Orchid Pharma Limited

February 10, 2023

Facilities	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	289.65 (Enhanced from 261.00)	CARE BBB; Stable	Revised from CARE BBB- (Rating Watch with Developing Implications) and removed from Rating Watch with Developing Implications ; Stable outlook assigned
Long Term / Short Term Bank Facilities	75.00	CARE BBB; Stable / CARE A3+	Assigned
Short Term Bank Facilities	99.00 (Enhanced from 50.00)	CARE A3+	Revised from CARE A3 (Rating Watch with Developing Implications) and removed from Rating Watch with Developing Implications

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

CARE Ratings Limited (CARE Ratings) had earlier placed the ratings assigned to the bank facilities of Orchid Pharma Limited (Orchid) on Rating Watch with developing implications following the company's announcement of a proposed scheme of amalgamation and arrangement between its parent company, Dhanuka Laboratories Limited (DLL), and itself. CARE Ratings has now removed the rating from Rating Watch with developing implications, as the company has now called off the proposed scheme and withdrawn the application with National Company Law Tribunal (NCLT).

Furthermore, CARE Ratings has revised the ratings assigned to the bank facilities of Orchid considering the improved operational performance marked by improved capacity utilisation levels, more so in the sterile segment where utilisation levels are nearly full. The improved demand for the company's products and streamlining of operations has helped the company report better profits despite cost pressures. Furthermore, the company's efforts in deleveraging the balance sheet by way of using the proceeds from sale of non-core assets have aided in improving the financial metrics.
The ratings continue to draw comfort from the promoter's experience in the pharmaceutical industry, accredited manufacturing facility of the company with presence in the regulated markets.
The ratings are tempered by the concentrated product portfolio, exposure to the regulatory risk and substantial dependence on imports from China for the raw materials.

CARE Ratings also takes into account the proposed large debt-funded capital expenditure plan in a subsidiary, which would be a backward integrated into production of key starting material (KSM). The equity contribution for this capital expenditure would be from the planned qualified institutional placement (QIP) issue and is not expected to be out of the existing accruals. CARE Ratings notes that with the scaling up of the existing operations backed by capacity addition and launch of new products, the overall leverage and debt coverage metrics would be in line with the rating category on a consolidated basis. The progress of the project and scaling up of operations would remain a key credit monitorable.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Scaling of operations to about ₹1000 crore on the back of enhanced capacities, new product launches and successful receipt of royalty proceeds from out licensing the New Chemical entity (NCE)

Negative factors

- Any negative regulatory observations resulting in disruption of operations.
- Increase in the leverage levels with total debt to gross cash accruals (GCA) exceeding 3.5x.
- Delays in project implementation or cost overruns in the project being implemented at a consolidated level

Analytical approach: Consolidated

CARE Ratings has adopted the consolidated approach for analysing Orchid Pharma Limited. The consolidated balance sheet of Orchid includes the following subsidiaries:

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

Subsidiaries	Shareholding
Orchid Pharmaceuticals Inc. USA	100%
Bexel Pharmaceuticals Inc. USA	100%
Orchid Pharmaceuticals SA(Proprietory)Limited, South Africa	100%
Diakron Pharmaceuticals Inc. USA	76.65%

Key strengths

State-of-the-art manufacturing facility with approvals from regulated markets:

Orchid has three plants with the main plant at Alathur, Chennai, being the active pharmaceutical ingredients (API) manufacturing unit. This plant is certified by USFDA, MHRA –UK, EDQM, and GMP for manufacture of Cephalosporin-based APIs. The company is also one among the three global players to have a USFDA approvals for Cephalosporin-based Sterile APIs. The Alathur API unit contributes to more than 95% to the total revenues of the company.

More than three decades of experience of the promoters in the pharmaceutical industry

The promoters, the Dhanuka group, have presence in the agrochemical and pharmaceutical industries. Their experience in the pharmaceutical business comes from two companies, viz., Dhanuka Laboratories Limited (DLL) and Synmedic Laboratories. Manish Dhanuka, the Managing Director of Orchid, is a chemical engineer from IIT Delhi, completing his masters in chemical Engineering from University of Akron, USA. He has more than 26 years' experience in the pharmaceutical industry.

Improvement in capacity utilisation and further capacity expansion

Since the implementation of CDR for Orchid under the earlier management in 2014, the strained working capital availability had significantly impacted the capacity utilisation levels of the units, leading to the company's output remaining at sub break-even levels, which resulted in accumulated losses and cash crunch. However, post the resolution and take-over, the company has shown steady improvement in capacity utilisation to about 42% in FY22. API - Sterile has been seeing a steady increase in utilisation from around 50% utilisation in FY19 to being fully utilised in FY22 and FY23.

Improved operational performance marked by increase in TOI and profitability

The demand for anti-biotics saw a dip due to reduction in elective surgical procedures and non-COVID-19-related treatments and the revenue saw a decline. Post-COVID, after opening up, there has been an increased demand and therefore the TOI of the company has seen an increase by 26% as against FY21 and an increase of 24% in 9MFY23 as against 9MFY22. Further, in terms of margins, the company has taken cost-saving measures after the take-over which has resulted in double digit margins as compared to losses in FY19. The margins dropped in FY22 due to increase in input costs in FY22, however, the same has corrected in 9MFY23 and Orchid has posted a PBILDT margin of 13% on a TOI of ₹ 473 crore for the period.

Successful completion of Phase III trials of NCE and commercialisation of the same

The company has developed a NCE known as Enmetazobactam which has completed global phase-3 clinical trials as well. Enmetazobactam is an anti-infective molecules to have completed phase-3 trials and is in the New Drug Application phase. The molecule was out-licensed in 2013 to a European company, Allecra Therapeutics, and Allecra has further outlicensed to Advanz Pharma in Europe and Shanghai Haini in China. As per the out-licensing agreement, Orchid Pharma is entitled to a royalty on worldwide sales of the product. The sales in China are expected to happen in the end of FY24, while US and Europe sales are expected from FY25.

Improvement in the capital structure backed by efforts to deleverage the balance sheet

Orchid had bank loans of ₹427 crore at the beginning of FY21, and it has been pre-paying the loans sale of non-core assets and other current asset realisations. The only non-core asset left to be sold as per the resolution agreement is the Orchid Towers. This is expected to be done in FY23, and the proceeds of the same are expected to be also used for repayment of the loan. Furthermore, The company has announced issue of shares through QIP programme and has approvals for ₹ 500 crore to be raised through this. With this QIP, the Dhanuka group would also be meeting its mandatory obligation to dilute 15% stake in Orchid and bring the shareholding down to 75% by March 2023.

Key weaknesses

Exposure to regulatory risk

The pharmaceutical industry is highly regulated and requires various approvals, licenses, registrations and permissions for conducting business activities. The approval process for a new product registration is complex, lengthy and expensive. The time taken to obtain approval varies across countries and authorities, usually taking a minimum of six months to several years from the date of application. Any delay or failure in obtaining approvals for new product launch could adversely affect the business prospects of the company.

Dependence on China for raw materials
Orchid imports nearly 70% of its raw material requirements, majority of them from China. The dependence on import of key starting material (KSM) increased from around 48% of the total purchases in FY18 to 66% in FY21. The increasing import dependency can be attributed primarily to the availability of low-cost raw materials; however, the high dependency on China for raw material procurement remains a concern.

Capital expenditure plans under its wholly-owned subsidiary
For mitigating the dependence on imports for majority of the raw materials, the company is now planning to start its own facility for manufacturing KSMs under a wholly-owned subsidiary. For this purpose, Orchid has set up a subsidiary called Orchid Bio Pharma limited for undertaking PLI-based capex project in Jammu. Orchid has received 1000 MTPA approval from Government of India in its WoS. The estimated cost is ₹500-600 crore out of which ₹ 150 crore is expected to be funded out of equity. This equity infusion is expected to happen from Orchid from the proceeds of QIP issue proposed. ₹400-450 crore would be met out of debt for which the company would have benefit of interest subvention under the PLI scheme. About 75% of the offtake is expected to be from Orchid, and the rest would be to third parties directly from the subsidiary.
Furthermore, the company is undertaking a capital expenditure for expansion of its capacity in standalone books at its Alathur facility for about ₹60 crore for which ₹50 crore of debt is sanctioned. Capacity expansion of about 75% is expected and the revenue is expected to flow from FY24 onwards.

Liquidity: Adequate
With working capital made available by the new management, the capacity utilisation has improved thereby improving cash flows. The company had cash balances of ₹4.59 crore as on September 30, 2022, and the working capital utilisation remained 50% for the 12 months ended November 2022. The company has also prepaid major portion of its term-loan obligations aided by liquidation of assets. However, the operations are working capital intensive with the company availing around 60-90 days of credit period from suppliers and 75 days credit period given to the customers. The company maintains inventory of about 120-130 days.

Industry prospects:
The Indian pharmaceutical industry globally ranks third in terms of volume and thirteenth in terms of value. The industry has exhibited compounded annual growth rate (CAGR) of 8%-9% during last five years, i.e., FY17-FY22. The export growth is expected to be led by increasing generic penetration in the regulated markets on the back of enhanced focus on the niche and complex product segments, patent expiries, medicine patent pool announcing licensing agreement with pharmaceutical companies and growing demand from semi-regulated pharma markets. Post-COVID-19, several global and domestic companies have sought for China plus one supplier base to have diversified supplier base, which has been advantageous to the Indian Pharma players. The Government of India has also seen this opportunity and announced incentives in the form of PLI schemes and policies, encouraging Indian players to invest and develop APIs. With growing demand from global and domestic markets, supported by expanding manufacturing capabilities and policy initiatives, the growth prospects of the Indian pharmaceutical industry remain healthy.

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

About the company
Orchid Pharma Limited (Orchid), established in 1992, is an integrated pharmaceutical company with presence in bulk drug manufacturing and formulations. The company was acquired by Dhanuka Laboratories Limited (DLL) under Corporate Insolvency Resolution Process (CIRP) by The National Company Law Tribunal (NCLT) and the resolution plan has been

implemented w.e.f. March 31, 2020. Orchid, at present, has three manufacturing facilities in Chennai. The API unit at Alathur is USFDA certified, while the two formulations unit in Alathur cater to exports to non-regulated markets and the domestic market.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	9MFY23 (Prov.)
Total operating income	453.55	567.14	473.69
PBILDT	54.22	62.16	61.63
PAT	-95.25	-1.95	-12.82
Overall gearing (times)	0.89	0.58	NA
Interest coverage (times)	1.04	1.86	2.49

A: Audited; Prov.: Provisional

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 the covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of the various instruments rated: Annexure-4

Lender details: Annexure-5

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		-	-	-	75.00	CARE BBB; Stable
Fund-based - LT-Term Loan		-	-	March 2027	214.65	CARE BBB; Stable
LT/ST Fund-based/Non-fund-based-CC/WCDL/OD/LC/BG		-	-	-	75.00	CARE BBB; Stable / CARE A3+
Non-fund-based - ST-BG/LC		-	-	-	99.00	CARE A3+

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 (02-Sep-20)	1)CARE D; ISSUER NOT COOPERATING* (03-Sep-19)
2	Fund-based - ST-	ST**	-	-	-	-	1)Withdrawn	1)CARE D;

	EPC/PSC						(02-Sep-20)	ISSUER NOT COOPERATING* (03-Sep-19)
3	Fund-based - LT-Term Loan	LT*	214.65	CARE BBB; Stable	1)CARE BBB- (RWD) (27-Dec-22)	1)CARE BBB- (CW with Developing Implications) (27-Dec-21) 2)CARE BBB-; Stable (29-Sep-21)	1)CARE BB+; Stable (05-Oct-20)	-
4	Non-fund-based - ST-BG/LC	ST**	99.00	CARE A3+	1)CARE A3 (RWD) (27-Dec-22)	1)CARE A3 (CW with Developing Implications) (27-Dec-21) 2)CARE A3 (29-Sep-21)	1)CARE A4+ (05-Oct-20)	-
5	Fund-based - LT-Cash Credit	LT*	75.00	CARE BBB; Stable	1)CARE BBB- (RWD) (27-Dec-22)	1)CARE BBB- (CW with Developing Implications) (27-Dec-21) 2)CARE BBB-; Stable (29-Sep-21)	-	-
6	LT/ST Fund-based/Non-fund-based-CC/WCDL/OD/LC/BG	LT/ST	75.00	CARE BBB; Stable / CARE A3+				

*Long term; **Short term.

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

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Fund-based - LT-Cash Credit	Simple
2	Fund-based - LT-Term Loan	Simple
3	LT/ST Fund-based/Non-fund-based-CC/WCDL/OD/LC/BG	Simple
4	Non-fund-based - ST-BG/LC	Simple

Annexure-5: Lender details

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

Note on the 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:

Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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