Natco Pharma Limited

April 05, 2018

Summary of rated instruments

Instrument*	Previously Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	300.00	100.00	[ICRA]AA (Stable); Reaffirmed
Long-Term Fund based limits	421.00	666.50	[ICRA]AA (Stable); Reaffirmed
Long-Term / Short-Term - Fund based/Non Fund Based	61.50	50.00	[ICRA]AA (Stable)/A1+; Reaffirmed
Short-Term Non-fund based limits	59.00	110.00	[ICRA]A1+;Reaffirmed
Long-Term / Short-Term Unallocated	59.40	73.50	[ICRA]AA (Stable)/A1+; Reaffirmed
Commercial Paper	200.00	200.00	[ICRA]A1+;Reaffirmed
Total	**1,100.90**	**1,200.00**	

*Instrument details in Annexure - I

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA (pronounced ICRA double A) on the Rs. 100.0. crore (revised from Rs.300 crore) term loans, Rs.666.5 crore (revised from Rs.421.00 crore) fund-based facilities, Rs.50 crore (revised from RRs.61.50 crore) Long-Term / Short-Term - Fund based/Non Fund Based facilities and Rs.73.50 crore (revised from Rs.59.40 crore) Long-Term / Short-Term unallocated facilities of Natco Pharma Limited (NPL / the company). The outlook on the long-term rating is Stable. ICRA has also reaffirmed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) on the Rs.110. crore non fund-based facilities, the Rs.73.50 revised from Rs.59.40 crore) Long-Term / Short-Term unallocated facilities and the Rs.200.0 crore commercial paper programme of the company.

Rationale

The assigned ratings continue to factor in the longstanding experience of the promoters, NPL's strong market position in the domestic oncology and Hep-C segments with leading volume share for key drugs; its focused strategy on expanding presence in regulated markets driven by a portfolio of limited competition and complex molecules; and its backward integrated nature of operations with strong capabilities in Active Pharmaceutical Ingredient (APIs) manufacturing supporting its business prospects. ICRA notes that launch of the generic version of Copaxone (40mg dosage; Innovator - Teva Pharmaceuticals Industries Inc.) in addition to healthy revenues from the generic version of Tamiflu (Innovator - Hoffman La-Roche Inc.) in the US is estimated to have supported the company's revenue growth, margin improvement and healthy cash accruals during Q4 FY2018. Going forward, NPL's robust Abbreviated New Drug Application (ANDA) pipeline in addition to continued investment in the company's R&D capabilities is expected to support its business prospects. NPL's financial profile continues to be characterized by healthy and improving operating and net margins (39.3% and 27.5% during 9m FY2018), comfortable capitalization and coverage indicators (TD/OPBDITA of 0.4x as on September 30, 2017 and interest coverage of 33.0x during H1 FY2018). ICRA also notes that the company's liquidity position has strengthened on the back of QIP proceeds of Rs.915 crore raised by the company during December 2017. We expect the company to utilize the same to fund its incremental working capital requirements and ongoing capital expenditure programme.

The ratings continue to factor intense competition in the domestic oncology and Hep-C segments leading to pricing pressure, and dependence on fewer therapeutic areas/key molecules as compared to other ICRA-rated entities. ICRA also notes that 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 along with timing of approval and launch for competitors in key molecules 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 India, NPL's working capital requirements are expected to increase going forward. Additionally, increasing scrutiny by the US FDA, compliance costs and risks associated with the same will be a key rating sensitivity going forward. While the company's ongoing capex is expected to support capacity and capability enhancement, ICRA will continue to monitor effect of the same on the company's financial profile.

Outlook: Stable

ICRA believes that NPL will continue to benefit from its leading market share in the domestic oncology and Hep-C segments in addition to recent launches in the US market and a robust ANDA pipeline. The outlook may be revised to 'Positive' if higher than expected revenue growth and profitability strengthens the financial risk profile. The outlook may be revised to 'Negative' if cash accruals continue to be lower than expected, or if further stretch in working capital cycle weakens the company's debt metrics and liquidity position.

Key rating drivers

Credit strengths

Strong market position in the domestic oncology and Hep-C segments – NPL is a leading oncology company with a portfolio focused on direct therapies for blood cancer and solid tumours. During the last 2-3 years, the company also branched into a comprehensive portfolio for treatment of Hepatitis-C. 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. The company has also launched Cardiology & Diabetology division recently and plans to introduce niche products over the next two years. ICRA will continue to monitor progress of the same.

Launch of Copaxone (40mg) during Q3 FY2018 to support margins and revenues in the immediate future – Approval and immediate launch of limited competition and complex generic version of Copaxone (40 mg) during October 2017 and healthy volumes from the same in addition to volumes from the generic version of Tamiflu is estimated to have supported the company's revenues and margins during Q4 FY2018. However, timing of approval and launch for competitors in these molecules will play an important role in both revenue and margin trajectory of the company 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 FY2017 the company invested ~6.0% of its revenues in R&D. Overall, the company has 29 approved ANDAs including 16 Para IV's are yet to be launched as on December 31, 2017; strong manufacturing capabilities in addition to backward integration into API manufacturing also continue to support the company's revenues from the US generics segment.

Strong financial profile – NPL's financial risk profile is characterized by improving profitability indicators supported by some key US launches in the recent past; capitalization and coverage metrics are expected to remain healthy over the next few quarters on the back of the recent QIP proceeds despite the ongoing capital expenditure programme.

Credit challenges

Increasing competitive pressures across key markets – Growing competition in the domestic market in both Hep-C and oncology space could pose concerns for NPL in maintaining growth momentum in the domestic market; pricing pressures and intense competition in the US generic market.

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, focus on high value APIs and increasing focus on markets outside India (which generally have a higher receivable period than the domestic segment), we expect NPL's working capital requirements to expand going forward.

Sizeable capital expenditure plans – The company had incurred capital expenditure to the tune of Rs.260 crore during 9M FY2018 and is estimated to have incurred ~Rs.320 crore by end of FY2018; capital expenditure is expected to be in the range of Rs.300 crore pa. for FY2019 and FY2020 as well. 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.

Increased regulatory scrutiny – Increasing regulatory interference and potential price erosion upon inclusion of key drugs under National List of Essential Medicines (NLEM) could lead to pressure on earnings in the domestic formulations business over the near-to-medium term. Similarly, increasing regulatory scrutiny by the US FDA, compliance costs and risks associated with the same will be a key rating sensitivity going forward.

Outcome of pending litigation for generic Copaxone (40 mg) –While NPL's tie-ups with leading generic players for the US market launch mitigates the risk associated with potential litigation challenges associated with Para IV filings, Mylan N.V. has won various patent cases for Copaxone in different jurisdictions. However, an appeal for certain patents filed by the innovator, are pending in the Federal Circuit on Mylan N.V., if ruled against Mylan N.V. on any of the Copaxone patents could result in payout from the company (shared with Mylan) which in turn would impact the company's accruals and margins going forward given that the generic Copaxone (40 mg) was an at-risk launch.

Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology - Pharmaceutical Industry

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 domestic and export markets. The company owns seven manufacturing facilities, and one upcoming facility, and a Natco Research Centre for R&D in Hyderabad. The company's formulation 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.

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 more recently, 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	FY2016	FY2017
Operating Income (Rs. crore)	1,042.3	2,020.2
PAT (Rs. crore)	155.8	484.9
OPBDIT/ OI (%)	26.7%	34.4%
RoCE (%)	20.7%	47.8%
Total Debt/ TNW (times)	0.1	0.1
Total Debt/ OPBDIT (times)	0.4	0.3
Interest coverage (times)	12.2	37.5
NWC/ OI (%)	44.7%	34.5%

Source: Company, ICRA research; OPBDITA: Operating Profit before Depreciation, Interest and Taxes; PAT: Profit After Tax; RoCE: Return on Capital Employed; TNW: Tangible Net Worth; NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2019)					Chronology of Rating History for the past 3 years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating April 2018	Date & Rating July 2017	Date & Rating in FY2017 Feb 2017	Date & Rating in FY2016 Dec 2015	Date & Rating in FY2015 Feb 2015
1	Term Loans	Long Term	100.00	NA	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Fund based facilities	Long Term	666.50	NA	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
3	Fund based/ Non-fund based limits	Long Term /Short Term	50.00	NA	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	-	-
4	Non-fund based limits	Short Term	110.00	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Proposed Limits	Long Term /Short Term	73.50	-	[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+
6	Commercial Paper	Short Term	200.00	-	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[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: Instrument Details

Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
Term Loans			Yet to be drawn down	100.00	[ICRA]AA(Stable)
Fund based facilities				666.50	[ICRA]AA(Stable)
Fund based/ Non-fund based limits	NA		NA	50.00	[ICRA]AA(Stable)/ [ICRA]A1+
Non-fund based limits				110.00	[ICRA]A1+
Proposed Limits				73.50	[ICRA]AA(Stable)/[ICRA]A1+
Commercial Paper				200.00	[ICRA]A1+

Source: Natco Pharma Limited

ANALYST CONTACTS

Subrata Ray
+91 22 6114 3408
subrata@icraindia.com

Pavethra Ponniah
+91 44 4596 4314
pavethrap@icraindia.com

Mythri Macherla
+91 44 43326407
mythri.macherla@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
naznin.prodhani@icraindia.com

Helpline for business queries:

+91-124-2866928 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 6606 9999