to the fine of € 13.9 million imposed by the European Commission for an alleged collusion with a French company. An unfavourable outcome would impact the financial profile of Unichem. However, the current cash surplus would help fund the same. Furthermore, ICRA notes the receipt of four observations from the USFDA in respect of its active pharmaceutical ingredients (API) manufacturing facilities at Pithampur (Madhya Pradesh) and Roha (Maharashtra). These facilities manufacture APIs for use in the manufacturing of formulations that are exported by the company to the US markets. ICRA takes comfort from the management indication that these observations are not critical and do not impact the continuity of the company's business. ICRA would monitor the developments in this regard.

## Outlook: Stable

ICRA believes the company will benefit from its extensive manufacturing experience and integrated operations that will help fuel the growth of its international business. The company also has a strong liquidity position. The outlook may be revised to Positive if the company is able to substantially scale up its business with an improvement in profitability. The outlook may be revised to Negative if the company is unable to generate adequate returns from its capital expenditure and R&D investments. An unfavourable outcome with respect to the fine imposed by the European Commission or any regulatory non-compliances with the USFDA would also be a negative.

## Key rating drivers

### Credit strengths

**Robust financial profile characterised by strong liquidity position and low debt** – On a consolidated basis, the company had a sizeable balance of cash and liquid investments of Rs. 1,577 crore and a relatively low debt of Rs. 150.7 crore, as of March 31, 2018. ICRA believes the current robust liquidity should be adequate for funding the company's capital expenditure and R&D investments and losses in the near to medium term.

**Enhanced focus on the growing international business** – Post sale of its domestic formulations business, the company has enhanced its focus on its international formulations business, especially its 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 APIs and formulations and its cost advantage due to backward integration is a positive factor, especially amid the current pricing pressures in the US market.

### Credit challenges

**Capability of the company to efficiently manage and generate returns from the enhanced capacities** – The company has been incurring considerable capital expenditure to enhance its manufacturing capacities and has been investing in its R&D capabilities to capitalise on certain identified opportunities. Furthermore, the company has a sizeable capital expenditure plan of ~Rs. 500 crore over FY2019 and FY2020. The ability of the company to efficiently manage such investments, resulting in breakeven at the operating level, remains to be seen. This is a key rating sensitivity.

**Company to continue to report operating losses in the near term** – Substantial investments in R&D and increased overheads due to on-going capacity expansions, coupled with pricing pressure in the US markets due to distribution channel consolidation, will 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) over the next two to three years until the international formulations business scales up. 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 net losses at present. This could be attributed to the high competitive pressures and 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.

**Analytical approach:** For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

**Links to applicable criteria:**

[Corporate Credit Rating Methodology](#)

[Rating Methodology for Pharmaceutical Industry](#)

### **About the company:**

Unichem Laboratories Limited is an integrated pharmaceutical company, headed by Dr. Prakash Mody. It was founded by Dr. Prakash Mody's father, the late Mr. Amrut Mody, in 1944. As on June 30, 2018, 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 pharmaceuticals formulations business, which contributed almost 55% to 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. 3,500 crore. Post the above business sale, Unichem now has formulations manufacturing facilities at Goa, Baddi (Himachal Pradesh) and Ghaziabad (Uttar Pradesh); while for APIs, it has manufacturing facilities at Roha (Maharashtra), Pithampur (Madhya Pradesh) and Kolhapur (Maharashtra).

### Key financial indicators (audited, consolidated)

	FY2017	FY2018
Operating Income (Rs. crore)	697.7	818.0
PAT (Rs. crore)	108.5	2545.1
OPBDIT/OI (%)	-5.8%	-16.1%
RoCE (%)	11.8%	144.2%
Total Debt/TNW (times)	0.1	0.1
Total Debt/OPBDIT (times)	-2.4	-1.1
Interest coverage (times)	-12.1	-16.5

For the three months ended June 2018, Unichem (standalone) reported a net loss of Rs. 20.7 crore on an operating income of Rs. 201.4 crore.

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

### Any other information: None

### Rating history for last three years:

		Current Rating (FY2019)			Chronology of Rating History for the Past 3 Years					
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding* (Rs. crore)	Date & Rating		Date & Rating in FY2018			Date & Rating in FY2017	Date & Rating in FY2016
				September 2018	June 2018	November 2017	August 2017	May 2017	May 2016	
1 Fund-based / Non-fund Based Facilities	Long-term	30.0	-	[ICRA]A+ (Stable)	-	-	-	-	-	-
2 Commercial Paper Programme	Short-term	15.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+&	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-

\*As on June 30, 2018; &: on rating watch with developing implications

### 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 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	30.0	[ICRA]A+ (Stable)
NA	Commercial Paper Programme	NA	NA	7-365 days	15.0	[ICRA]A1+

*Source: Unichem Laboratories Limited*

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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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For more information, visit [www.icra.in](http://www.icra.in)

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