September 10, 2020

Indoco Remedies Limited: Ratings upgraded to [ICRA]A+ (Stable)/[ICRA]A1

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Loans	250.00	250.00	[ICRA]A+ (Stable);upgraded from [ICRA]A (Negative)
Long-term, Fund-based Limits	29.40	29.40	[ICRA]A+ (Stable); upgraded from [ICRA]A (Negative)
Long-term, Non-fund Based Limits	24.37	24.37	[ICRA]A+ (Stable); upgraded from [ICRA]A (Negative)
Short-term, Fund-based Limits	20.00	20.00	[ICRA]A1; upgraded from [ICRA]A2+
Short-term, Non-fund Based Limits	20.25	20.25	[ICRA]A1;upgraded from [ICRA]A2+
Long-term/Short-term, Fund-based Limits	25.00	25.00	[ICRA]A+ (Stable) / [ICRA]A1 upgraded from [ICRA]A(Negative)/[ICRA]A2+
Long-term/ Short-term, Unallocated Limits	60.00	60.00	[ICRA]A+ (Stable) / [ICRA]A1 upgraded from [ICRA]A(Negative) / [ICRA]A2+
Total	**429.02**	**429.02**	

**Instrument details are provided in Annexure-1*

Rationale

The upgrade of the rating factors in the improved financial profile of Indoco Remedies Limited (IRL), driven by a pickup in its high-margin international formulations sales following the resolution of the regulatory non-compliances at two of its three affected plants. Coupled with limited capital expenditure (capex) and controlled working capital intensity of operations, this led to a reduction in the company's total debt to Rs. 268 crore as on June 30, 2020 vis-a-vis Rs. 296.3 crore as on March 31, 2019. Its liquidity position has improved and remains adequately supported by increased cash flows, unutilised bank limits of ~Rs.79 crore[1] and unencumbered cash and bank balances, along with liquid investments of Rs. 27.2 crore as on June 30, 2020. The ratings derive comfort from the company's experienced management.

IRL reported a YoY growth of 17% in revenues in FY2020, led by a healthy 27% YoY growth in its international formulations sales (mainly from the Europe and US regions) and 13% YoY growth in domestic formulations sales. The improvement in sales in international markets, in turn, followed the successful re-instatement of EU-GMP[2] certificate in September 2019 from the Medicines and Healthcare Products Regulatory Agency of the United Kingdom (UK-MHRA) for IRL's Goa-Plant-I, which resulted in a healthy 45% YoY growth in sales to Europe in

[1]*Includes undrawn corporate loan of Rs. 14 crore*

[2] *European Union- Good manufacturing practice*

FY2020. The pace of approvals of abbreviated new drug applications (ANDA) for the US market picked up in FY2020, following the successful resolution of the warning letter (issued in March 2017 by the United States Food and Drug Administration or USFDA) in March 2019 for its Goa Plant-II and III. This led to a revenue generation of Rs. 56.5 crore (including Rs. 51.9 crore of milestone payments) from US region in FY2020, reflecting a YoY growth of 127%. Aided by increased sales and improved product mix, IRL reported a healthy 320 bps improvement in its operating profit margin (OPM) to 11.2% in FY2020. Coupled with limited capex and controlled working capital intensity of operations, the company witnessed reduced debt levels, thus marking an improvement in its overall financial profile. IRL reported total debt/OPBDITA of 2.2 times as on March 31, 2020 (vis-a-vis 3.8 times as on March 31, 2019), interest cover of 4.7 times in FY2020 (vis-a-vis 3.8 times in FY2019) and net cash accruals as a percentage of total debt (NCA/TD) of 35% in FY2020 (vis-a-vis 17% in FY2019).

IRL's revenue outlook for the international formulations segment remains strong. It reported a healthy 61% YoY growth in international formulations in Q1 FY2021 and is expected to continue to witness high revenue growth over the medium term. The company has launched five new products (including one solid oral and four injectables) in US in 5M FY2021 and plans to launch another three-four products in FY2021. ICRA notes that IRL has backward-integrated operations for supplying its active pharmaceutical ingredient (API) for a significant number of its new launches. As on March 31, 2020, it had 35 ANDAs (including a mix of ophthalmic, injectables and solid orals) pending approval from the USFDA. The company also has a healthy order book for its European business in FY2021 and plans to launch new products in FY2021. It is also looking to scale up its supplies to the emerging markets.

The company is, however, yet to resolve the warning letter issued by the USFDA to its Goa Plant-I. This has impacted the sales to South Africa, New Zealand and Australia, which are being catered to by this plant. The current supplies from this plant to US are small and only four ANDAs (three of which have long patent expiry) are pending for approval from Goa Plant-I. ICRA also notes that its key marketing partner in US, TEVA Pharmaceuticals, is in the process of returning some of the ANDAs (in the ophthalmic therapeutic segment), which are required to be filed in IRL's own name.

IRL's sales in domestic formulations segment remain skewed towards acute therapies, which account for ~90% of the sales. The company has a wide therapeutic coverage with a strong presence in anti-infectives, respiratory systems and dental therapies, with its major brands positioned among the top five brands in their respective categories. While this segment outperformed the Indian Pharmaceutical market (IPM) in FY2020, the revenue growth was, however, adversely impacted in Q1 FY2021 (with YoY degrowth of 9%) following the pandemic due to muted prescription growth as discretionary visits to doctors had reduced. The prescription growth remains subdued in Q2 FY2021, though some improvement is likely to be seen in the coming quarters. ICRA also notes the regulatory risks associated with pricing controls in the domestic market.

The company's profit margins remain vulnerable to foreign exchange fluctuations on account of its foreign operations as well as foreign currency borrowings, despite entering into forward contracts to hedge its exposure. ICRA notes that IRL capitalises the development expenditure towards ANDAs/drug master files (DMFs)/ dossiers. In this regard, any higher-than-expected price erosion or lower-than-expected returns exposes the company to the risk of impairment of intangibles.

The Stable outlook reflects ICRA's expectation that IRL will be able to sustain its improved credit profile, aided by healthy cash accruals and an improvement in the revenue run-rate for the US and European regions.

Key rating drivers and their description

Credit strengths

Established brands in respiratory, dental and anti-infective therapies of the domestic formulations market – IRL's presence in the domestic market is primarily limited to mature molecules in acute therapies (which account for ~90% of sales) with intense competition. Notwithstanding this, it has a wide therapeutic coverage with a strong presence in anti-infectives, respiratory systems and dental therapies. The company enjoys a healthy reputation in the domestic market, with its major brands positioned amongst the top five positions in their respective therapy segments. However, given the matured molecules and presence of a large number of players, IRL's market share and pricing power remain low.

Experienced management – The company's operations are, at present, managed by Ms. Aditi Kare Panandikar and Mr. Sundeep Bambolkar, who have over 30 years of experience in the pharmaceutical industry.

Improved financial profile – The company's financial profile improved in FY2020 and Q1 FY2021, led by pickup in high-margin international formulations sales, following the resolution of the regulatory non-compliances at two of its three affected plants. IRL reported a YoY growth of 17% in revenues in FY2020, driven by a healthy 27% YoY growth in its international formulations sales (mainly accounted for by Europe and US regions) and a 13% YoY growth in domestic formulations sales. Aided by increased sales and improved product mix, it reported a healthy 320 bps improvement in its OPM to 11.2% in FY2020. Coupled with limited capex and controlled working capital intensity of operations, this led to reduced debt levels, which strengthened its overall financial profile. IRL reported total debt/OPBDITA of 2.2 times as on March 31, 2020 (vis-a-vis 3.8times as on March 31, 2019), interest cover of 4.7 times in FY2020 (vis-a-vis 3.8 times in FY2019) and NCA/TD of 35% in FY2020 (vis-a-vis 17% in FY2019).

Credit challenges

Pending resolution of warning letter from the USFDA at Goa-Plant I – IRL is yet to resolve the warning letter issued by the USFDA to its Goa Plant-I. This has impacted its sales to South Africa, New Zealand and Australia, which are being catered to by this plant. The current supplies from this plant to US remain small and only four ANDAs (three of which have long patent expiry) are pending for approval from Goa Plant-I.

Expected muted prescription growth in domestic formulations in FY2021 due to the pandemic; the segment also remains vulnerable to changes in Government policies related to price control – There has been a slowdown in the demand in the domestic markets following the pandemic, owing to reduced discretionary visits to doctors, thereby impacting the prescriptions segment. IRL reported a YoY degrowth of 9% in domestic formulations sales in Q1 FY2021. The prescription growth remains muted in Q2 FY2021, though some improvement is expected in the coming quarters. ICRA notes the regulatory risks associated with the pricing controls in the domestic market. However, at present, the company has only 9.8% of its total domestic formulations sales under price control. Any adverse change in the Government policy related to price control can lead to pricing pressures and impact its profit margins in the domestic formulations business.

Vulnerability of profit margins to foreign exchange fluctuations and risks of impairment of intangibles – The company's profit margins remain vulnerable to foreign exchange fluctuations on account of its foreign operations as well as foreign currency borrowings, despite entering into forward contracts to hedge its exposure. ICRA notes that IRL capitalises the development expenditure towards ANDAs/DMFs/dossiers and any higher-than-expected price erosion or lower-than-expected returns, exposes the company to the risk of impairment of intangibles.

Liquidity position: Adequate

The company's liquidity position is **adequate**. Aided by the expected improvement in revenues and profits in FY2021, the cash flows are likely to remain adequate to cover its debt servicing obligations (Rs. 51.3 crore in FY2021). Comfort is drawn from the headroom available to IRL with respect to its working capital utilisation. The working capital utilisation over the last 15 months has averaged around 68%, with the company having unutilised bank limits of ~Rs. 79 crore[3], unencumbered cash and bank balances as well as liquid investments of Rs. 27.2 crore as on June 30, 2020. Its total capex in FY2021 is anticipated to remain moderate in the range of Rs. 75-80 crore, for which a sanction of Rs. 50-crore term loan is in place.

Rating sensitivities

Positive triggers: The rating is unlikely to be upgraded in the near term unless there is a significant improvement in overall revenues and profitability. Specific credit metrics that will result in a rating upgrade include total debt/OPBDITA improving to below 1.5 times on a sustained basis and return on capital employed (ROCE) improving to above 20% on a sustained basis.

Negative triggers: The rating may be downgraded if there is a weakening in the company's profit margins and overall financial profile, leading to a sustained deterioration in TD/OPBDITA above 2.3x. Delays in resolution of existing regulatory non-compliances or any other regulatory non-compliance issued to IRL for its products and/or manufacturing facilities, thereby impacting its product launches and thus revenues and profitability, would also be a negative trigger. Large debt-funded inorganic investments by the company would remain an event risk, and the impact of such investments on the company's business and credit profile would be monitored on a case by case basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Pharmaceutical Industry
Parent / Group Support	Not applicable
Consolidation / Standalone	The ratings are based on the standalone financial profile of the company

About the company

IRL was established by Mr. Govind Ramnath Kare in 1945 as Indo Continental Trading Company. It was involved in importing pharmaceutical formulations from Europe and selling the same in India. In 1963, the current Chairman and Managing Director, Mr. Suresh G. Kare took over.

[3] *Includes undrawn corporate loan of Rs. 14 crore*

At present, IRL manufactures and markets branded formulations, APIs and contract research and manufacturing services (CRAMS), with a strong presence in domestic formulations, which contributed ~64% to its total revenues in FY2020. In the domestic business, the company enjoys a prominent presence in the anti-infective, respiratory, gastro-intestinal and dental segments, with its major brands positioned amongst the top five in their respective categories.

IRL's formulations plants are located at Goa (three plants), Mumbai, Waluj (Aurangabad) and Baddi (Himachal Pradesh), while API plants are located at Patalganga (Maharashtra) and Rabale (Navi Mumbai). In FY2017, it acquired Micro Labs Limited's solid oral dosage manufacturing facility located in Baddi, which is being utilised to manufacture formulations for the European and the UK markets, post receipt of the EU-GMP certification and the UK-MHRA approval. The facilities have been approved by most of the regulatory authorities including the USFDA and the UK-MHRA. IRL's Goa Plant-I is, at present, under a warning letter from the USFDA.

For Q1 FY2021, IRL reported a profit after tax (PAT) of Rs. 17.2 crore on an operating income (OI) of Rs. 275.9 crore, against a PAT of Rs. 2.2 crore on an OI of Rs. 252.7 crore in Q1 FY2020.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	967.7	1,106.0
PAT (Rs. crore)	-2.8	24.3
OPBDIT/OI (%)	8.0%	11.2%
PAT/OI (%)	-0.3%	2.2%
Total Outside Liabilities/ Tangible Net Worth (times)	0.9	0.9
Total Debt/OPBDIT (times)	3.8	2.2
Interest Coverage (times)	3.8	4.7

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, and Taxes

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Type	Current Rating (FY2021) Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating 10-Sep-20	Chronology of Rating History for the Past 3 Years FY2020 30-Aug-19	FY2019 31-Jan-19	21-Nov-18	12-Sep-18	31-Aug-18	4-Apr-18	FY2018 17-Nov-17	10-Apr-17
1	Term Loans	Long-term	250.00	80.7*	[ICRA]A+ (Stable)	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)
2	Fund-based Limits	Long-term	29.40	NA	[ICRA]A+ (Stable)	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)
3	Non-fund Based Limits	Long-term	24.37	NA	[ICRA]A+ (Stable)	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-	-	-
4	Fund-based Limits	Short-term	20.00	NA	[ICRA]A1	[ICRA]A2+	[ICRA]A1	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Non-fund Based Limits	Short-term	20.25	NA	[ICRA]A1	[ICRA]A2+	[ICRA]A1	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
6	Fund-based Limits	Long-term /Short-term	25.00	NA	[ICRA]A+ (Stable)/[ICRA]A1	[ICRA]A(Negative)/ [ICRA]A2+	[ICRA]A+ (Negative)/ [ICRA]A1	[ICRA]A+ (Stable) / [ICRA]A1	[ICRA]A+ (Stable) / [ICRA]A1	-	-	-	-
7	Unallocated	Long-term /Short-term	60.00	NA	[ICRA]A+ (Stable)/[ICRA]A1	[ICRA]A(Negative)/ [ICRA]A2+	[ICRA]A+ (Negative)/ [ICRA]A1	[ICRA]A+ (Stable) / [ICRA]A1	[ICRA]A+ (Stable) / [ICRA]A1+	[ICRA]A+ (Stable) / [ICRA]A1+	-	-	-
8	Commercial Paper Programme	Short-term	-			[ICRA]A2+, withdrawn	[ICRA]A1	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

**As on June 30, 2020*

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 No	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Term Loan 1	June2016	9.50%	July 2020	55. 0	[ICRA]A+ (Stable)
-	Term Loan 2	September2016	6.70%	September2021	55. 0	[ICRA]A+ (Stable)
-	Term Loan 3	September2016	5.60%	September2021	55.0	[ICRA]A+ (Stable)
-	Term Loan 4	December 2016	9,15%	December 2021	35.0	[ICRA]A+ (Stable)
-	Term Loan 5	FY2018	8.05%	FY2025	50.0	[ICRA]A+ (Stable)
-	Cash Credit 1	-	-	-	8.4	[ICRA]A+ (Stable)
-	Cash Credit 2	-	-	-	12.0	[ICRA]A+ (Stable)
-	Cash Credit 3	-	-	-	9.0	[ICRA]A+ (Stable)
-	Non-fund Based 1	-	-	-	12.66	[ICRA]A+ (Stable)
-	Non-fund Based 2	-	-	-	11.71	[ICRA]A+ (Stable)
-	Fund-based 1	-	-	-	10.0	[ICRA]A1
-	Fund-based 2	-	-	-	10.0	[ICRA]A1
-	Non-fund Based 1	-	-	-	5.25	[ICRA]A1
-	Non-fund Based 2	-	-	-	3.0	[ICRA]A1
-	Non-fund Based 3	-	-	-	5.0	[ICRA]A1
-	Non-fund Based 4	-	-	-	7.0	[ICRA]A1
-	Fund-based 1	-	-	-	10.0	[ICRA]A+ (Stable) / [ICRA]A1
-	Fund-based 2	-	-	-	15.0	[ICRA]A+ (Stable) / [ICRA]A1
-	Unallocated	-	-	-	60.0	[ICRA]A+ (Stable) / [ICRA]A1

Source: Indoco Remedies Limited

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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.

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