Hetero Labs Limited

October 19, 2021

Ratings

Facilities	Amount (Rs. crore)	Rating1	Rating Action
Long Term Bank Facilities	3,118.49	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	1,250.00	CARE A+ / CARE A1+ (CWD) (Single A Plus / A One Plus) (Under Credit watch with Developing Implications)	Placed on Credit watch with Developing Implications
Total Bank Facilities	**4,368.49 (Rs. Four Thousand Three Hundred Sixty-Eight Crore and Forty-Nine Lakhs Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

CARE has placed the ratings of Hetero Labs Limited (HLL) on 'Credit watch with developing implications' following the various media articles with regard to 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 their 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 HLL.

The ratings assigned to the bank facilities of HLL continue to factor in the healthy growth in total operating income, improvement in profitability margins during FY20 (refers to period April 01 to March 31), at consolidated level. The ratings also take into account the healthy growth prospects backed by licensing agreement with Gilead Sciences for manufacture of drugs being used for COVID-19 treatment. Further, at standalone level, during H1FY21, the total operating income of the company has improved significantly along with considerable improvement in profitability margins. 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, comfortable capital structure and moderate debt coverage indicators, integrated operations and favorable outlook for the pharmaceutical industry. The ratings, however, continue to remain constrained by elongated operating cycle, foreign exchange fluctuation risk and regulatory risk inherent in the pharmaceutical industry.

Rating Sensitivities

Positive Factors

- Improvement in the PBILDT margins on a sustained basis above 17%.
- Maintaining operating cycle days consistently below 180 days.

Negative Factors

- Overall gearing going above 1.30x on sustained basis.
- Substantial increase in exposure towards group companies.
- Undertaking any major capex or acquisition by utilizing the internal accruals which places the company under liquidity pressure.

Detailed description of the key rating drivers

Key Rating Strengths

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 product portfolio of around more the 300 products spread across various therapeutic segments with presence in over 126 countries and has over

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

36 manufacturing units. 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 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 and reputed clientele
HLL has a strong product portfolio of over 300 products in APIs and formulations. HLL has a presence across 20 therapeutic segments with majority of revenue contribution from high growth segments such as Antiretroviral (32.81% of total operating revenue during FY20), Antihypertensive (12.19%), Antiviral (10.16%), and Anti-neoplast (6.39%) etc. Further, HLL has been supplying APIs and formulation to most of the major pharmaceuticals players such as Sun Pharmaceutical Industries Limited, Cipla Limited, Lupin Limited, Dr. Reddy's Laboratories Limited, Torrent Pharmaceuticals Limited etc. Further, during FY20, revenue from US market contributed to the highest share of the revenue followed by domestic market, South Africa, UAE and Thailand.

Licensing Agreement with Gilead on Remdesivir and other COVID drugs:
Under current pandemic crisis, Hetero Labs Limited is one of the first companies in India that had introduced two products in India for treatment of COVID-19. They include Remdesivir and Favipiravir which were launched in June and July 2020 respectively. US-based bio-pharma firm Gilead Sciences Inc. signed non-exclusive voluntary licensing agreements with HLL and four other pharmaceutical companies to manufacture Remdesivir (antiviral drug) for distribution in 127 countries, subject to regulatory approvals in respective countries including India for COVID-19. In June 2020, Hetero received manufacturing and marketing approval for Remdesivir from Drug Controller General of India(DCGI) and it is being marketed under brand name 'COVIFOR' in India. The drug is available in 100mg vial (Injectable) and priced at Rs.5400 per vial. Hetero under the group company, Hetero Healthcare Limited delivered 20,000 vials in India. Besides Remdesivir, Hetero group launched Favipiravir in India under the brand name 'Favivir' in July 2020 for the treatment of COVID-19.

Healthy growth in total operating income and profitability margins during FY20 and H1-FY21
At consolidated level, HLL has achieved y-o-y growth of 12.38% in its total operating income which stood at Rs. 8193.01 crore during FY20 as against Rs. 7289.85 crore during FY19 (19.75% growth during FY19). Export sales contributed to 67.44% during FY20 as against 65.7% during FY19. HLL on standalone level achieved Rs. 5521.2 crore during the period ended September 30, 2020. HLL has already achieved 76% of the turnover registered during whole of FY20 during the first 6 months of FY21. The significant growth in revenue in H1-FY21 is due to increase in some of the existing products such as DLT (used for AIDS treatment), Levetiracetam (used for Anti-Convulsant) and Losartan and new products such as Remedisivir which is being used in COVID treatment. During FY20, the company has also filed 11 Abbreviated New Drug Applications (ANDA) approvals and received 6 ANDA approvals.
The PBILDT margin at consolidated level has improved marginally by 30 bps from 13.10% during FY19 to 13.40% during FY20. The margins are improving gradually with exports contributing to higher share in the revenue over the last three years. Further, the PAT margin improved by 119 bps from 2.87% during FY19 to 4.06% during FY20 due to fixed costs. HLL registered a PBILDT margin of 22.93% at standalone level during H1- FY21.

Comfortable capital structure and moderate debt coverage indicators
Capital structure of HLL (consolidated) continued to remain comfortable represented by debt to equity and overall gearing as on March 31, 2020. The overall gearing as on March 31, 2020 stood at 1.09x as against 1.02x as on March 31, 2019. The marginal deterioration in overall gearing is mainly due to adoption of IND AS 116 resulting in additional debt to the tune of Rs.204.10 crore on account of lease liability. Excluding the lease liability, the overall gearing would be at 1.04 times as on March 31, 2020. The debt risk metrics such as term debt/GCA improved to 3.87x in FY20 (against 4.85x in FY19) and total debt/GCA improved to 9.16x in FY20 (against 9.56x in FY19) owing to improvement in GCA levels from Rs. 520.92 crore during FY19 to Rs. 619.13 crore during FY20.

Healthy industry prospects
The Indian pharmaceutical industry is the third largest in the World in terms of volume and tenth largest in terms of value. The total size of the industry (including drugs & medical devices) is around US$43 billion and is currently having a growth rate of 7-8% in drug sector and 15- 16% in medical device sector. Total exports (drugs and medical devices) are to the tune of US$20 billion of which drugs form around 90% of the total exports. India is the largest provider of generic drugs globally. India is known for its affordable HIV treatment and low-cost vaccines in the world. The current Covid-19 crisis provides an opportunity to the Indian pharmaceutical industry to play an even more important role in global healthcare.

Integrated operations with presence across the pharma value chain
HLL procures a portion of raw material requirement i.e. APIs and intermediates from its group companies. The group has established various backward integrated units. During FY20, around 33.0 percent of the total raw materials were procured from its group companies (subsidiaries/associates and the companies on which key management personnel of HLL can exercise significant influence) out of which, HDL and Honour Labs were the major contributors. HLL is primarily engaged in the business of formulations segment, whereas HDL is mainly focusing on the API segment. HLL would continue to depend to procure APIs required for manufacture of finished dosages primarily from its associate concerns particularly Hetero Drugs Ltd, Honour Lab Ltd, Hindys labs, Dasami Labs and Cirex Pharmaceuticals Ltd.

Key Rating Weaknesses
Elongated operating cycle:
During FY20, the operating cycle of the company remained stable at 221 days as against 226 days during FY19. The average collection days and average inventory days stood at 150 days and 167 days respectively during FY20 as against 154 days and 173 days respectively during FY19. Further, the receivables below 90 days constituted 59.20% of total debtors as on September 30, 2020 as against 44.31% as on March 31st, 2020 and 45.73% as on March 31st, 2019 indicating better realizations over a period of time. However, the average collection period and average inventory holding period are relatively high as majority of the revenue is from exports and in order to have long withstanding relationship with the overseas clients, the company is offering credit period to its customers. Further, HLL has to maintain inventory at Camber Pharmaceuticals as the company caters to the top 3 wholesalers in the US market. HLL has to supply the products at just in time basis and any delay in supply attracts penalties. To overcome penalties the company has to maintain buffer stock. However, the same is offset to some extent by credit period from suppliers and balance is met through working capital limits.

Exposure to regulatory risk
The pharmaceutical industry is highly regulated and requires various approvals, licenses, registrations and permissions for business activities. Each authority has its own requirement and they could delay or refuse to grant approval, even when a product has already been approved in another country. HLL (standalone) has received about 6 ANDA approvals during FY2020 taking the total ANDA approvals to 92. HLL focuses on research and development and add new products in their portfolio every year. Further, Unit V located at Jadcherla was inspected by USFDA during December 2016. The warning letter cited significant violations of current good manufacturing practice (CGMP) regulations for finished pharmaceuticals. Based upon the nature of the violations, the USFDA strongly recommend engaging a consultant to assist the firm in meeting CGMP requirements. Until correction of all violations completely, FDA may withhold approval of any new applications or supplements listing HLL as a drug manufacturer. The company had appointed a consultant and has addressed the issue. Further, USFDA inspection of the same took place during Q2FY20 and the company is yet to receive revert from USFDA. The company can file for ANDA approvals from the Unit V once the USFDA issues closeout letter. Nonetheless, HLL continues to file ANDAs from other units.

Liquidity **: Strong**
Liquidity is marked by strong accruals of Rs.619.13 crore during FY20 against repayment obligations of Rs.319.50 crore during FY21. The company had cash balance of Rs. 94.14 crore as on March 31, 2020. Further, out of the total debt obligation of Rs. 319.50 crore, during FY21 the company had repaid Rs. 179.51 crore till Sep 30, 2020. Average of maximum monthly utilization of fund based limits during last 12 months ending October 2020 is at 78.47% and average of maximum monthly utilization of non-fund based limited during last 12 months ending June 2020 stood at 65.15%. On account of moderate utilization of fund based and non-fund based limits, the company has sufficient cushion of about Rs. 1050 crore (Rs. 612 crore of fund based limits and Rs. 438 crore of non-fund based limits) to meet any kind of exigencies. The current ratio of the company stood comfortable at 1.46 during as on March 31st, 2020. Further, the company did not avail any moratrorium as part of RBI COVID-19 regulatory package.

Analytical approach: Consolidated
Consolidated **-** CARE in its analysis has considered the consolidated business and financial risk profiles of Hetero Labs Limited and its subsidiaries/associates/Joint Ventures (provided 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
Incorporated in 1989, Hetero Labs Ltd (HLL) is the flagship company of the Hetero Group. HLL is a pharmaceutical company primarily engaged in manufacturing of active pharmaceutical ingredients (APIs) and finished dosages formulations (FDF). The company is promoted by Dr. B. Partha Saradhi Reddy, Chairman of the company and Hetero Group. HLL is a closely held company with entire 100% shareholding held by promoters and their associates. Hetero group is one of the leading generic pharmaceutical companies and is one of the world's largest producers of anti-retroviral drugs for the treatment of HIV/ AIDS. With more than two decades of experience in the pharma industry, the group's strategic business areas include APIs, generics and bio-similars. The group has more than 36 state of the art manufacturing facilities, located worldwide. Majority of the facilities have been successfully audited and approved by various regulatory authorities. The product portfolio of the group includes more than 400 products encompassing major therapeutic segments such as HIV/ AIDs, Oncology, Cardiovascular, Neurology and Hepatitis etc. The group has a global presence across 126 countries worldwide. HLL has 10 manufacturing facilities located at various places in Andhra Pradesh and Telangana, including one manufacturing facility for formulations in Baddi, Himachal Pradesh. Manufacturing facilities of the company have been approved by the US FDA, WHO, COFEPRIS Mexico, ANVISA-Brazil, NOMA – Norway and MCC South Africa.

Hetero Labs Limited- Consolidated

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	7073.00	7945.40
PBILDT	955.30	1098.21
PAT	209.46	333.21
Overall gearing (times)	1.01	1.09
Interest coverage (times)	2.49	2.68

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-Working Capital Limits	-	-	-	2917.63	CARE A+ (CWD)
Fund-based - LT-Term Loan	-	-	March 2023	200.86	CARE A+ (CWD)
Non-fund-based - LT/ ST-BG/LC	-	-	-	1250.00	CARE A+ / CARE A1+ (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-Working Capital Limits	LT	2917.63	CARE A+ (CWD)	-	1)CARE A+; Positive (08-Jan-21)	1)CARE A; Stable (13-Feb-20)2)CARE A; Stable (04-Apr-19)	1)CARE A+; Negative (11-May-18)
2.	Fund-based - LT-Term Loan	LT	200.86	CARE A+ (CWD)	-	1)CARE A+; Positive (08-Jan-21)	1)CARE A; Stable (13-Feb-20)2)CARE A; Stable (04-Apr-19)	1)CARE A+; Negative (11-May-18)
3.	Non-fund-based - LT/ ST-BG/LC	LT/ST	1250.00	CARE A+ / CARE A1+ (CWD)	-	1)CARE A+; Positive / CARE A1+ (08-Jan-21)	1)CARE A; Stable / CARE A1 (13-Feb-20)2)CARE A; Stable / CARE A1 (04-Apr-19)	1)CARE A+; Negative / CARE A1 (11-May-18)

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-Term Loan	Simple
2.	Fund-based - LT-Working Capital Limits	Simple
3.	Non-fund-based - LT/ ST-BG/LC	Simple

Annexure-5: List of subsidiaries / joint ventures / associates of HLL getting consolidated

Sr. No.	Name of the Entity	Subsidiary / Joint Venture / Associate	% Shareholding by HLL as on March 31, 2020
1.	Annora Pharma Private Limited	subsidiary	100.00
2.	Aspiro Pharma Limited	subsidiary	92.00
3.	Strivo Pharma Private Limited#	subsidiary	100.00
4.	Evaric Pharma Limited	subsidiary	100.00
5.	Hetero Biotech Limited	subsidiary	100.00
6.	Hetero Med Solutions Limited	subsidiary	51.00
7.	Hetero Wind Power(Ananta)Private Limited	subsidiary	100.00
8.	Hetero Wind Power(Pennar)Private Limited	subsidiary	100.00
9.	Hetero Wind Power(Rayala)Private Limited	subsidiary	100.00
10.	Hetero Wind Power Limited	subsidiary	51.38
11.	Wallet Pharma Private Limited	subsidiary	100.00
12.	Actero Pharma Private Limited	subsidiary	100.00
13.	Abhiru Industries Limited	subsidiary	100.00
14.	Yatnam Lab Limited	subsidiary	100.00
15.	Hetero Biopharma Limited	subsidiary	100.00
16.	Akar colombia SAS	subsidiary	100.00
17.	Camber Consumer Care Inc.	subsidiary	100.00
18.	Camber Pharmaceuticals Inc	subsidiary	100.00
19.	Amarox Pharmaceuticals,S.A.	subsidiary	100.00
20.	Camber Pharmaceuticals S.A	subsidiary	100.00
21.	DMN Invest LLC	subsidiary	99.99

Sr. No.	Name of the Entity	Subsidiary / Joint Venture / Associate	% Shareholding by HLL as on March 31, 2020
22.	Excellen Peru S.A.C	subsidiary	99.90
23.	Hetero Australia pty Limited	subsidiary	90.00
24.	Hetero FZCO U.A.E	subsidiary	95.00
25.	Hetero Kenya Limited	Subsidiary	90.00
26.	Hetero Labs Nigeria Limited	subsidiary	90.00
27.	Hetero Malta Limited	subsidiary	99.95
28.	Camber Pharmaceuticals Inc (formerly Hetero Philppines Inc.)	subsidiary	100.00
29.	Hetero Singapore Pte Ltd.	subsidiary	100.00
30.	Camber Pharmaceutical Co. Ltd. Thailand(formerly Hetero Thailand Limited)	subsidiary	100.00
31.	Makiz Pharma LLC.	subsidiary	100.00
32.	Pharmed Healthcare Company SAE	Joint venture	25.50
33.	Furen Hetero Onco Therapeutics Limited	Joint venture	49.00
34.	Mintz Pharmaceuticals Inc.	Joint venture	46.80
35.	Nexgen Pharma FZ (L.L.C.)	Joint venture	50.00
36.	Camber Farmaceutical Ltda	subsidiary	100.00
37.	Ascent Pharma Inc	Joint venture	51.00
38.	Hetero Pharma Russia LLC, Russia	subsidiary	100.00
39.	Secura Pharma GMBH	subsidiary	100.00
40.	Hetero Saudi Labs Limited, U.A.E.	Joint venture	50.00
41.	Hetero Infrastructure SEZ Limited	Associate	50.00
42.	Sri Sai Ashirwaad Logistic Limited	Associate	50.00
43.	Dialog Pharma LLC	Associate	50.00
44.	Hetero Europe S.L	Associate	50.00
45.	Hetero USA Inc.	Associate	50.00
46.	Novaxa Pharmacueticals AG	Joint venture	40.00
47.	PT Amarox global	subsidiary	81.00
48.	Anaika Industries Limited	subsidiary	100.00
49.	Evaric Pharmaceuticals Inc.	subsidiary	100.00
50.	Amarox UK	subsidiary	100.00
51.	Hetero Labs South Africa PTY	Subsidiary	100.00
52.	Camber Pharma LLP	subsidiary	100.00
53.	Tarbis Farma SLU	subsidiary	100.00
54.	AK Sintvita LLC	subsidiary	100.00
55.	Camber Laboratories SDN BHD	subsidiary	100.00
56.	Hetero Pharma Beijing Co Ltd	Subsidiary	100.00
57.	Camber Pharmaceuticals HongKong Limited	Subsidiary	100.00
58.	Amarox Pharma B.V	Subsidiary	100.00
59.	Camber Pharmaceuticals Co. Ltd	Subsidiary	100.00

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:
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