

Hetero Drugs Limited

October 19, 2021

Ratings

Facilities	Amount (Rs. crore)	Rating ¹	Rating Action
Long Term Bank Facilities	478.00 (Reduced from 503.00)	CARE A+ (CWD) (Single A Plus) (Under Credit watch with Developing Implications)	Placed 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)	Placed on Credit watch with Developing Implications
Total Bank Facilities	678.00 (Rs. Six Hundred Seventy-Eight Crore Only)		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

CARE has placed the ratings of Hetero Drugs Limited (HDL) on 'Credit watch with developing implications' following the various media articles on 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 mentioned 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 the company's regular operations.

CARE is trying to reach out to management to understand the impact of event and outcome of the ITD raid. CARE will remove the rating 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) continue to factor in healthy growth in total operating income, improvement in profitability margins during FY20 (Refers to period April 01 to March 31) and during H1-FY21. The long term rating also factors in improvement in overall financial risk profile marked by overall gearing and debt coverage indicators along with improvement in working capital cycle during FY20. 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, integrated 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

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

Negative Factors

- Overall gearing deteriorating beyond 0.60x on sustained basis
- Further investments in associate companies beyond 20% of the net worth

Detailed description of the key rating drivers

Key Rating Strengths

Part of the Hetero group, a reputed player in the pharma business

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 over 300 products spread across various therapeutic segments. The group has presence in over 120 countries with around 33 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.

Strong product portfolio spread across multiple therapeutic segments

HDL (standalone) has a strong product portfolio of 117 products in APIs. During FY20, Pantoprazole contributed to 11.54% of net sales. The contribution of Pantoprazole increased from 5.95% during FY19 to 11.54% during FY20. The other products

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

such as Nebivolol (9.29%), Montelukast Sodium (6.45%), continue to be the major revenue contributors during FY20. The top 10 products have contributed 52.66% of the net sales during FY20 as against 47.28% during FY19 of net sales. Further, HDL has a presence across 48 therapeutic segments; with majority contribution from segments like Antihypertensive, Antiviral and antiulcer. Revenue from top 5 therapeutic segments during FY20 stands at 59.45% as against 55.57% in FY19.

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 FY20, Hetero Labs Ltd (22.99%), Invagen Pharmaceuticals Inc (6.72%), Balkanpharma Dupnitsa Ad (5.32%) and Novartis International Pharmaceutical (5.44%) continued to be the major revenue contributors. The revenue from top 5 clients stood at 42.98% during FY20 as against 38.24% during FY19. Further, During FY20, revenue from domestic market contributed to the highest share followed by USA, Ireland, Bulgaria, Turkey and Switzerland among others.

Healthy growth in total operating income with stable profitability margins during FY20 and H1-FY21

During FY20, at consolidated level, the company has achieved around 15.86% growth in its total operating income which stood at Rs.2068.03 crore during FY20 as against Rs.1784.92 crore during FY19. The total operating income of the company improved on account of healthy growth in sales in Anti-Ulcer therapeutic segment (51.74% growth during FY20) which led to growth in sales of Pantoprazole. Revenue contribution from domestic markets increased to 48.55% during FY20 from 32.47% during FY19. The PBILDT margins improved marginally by 16 bps from 14.76% to 14.92% during FY20. Further the PAT margins also improved to 9.00% during FY20 from 6.93% during FY19 on account of fixed costs. The company achieved turnover of Rs.1385 crore till Sep 30, 2020 at standalone level with PBILDT of Rs. 201.00 crore. The company has export order book of Rs.346.06 crore as on October 31st, 2020 to be executed during FY21.

Comfortable capital structure and moderate debt coverage indicators

Capital structure of HDL (consolidated) continued to remain comfortable represented by comfortable debt to equity and overall gearing as on March 31, 2020. The overall gearing as on March 31, 2020 improved marginally and stood at 0.31x as against 0.34x as on March 31, 2019. Further, total debt to GCA improved to 2.44x in FY20 as against 2.90x in FY19 due higher GCA levels during FY20. The interest coverage indicator of the company represented by PBILDT/interest though deteriorated remained comfortable at 9.32 times during FY20 against 14.22 times during FY19. The increase in finance cost is due to disbursement of additional term loan during FY20 to the tune of Rs. 45.79 crore and due to interest on lease liability on account of adoption of IND AS 116 during FY20.

Healthy future business prospects

HDL has added new products to its product lines and filed DMFs globally. Hetero's product portfolio includes a mix of APIs across major therapeutic categories and has internationally accredited API manufacturing facilities capable of handling complex and hazardous reactions. Further, the company has introduced new products such as allopurinol (Anti-gout), metaxalone (muscle relaxant), bilastine (anti-histamines), regadenoson (anti-neoplast) during FY20. With high numbers of DMF's and wide opportunity available in USA and other markets the future prospects of the business are healthy.

Key Rating Weaknesses

Elongated operating cycle

During FY20, the operating cycle of the company improved to 144 days from 184 days during FY19. The collection days stood at 158 days during FY20 as against 193 days during FY19. 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 Ltd and with the healthy credit profile of Hetero Labs Ltd 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 (51.45% of HDL's revenue is from the exports) and in order to have long withstanding relationship with the overseas clients, the company offers credit period to its customers. However, the higher collection period is offset to some extent by credit period received from suppliers and balance is met through working capital limits. The average inventory holding period remained moderate at 76 days during FY20 as against 62 days during FY19.

Exposure towards group companies:

In order to reduce dependence on fossil fuel, Hetero group has set up Hetero Wind Power Limited (HWPL), with objective of wind power generation for captive consumption by Hetero Drugs Ltd (HDL) and Hetero Labs Ltd (HLL). HWPL had undertaken 54 MW [27 X 1.5 MW and 9 X 1.5 MW Regen Make V87 WTGs) wind power project during FY2013 at a cost of Rs.374.02 crore. HLL & HDL have extended joint Corporate Guarantee of Rs.182.41 crore (Rs. 144.49 crore outstanding as on December 22, 2020) for the loan availed by HWPL. The plant is located at Thirumalayapalli, YSR District. During FY17, Shri Bhramarambikas Industries Limited (SBIL, presently known as M/s. Saketha Drugs and Intermediates LLP) [in which the directors of M/s. Hetero Drugs Limited (HDL), cumulatively hold controlling stake], entered into a Stock Purchase Agreement

to sell its controlling stake in M/s Invagen Pharmaceutical Inc. New York, USA to M/s Cipla (EU) Limited, UK. To comply with one of the covenants of the said Stock Purchase Agreement, which required execution of a corporate guarantee to secure M/s. Cipla (EU) Limited, UK against improper discharge of various obligations of SBIL, HDL executed Corporate Guarantee to M/s Cipla Limited, India for an amount not exceeding Rs. 3,120.00 crore for a period of 6 years from the closing date (February 18, 2016). Besides, HDL invested Rs.115.01 crore in Hetero Wind Power Limited during FY20 to support its working capital requirements.

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. During FY20 HDL had forex fluctuation loss to the tune of Rs.6.5 crore against forex gain of Rs.30.99 crore during FY19.

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.209.74 crore against debt repayment obligations of Rs.54.31 crore. HDL is having liquid investments in the form of cash and bank balances to the tune of Rs.21.24 crore as on March 31, 2020. The overall gearing stood comfortable at 0.31x as on March 31st, 2020. The average utilization of working capital limits stood below 65% during the 12 month period ended September 30, 2020 leaving adequate unutilized bank lines to meet its incremental working capital needs over the next one year. Further the company did not avail moratorium under COVID-19 regulatory package.

Analytical approach: Consolidated

CARE in its analysis has considered the consolidated business and financial risk profiles of Hetero Drugs Limited and its subsidiaries/Associates/Joint Ventures (enlisted in Annexure 5) as these entities are linked through a parent-subsidiary relationship and collectively have common management, business & financial linkages.

Applicable Criteria

[Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings](#)

[Rating Methodology for consolidation and factoring Linkages in Ratings](#)

[CARE's Policy on Default Recognition](#)

[Liquidity analysis of Non-Financial Sector Entities](#)

[Criteria for Short Term Instruments](#)

[Rating Methodology- Manufacturing Companies](#)

[Rating Methodology- Pharmaceutical](#)

[Financial Ratios- Non-Financial Sector](#)

About the Company

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, 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. Hetero Drugs Limited- Consolidated

Brief Financials (Rs. crore)	FY19 (A)	FY20(A)
Total operating income	1784.93	2068.03
PBILD	263.47	308.68
PAT	123.73	186.25
Overall gearing (times)	0.34	0.31
Interest coverage (times)	14.22	9.32

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	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	118.00	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+; 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+; 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	118.00	CARE A+ (CWD)	-	1)CARE A+; Stable (08-Jan-21)	1)CARE A; Stable (04-Mar-20)	-

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities- NA
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-5: List of subsidiaries/Joint Venture/Associates of HDL getting consolidated

Sr. No.	Name of the Entity	Subsidiary / Joint Venture / Associate	% Shareholding by HDL as on March 31, 2020
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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