Honour Lab Limited

January 10, 2023

Ratings

Facilities	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	220.00 (Enhanced from 191.25)	CARE A; Stable (Single A; Outlook: Stable)	Reaffirmed and removed from (Rating Watch with Developing Implications; Stable outlook assigned)
Short Term Bank Facilities	231.00 (Enhanced from 201.00)	CARE A1 (A One)	Reaffirmed and removed from (Rating Watch with Developing Implications)
Total Bank Facilities	**451.00 (₹ Four Hundred Fifty-One Crore Only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

The ratings assigned to the bank facilities of Honour Lab Limited (hereinafter known as 'Honour' or the 'Company') have been reaffirmed and removed from 'Rating Watch with Developing implications (RWD)'. The ratings earlier were placed on RWD subsequent to Income Tax search operations carried out in the company during October 2021 and the probable impact of the same on business and operations of the company. During the period under credit watch, CARE Ratings Limited (CARE Ratings) had been engaging in dialogue with the company's management to understand developments pertaining to the event. As per the company it has not received any demand from Income Tax department and the company has offered additional income during FY22 (refers to period April 01 to March 31) post Income tax search and has provided for the tax on the same. During FY22 the company reported Total operating income of Rs. 2250 crore (as against Rs. 2184 crore during FY21) with PBILDT margin of 14% (as against 24% during FY21). Overall gearing remained comfortable at 0.29 as on March 31st, 2022. However, CARE Ratings would continue to monitor development with regard to the above event.

Ratings assigned to the bank facilities of Honour Lab Limited continues to derive strength from experienced promoters, synergizing the operations of the group through expanding the backward integration, adequate liquidity position and favourable industry prospects. The ratings have also factored in the robust capital structure and attractive debt coverage indicators. The ratings, however, are tempered by revenue concentration in the product portfolio, client concentration risk and exposure to regulatory risk. The muted growth in revenues combined with fall in profitability margins and stretched working capital cycle act as a constraint.

Rating sensitivities

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

- Improvement in scale of operations by 10% while maintaining PBILDT margin at 20% and above on a sustained basis
- Ability of the company to reduce the product and customer concentration risk by increasing its product and customer portfolio.

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

- Deterioration in capital structure as marked by overall gearing beyond 0.7x
- Elongation of debtor days beyond 100 days in future years
- Any adverse assessment proceeding from income tax department resulting negatively on the operation or liquidity of the company

Detailed description of the key rating drivers

<u>Key rating strengths</u>

Robust capital structure and comfortable debt coverage indicators

The overall gearing at the consolidated level as od March 31, 2022 remained comfortable and remained largely in line with last year figures at 0.28x (PY 0.26x). Furthermore, the debt coverage indicators remained comfortable in FY22. Interest coverage ratio moderately reduced from 18x in FY21 to 13x in FY22 on account of decrease in PBILDT levels. Total debt/GCA increased from 0.53x as in FY21 to 1.19x in FY22 on the back of increase in debt levels and a ~34% fall in GCA.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Promoted by promoter of the Hetero group, a reputed player in the pharma business
Hetero is one of the major pharmaceutical groups in India which is promoted by Dr B Parthasaradhi Reddy. The group consists of various pharmaceuticals companies such as Hetero Labs Limited, Hetero Drugs Limited, Honour, Hindys Lab Private Limited, Hazelo Lab Private Limited, Dasami Lab Private Limited, etc. 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 600 products spread across various therapeutic segments. The group has a presence in 140 countries and has 25 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.

Synergizing the operations of the group through expanding the backward integration albeit high customer concentration
Honour commenced its operations in May 2012 with an objective to primarily facilitate and enhance the cost competitive advantage in procuring intermediates and APIs for group companies particularly Hetero Labs Limited (HLL) and Hetero Drugs Limited (HDL). Earlier, HLL and HDL used to import certain Intermediates and APIs from China. However, due to its large volume requirement and high price of imported product, the group decided to manufacture the same in-house within the group. Hence, Honour was incorporated to support Hetero's requirement largely for intermediates and a few APIs and thus function as a backward integration arm of Hetero. With setting up of Honour, the group's pressure arising from low bargaining power with suppliers, which in turn can affect profitability, has reduced to a large extent. Hence, HLL and HDL are the prime clients for Honour which contributed around 55% and 2% of the total operating income, respectively, during FY22 (against combined sales of 63% and 2% during FY21 to HLL and HDL). The balance 42% sales are from other reputed clients, namely, Mylan Laboratories Limited, Alkem Laboratories Limited etc. In order to support the growing operations, the company has continuously increased its capacity every year. Honour has five operating units, two located at Pune, one at Medak district in Telangana, one at Nakkapalli Mandal in Vizag and one in Sangareddy district in Telangana.

Key rating weaknesses
Muted growth in operating revenue coupled with deterioration in profitability margins
The total operating income of the company, at consolidated level, has increased 3% from Rs. 2184 crore during FY21 to Rs. 2250 crore during FY22 vs a 67% YoY increase in FY21. The significant increase in the revenue in FY21 was on account of new products added namely Remdesivir (sales in FY22 fell 53% to Rs. 188 crores as compared to Rs. 401 corers in FY21) and Favipiravir (sales fell 10% from Rs. 101 crores in FY21 to Rs. 90 crores in FY22) which are being used in treating Covid-19 extensively. Sales growth was muted in FY22 and is expected to further moderate during FY23 owing to fall in sales of the COVID related products.
PBILDT margins for FY22 moderated from 24% in FY21 to 14% owing to a 25% increase in raw material costs. The raw material costs increased on account of overall inflationary scenario, higher solvents price and the increase in logistics costs, resulting from the Russian Ukraine war. Also, the exceptional margins in FY21 was also on account of account of sudden spike in the demand for COVID related antiviral products for which the company enjoyed better pricing power in FY21.

Extended working capital cycle
The working capital cycle of Honour on consolidated basis stood at 90 days in FY22 vis-a-vis 68 days in FY21. This is mainly due to higher inventory holding period. The inventory holding period increased from 68 days during FY21 to 79 days during FY21. The collection period remained largely in line with FY22 figures at 58 days (PY 57 days). Further, the average working capital utilization of the company for the past 12 months ended September 2022 remained at 86%.

Product concentration risk
Honour has a product portfolio of about 75 products in intermediates and APIs catering to various therapeutic segments such as anti-retroviral, antiviral, antidepressant, epilepsy, antibiotic etc. However, Honour is exposed to product concentration risk with 57% of sales being derived from top 10 products (64% in FY21). The revenue from Remdesivir contributed 8% of the revenue in FY22 which was being used in treating Covid-19 extensively. Nevertheless, the company has been adding new products to its portfolio to reduce the product concentration risk. Further, the company has filed around 9 DMFs during FY22 and is expecting to file more DMFs in the coming quarters. The company has total 47 DMFs filed on its name till March 31, 2022.

Exposure to regulatory risk
Honour along with the subsidiaries is exposed to regulatory risk with its operations centered majorly into manufacturing pharmaceutical formulations along with 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 Honour. 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 Honour as it seeks to strengthen its position in the regulated markets like USA, UK etc.

Liquidity: Adequate
The liquidity profile of the company is adequate. The company has been generating sufficient cash accruals at around Rs. 200-250 crores vis-à-vis repayment obligations of around Rs. 35 crores. The company has unutilized bank limits around 15%-20% supported by current ratio of 1.71x as on March 31, 2022. The gross cash accruals of Rs. 239 crore is more than adequate to meet its incremental working capital needs in the near future. With a gearing of 0.29x as of March 31,2022, the company has sufficient gearing headroom, to raise additional debt for its capex.

Analytical approach
Consolidated; the consolidated business and financial risk profiles of Honour and its subsidiaries is being considered as these entities are linked through a parent-subsidiary relationship and collectively have common management, business & financial linkages. The approach also factors in linkages with the Hetero group.

Applicable criteria
Policy on default recognition
Consolidation
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Manufacturing Companies
Pharmaceutical
Policy on Withdrawal of Ratings

About the company
Incorporated in November 2011, Honour Lab Limited (Honour), is a part of the Hetero group, promoted by Dr B. Parthasaradhi Reddy. Honour is a pharmaceutical company, primarily engaged in the manufacturing of intermediates and Active Pharmaceutical Ingredients (APIs). Honour commenced its operation in May 2012 by acquiring bulk drug intermediary manufacturing unit with export potential in the special economic zone (for pharmaceuticals being promoted by Hetero Infrastructure SEZ Limited) at Narsapuram village, Nakkapalli, Andhra Pradesh. Subsequently, Honour has been doing continuous capacity expansion with addition of new units. As on March 31, 2020, Honour has five manufacturing unit at various locations in the state of Telangana, Maharashtra and Andhra Pradesh. The unit at Nakkapalli in Andhra Pradesh is approved by USFDA. The unit at Sangareddy in Telangana is approved by domestic GMP and GMP, Germany. Honour at present is engaged in manufacturing of intermediates largely and few APIs which are mainly supplied to Hetero Labs Limited (HLL) to cater the requirement of HLL's API unit for antiretroviral (ARV) drugs. Hetero group is a research based global pharmaceutical company focused on development, manufacturing and marketing of intermediates chemicals, APIs and finished dosages through its various companies; HLL, Hetero Drugs Limited (HDL), Cirex Pharmaceuticals Limited, Hetero Med Solutions Limited, Hindys Lab Private Limited, Hetero Healthcare Limited, etc

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	H1FY23 (UA)	Q3FY23 (UA)
Total operating income	2184.01	2250.04	1087.51	NA
PBILDT	533.99	316.64	101.69	
PAT	362.79	210.71	54.80	
Overall gearing (times)	0.26	0.29	NA	
Interest coverage (times)	17.80	12.85	6.13	

A: Audited; UA: Unaudited; NA – Not available

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: 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 (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Cash Credit		-	-	-	220.00	CARE A; Stable
Fund-based - ST-Working Capital Demand loan		-	-	-	80.00	CARE A1
Non-fund-based - ST-Bank Guarantee		-	-	-	10.00	CARE A1
Non-fund-based - ST-Letter of credit		-	-	-	141.00	CARE A1

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Term Loan	LT	-	-	-	-	1)Withdrawn (04-Jan-21)	1)CARE A-; Stable (06-Jan-20)
2	Fund-based - LT-Cash Credit	LT	220.00	CARE A; Stable	1)CARE A (RWD) (27-Dec-22)	1)CARE A (CW with Developing Implications) (19-Oct-21) 2)CARE A; Positive (06-Oct-21)	1)CARE A; Stable (04-Jan-21)	1)CARE A-; Stable (06-Jan-20)
3	Non-fund-based - ST-Letter of credit	ST	141.00	CARE A1	1)CARE A1 (RWD) (27-Dec-22)	1)CARE A1 (CW with Developing Implications) (19-Oct-21) 2)CARE A1 (06-Oct-21)	1)CARE A2+ (04-Jan-21)	1)CARE A2 (06-Jan-20)
4	Non-fund-based - ST-Bank Guarantee	ST	10.00	CARE A1	1)CARE A1 (RWD) (27-Dec-22)	1)CARE A1 (CW with Developing Implications)	1)CARE A2+ (04-Jan-21)	1)CARE A2 (06-Jan-20)

						(19-Oct-21) 2)CARE A1 (06-Oct-21)		
5	Fund-based - ST-Working Capital Demand loan	ST	80.00	CARE A1	1)CARE A1 (RWD) (27-Dec-22)	1)CARE A1 (CW with Developing Implications) (19-Oct-21) 2)CARE A1 (06-Oct-21)	1)CARE A2+ (04-Jan-21)	1)CARE A2 (06-Jan-20)

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/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 - ST-Working Capital Demand loan	Simple
3	Non-fund-based - ST-Bank Guarantee	Simple
4	Non-fund-based - ST-Letter of credit	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

Annexure – 6: List of subsidiaries consolidated as on March 31, 2022

Name	% Holding as on March 31, 2022
Veer East Realty India Private Limited	100%
Hoster Labs Private Limited	100%
Dyuthi Labs Private Limited	100%

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

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About us:
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