Hetero Drugs Limited

December 07, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	412.30 (Reduced from 478.00)	CARE A+ (CWD) (Single A Plus) (Under Credit watch with Developing Implications)	Continues to be on Credit watch with Developing Implications
Long Term / Short Term Bank Facilities	200.00	CARE A+ / CARE A1 (CWD) (Single A Plus / A One) (Under Credit watch with Developing Implications)	Continues to be on Credit watch with Developing Implications
Total Bank Facilities	**612.30 (Rs. Six Hundred Twelve Crore and Thirty Lakhs Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings of Hetero Drugs Limited (HDL) continue to remain on 'Credit watch with developing implications' following the various media articles regarding the Income Tax Department (ITD) conducting search operations from 6th to 11th October 2021 across various offices, manufacturing sites and other locations of Hetero Group. The management of Hetero Group has not shared the exact details of income tax search; however, they have confirmed that the ITD has found some cash and seized the same. Further ITD has also carried some of the groups records and documents for verification. The management has also confirmed that the ITD has not stopped their regular operations. CARE is trying to reach out to management to understand the impact of event and outcome of the ITD raid. CARE Ratings will remove the ratings from watch and take a final rating action once it has clarity on the impact of IT raid on business and financial profile of HDL.

The ratings assigned to the bank facilities of Hetero Drugs Limited (HDL) factor in healthy growth in total operating income, improvement in profitability margins during FY21 (Refers to period April 01 to March 31). The ratings also factors in improvement in overall financial risk profile marked by overall gearing and debt coverage indicators along with improvement in operating cycle during FY21. Further the ratings continue to derive strength from strong promoter group with established track record and experienced management team, strong product portfolio spread across multiple therapeutic segments and reputed clientele, deeply integrated nature of operations and favorable outlook for the pharmaceutical industry. The ratings, however, continue to remain constrained by exposure to the group companies in the form of corporate guarantees, elongated operating cycle, foreign exchange fluctuation risk and highly fragmented industry with regulatory risk inherent in the pharmaceutical industry.

Rating Sensitivities

Positive Factors - Factors that could lead to positive rating action/upgrade:

- Improvement in the PBILDT margins on a sustained basis over 18%.
- Maintaining operating cycle days consistently below 150 days

Negative Factors- Factors that could lead to negative rating action/downgrade:

- Overall gearing going beyond 0.60x on sustained basis
- Further investments in associate companies beyond 20% of the Networth.

Detailed description of the key rating drivers

Key Rating Strengths

Healthy growth in total operating income with stable profitability margins during FY21; comfortable capital structure

During FY21, at consolidated level, the company has achieved around 47% growth in its total operating income which stood at Rs. 3033.38 crore in FY21 as against Rs.2068.03 crore during FY20. The PBILDT margins improved marginally to 15.47% during FY21 from 14.92% during FY20 on account of reduction in employee and better realization. Capital structure of HDL (consolidated) continued to remain comfortable with overall gearing as on March 31, 2021 improved to 0.19x as against 0.31x as on March 31, 2020. Further, total debt to GCA improved to 1.06x in FY21 as against 2.44x in FY20. The interest coverage remained comfortable at 15.34 times during FY21 as against 9.32x times during FY20.

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

Established track record and experienced promoter and management
Hetero is one of the major pharmaceutical groups in India. The group is engaged in the development and manufacturing of Active Pharmaceutical Ingredients (APIs), Intermediate Chemicals and Finished Dosage. The group has a portfolio of around more the 300 drugs spread across various therapeutic segments. The group has a presence in over 126 countries and has over 36 manufacturing units for pharmaceuticals products.
The group was established by Dr B Parthasaradhi Reddy in 1993. Dr Reddy has more than three decades of experience in the Indian pharmaceutical industry. The company has been growing over the years, adding numerous API products to its portfolio. The company has entered into formulations segment in 2006, and since then, it is focusing more on the finished dosages and has added about 300 products to its portfolio. The overall management of the company is looked after by the promoter himself and is supported by experienced and professional management team with a long track record in the pharmaceutical industry.

Strong product portfolio spread across multiple therapeutic segments
HDL (standalone) has a strong product portfolio of 110 products in APIs. During FY21, Nebivolol contributed 12% of net sales. The contribution of Nebivolol increased from 9.29% during FY20 to 12.00% during FY21. The other products such as Pantoprazole (7.61%), Atovaquone (6.36%), continue to be the major revenue contributors during FY21. The top 10 products have contributed 56.41% of the net sales during FY21 as against 52.66% during FY20 of net sales. Further, HDL has a presence across 49 therapeutic segments; with majority contribution from segments like Antihypertensive, Antiviral and antiulcer. Revenue from top 5 therapeutic segments during FY21 stands at 62.33% as against 59.45% in FY20.

Reputed and diversified clientele base
HDL has a diversified client base for APIs, including most of the major pharmaceuticals players in India, USA and European countries. During FY21, Hetero Labs Ltd (27.14%), Invagen Pharmaceuticals Inc (5.90%), Sandoz AG (4.14%) and Novartis International Pharmaceutical (4.15%) continued to be the major revenue contributors. The revenue from top 5 clients stood at 45.13% during FY21 as against 42.98% during FY20. The company also supplies to other reputed pharma players such as Ajanta Pharma Limited , Cipla Limited, Lupin Limited , Intas Pharmaceuticals. Further, During FY21 domestic revenue contributed to the highest share of the revenue at 45.87% followed by USA(11.32%), Ireland(5.42%), Bulgaria (3.85%) among others.

Key Rating Weaknesses
Continued elongated operating cycle; albeit improved
During FY21, the operating cycle of the company improved to 109 days from 144 days during FY19. The collection days stood at 114 days during FY21 as against 158 days during FY20. The collection period is relatively on a higher side due to extended credit period provided to the group companies mainly Hetero Lab Limited. About 34% of the total receivables are to be received from Hetero labs and with the healthy credit profile of Hetero Labs and other clients of the company, the risk of debtors getting defaulted is mitigated to a great extent. Further, substantial revenue is derived from exports (59.48% of HDL's revenue is from the exports) and in order to have long standing relationship with the overseas clients, the company is offering credit period to its customers. However, the higher collection period is offset to some extent by credit period from suppliers and balance is met through working capital limits.

Foreign exchange fluctuation risk
HDL is exposed to foreign exchange fluctuation risk in view of huge volume and high value transactions of export and import, a phenomenon common to the players in the industry. However, for HDL, the risk gets mitigated to certain extent as the contracts have clause embedded for the exchange rate fluctuation and there is natural hedging through netting off the imports and exports.

Exposure to regulatory risk
The company is exposed to regulatory risk with its operations centered majorly into manufacturing APIs. The pharmaceutical industry is highly regulated in many other countries and requires various approvals, licenses, registrations and permissions for business activities. The approval process for a new product registration is complex, lengthy and expensive. The time taken to obtain approval varies by country but generally takes from six months to several years from the date of application. Any delay or failure in getting approval for new product launch could adversely affect the business prospect of the company. Given, India's significant share in the USA's generic market, the USFDA has increased its scrutiny of manufacturing facilities and other regulatory compliance of the Indian pharma companies supplying generics drugs to the USA. Non-compliance may result in regulatory ban on products/facilities (as in the recent cases of import alerts issued by the USFDA to top pharma companies) and may impact a company's future approvals from USFDA. Hence, ongoing regulatory compliance has become critical for Indian pharma companies including HDL as it seeks to strengthen its position in the regulated markets like USA, UK etc. During FY20 USFDA inspected Unit I and no critical observations were made.

Liquidity: Strong
Liquidity is marked by strong accruals of Rs. 346 crore against debt repayment obligations of Rs. 51 crore. HDL is having liquid investments in the form of cash and bank balances to the tune of Rs.48 crore as on March 31st, 2021. The overall gearing stood comfortable at 0.19x as on March 31st, 2021. The average working capital utilization limits stood below 35% during the 12 month period ended October 2021 leaving adequate unutilized bank lines to meet its incremental working capital needs over the next one year.

Analytical approach:
Consolidated - CARE Ratings in its analysis has considered the consolidated business and financial risk profiles of Hetero Drugs Limited and its subsidiaries/associates/Joint Ventures as these entities are linked through a parent-subsidiary relationship and collectively have common management, business & financial linkages.

Applicable Criteria
Policy on default recognition
Consolidation
Factoring Linkages Parent Sub JV Group
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Manufacturing Companies
Pharmaceutical

About the Company
Incorporated in 1993, Hetero Drugs Ltd (HDL) is a part of the Hetero Group. HDL is a pharmaceutical company, primarily engaged in manufacturing of Active Pharmaceutical Ingredients (API's). HDL was initially incorporated as a Private Limited Company and subsequently converted into Public limited company in 1996. Hetero group is one of the major pharmaceutical groups in India.
HDL is promoted by Dr. B. Parthasaradhi Reddy, Chairman and Managing Director of the company. HDL is a closely held company with entire 100% shareholding being held by promoters and associates.
HDL has three manufacturing units and one R&D unit, which are located in Telangana and Andhra Pradesh. Manufacturing facilities have been approved by the US FDA, WHO-Geneva, Spanish Agency of Medicines & Healthcare products, ANVISA-Brazil, IDA-Netherlands etc.

Brief Financials (Rs. crore)	31-03-2020 (A)	31-03-2021 (A)	H1FY22
Total operating income	1,879.51	2,442.18	Not available
PBILDT	306.80	382.05	
PAT	187.26	223.39	
Overall gearing (times)	0.31	0.20	
Interest coverage (times)	9.37	12.64	

A: Audited
Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3*

Complexity level of various instruments rated for this company: Annexure 4

Annexure-1: Details of Instruments / Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit		-	-	-	360.00	CARE A+ (CWD)
Non-fund-based - LT/ ST-BG/LC		-	-	-	200.00	CARE A+ / CARE A1 (CWD)
Fund-based - LT-Term Loan		-	-	March 2023	52.30	CARE A+ (CWD)

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Fund-based - LT-Cash Credit	LT	360.00	CARE A+ (CWD)	1)CARE A+ (CWD) (19-Oct-21)	1)CARE A+; Stable (08-Jan-21)	1)CARE A; Stable (04-Mar-20) 2)CARE A; Stable (13-Feb-20) 3)CARE A; Stable (04-Apr-19)	-
2	Non-fund-based - LT/ ST-BG/LC	LT/ST*	200.00	CARE A+ / CARE A1 (CWD)	1)CARE A+ / CARE A1 (CWD) (19-Oct-21)	1)CARE A+; Stable / CARE A1 (08-Jan-21)	1)CARE A; Stable / CARE A1 (04-Mar-20) 2)CARE A; Stable / CARE A1 (13-Feb-20) 3)CARE A; Stable / CARE A1 (04-Apr-19)	-
3	Fund-based - LT-Term Loan	LT	52.30	CARE A+ (CWD)	1)CARE A+ (CWD) (19-Oct-21)	1)CARE A+; Stable (08-Jan-21)	1)CARE A; Stable (04-Mar-20)	-

** Long Term / Short Term*

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities : Not Applicable

Annexure 4: Complexity level of various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	Fund-based - LT-Cash Credit	Simple
2	Fund-based - LT-Term Loan	Simple
3	Non-fund-based - LT/ ST-BG/LC	Simple

Annexure-6: List of subsidiaries / joint ventures / associates of HDL getting consolidated

Sr. No.	Name of the Entity	Subsidiary / Joint Venture / Associate	% Shareholding by HDL as on March 31, 2021
1.	Aanodayaa Industries Limited	Subsidiary	100.00
2.	Vibhavari Industries Limited	Subsidiary	100.00
3.	Hetero Drugs South Africa (PTY) Limited	Subsidiary	100.00
4.	Asphar Research Labs Private Limited	Subsidiary	90.00
5.	Valary Labs Private Limited	Subsidiary	100.00
6.	Sicopa Labs Private Limited	Subsidiary	100.00
7.	Hetero Med Solutions Limited	Associate	49.03
8.	Sri Sai Ashirwaad Logistics Limited	Associate	50.00
9.	Hetero Wind Power Limited	Associate	48.62
10.	Hetero Europe S.L	Associate	50.00
11.	Hetero USA Inc	Associate	50.00
12.	Pharma Healthcare SAE	Joint Venture	25.50

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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