Natco Pharma Limited

April 04, 2019

Summary of rated instruments

Instrument*	Previously Rated Amount (Rs. crore)[1]	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	100.00	-	-[2]
Long-Term Fund based limits	666.50	876.50	[ICRA]AA (Stable); Reaffirmed
Long-Term / Short-Term - Fund based/Non- Fund-based	50.00	14.00	[ICRA]AA (Stable)/A1+; Reaffirmed
Short-Term Non-fund-based limits	110.00	116.00	[ICRA]A1+; Reaffirmed
Long-Term / Short-Term Unallocated	73.50	93.50	[ICRA]AA (Stable)/A1+; Reaffirmed
Commercial Paper	200.00	400.00	[ICRA]A1+; Reaffirmed
Total	**1,200.00**	**1,500.00**	

*Instrument details in Annexure - I

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA (pronounced ICRA double A) outstanding on the Rs.876.50 crore (revised from Rs.666.50 crore) fund-based facilities, Rs.14.00 crore (revised from Rs.50.00 crore) Long-Term / Short-Term - Fund based/Non Fund Based facilities and Rs.93.50 crore (revised from Rs.73.50 crore) Long-Term / Short-Term unallocated facilities of Natco Pharma Limited (NPL / 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 plus) outstanding on the Rs.14.00 crore (revised from Rs.50.00 crore) Long-Term / Short-Term - Fund based/Non Fund Based facilities, the Rs.116.00 crore (revised from Rs.110.00 crore) non-fund-based facilities, the Rs.93.50 crore (revised from Rs.73.50 crore) Long-Term / Short-Term unallocated facilities of Natco Pharma Limited and the Rs.400.0 crore (revised from Rs.200.00 crore) commercial paper programme of the company.

Rationale

The reaffirmation in ratings considers NPL's strong financial profile characterized by healthy operating margins (42.5% during FY2018 and 39.4% during 9m FY2019), robust debt protection metrics (gearing of 0.1x and TD/OPBDITA of 0.3x as on September 30, 2018) and strong cash and liquid investment balances of approximately Rs.1,300 crore as on September 30, 2018. ICRA notes that healthy revenues and profit share from the generic versions of Tamiflu (Innovator - Hoffman La-Roche Inc.), Copaxone (Innovator - Teva Pharmaceuticals Industries Inc.) and, Liposomal Doxorubicin (Innovator - J&J) supported the company's revenue growth, margin improvement and healthy cash accruals during FY2018 and 9m FY2019. The ratings also continue to factor in the longstanding experience of the promoters, NPL's strong market position in the domestic oncology and Hep-C segments, its focused strategy on expanding presence in regulated markets driven by a portfolio of limited competition and complex molecules, and its backward integrated nature of

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

[2] *ICRA had rating outstanding of [ICRA]AA (Stable) on Rs.100 crore term loans of NPL earlier. This has currently been revised to nil.*

operations with strong capabilities in active pharmaceutical ingredient (APIs) manufacturing supporting its business prospects. Going forward, NPL's robust Abbreviated New Drug Application (ANDA) pipeline in addition to investments currently being made by the company to diversify into newer geographies like Brazil, Canada, South East Asia and China are expected to support its revenue growth.

Over the next two years, NPL's revenues are expected to remain largely flat because of sharp decline in gTamiflu revenues due to entry of multiple players getting approvals over the last two years and shrinkage of the domestic Hep-C market due to reduction in patient base. The ratings also factor intense competition and pricing pressures in both the domestic and US markets. Further, with a growing product portfolio and increasing focus on markets outside India, NPL's working capital requirements are expected to remain high going forward.

While Mylan (Natco's marketing partner)'s market share for Copaxone has increased over the last two quarters, with the entry of a third generic player expected to happen in CY2019, revenues and margins from gCopaxone will be a key credit monitorable for the company. While the company's ongoing capex programme (NPL has incurred capex of Rs.426 crore and Rs.222.5 crore during FY2018 and H1 FY2019) is expected to support capacity and capability enhancement, ICRA will continue to monitor the effect of the same on the company's financial profile. NPL had recently announced foray into the agro-chemical space and is likely to spend ~Rs.150 crore over the next one-two years and will manufacture both agro-chemical technical and formulations products. Performance of the same will be a key credit monitorable given the significant upfront investments in the business. Additionally, increasing scrutiny by the US FDA, compliance costs and risks associated with the same will be key rating sensitivities going forward.

Outlook: Stable

ICRA believes that NPL will continue to benefit from its strong market position in the domestic oncology and Hep-C segments, robust ANDA pipeline and growing presence in other international markets. The outlook may be revised to 'Positive' if higher than expected revenue growth and profitability strengthens the financial risk profile. The outlook may be revised to 'Negative' if cash accruals are lower than expected, or if higher-than-expected capital expenditure or further stretch in working capital cycle weakens the company's liquidity position.

Key rating drivers

Credit Strengths

- **Strong market position in the domestic oncology and Hep-C segments –** NPL has a strong market share in the domestic oncology and Hep-C segments. By virtue of being an early entrant, regular product introductions and competitive pricing in the aforementioned segments, NPL has managed to establish a strong presence in the domestic formulations market. The company has also launched a Cardiology & Diabetology division during FY2016. While revenue contribution from the same is not significant currently, the same is expected to provide diversification and revenue growth benefits to the company over the longer term.
- **gCopaxone (40mg) to support margins and revenues in the immediate future –** Approval and immediate launch of limited competition and complex generic version of Copaxone (40 mg) during October 2017 in addition to healthy volumes from gTamiflu had supported the company's revenues and margins during FY2018 and 9m FY2019. However, timing of approval and launch of competitor products in gCopaxone and consequent effect of the same on Mylan's market share will play an important role in both revenue and margin trajectory of the company going forward.

- **Strong R&D and manufacturing capabilities –** NPL has strong R&D capabilities and track record of building limited competition and difficult-to-develop molecules for regulated markets with focus on U.S. generics. During FY2018 the company invested ~7.6% of its revenues in R&D; strong manufacturing capabilities in addition to backward integration into API manufacturing also continue to support the company's revenues under the US generics segment.
- **Strong financial profile –** NPL's financial risk profile is characterized by healthy operating margins (42.5% during FY2018 and 39.4% during 9m FY2019), robust debt protection metrics (gearing of 0.1x and TD/OPBDITA of 0.3x as on September 30, 2018) and strong cash and liquid investment balances of approximately Rs.1,300 crore (NPL had raised Rs.915 crore during December 2017 through a QIP) as on September 30, 2018.

Credit Weaknesses

- **High revenue concentration on gTamiflu during FY2018 and gTamiflu and gCopaxone during 9m FY2019; steep decline in gTamiflu sales for NPL expected to affect revenue growth during FY2020 –** After witnessing robust growth of 93.8% during FY2017 on the back of gTamiflu in the US market, the company's revenue growth declined to 8.1% during FY2018. This was largely on account of the base of FY2017 and absence of sizable launches in the US market post gTamiflu and gCopaxone (where market share gains have been slow). Going forward, till launch of limited quantities of gRevlimid (with market size of US$ 6 bn and upwards) in March 2022 in the US market, the company's revenue growth momentum is expected to remain low. That said, the company's efforts to monetize its existing portfolio in other geographies like Brazil, Canada, South East Asia and China in addition to its established position in the domestic formulations market is expected to support the company's revenue growth to a certain extent going forward.
- **Sizeable capital expenditure plans –** The company had incurred capital expenditure to the tune of Rs.426 crore during FY2018 and is estimated to incur Rs.400 crore by end of FY2019; major parts of these spends are towards setting up a greenfield oral solids facility in Visakhapatnam (expected to begin commercial operations from FY2020) and upgradation of the company's API facilities. Capital expenditure is expected to be in the range of Rs.300-400 crore per annum for FY2020 and FY2021 as well. While this is expected to support capacity and capability enhancement of the company in addition to its foray into agrochemical space, ICRA will continue to monitor effect of the same on the company's financial profile.
- **Increasing competitive intensity across key markets –** Growing competition in the domestic market in both Hep-C and oncology space could pose concerns for NPL in maintaining growth momentum in the domestic market; pricing pressures and intense competition in the US generic market.
- **High working capital intensity –** As NPL expands its product portfolio, it needs to maintain a certain level of inventory to optimize production schedule and minimize switch-over costs at plants which manufacture multiple APIs or formulations. Thus, with a growing product portfolio, and increasing focus on markets like Brazil, Canada, South East Asia and China (which generally have a higher receivable period than the domestic segment), ICRA expects NPL's working capital requirements to remain high going forward.
- **Increased regulatory scrutiny –** While the recent NPPA circular bringing 42 non-scheduled cancer drugs under price control by capping their trade margin at 30% is not expected to significantly affect the company's margins, increasing regulatory interference and potential price erosion upon inclusion of key drugs under National List of Essential Medicines (NLEM) could lead to pressure on earnings in the domestic formulations business over the near-to-medium term. Similarly, increasing regulatory scrutiny by the US FDA, compliance costs and risks associated with the same will be a key rating sensitivity going forward.

Liquidity Position:

The company currently has fund-based (FB) working capital limits of Rs.240 crore from consortium banks. The average fund-based working capital utilization of the company was moderately low at 33.4% over the 12-month period ending February 28, 2019. In addition to the aforementioned limits, the company also regularly places CPs and utilizes Working Capital demand loan (WCDL) to enjoy interest rate benefit. Currently, the company has two outstanding CPs of Rs.65 crore and Rs.50 crore each which have been placed at 7.58% and 7.6% respectively. NPL does not have any outstanding term loans as on date.

NPL had raised Rs.915 crore during December 2017 through a QIP subsequent to which the company had strong cash balances to the tune of ~Rs.1,300 crore as on September 30, 2018 in addition to comfortable accruals supported by healthy operating margins indicating a strong liquidity position. In terms of usage of cash, the company has an ongoing buyback of Rs.250 crore (which started in November 2018 and will close in May 2019) wherein it has decided to pay up to Rs.1,000 per equity share (face value of Rs.2 each). As on February 28, 2019, the company had bought back 44.5% of the targeted amount of buyback of Rs.250 crore. NPL plans to fund its ongoing capital expenditure for building its Visakhapatnam plant and upgrading its API facilities in addition to maintenance capex across plants through its healthy cash balances and robust operating accruals.

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:

NPL is a medium-sized pharmaceutical company engaged in developing, manufacturing and marketing formulations and active pharmaceutical ingredients (APIs). Founded in 1981, NPL has emerged as an established pharmaceutical company with presence in formulations, and APIs across both domestic and export markets. The company owns seven manufacturing facilities, and one upcoming facility, and a Natco Research Centre for R&D in Hyderabad. The company’s formulation unit in Kothur and API facilities at Chennai and Mekaguda are approved by authorities of regulated markets including US FDA. The company’s R&D activities are focused on a) synthetic chemistry, b) novel drug delivery mechanism and c) development of new chemical entities. The company is currently setting up an oral solid dosages facility in Vishakhapatnam.

By virtue of being an early entrant and with strong R&D capabilities, NPL has established itself as a leading player in the oncology and more recently, Hep-C segments in India. In addition, it also generates sizeable proportion of its formulations business from exports with presence in generics business in regulated markets of North America and Europe and branded generics in RoW.

Key financial indicators (audited) - Consolidated

Consolidated	FY2017	FY2018
Operating Income (Rs. crore)	2,020.2	2,184.8
PAT (Rs. crore)	484.9	695.2
OPBDITA/ OI (%)	34.4%	42.5%
RoCE (%)	47.8%	42.0%
Total Debt/ TNW (times)	0.1	0.1
Total Debt/ OPBDITA (times)	0.3	0.2
Interest coverage (times)	37.5	60.3

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:

			Current Rating (FY2020)			Chronology of Rating History for the past 3 years			
			Amount Rated (Rs. crore)	Amount O/s (Rs. Crore)	Date & Rating	Date & Rating In FY2019	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
	Instrument	Type			April 2019	Apr 2018	Jul 2017	Feb 2017	Dec 2015
1	Fund based facilities	Long Term	876.50	NA	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)
2	Fund based/ Non-fund-based limits	Long Term /Short Term	14.00	NA	[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	116.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Proposed Limits	Long Term /Short Term	93.50	-	[ICRA]AA (Stable) / [ICRA]A1+	[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+	[ICRA]A1+
6	Term Loans	Long Term	100.00	NA	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)

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
Fund based facilities	NA			876.50	[ICRA]AA(Stable)
Fund based/ Non-fund-based limits				14.00	[ICRA]AA(Stable)/ [ICRA]A1+
Non-fund-based limits				116.00	[ICRA]A1+
Proposed Limits				93.50	[ICRA]AA(Stable) / [ICRA]A1+
Commercial Paper				400.00	[ICRA]A1+

Source: the company

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

Company Name	Ownership	Consolidation Approach
NATCO Pharma, Inc.	100.00%	Full consolidation
Time Cap Overseas Limited	89.81%	Full consolidation
NATCO Farmo Do Brazil	88.30%	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

Source: the company

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