Shilpa Medicare Limited

March 22, 2019

Summary of rated instruments

Instrument*	Previously Rated Amount (Rs. crore)[1]	Current Rated Amount (Rs. crore)	Rating Action
Long-Term Fund Based Limits	20.00	100.00	[ICRA]A (Stable); Reaffirmed
Term Loans	150.00	200.00	[ICRA]A (Stable); Reaffirmed
Short-Term Fund based limits	100.00	25.00	[ICRA]A1; Reaffirmed
Short-Term Non-fund based limits	20.00	15.00	[ICRA]A1; Reaffirmed
Total	**290.00**	**340.00**	

*Instrument details in Annexure - I

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]A (pronounced ICRA A) outstanding on the Rs.100 crore (revised from Rs.20.0 crore) long-term fund-based limits and the Rs.200 crore (revised from Rs.150.0 crore) term loans of Shilpa Medicare Limited (SML / the company) The outlook on the long-term rating is Stable. ICRA has also reaffirmed the short-term rating of [ICRA]A1 (pronounced ICRA A One) outstanding on the Rs.25 crore (revised from Rs.100 crore) short-term fund based limits and the Rs.15.00 crore (revised from Rs.20 crore) short-term non-fund-based facilities of SML.

Rationale

The assigned ratings continue to consider the longstanding experience of the promoter in the industry, strong market position of the company in the oncology API segment with supplies to large pharmaceutical players both in the domestic and export markets, its healthy financial profile characterized by strong debt protection metrics (gearing of 0.1x and TD/OPBDITA of 0.8x as on September 30, 2018) and substantial cash and liquid investment balances (Rs.182.0 crore as on September 30, 2018). ICRA also notes that healthy revenue growth under the formulations segment and USFDA approvals on four ANDAs during H2 FY2019 coupled with a robust ANDA pipeline (with 20+ ANDAs pending approval) is expected to support the company's business prospects and enable diversification going forward. Further, manufacturing capabilities with facilities approved by various regulatory authorities continue to support the company's business prospects. Going forward, margins of the company are expected to remain dependent on timing of approvals for its ANDA filings and the success of its ongoing substantial investments in novel areas like bio-similars, transdermal patches and fast-disintegrating oral strip technology etc. through its subsidiaries.

The ratings are, however, constrained by SML's moderate scale of operations, high customer concentration under its API segment, high working capital intensity on account of nascent stage of operations under its formulations segment and continuous decline in revenues under the CRAMS segment given SML's recent exit from its JV company, Raichem Medicare Private Limited (RMPL). Over the last few years, SML had invested ~Rs.105 crore in a 50:50 JV with a major customer under CRAMS segment to develop a new facility for producing ursodeoxhycolic acid (for supplies to the customer). However, due to increasing uncertainty about profitability under RMPL (SML's share of cumulative losses

[1] *100 lakh = 1 crore = 10 million*

under RMPL were ~Rs.22.3 crore till Q1 FY2019), SML had decided to exit the same and is expected to receive a compensation of US$ 5mn after accounting SML's share of losses (till Q1 FY2019) to the JV partner's account, in addition to receiving the equity and debt invested in the company at actuals. Going forward, SML will have revenues of Rs.100 crore per annum for the next three years from the CRAMS segment (for the ex-JV partner) between FY2019 and FY2021.

SML intends to make up for the loss in revenues under the CRAMS segment by ramping up revenues under its non-oncology API and formulations segments over the next two-three years. ICRA also notes that the substantial unutilized capacities under the formulations and continuous investments in novel areas like bio-similars, transdermal patches and fast-disintegrating oral strip technology etc. through its subsidiaries, continue to be a drag on the company's margins. SML also has major capital expenditure plans of Rs.375 crore over the next three years towards expansion of its API and formulation facilities, investments in development of bio-similars, transdermal patches and fast-disintegrating oral strip technology etc. The aforementioned capex is expected to be funded through the company's cash balances, internal accruals in addition to term loans of Rs.100 crore. Going forward, performance of the company during the planned capex and initial stage of operations of these investments will continue to be a key credit monitorable.

Outlook: Stable

ICRA believes SML will continue to benefit from its strong market position in the API segment and its healthy financial profile. Further, with a robust pipeline of ANDA applications, the company's revenues are expected to grow over the next 2-3 years. The outlook may be revised to 'Positive' if there is an improvement in the company's financial risk profile supported by healthy growth in revenue and profitability accompanied by an improvement in its working capital intensity. The outlook may be revised to 'Negative' if cash accruals are lower than expected given the substantial capital expenditure plans of the company, or if higher than expected debt funded capex leads to deterioration of debt metrics, or if there is further stretch in the working capital cycle, leading to deterioration in its liquidity position.

Key rating drivers

Credit Strengths

- **Longstanding experience of the promoter and strong market position of the company in the API segment** – SML is a medium-size pharmaceutical company with presence in APIs, CRAMS and formulations segments. Over the years, the company has established its presence in the oncology API segment through various DMF filings and currently supplies its products to several of the large pharmaceutical companies in India and export markets. Going forward, established relationships with its customers in the API segment and forward integration into the formulations segment for more molecules is expected to support the company's business prospects.
- **Robust abbreviated new drug applications (ANDA) pipeline** – SML commenced its supplies to the US generic formulations market through launch of g-Xeloda and g-Vidaza during FY2017. The company also got approval on its ANDAs for generics dimethyl fumarate, imatinib, gemcitabine, irinotecan during H2 FY2019 and is expected to launch the same in the US market shortly. Going forward, SML's strong pipeline of 20+ ANDAs and ongoing investment in R&D are expected to support its scale-up in the US market. Further, with SML's plans to file for more oncology products under its ANDA pipeline in Europe, ramp up under the formulations segment is expected to be healthy going forward. Strong manufacturing capabilities with facilities approved by various regulatory authorities continue to support the company's business prospects.

- **Strong financial profile** – SML's financial profile is characterized by strong debt protection metrics (gearing of 0.1x and TD/OPBDITA of 0.8x as on September 30, 2018), ample liquidity (Rs.182.0 crore as on September 30, 2018), relatively high margins, and modest utilization of sanctioned working capital limits (average of 53% of sanctioned limits during the 12-month period ending December 31, 2018).

Credit Weaknesses

- **Moderate scale of operations and high customer concentration** – SML has moderate scale of operations with revenues of Rs.788.8 crore during FY2018. Further, the company's scale under the CRAMS segment is expected to decline gradually over the next few years following loss of a customer. SML also has high customer concentration with ~60% of its revenues being derived from the top three customers under the API segment (which is its major revenue generator at 53.1% of total revenues during FY2018).
- **Substantial capex plans on the anvil** – SML plans to incur a capex of Rs.375.0 crore over the next three years to expand its API and formulations capacities, invest in development and plants for production of bio-similars and transdermal patches etc. While majority of this capex is expected to be funded through the strong cash and liquid investment balances, the company proposes to take term loans of Rs.100 crore. Profitability of these new capacities post launch will be a key credit monitorable given substantial investments towards development.
- **High working capital intensity** – ICRA notes that the company's working capital intensity has increased over the last 2-3 years on account of nascent stage of operations of the formulations segment which generally entails a relatively higher receivable and inventory holding period as compared to its API business. Going forward, working capital intensity is expected to remain relatively high to support SML's entry into the US generic formulations segment.
- **Increasing regulatory scrutiny and high competitive intensity in the generic market** – Increasing scrutiny and stricter controls by regulatory authorities of developed markets have resulted in higher compliance costs for Indian pharma players in the recent past. Further, pricing pressures and intense competition in the US generic market will play an important role on both the revenue and margin trajectory of the company.

Liquidity Position:

The company currently has fund-based (FB) working capital limits of Rs.115 crore from various banks. The average fund-based working capital utilization of the company was moderate at 53.0% over the 12-month period ending December 31, 2018. The companyhas strong cash balances to the tune of Rs.182 crore as on September 30, 2018 in addition to comfortable accruals supported by healthy operating margins.

The company had term loans of Rs.92.9 crore outstanding as on March 31, 2018 and repayment for the same is ~Rs. 24.9 crore per annum during FY2019 to FY2021. In addition to the same, the company is also expected to draw down on an additional term loan of Rs.100 crore (already sanctioned) for the ongoing capex towards expansion of API and formulation capacities, R&D and development of plants for bio-similars and transdermal patches. Including the repayments of the additional loans to be availed, the company's projected accruals appear to be comfortable in comparison to the repayments indicating a strong liquidity position.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for entities in pharmaceutical industry
Parent/Group Support	NA
Consolidation / Standalone	The rating is based on consolidated financial statements of the company

About the company:

Incorporated in 1987 and listed in 1995, SML was promoted by Mr.Vishnukant Bhutada and is engaged in manufacturing of APIs, intermediates, and formulations. The company began operations as a small-scale unit involved in manufacturing antibiotics and has now become an integrated pharmaceutical company with seven manufacturing facilities (six in India and one in Austria) and two R&D centres. Its facilities are approved by USFDA, UKMHRA, EDQM, TG Australia, PMDA-Japan, KFDA-Korea, and TPD-Canada. The company currently has 1,500+ permanent employees and 1,000+ contract employees.

SML currently derives majority of its formulations revenues from the USA while the company derives API revenues from across the world including regulated markets like Europe, Japan and South Korea among others. The company has also developed the capability and facility for oncology formulations and commenced commercial production for the US market during FY2017. While the company had launched its generic version of Azacitidine and Capecitabine in the US market, the formulations segment for the US market is expected to drive value growth for the company over the medium to longer term. The company had about 24 ANDA filings as on March 31, 2018, some under its own name while some have been filed under its customers' name with the USFDA.

While Mr. Bhutada was initially supported by his family, the company raised equity through an IPO in 1994. Post the IPO, regular private equity infusion has supported the company in expanding and ramping up its revenues. Baring India Private Equity (Baring) initially invested in Shilpa Medicare in 2010 – current stake of Baring in the company is 8.72%. Tano Capital (Tano) has invested twice in the company during 2012 and 2014 – current stake of Tano in the company is 7.58%. The most recent private equity investment was by TA FII Investors Limited (TA) which had invested Rs 172.4 crore (USD 25.5 million) in the company during FY2017. Currently, TA owns about 3.71% stake in the company. The board of directors consists of nine directors with five independent directors (including nominees from Baring Private Equity Partners, Tano India Advisors Private Limited and TA Associates). Overall public shareholding (including PE players) as on December 31, 2018 stands at 46.2%.

Key financial indicators (audited) - Consolidated

Consolidated	FY2017	FY2018
Operating Income (Rs. crore)	779.2	788.8
PAT before OCI (Rs. crore)	110.6	110.1
OPBDITA/ OI (%)	22.2%	20.9%
RoCE (%)	16.8%	12.7%
Total Debt/ TNW (times)	0.2	0.2
Total Debt/ OPBDITA (times)	1.4	1.2
Interest coverage (times)	55.3	61.9

Source: the company, ICRA research; OPBDITA: Operating Profit before Depreciation, Interest and Taxes; PAT: Profit After Tax; RoCE: Return on Capital Employed; TNW: Tangible Net Worth

Status of non-cooperation with previous CRA: NA

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs.crore)	Amount Outstanding as on March 31, 2018 (Rs Crore)	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
					March 2019	January 2018	-	-
1	Fund based facilities	Long Term	100.0	98.1	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-
2	Term Loans	Long Term	200.0	92.9	[ICRA]A (Stable)	[ICRA]A (Stable)	-	-
4	Fund based facilities	Short Term	25.0	NA	[ICRA]A1	[ICRA]A1	-	-
3	Non-fund based facilities	Short Term	15.0	10.8	[ICRA]A1	[ICRA]A1	-	-

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

Annexure-1: Instrument Details

Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Long-Term Fund Based Limits	FY2016	-	-	100.00	[ICRA]A (Stable)
Term Loans	FY2016/ FY2019	8.9%	FY2022	100.00	[ICRA]A (Stable)
Short-Term Fund based limits	FY2019	-	-	25.00	[ICRA]A1
Short-Term Non-Fund based limits	FY2016	-	-	15.00	[ICRA]A1

Source: the company

Annexure-2: List of entities considered for consolidated analysis – as on March 31, 2018

Company Name	Ownership	Consolidation Approach
Zatortia Holdings Limited	100.00%	Full consolidation
Loba Feinchemie GmbH (step-down)	99.99%	Full consolidation
Shilpa Therapeutics Private Ltd	100.00%	Full consolidation
Makindus. Inc	55.78%	Full consolidation
INM Technologies Private Limited	75.00%	Full consolidation
Koanaa Healthcare Limited	100.00%	Full consolidation
Koanaa Healthcare GmbH	100.00%	Full consolidation
Reva Pharmachem Private Limited	33.33%	Equity Method
Maia Pharmaceuticals Inc.	34.79%	Equity Method
Reva Medicare Private Limited	50.01%	Equity Method
Raichem Medicare Private Limited	50.00%	Equity Method

Source: the company

ANALYST CONTACTS

Subrata Ray
+91 22 6114 3408
subrata@icraindia.com

Pavethra P
+91 44 4596 4314
pavethrap@icraindia.com

Mythri Macherla
+91 44 43326407
mythri.macherla@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999