September 13, 2019

Syngene International Limited: [ICRA]AA (Positive) and [ICRA]A1+ ratings reaffirmed for bank lines

Summary of rated instruments

Instrument*	Previously Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term loans (External Commercial Borrowings)	660.00	606.60	[ICRA]AA (Positive) reaffirmed
Long-term unallocated	235.50	-	-
Long-term/short-term fund based	64.50	-	-
Long-term/short-term unallocated	-	353.40	[ICRA]AA (Positive) and [ICRA]A1+ reaffirmed
Total	**960.00**	**960.00**	

**Instrument details in Annexure – I*

Rationale

The Positive outlook considers Syngene International Limited's (Syngene) strong performance in FY2019 and its healthy business prospects over the medium term. Syngene's operating income (OI) grew by 28.3% year on year (YoY) in FY2019 to Rs. 1,825.6 crore aided by steady growth across all verticals. In the dedicated R&D contracts (~33% of revenues in FY2019), the company extended its collaboration with Baxter until 2024 with enhanced scope, while the dedicated R&D contracts extended with Amgen and Bristol-Myers Squibb (BMS, until 2026) in FY2018 were also streamlined, resulting in higher revenues. The company's contract renewals, deeper client engagements and new client wins (Syngene added 15 new clients in FY2019) also contributed to the topline growth. Globally, contract research organisations (CROs) are expected to benefit from the trend of pharmaceutical companies increasingly outsourcing their research activities. Further, Asian CROs are likely to have an advantageous position, given their cost competitiveness. The robust demand for CROs and Syngene's new business additions/extensions are likely to aid double-digit YoY revenue growth in the medium term. While the company already has an integrated presence across discovery and development services, the forward integration into commercial scale manufacturing through the upcoming Mangalore facility in Q4 FY2020 would diversify Syngene's operations further and strengthen its position in the drug-discovery-to-manufacture value chain.

Syngene continued to maintain its healthy profit margins, with an operating profit margin (OPM) of 29.5% (previous year (PY): 28.1%) and net margin of 18.2% in FY2019 (PY: 21.5%). The company's return on capital employed (RoCE) stood at a healthy 18.6% in FY2019 (PY: 18.1%) despite the ongoing capex. Syngene's liquidity position also remained strong with cash and liquid investments of Rs. 1,152.9 crore as on March 31, 2019 and it remained net debt negative as on the said date. Although the company has a total capex plan of ~Rs. 1,400 crore ($200 million) and repayment obligations of about Rs. 574 crore on aggregate basis for FY2020-FY2021, ICRA draws comfort from the anticipated healthy accruals from the business and the absence of any borrowings to fund this capex until FY2021. Syngene is expected to remain net debt negative until FY2021.

ICRA notes that the significant growth opportunities in the contract research space could increase competition going forward, resulting in pricing pressure and margin compression. However, the company's robust infrastructure/employee skillset, constant focus on compliance and safety, and its established client relationships are likely to mitigate competitive threats to a large extent. Akin to other industry players, the company is bound by strict regulations for clinical trials for regulated markets. Nevertheless, Syngene's legacy of zero regulatory issues in clinical trials provides comfort. Given that about 95% of its revenues are from overseas markets, Syngene's revenues and margins are susceptible to unfavourable forex movements. However, the hedging mechanism adopted by the company (hedging majority of its net exposure over the next 24 months through forwards and put/option contracts) mitigates the forex risk to an extent. Syngene also has high customer and geographic concentration currently, with 62% of its revenues in FY2019 from its top 10 customers and 73% of its revenues in FY2019 from USA.

Syngene is a subsidiary of Biocon Limited (Biocon; rated [ICRA]AA+ (Stable)/[ICRA]A1+) and contributed to 33% of the consolidated revenue and 39% of the consolidated operating profit of the latter in FY2019. Although the company does not require operational or financial support from the parent, Syngene enjoys implicit financial and operational flexibility by virtue of being Biocon's subsidiary.

Key rating drivers and their description

Credit strengths

- **Strong business profile with integrated presence across discovery and development services; forward integration into commercial scale manufacturing in pipeline** – Syngene has presence across discovery and development services for novel molecular entities. The company operates through three verticals, namely a) dedicated R&D centres for global majors like BMS, Baxter, Amgen and Herbalife; b) discovery services; and c) development and manufacturing services. Syngene will commence commercial scale manufacturing of intermediates/APIs once its upcoming facility in Mangalore is commissioned in Q4 FY2020. This is expected to diversify the company's revenue stream and strengthen its position in the drug-discovery-to-manufacture value chain.

- **Established client relationships; healthy client addition in the last one year** – The company has long-term research contracts with reputed clients like BMS, Baxter, Amgen and Herbalife. It has extended its contract with Baxter till 2024 with expanded scope in FY2019. Syngene also increased its client base by 15 customers to 331 clients in FY2019 with Artelo Biosciences and Zumutor Biologics being some of the new names. The deeper engagements and client additions provide revenue visibility for Syngene over the medium term.

- **Healthy revenue growth in FY2019; expected to continue over the medium term** – Aided by steady growth across segments, Syngene reported a strong growth of 28.3% in OI to Rs. 1,825.6 crore in FY2019 from Rs. 1,423.1 crore in FY2018. While the growth in the dedicated R&D segment was underpinned largely by the expansion of services to the existing clients, the growth in development and manufacturing services was largely driven by the strong performance of the chemical development business and traction in biologics manufacturing. The company's revenues are expected to witness double-digit growth on YoY basis over the medium term, given the anticipated healthy growth in the global contract research industry and higher growth in Asia, and Syngene's new business additions.

- **Strong financial profile** – Syngene continued to maintain its profit margins and profitability at healthy levels, with an operating profit margin (OPM) of 29.5% (against 28.1% in FY2018), net margin of 18.2% (against 21.4% in FY2018) and RoCE of 18.6% in FY2019 (18.0% in FY2018). Further, the company was net debt negative at Rs. 339.6 crore[1] as on March 31, 2019, while its interest coverage remained strong at 16.7 times for FY2019. For Q1 FY2019, the company reported operating and net margin of 28.4% and 17.1% respectively, while its interest coverage stood at 16.8 times. Syngene's margins are likely to remain healthy and the company is likely to continue to be net debt negative over the medium term.

- **Strong parentage** – Syngene is a subsidiary of Biocon Limited (rated [ICRA]AA+ (Stable)/[ICRA]A1+). The company has robust infrastructure (with ~4,600 scientists and 1.4 million sq ft of research space) and strong accruals. Thus, it does not require operational or financial support from the parent. However, Syngene enjoys implicit financial and operational flexibility by virtue of its parentage.

Credit challenges

- **Significant capex plans and repayment obligations over the next two years** – The company has a total capex plan of ~Rs. 1,400 crore ($200 million) over the next two years for its upcoming API manufacturing facility in Mangalore and other infrastructure for business expansion. Also, Syngene has aggregate repayment obligations of about Rs. 574 crore for FY2020-FY2021. However, ICRA draws comfort from the anticipated healthy accruals from the business (which are likely to support the capex and repayments) and absence of incremental debt until FY2021.

- **High customer and geographic concentration** – Syngene derived about 62% of its revenues in FY2019 from its top 10 customers and 73% of its revenues in FY2019 from USA. This exposes the company to revenue risks arising from loss of customers to competitors and region-specific challenges. However, Syngene's stated intent to gradually diversify its customer base going forward and presence of customers globally across regions provides comfort to an extent.

- **Growing competition in the contract research space** – With the industry poised for healthy growth over the next few years, several global and domestic players are increasing presence in contract research. This is likely to increase competition and pricing pressure for Syngene going forward. However, the company's robust infrastructure/employee skillset, constant focus on compliance and safety, and Syngene's established client relationships are likely to mitigate competitive threats to a large extent.

- **Regulatory risks and vulnerability to unfavourable forex movement** – Akin to other industry players, the company is bound by strict regulations for clinical trials for regulated markets. Although any deviation in the same could result in reputational risks and other penalties for the company, historical absence of regulatory issues in clinical trials provides comfort to a large extent. Also, with about 95% of its revenues from overseas markets, the company's revenues and margins are susceptible to risks arising from adverse forex movements including appreciation of rupee against dollar. However, the hedging mechanisms adopted by the company mitigate the risk to an extent.

Liquidity position: Superior

[1] Calculated as gross debt minus cash and liquid investments

Syngene's liquidity position has remained strong with positive retained cash flows and low working capital intensity in the last four years. The company had cash and liquid investments of Rs. 1,152.9 crore as on March 31, 2019. Syngene has a total tangible capex plan of ~Rs. 1,400 crore ($200 million) for its upcoming API manufacturing facility in Mangalore and other infrastructure for business expansion, over the next two years. Also, Syngene has consolidated repayment obligations of about Rs. 574 crore for FY2020-FY2021. Despite this, the company's liquidity position is expected to remain strong over the medium term, supported by its healthy accruals and absence of incremental debt until FY2021. ICRA expects Syngene to maintain its net debt negative position over the medium term.

Rating sensitivities

Positive triggers – ICRA could upgrade Syngene's ratings if the company achieves material improvement in its scale of operations and significant diversification of customer base, while maintaining its strong credit profile despite the sizeable ongoing capex.

Negative triggers – Negative pressure on Syngene's ratings could arise if its profit margins weaken; or if the company's debt increases significantly, resulting in deterioration in capital structure and coverage metrics.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Pharmaceutical Industry
Parent/Group Support	Biocon Limited (rated [ICRA]AA+ (Stable)/[ICRA]A1+) holds 70.2% stake in Syngene. Syngene enjoys implicit financial and operational flexibility by virtue of its parentage
Consolidation / Standalone	Consolidation

About the company

Syngene International Limited (Syngene), a subsidiary of Biocon Limited, is a CRO providing integrated discovery and development services for novel molecules across multiple platforms, including small molecules, large molecules, antibody drug conjugates and oligonucleotides. The company's strengths include synthetic chemistry and molecular biology. Syngene offers outsourced services to 331 global customers across biotechnology, nutrition, animal health, consumer goods and specialty chemicals including majors such as BMS, Amgen, Herbalife and Baxter, etc. Syngene has 1.4 million sq. ft. of R&D infrastructure and about 4,600 scientists currently. Syngene also incorporated a wholly-owned subsidiary, Syngene USA Inc., in the USA in FY2018 for providing marketing services to the company in the region.

Key Financial Indicators (audited)

Consolidated	FY2018	FY2019
Operating Income (Rs. crore)	1,423.1	1,825.6
PAT (Rs. crore)	305.4	331.6
OPBDIT/ OI (%)	28.1%	29.5%
RoCE (%)	18.1%	18.6%
Total Debt/ TNW (times)	0.5	0.4
Total Debt/ OPBDIT (times)	2.0	1.5
Interest coverage (times)	17.6	16.7

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2020)				Chronology of Rating History for the past 3 years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating 13-Sep 2019	Date & Rating in FY2019 31-Jul 2018	Date & Rating in FY2018 13-Apr 2017	Date & Rating in FY2017 10-Feb 2017
1	Term loans (ECB)	Long Term	606.60	›06.60 (as on Mar 31, 2019)	[ICRA]AA (Positive)	[ICRA]AA (Positive)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Long-term unallocated	Long Term	-		-			
3	Long-term/short-term fund based	Long Term/ Short Term	-		-	[ICRA]AA (Positive)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ ICRA]A1+
4	Long-term/short-term unallocated	Long Term/ Short Term	353.40		[ICRA]AA (Positive)/ [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

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loans (ECB)	FY2016	Libor + 1.2%	FY2021	606.60	**[ICRA]AA (Positive)**
NA	Long-term/Short-term unallocated	NA			353.40	**[ICRA]AA (Positive)/ [ICRA]A1+**

Source: Syngene International Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Syngene USA Inc	100%	Full consolidation
Syngene Employees Welfare Trust	100%	

Source: Syngene International Limited

ANALYST CONTACTS

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

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

Vinutaa S
+91 44 4596 4305
vinutaa.s@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