

March 23, 2020

## Natco Pharma Limited: Ratings reaffirmed; rated amount enhanced

### Summary of rated instruments

Instrument*	Previously Rated Amount (Rs. crore) <sup>1</sup>	Current Rated Amount (Rs. crore)	Rating Action
Long-Term Fund based limits	876.50	917.50	[ICRA]AA (Stable); Reaffirmed
Long-Term / Short-Term - Fund based/Non- Fund-based	14.00	105.00	[ICRA]AA (Stable)/A1+; Reaffirmed
Short-Term Non-fund-based limits	116.00	85.00	[ICRA]A1+; Reaffirmed
Long-Term / Short-Term Unallocated	93.50	42.50	[ICRA]AA (Stable)/A1+; Reaffirmed
Commercial Paper	400.00	400.00	[ICRA]A1+; Reaffirmed
<b>Total</b>	<b>1,500.00</b>	<b>1,550.00</b>	

\*Instrument details in Annexure - I

### Rationale

The reaffirmation in ratings continues to take into account Natco Pharma Limited's (NPL/the company) strong position in the domestic formulations segment with market-leading presence in the oncology and Hep-C segments, healthy ANDA pipeline complemented by strong R&D and manufacturing capabilities and strong financial profile characterized by robust debt protection metrics (gearing of 0.1x and TD/OPBDITA of 0.5x as on September 30, 2019) and strong cash and liquid investment balances of over Rs. 1,000.0 crore as on September 30, 2019. Albeit reducing (on account of increasing competition across segments), the company's operating margins continue to remain healthy (38.1% during FY2019 and 31.1% during 9m FY2020). The ratings also continue to factor in the longstanding experience of the promoters, its focused strategy to leverage its limited competition and complex molecule portfolio in newer geographies like Brazil, Canada, Australia, Singapore and China and its backward integrated nature of operations with strong capabilities in active pharmaceutical ingredient (APIs).

While healthy revenues and profit share from the generic version of Tamiflu (Innovator - Hoffman La-Roche Inc.) supported the company's revenues and margins during FY2018 and FY2019, with entry of multiple other generic players, the company has witnessed sequentially lower revenues from the same. However, steady improvement in market share and revenues from generic version of Copaxone (40mg dosage; Innovator - Teva Pharmaceuticals Industries Inc.) for Mylan (Natco's marketing partner) has supported the company's revenues and margins during FY2019 and 9m FY2020. Over the medium-term, the company's revenues and margins are expected to be supported by the launch of the generic version of Revlimid (Innovator – Celgene Corp) from FY2023. That said, competitive scenario in each molecule of its ANDA portfolio is expected to have a bearing on the company's business profile.

The ratings also take into account high product concentration wherein the company's revenues are dependent on a few molecules in the US and Hep-C portfolio in the domestic market forms a sizeable portion of the company's revenues. Consequently, Over the next two years, NPL's revenues are expected to remain largely flattish because of sharp decline in gTamiflu sales and intense competition leading to shrinkage of the domestic Hep-C market over the last few quarters.

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

While peak revenues for Natco from the Hep-C segment were around Rs. 120 crore per quarter, the same has now reduced to ~Rs. 30 crore per quarter. The ratings continue to 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 will continue to remain high going forward.

NPL had announced foray into the agrochemical space a during FY2019 and has invested close to ~Rs.150 crore towards product development and setting up a manufacturing facility in Andhra Pradesh. NPL is currently in litigation with another company over one of its products (with market size of more than Rs. 1,500 crore) under the agrochemical division. While ICRA understands that NPL can generate significant amount of revenues from this product, performance under this division 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 and effect of supply chain disruptions on account of the Corona Virus outbreak on the company's operations will be key rating sensitivities going forward.

In addition to capex of ~Rs. 875 crore during FY2018 and FY2019, the company is expected to spend an incremental Rs. 350 crore during FY2020 towards completion of its Vizag plant and setting up an agrochemical facility in Nellore in addition to investments towards capacity and capability enhancement across its plants. Further, the company is expected to spend close to Rs. 250 crore each fiscal towards regular maintenance capex.

## 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. Even while the competitive intensity under these segments has been increasing over the last few years, Natco remains one of the market leaders. The company has also launched a Cardiology & Diabetology division (C&D) during FY2016. While revenue contribution from C&D is increasing steadily, it is also expected to provide diversification and revenue growth benefits to the company over the longer term.

**Healthy ANDA pipeline lends visibility to revenues** – Approval and immediate launch of limited competition and complex generic version of Copaxone (40 mg) during October 2017 and steady gain in market share by marketing partner Mylan has supported the company's revenues and margins from the US market. 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 charting the revenue and margin trajectory of the company going forward. The launch of the generic version of Revlimid is expected to contribute to revenues and profits of the company from FY2022 and increase steadily thereafter every year. Further, the company's strategy to leverage its limited competition and complex molecule portfolio in newer geographies like Brazil, Canada, Australia and other south-east Asian countries is also expected to support the company's revenues 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 FY2019, the company invested ~9.4% 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. Further, tie-ups with leading generic players for the U.S. market mitigate the risks associated with potential litigation challenges in case of Para IV filings or at-risk launches

**Robust financial profile** – NPL's financial risk profile is characterized by healthy operating margins (albeit decreasing, margins are healthy at 33.3% during FY2019 and 31.1% during 9m FY2020), robust debt protection metrics (gearing of

0.1x and TD/OPBDITA of 0.5x as on September 30, 2019) and strong cash and liquid investment balances of more than Rs. 1,000 crore as on September 30, 2019.

## Credit Weaknesses

**High product concentration** – The company derived majority of its US revenues from gTamiflu and gCopaxone during FY2018 and FY2019. However, with increasing competitive scenario under gTamiflu, the company's revenues from the same are expected to witness steep decline during FY2020. Going forward, till launch of limited quantities of gRevlimid 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 is expected to support the company's export revenues to a certain extent. While the company's peak revenues from the domestic Hep-C portfolio were Rs. 120 crore per quarter, the same has now declined to ~Rs. 30 crore per quarter. This has significantly affected the company's revenues from the domestic market. Going forward, the company's leadership position and continued new launches in the oncology division in addition to steady improvement in C&D revenues is expected to support the company's domestic revenues going forward.

**Increasing competitive intensity across key markets** – New entrants and the consequent pricing pressure in the Hep-C domestic market space has affected the company's revenues adversely over the last two years. Further, increasing competition under the oncology space could pose concerns for NPL in maintaining growth momentum in the domestic market. Additionally, new entrants, pricing pressures and intense competition in the company's Para IV portfolio is also expected to have a bearing on the company's revenues and margins going forward

**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** – Price control measures on 42 oncology drugs during Q4 FY2019 impacted the company's domestic margins during FY2020. Similarly, increasing regulatory scrutiny by the USFDA, compliance costs and risks associated with the same will be a key rating sensitivity going forward.

**Sizeable capital expenditure plans** – The company had incurred capital expenditure of ~Rs. 875 crore during FY2018 and FY2019; it is expected to incur a further ~Rs. 350 crore capex during FY2020. Major parts of this spend is towards setting up a greenfield oral solids facility in Visakhapatnam (expected to begin commercial operations during FY2021 for US), setting up the company's agrochemicals plant in Nellore and upgradation and capacity enhancement of the company's other API and formulation facilities. Capital expenditure is expected to be in the range of Rs. 250 crore pa. for FY2021 and FY2022. While this is expected to support capacity and capability enhancement of the company, ICRA will continue to monitor effect of the same on the company's financial profile.

## Liquidity Position: Strong

The company currently has fund-based working capital limits of Rs. 670 crore from various banks. The average fund-based working capital utilization of the company was moderately low at 31.3% over the 11-month period ending January 31, 2020. In addition to the aforementioned limits, the company also regularly places commercial papers to enjoy an interest rate benefit. NPL does not have any outstanding term loans as on date.

NPL had raised Rs.913.6 crore during December 2017 through a QIP. This, in addition to strong accruals of the company over the last two years have resulted in sizeable cash balances of over Rs. 1,000 crore as on September 30, 2019. NPL plans to use the excess funds towards investments in niche product development opportunities or acquisitions which

would be a strategical fit for the company or diversification (like agrochemicals) which is likely to support the long-term revenue growth for the company.

## Rating sensitivities

**Positive triggers** – Natco’s ratings could be upgraded if there is significant improvement in the company’s product diversification given its high concentration on few critical molecules and scale up in revenues with continued robust debt protection metrics.

**Negative triggers** – Negative pressure on Natco’s ratings could arise if there is any deterioration in margins and, debt-funded capex or acquisitions or regulatory measures lead to weakening of the company’s credit profile with TD/OPBDITA>1.5x on a sustained basis; effect of supply chain disruptions on account of the Corona Virus outbreak on the company’s operations will be a key near-term monitorable.

## Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Rating Methodology for entities in pharmaceutical industry</a>
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 the domestic and export markets. The company owns seven manufacturing facilities, one upcoming facility in Vizag, and a Natco Research Centre for R&D in Hyderabad. The company’s formulations 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 has also set up an oral solid dosages facility in Vishakhapatnam recently and the same is currently awaiting US FDA approval. The company has also set up an agrochemicals facility in Nellore during FY2020. 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 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	FY2018	FY2019
Operating Income (Rs. crore)	2,184.8	2,094.5
PAT (Rs. crore)	695.2	642.4
OPBDITA/ OI (%)	42.5%	38.1%
RoCE (%)	42.5%	28.5%
Total Debt/ TNW (times)	0.1	0.1
Total Debt/ OPBDITA (times)	0.2	0.5
Interest coverage (times)	60.3	41.3

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:**

	Instrument	Current Rating (FY2020)			Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount O/s (Rs. Crore)	Date & Rating March 23, 2020	Date & Rating In FY2020	Date & Rating In FY2019	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
						April 4, 2019	April 5, 2018	July 10, 2017	Feb 20, 2017	Dec 31, 2015
1	Fund based facilities	Long Term	917.50	NA	[ICRA]AA (Stable)	[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	105.00	NA	[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+	-
3	Non-fund-based limits	Short Term	85.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Proposed Limits	Long Term /Short Term	42.50	-	[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+	[ICRA]AA-(Stable) / [ICRA]A1+
5	Commercial Paper	Short Term	400.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
6	Term Loans	Long Term	-	-	-	-	[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](http://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				917.50	[ICRA]AA(Stable)
Fund based/ Non-fund-based limits				105.00	[ICRA]AA(Stable)/ [ICRA]A1+
Non-fund-based limits	NA			85.00	[ICRA]A1+
Proposed Limits				42.50	[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, 2019

Company Name	Ownership	Consolidation Approach
NATCO Pharma, Inc.	100.00%	Full consolidation
Time Cap Overseas Limited	90.36%	Full consolidation
NATCO Farmo Do Brazil	90.90%	Full consolidation
NATCO Pharma (Canada), Inc.	99.04%	Full consolidation
NATCO Pharma Asia Pte.Ltd.	99.73%	Full consolidation
NATCO Pharma Australia PTY Ltd.	100.00%	Full consolidation
NATCO Lifesciences Philippines Inc	100.00%	Full consolidation

Source: the company

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