Natco Pharma Limited

Instrument	Amount In Rs Crore[*]	Rating December 2015
Term Loans	171.0	[ICRA]AA- (Stable) / re-affirmed
Long Term Fund Based Limits	340.0	[ICRA]AA- (Stable) / re-affirmed
Short term Non Fund based Limits	35.0	[ICRA]A1+ / re-affirmed
LT/ST Proposed	70.9	[ICRA]AA- (Stable) / [ICRA]A1+ (assigned)
Commercial Paper	40.0	[ICRA]A1+ / re-affirmed

ICRA has re-affirmed the long term rating outstanding on the Rs. 171.0 Crore (reduced from Rs 245.9 Crore) term loan facilities and the Rs. 340.0 Crore (increased from Rs. 336.0 Crore) fund-based facilities of Natco Pharma Limited ("NPL"/"the Company") at [ICRA]AA- (pronounced as ICRA double A minus)†. The outlook on the long term rating is 'stable'. ICRA has re-affirmed the short term rating outstanding on the Rs. 35.0 crore non-fund based limits and Rs. 40.0 Crore Commercial Paper (CP) programme of NPL at [ICRA]A1+ (pronounced as ICRA A one plus). For the proposed Rs. 70.9 crore fund based facilities, rating of [ICRA]AA- or [ICRA]A1+ will apply depending on the tenure of the facility.

The re-affirmation of ratings reflects the steady operational and financial performance of the company witnessed during the recent past, characterized by healthy growth in the domestic formulation business, stable operating profitability indicators and conservative capital structure. The revenue growth during the recent quarters has been primarily supported by the strong traction in the domestic branded formulations segment, driven by consistent growth in the oncology segment and robust volumes of the Hepatitis C drug launched during March 2015, buffering the impact of modest performance witnessed in the formulation and API export business segments owing to intense competition led pricing pressures and lack of any major product launches during the year. Thus the diversified business profile of the company lends stability to operations, limiting the impact of slowdown in performance of any particular segment on the overall revenues and earnings of the company. The financial profile of the company has also improved during the recent past, supported by the stable accruals and the recent equity infusion made during Q2 2015-16, which have been primarily utilized towards reducing external debt and funding capital expenditure resulting in gearing and Total Debt / OPBDITA levels for the company reducing to conservative levels of 0.1 times and 0.6 times respectively as on September 30, 2015. The ratings also consider the expected improvement over the medium term backed by planned product launches in the USA and other markets, including India. Growth in its international business would be supported by the potential launch of generic version of Tamiflu® (an influenza infection drug marketed by Roche) and generic version of Copaxone® (a multiple sclerosis drug marketed by Teva) in the U.S.A. While there has been delay in launch of gCopaxone pending USFDA (U S Food and Drug Administration) approval, NPL is favourably positioned to benefit from a sizeable generic opportunity (upon launch after obtaining the necessary approval) given the large market potential and relatively limited competition for these drugs in the US market. Growth in the domestic market of NPL would continue to be driven by its strong presence in the Oncology segment and also the expected steady growth in volumes of sofosbuvir and its combination drugs (Hepatitis C drugs).

The ratings also consider NPL's continued strong market position in the oncology segment in India with leading volume share for its key drugs, its focused strategy on expanding presence in regulated markets driven by a portfolio of niche and complex molecules, and its backward integration in APIs. By virtue of being an early entrant, NPL has established a strong portfolio of products in some of the targeted therapy areas within oncology, helping it command a strong presence in the domestic market. To diversify its revenue base and reduce concentration in the oncology segment in the domestic

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

† *For complete rating scale and definitions, please refer to ICRA's Website www.icra.in or other ICRA Rating Publications*

market, the company has also been actively involved in developing drugs in other therapeutic areas including gastroenterology which has supported revenue growth during the recent past. Also as a means of business diversification and to leverage on its strong R&D capabilities, NPL has been investing in developing a portfolio of ANDAs with Para IV filings on niche and complex molecules for the USA market. Despite a considerable portion of NPL's portfolio pending approvals in the USA, its focus and consistent track record of developing 'difficult-to-develop' molecules demonstrates its strong R&D skills. The focused research and product development initiatives have aided NPL in building a wide product portfolio with increasing number of new drug filings across markets, where its ability to identify and develop complex and difficult-to-develop molecules, successfully file dossiers and tie-up contracts with leading generic majors remains a critical component to drive future growth. NPL follows a relatively de-risked business model, particularly in the US market, wherein it develops and files ANDAs and enters into agreements with leading generic players to manage the patent litigation risk and also for marketing and distribution activities. With pricing pressures witnessed across business segments, NPL's formulation exports driven by new drug launches is likely to be the key growth driver, supported by its diversified presence across both the regulated and emerging markets.

The ratings continue to factor in NPL's relatively high concentration on the oncology segment in India (more than 60% of domestic revenues in H1 2015-16, albeit lower than the high levels of 80% witnessed in the past supported by the success of the Hepatitis C drug launched), dependence on few brands and limited presence in some of the fast-growing lifestyle related therapy areas as compared to other ICRA-rated entities. Concentrated product portfolio amidst increasing competition and potential price erosion upon inclusion of oncology segment under essential drugs could result in pressure on earnings from domestic formulations business over the near-to-medium term. While risks of delays in product approvals, outcome of patent litigations, adverse market dynamics and intensifying competitive scenario limiting scale-up in regulated markets business persists, these are largely offset by the operational strengths of NPL including its strong R&D capabilities, broad product pipeline and its integrated nature of operations with improving product and market diversification. NPL's credit profile is also aided by its strong capital structure with healthy coverage metrics and sound liquidity position, supported by the growing accruals and the equity infusion made during the current fiscal.

Company Profile

A medium-sized pharmaceutical company, Natco Pharma Limited (NPL), develops, manufactures and markets formulations and active pharmaceutical ingredients (APIs). Founded in 1981 by Mr. V.C. Nannapaneni, NPL began manufacturing formulations as a private limited company – NPL Fine Pharmaceuticals Private Limited in Andhra Pradesh. Since then, NPL has emerged as an established pharmaceutical company with consolidated revenues of Rs. 825 crore in 2014-15 and presence in formulations, APIs, CRAMS and retail pharmacy business. The company owns seven manufacturing facilities, including five formulations and two facilities for APIs in India, and a Natco Research Centre for R&D in Hyderabad. The formulation unit in Kothur and API facility at 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.

NPL generates revenues from three segments – Formulations (including CRAMS), APIs and Retail Pharmacy Business. Comprising of branded generics in India and formulations exports primarily to US and Latin American markets, formulations contributed 55% to company's consolidated turnover in 2014-15 followed by APIs (33%) and retail pharmacy business (12%). By virtue of being an early entrant and strong R&D capabilities, NPL has established itself as a leading player in the oncology segment in India. In addition, it also generates ~40% of its formulations business from exports with presence in generics business in regulated markets of North America and Europe and branded generics in RoW. Besides manufacturing formulations and APIs, NPL also operates retail pharmacy business in the U.S., which it started by acquiring three stores over 2005-06. However, the business became financially unviable with two of its stores getting impacted by cut down in payments to health programmes. In 2014-15, the U.S. retail pharmacy business contributed 12% to company's consolidated turnover. The promoter's stake in the company reduced to 51.3% in September 2015 from earlier levels of 53.5% a year earlier, post the raising of funds by NPL during Q2 2014-15 through Qualified Institutional Placement (QIP) with the objective to fund its capital expenditure and bring down its debt levels.

Recent Results

In H1 2015-16, NPL's consolidated revenues grew by 7% to Rs. 459 crore driven by strong growth in the domestic formulation business. In terms of operating profitability, the company's margins moderated by ~150 bps during the same period owing to the shift in product mix, with drop in sales from formulation and API exports.

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