

March 23, 2020

Shilpa Medicare Limited: Ratings reaffirmed

Summary of rating action

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

*Instrument details are provided in Annexure-1

Rationale

The ratings reflect Shilpa Medicare Limited's (SML) strong presence in the domestic oncology active pharmaceutical ingredients (API) segment and the long-standing experience of its promoter, Mr. Vishnukant Bhutada. The ratings also consider SML's comfortable debt protection metrics (gearing of 0.2x and TD/OPBITDA of 1.5x as on December 31, 2019). The company reported revenues of Rs. 733.7 crore in FY2019 and Rs. 687.9 crore in 9M FY2020. The operating margins improved to 24.2% in 9M FY2020 from 21.1% in FY2019 on the back of healthy growth in the export formulations business coupled with a margin-accretive one-time licence income of Rs. 72.6 crore in Q2 FY2020. Excluding the one-time income, the operating margins stood at 20.7% in 9M FY2020. With experience of more than 15 years in the development and manufacturing of oncology APIs, SML forward integrated into the oncology formulations segment in FY2017. It has a portfolio of 25 approved abbreviated new drug applications (ANDAs) and 16 ANDAs pending approval as on December 31, 2019. Going forward, the company's business prospects are expected to be supported by its manufacturing capabilities with its facilities approved by various regulatory authorities, a robust ANDA pipeline along with the ramp-up of the production of its approved products. SML's long-term revenue growth and margins would depend on the success of its ongoing investment in novel areas like biosimilars, transdermal patches and fast-disintegrating oral strip technology.

The ratings are, however, constrained by SML's moderate scale of operations and high customer concentration in its API and contract research and manufacturing services (CRAMS) segments in addition to high product concentration in its formulations segment. The ratings are also constrained by SML's high working capital intensity on account of its entry in the formulations segment in regulated markets, which generally entails a relatively higher receivables and inventory holding period. Going forward, the working capital intensity is expected to remain elevated with increasing revenue from the US generic formulations segment. The company's revenue from the CRAMS segment has been declining continuously since FY2018 following the setting up of a joint venture (JV), Raichem Medicare Private Limited (RMPL), with its customer. The revenue from the CRAMS segment was expected to gradually shift to this new JV by FY2020. However, given the increasing uncertainty regarding the profits, SML

¹ 100 lakh = 1 crore = 10 million

decided to exit the JV in favour of its JV partner in FY2019. SML will generate Rs. 100-crore revenue per annum through the CRAMS segment sale to its erstwhile JV partner till FY2021 as per the agreement, after which the CRAMS revenues will cease. Supported by the healthy growth in its formulations segment, the company has been able to make up for the loss of revenue from the CRAMS segment.

SML's net margins improved to 17.4% in 9M FY2020 from 16.0% in FY2019, in line with the improvement in the operating margins. However, the net margins are expected to decline over the near term, given the company's major capital expenditure plans towards the expansion of its API and formulation facilities and its investment in the development of biosimilars, transdermal patches and fast-disintegrating oral strip technology.

Key rating drivers and their description

Credit strengths

Long-standing experience of the promoter and SML's strong market position in API segment – SML is a medium-sized pharmaceutical company with a presence in the API, CRAMS and formulations segments. Over the years, the company has established its presence in the oncology API segment through various drug master file (DMF) submissions and supplies to large pharmaceutical companies in India and export markets. Going forward, SML's established relationships with its customers in the API segment and forward integration into the formulations segment are expected to support its business prospects.

Robust ANDA pipeline – SML started supplying to the US generic formulations market through the launch of capecitabine and azacitidine in FY2017. It also received approval (including tentative approval) for its ANDAs for the generic versions of pirfenidone, zoledronic acid and bortezomib in FY2020 and is expected to launch the same in the US market shortly. Further, SML's strong pipeline of 16 ANDAs pending approval and its ongoing investment in R&D are expected to support its scale-up in the US market. Given its plans to file for more oncology products from its ANDA pipeline in Europe, the ramp-up of the formulations segment is expected to be healthy going forward. Strong manufacturing capabilities with facilities approved by various regulatory authorities continue to support SML's business prospects.

Strong financial profile – SML's financial profile is characterised by relatively high margins (operating margins of 21.1% in FY2019 and 24.2% in 9M FY2020) and comfortable debt protection metrics (gearing of 0.2x and TD/OPBITDA of 1.5x as on December 31, 2019).

Credit challenges

Moderate scale of operations with high customer concentration – SML has a moderate scale of operations with revenues of Rs. 733.7 crore in FY2019 and Rs. 687.9 crore in 9M FY2020. Further, the company's business under the CRAMS segment is expected to cease by FY2021. SML has high customer concentration with ~53% of its API revenues being derived from the top two customers in 9M FY2020. SML also has high product concentration in its formulations segment, with its top molecule, azacitidine, accounting for more than 64% of the segment's revenue.

Substantial capex plans – To expand its API and formulations capacities and to invest in the development of biosimilars and transdermal patches, SML plans to incur significant capex during FY2020 and FY2021. As of

December 2019, SML had invested ~Rs. 240 crore in the construction of a facility and for the R&D of products in the biosimilars segment. Similarly, it had invested ~Rs. 150 crore, as of December 2019, in the transdermal patch segment. In FY2021, SML intends to invest an incremental ~Rs. 80 crore in these segments. Further, the API and formulations segments are expected to witness incremental capex of Rs. 50 crore each in FY2021 for capacity expansion. While a significant portion of this capex is expected to be funded through internal accruals and cash reserves, a part of it would also be funded through borrowings. The same is likely to affect the company's margins in the initial stage of operations to a certain extent.

High working capital intensity – ICRA notes that SML's working capital intensity has increased over the last three years on account of its entry in the formulations segment, which generally entails a relatively higher receivables and inventory holding period compared to its API business. Going forward, the working capital intensity is expected to remain elevated with the company's increasing presence in the US generic formulations segment. SML's average working capital limit utilisation was moderately high at 67.8% for the 12-month period ending December 31, 2019.

Increasing regulatory scrutiny and intense competition – Increasing scrutiny and stricter controls by regulatory authorities in developed markets have resulted in higher compliance costs for Indian pharma players in the recent past. Further, pricing pressure and intense competition in the US generics market will be important factors for the revenue and margin trajectory of the company.

Liquidity position: Adequate

SML's liquidity position is **adequate** with cash and liquid investments of Rs. 41.9 crore, undrawn term loans of Rs. 50 crore and an undrawn working capital facility of Rs. 16.8 crore as on December 31, 2019. As per the current debt profile, repayments are expected to be Rs. 24.9 crore in FY2020, Rs. 49.4 crore in FY2021 and Rs. 48.7 crore in FY2022, which can be comfortably funded through internal accruals. SML has capex plans of ~Rs. 200 crore in FY2021. Incremental drawdowns of term loans towards capex would entail additional repayments in addition to the amounts mentioned above. SML has strong financial flexibility with a record of raising equity in the past from reputed firms such as Baring Private Equity Partners, Tano Capital and TA Associates.

Rating sensitivities

Positive triggers – ICRA could upgrade SML's ratings if the company demonstrates significant growth in its revenues and margins in addition to maintaining its strong debt metrics on a sustainable basis.

Negative triggers – Pressure on the ratings could arise if the company's operations are adversely impacted by the coronavirus-related supply chain disruption. The ratings can also be downgraded if SML continues to incur significant capex without sufficient accruals, resulting in a deterioration in its debt metrics. A specific credit metric that could lead to a downgrade is $TD/OPBITDA > 2.3$ times on a sustained basis.

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 ratings are based on the consolidated financial statements of the company

About the company

Incorporated in 1987 and listed in 1995, SML is promoted by Mr. Vishnukant Bhutada. The company manufactures niche APIs, intermediates, and formulations and also undertakes CRAMS for some of its customers. SML began operations as a small-scale unit, manufacturing antibiotics with a turnover of Rs. 0.1 crore and with a workforce of 20. It has now become an integrated pharmaceutical company with seven facilities (six in India and one in Austria) and three R&D centres with consolidated revenues of Rs. 733.7 crore in FY2019. Its facilities are approved by various regulatory authorities.

While the majority of the company's revenues are currently derived from the API segment, it has also developed the capability and facility for oncology-based formulations and commenced commercial production for the US market in FY2017. While SML has already launched its generic versions of azacitidine and capecitabine in the US market, the formulations segment in the US market is expected to drive value growth for the company in the medium to long term.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	789.4	733.7
PAT (Rs. crore)	110.1	117.5
OPBDIT/OI (%)	19.3%	21.1%
RoCE (%)	13.0%	14.4%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.4
Total Debt/OPBDIT (times)	1.3	1.3
Interest Coverage (times)	57.1	42.1
DSCR	16.2	5.3

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					23-Mar-2020	22-Mar-2019	05-Jan-2018	-
1	Fund-based facilities	Long Term	100.0	NA	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	-
2	Fund-based term loans	Long Term	200.0	126.7	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	-
3	Fund-based facilities	Short Term	25.0	NA	[ICRA]A1	[ICRA]A1	[ICRA]A1	-
4	Non-fund based facilities	Short Term	15.0	NA	[ICRA]A1	[ICRA]A1	[ICRA]A1	-

Amount in Rs. crore

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	Fund-based facilities	NA	NA	NA	100.0	[ICRA]A (Stable)
NA	Fund-based term loans	FY2016/ FY2019	8.1%-8.9%	FY2022/ FY2024	200.0	[ICRA]A (Stable)
NA	Fund-based facilities	NA	NA	NA	25.0	[ICRA]A1
NA	Non-fund based facilities	NA	NA	NA	15.0	[ICRA]A1

Source: Company

Annexure-2: List of entities considered for consolidated analysis

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
Shravathi Advance Process Technologies Private Limited	65.00%	Equity Method
INM Nuvent Paints Private Limited	75.00%	Full consolidation
Shilpa Pharma Inc	100.00%	Full consolidation

Source: Company

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