February 20, 2017

Natco Pharma Limited

Instrument*	Rated Amount (in crore)	Rating Action
Term Loans	300.00 (Enhanced from 171.00)	[ICRA]AA (Stable) / upgraded from [ICRA]AA- (Stable)
Long-Term Fund based limits	421.00 (Enhanced from 340.00)	[ICRA]AA (Stable) / upgraded from [ICRA]AA- (Stable)
LT / ST - Fund based/Non Fund Based	61.50	[ICRA]AA (Stable) / [ICRA]A1+ / assigned
Short-Term Non-fund based limits	59.00 (Revised from 35.00)	[ICRA]A1+/ reaffirmed
LT/ST Proposed	59.40 (Revised from 70.90)	[ICRA]AA (Stable) / upgraded from [ICRA]AA- (Stable) / [ICRA]A1+ / reaffirmed
Commercial Paper	100.00 (Enhanced from 40.00)	[ICRA]A1+/ reaffirmed
Total	**1000.90**	

*Instrument Details are provided in Annexure-1

Rating Action

ICRA has upgraded the long-term rating outstanding on the Rs.300.00 crore (enhanced from Rs.171.00 crore) term loans and Rs.421.00 (enhanced from Rs.340.00 crore) long term fund based limits of Natco Pharma Limited (NPL / the company) to [ICRA]AA (pronounced ICRA double A) from [ICRA]AA- (pronounced ICRA double A minus). The outlook on the long term rating is Stable. ICRA has also re-affirmed the short term rating outstanding on the Rs.59.00 crore (enhanced from Rs.35.0 crore) non-fund based limits and Rs.100.00 crore (enhanced from Rs.40.0 Crore) Commercial Paper (CP) programme of NPL at [ICRA]A1+ (pronounced as ICRA A one plus).ICRA has also assigned ratings of ICRA]AA / [ICRA]A1+ to the Rs.61.50 crore LT/ST fund based / non fund based interchangeable limits of the company. For the proposed Rs.59.4 crore (revised from Rs.70.9 crore), rating of [ICRA]AA or [ICRA]A1+ will apply depending on the tenure of the facility.

Rationale

The upward revision in ratings factors in NPL's sustained strong financial profile characterized by robust revenue growth of 38.3% during FY2016 and 41.6% during H1 FY2017 (YoY), healthy operating margins and comfortable capitalization and coverage indicators. While revenue growth of the company during FY2016 and H1 FY2017 has been primarily on back of volume expansion and strong market share of the Hepatitis C drug portfolio launched in the domestic market during CY2015, the company's supplies for generic version of Tamiflu which was recently launched in the USA also supported revenues of the company during H1 FY2017. Profit share from launch of Tamiflu from its marketing partner is likely to support healthy operating margins for the company during H2 FY2017. The ratings also continue to factor NPL's strong market position in the domestic oncology formulations segment 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 Active Pharmaceutical

Ingredients (APIs). While the company derived majority of its revenues from oncology earlier, with healthy revenue expansion in the gastroenterology segment (Hep-C drug portfolio) in the recent past, the company has achieved improved therapeutic diversity.

The ratings continue to factor intense competition in the domestic oncology segment leading to pricing pressures, dependence on few brands and limited presence in some of the fast-growing lifestyle related therapy areas as compared to other ICRA-rated entities. Also, increasing regulatory interference and potential price erosion upon inclusion of oncology segment under National List of Essential Medicines (NLEM) could result in pressure on earnings from domestic formulations business over the near-to-medium term. Further, intense competition and pricing pressures in the US generic market will also play an important role in both revenue and margin trajectory of the company. ICRA also notes that with growing product portfolio and increasing focus on markets outside in India, NPL's working capital requirements will consistently expand going forward. Further, increasing regulatory scrutiny by the US FDA, compliance costs and risks associated with the same will be a key rating sensitivity going forward. NPL's ability to maintain its revenue growth momentum and its stable financial risk profile through the planned capital expenditure programme will also remain key credit monitorables.

Key rating drivers

Credit Strengths

- Leading player in the domestic oncology segment; business strength characterized by dominant market share in its key products in the oncology space
- Domestic market position further strengthened by healthy market share under the gastroenterology segment with launch of Hepatitis C drug portfolio during CY2015
- Healthy sales of Natco's generic version of Tamiflu expected to support company's robust EBITDA during H2 FY2017
- Strong Research & Development (R&d) capabilities and track record of building a product pipeline of complex and difficult-to-develop molecules for regulated markets with focus on U.S. generics; presence in niche APIs, Abbreviated New Drug Application (ANDA) programs reflects company's strategy to develop sustainable and high-value business streams
- Tie-up with leading generic players for the U.S. market mitigates the risk associated with potential litigation challenges associated with Para IV filings or at-risk launches
- Pipeline of ANDAs provides strong growth potential over the medium to long term; however, visibility of monetizing the ANDAs held, consistently over a period of time remains dependent on outcome of patent litigations and approvals on existing product pipeline considering the strong focus on Para IV/FTF filings for complex drugs
- Strengthening manufacturing capabilities, supported by adequate backward integration into manufacturing of active pharmaceutical ingredients (APIs) and regulatory market approvals
- Financial risk profile characterised by robust revenue growth, healthy profitability indicators and comfortable capitalization and coverage indicators

Credit Weakness

- Growing competition in the domestic market could pose concerns in maintaining growth momentum and pricing in the domestic market; however, healthy market share and proposed new drug launches in oncology and gastroenterology segments likely aid revenues
- Pricing pressures and intense competition in the US generic market will play an important role in both revenue and margin trajectory of the company
- Increasing working capital cycle with increasing share of international business
- Ongoing and planned debt-funded capital expenditure likely to impact margins (till capacities are at optimum utilization levels) and capitalization indicators over the near-to-medium term

Description of key rating drivers highlighted above:

NPL is a mid-size pharmaceutical company with presence across R&D, manufacturing and marketing of formulations and bulk drugs/APIs in India as well as international markets. The company derived 89% of its revenues from the formulations segment while the balance (11%) was derived from the APIs segment during H1 FY2017 as against 76% from formulations, 15% from APIs and 9% from its retail pharmacy business during FY2015. While the company owned a retail pharmacy business in the USA in the past, the same was divested during FY2016. The sales mix of the company has witnessed some volatility over the last two fiscals, owing to the modest performance of API exports coupled with the sharp growth in domestic branded formulations under both oncology and gastroenterology segments.

As a means of business and geographic diversification and to leverage 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 complex 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.

Growth in NPL's international business is likely to be supported by the recent launch of generic version of Tamiflu (an influenza infection drug earlier marketed only by Roche) and potential launch of generic version of Copaxone (a multiple sclerosis drug marketed by Teva and Mylan) 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. While a healthy ANDA pipeline is expected to support revenue growth of the company going forward, increasing share of revenues from international business is expected to increase the working capital requirements of the company. Further, the company also plans to expand its capacities and R&D infrastructure by investing Rs.230-250 crore per annum over the next 2-3 fiscals. The company plans to fund this capital expenditure with a mix of internal accruals and term loans of Rs.300 crore of which about Rs.250 crore has already been tied up with various banks. While the aforementioned capital expenditure is expected to provide boost to the company's manufacturing capabilities, it is likely to impact NPL's margins (till capacities are at optimum utilization levels) and capitalization indicators over the near-to-medium term.

Analytical approach: For arriving at the ratings, ICRA has taken a consolidated view of NPL and its subsidiaries.

Links to applicable Criteria
http://www.icra.in/Files/Articles/2009-October-Rating-Corp-Rating-Methodology.pdf
http://www.icra.in/Files/Articles/Pharma-Methodology-Finalised.pdf

About the Company:
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 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.

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 sizeable 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 operated retail pharmacy business in the U.S., which it started by acquiring three stores over FY2006. However, the business became financially unviable with two of its stores getting impacted by cut down in payments to health programmes. Eventually, the company divested this business during FY2016. The company had also raised Rs.341 crore through Qualified Institutional Placement (QIP) with the objective to fund its capital expenditure and bring down its debt levels during FY2016.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years:

Table: Rating History

S.No	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. Crore)	Month-year & Rating	Month-year & Rating in FY2016	Month-year & Rating in FY2015	Month-year & Rating in FY2014
				February 2017	December 2015	February 2015	February 2014
1	Fund based facilities	Long Term	421.00	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
2	Term Loans	Long Term	300.00	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
3	Fund based/ Non-fund based limits	Long Term /Short Term	61.50	[ICRA]AA (Stable)/ [ICRA]A1+	-	-	-
4	Non-fund based limits	Short Term	59.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Commercial Paper	Short Term	100.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
6	Proposed Limits	Long Term /Short Term	59.40	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [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

Details of Instrument

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Cash Credit/EPC/BD	-	-	-	421.00	[ICRA] AA (Stable)
Term Loans	-	-	5 years from drawdown	300.00	[ICRA] AA (Stable)
Fund based/ Non-fund based limits	-	-	-	61.50	[ICRA] AA (Stable) / [ICRA] A1+
LC/BG	-	-	-	59.00	[ICRA] A1+
Commercial Paper	-	-	-	100.00	[ICRA] A1+
Proposed Limits	-	-	-	59.40	[ICRA] AA (Stable) / [ICRA] A1+

Source: Natco Pharma 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.

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.

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