Cohance Lifesciences Limited

March 11, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	112.37	CARE AA- (RWD)	Placed on 'Rating watch with developing implications'
Long-term/short-term bank facilities	296.80	CARE AA-/CARE A1+ (RWD)	Placed on 'Rating watch with developing implications'

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

CARE Ratings Limited (CARE Ratings) has placed the rating of Cohance Lifesciences Limited (CLL) on 'Rating watch with developing implications'. This action is on the back of the announcement by Suven Pharmaceuticals Limited (Suven) on 29th February 2024, about a proposed scheme of amalgamation for merging CLL with Suven, with the latter as the surviving entity. Transaction is likely to be completed in the next 12-15 months, subject to approvals. CARE Ratings will continue pursuing updates from the management and will monitor major updates of the transaction.

While ZCL Chemical Limited (ZCL) and Avra Laboratories Private Limited (Avra) have been merged with CLL, pending transfer of bank facilities of CLL, ratings of ZCL and Avra continue.

Suven derived 83% of revenues from the CDMO segment (contract development and manufacturing organisation) and reported a total operating income (TOI) of ₹798.4 crore in 9MFY24 with adjusted earnings before interest, taxes, and depreciation (EBITDA) margin of 44%. The liquidity profile is also comfortable with a negative net debt of ₹719 crore as on December 31, 2023. On a combined level, 9MFY24 sales is at ₹1690.3 crore with an adjusted EBITDA margin of 35%.

Ratings assigned to bank facilities of CLL at the combined level (CLL, ZCL, and Avra) derives strength from diversified business operations with presence across major pharmaceutical markets in India and abroad, accredited manufacturing facility, diversified product profile, and reputed clientele base. The stable scale of operations with healthy margins, comfortable liquidity position, and strong credit risk profile also strengthen ratings.

Additionally, the existence of a strong parent, Advent International Corporation (AIC or Advent; a global private equity [PE] investor), and experienced management also augur well for the company. Advent's global network is expected to benefit the three companies, enabling them to deepen their market penetration in regulated markets going forward. Advent has acquired a controlling stake in all three companies and has combined them into CLL in Q4FY24.

CLL has an established track record of more than two decade and has presence in major regulated pharmaceutical markets, with majority of the revenue derived from exports (79% in FY23 against 75% in FY22). CLL has a presence across 42 therapeutic segments and mainly caters to niche therapeutic segments such as anti-spasmodic and anti-depressant, apart from muscle relaxants, anti-epileptic, and anti-parkinson's. Top five therapeutic segments contributed to 57% of the revenue in FY23 as against 60% in FY22. CLL's manufacturing facilities have approvals from the United States Food and Drug Administration (USFDA), Korean Food and Drug Administration (KFDA), World Health Organization-Good Manufacturing Practices (WHO-GMP), European Directorate Quality of Medicines (EDQM), and Japan Pharmaceutical and Medical Devices Agency (PMDA).

Sales in 9MFY24 slightly moderated owing to short-term macro headwinds (destocking) and delay in vendor qualification for a few products. However, the same is expected to improve Q4FY24 onwards. CLL's PBILDT (Profit Before interest, lease rentals, depreciation and tax) margin is maintained, driven by better CDMO mix, despite revenue growing slowly.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Improvement in the total operating income (TOI) by 15% on continuous basis.
- Improvement in the profit before interest, lease rentals, depreciation and taxation (PBILDT) margins on a sustained basis over 30%

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

Negative factors

- Elongation of working capital cycle beyond 200 days
- Overall gearing going beyond 1.00x on sustained basis
- Dividend or any other form of outflow of cash to the holding companies exceeding 1x of the net profits for the year.
- Any major debt funded capex, increasing the Total debt/PBILDT more than 1.5x, leading to weakening of credit risk profile of company at combined level.

Analytical approach: Combined

CARE Ratings has assessed CLL, factoring the other two entities i.e. ZCL and Avra, given they were merged in Q4FY24.

Outlook: NA

Detailed description of key rating drivers

Key strengths

Diversified business operations with presence across major pharmaceutical markets

On a combined basis, domestic sales of the three companies were only about 19% in FY23. Majority sales or 81% is derived from exports. These companies on a combined level derived more than 50% TOI from regulated markets, with Europe contributing about 30% and the US about 27%. Therapeutic segment-wise, the company derives about 47% of its TOI from therapies such as gastrointestinal (21%), anti-spasmodic (13%), anti-depressant (9%), muscle relaxant (7%), and anti-parkinson’s (6%). CARE Ratings expects business operations to continue diversifying, going forward.

Accredited manufacturing facilities

CLL has formulation units, API units, clinical research unit, and R&D facilities. Its manufacturing facilities have approvals from USFDA, KFDA, WHO-GMP, EDQM, and Japan PMDA. ZCL has an API and R&D facility at Ankleshwar, Gujarat, and these facilities are successfully inspected and audited by regulatory authorities such as USFDA, EDQM, KFDA, WHO-GMP, COFEPRIS, and the Japanese MOH. Avra has APIs and R&D facilities, with its manufacturing facilities in Hyderabad (USFDA and WHO-GMP-approved) and Vizag approved by regulatory authorities.

Diversified product profile and reputed clientele base

The company at a combined level has more than 100 products, with revenue derived from top 10 products contributing to about 47% of the TOI. Notably, 28 drug master files (DMFs) and 17 abbreviated new drug applications (ANDAs) are also pending approvals. CARE Ratings expects that this would benefit these companies to expand further into regulated markets.

Stable Total Operating Income (TOI) with healthy profitability margins: The total operating income witnessed a growth of about 5.4% during FY23 from ₹1,289 crore during FY22 to ₹1,359 crore during FY23. The growth is driven by increase in sales volumes of existing products in new markets. The growth in total operating income was majorly driven by growth in Finished Dosage Forms (FDF) segment. The API segment saw slight moderation, while the FDF segment grew by 29% during FY23.
There has been a slight moderation in 9MFY24 sales owing to short-term macro headwinds (destocking), delay in vendor qualification for some products, however the same is expected to improve going forward from Q4FY24 onwards. The PBILDT margins of CLL is maintained, driven by better CDMO mix, despite some softness in revenue growth.

Strong credit risk profile, despite recent moderation:

During FY23, the company (at combined level) was able to reduce the long-term debt from ₹77.34 crores to ₹59.36 crores by way of scheduled repayments. Contrastingly, the short-term debt has increased from ₹118 crores as on March 31, 2022 to ₹229 crores as on March 31, 2023 to fund working capital requirements. The two companies – ZCL and Avra had paid dividend of around ₹373 crores and ₹81 crores respectively in FY23. This has resulted in a fall in cash and liquid assets balance at combined level from ₹389 to ₹97 crores as on March 31, 2023 and moderation in net worth. Owing to increase in total debt and slight moderation in networth, the overall gearing of the company has increased from 0.15x as on March 31, 2022 to 0.26x as on March 31, 2023. Total debt/GCA deteriorated to 1.12 times during FY23 vis-à vis 0.73 times during FY22 due to the same reason. The debt-to-equity ratio has however improved slightly from 0.06x to 0.05x on lower long-term debt. The interest coverage ratio has deteriorated from 25.24x in FY22 to 5.97x in FY23 due to increase in interest costs by ₹50 crores on account of payment of interest on CCDs (~₹1000 crores) issued by the erstwhile holding company of RA Chem (now merged and renamed as Cohance). The CCDs have been converted into equity in February 2024. The company continues to maintain higher inventory levels (₹364 crores in FY23 vs ₹327 crores in FY22) mainly towards orders which materialized in H1FY24.

Strong parentage and experienced management:

The company is owned and managed by Advent International which is one of the globally reputed and leading PE firms. Dr. V. Prasada Raju is the Managing Director and Chief Executive Officer of the company. In addition to having a PhD in chemistry and PG Dip in patents law, he is also an alumina of the IIMc under Sr Management programme and IIT, Chicago, USA, where he was trained in material sciences. He has 28+ years of techno-commercial experience in the pharmaceutical space across the value chain. Dr Prasada Raju served in various leadership roles at Granules India Limited and Dr. Reddy's Laboratories. Additionally, AIC is represented on the board of CLL and ZCL by Pankaj Patwari and Shweta Jalan.

Key weaknesses

Working capital intensive nature of operations:

The working capital cycle still remains elongated and stood at 166 days during FY23 (FY22: 148 days) on account of increased inventory days. The average Inventory days increased from 114 days during FY22 to 131 days during FY23. The high closing inventory is on account of orders which materialized in H1FY2024. Furthermore, the company has to maintain semi-finished goods and finished goods inventory to meet expected demand as part of its growing business, resulting in stretched working capital cycle for the company.

Forex risk on account of exports:

CLL at combined level is exposed to forex risk as major revenue (81% of the revenue) of the company is derived from exports. The company imports around 10-15% of its raw material consumption which provides natural hedge to some extent of the total foreign exchange earnings. The company manages currency fluctuations by having a better geographic balance in revenue mix and ensures a foreign currency match between liabilities and earnings. According to the company's management, it continually assesses the currency volatility impact on the cost structure and engages with customers to address such risks. Also, the company enters into hedging transactions as and when it is required. During FY23, the company booked a net forex gain of ₹14.7 crore.

Exposure to regulatory risk:

The company is exposed to regulatory risk with its operations centered mainly into manufacturing pharmaceutical formulations and APIs. Besides, 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, the ongoing regulatory compliance has become critical for Indian pharma companies including CLL, ZCL and Avra as they seek to strengthen its position in the regulated markets like USA, UK etc.

Given that the manufacturing facilities are approved by USFDA and other regulatory authorities and as of September 2023 these companies have successfully cleared all the audits carried out by various regulatory authorities without any observations, this risk is mitigated to an extent.

Liquidity: Strong

The company's liquidity profile at a combined level is strong. It has been generating healthy cash accruals as against repayment obligations. The average utilisation of working capital limits remained moderate at about 65% for the 12 months ended June 30, 2023. ZCL and Avra have paid dividends of about ₹373 crore and ₹81 crore, respectively, in FY23, resulting in a fall in aggregate cash and liquid assets balance from ₹389 crore to ₹97 crore as on March 31, 2023 and moderation in net worth. Net cashflow from operations with improving scale of operations is expected to remain at about ₹300 crore, going forward, and this is more than adequate to meet any incremental working capital needs in the near future.

The interest coverage ratio deteriorated from 25.24x in FY22 to 5.97x in FY23 due to increasing interest costs by ₹50 crore on the back of paying interest on CCDs (about ₹1,030 crore) issued by the erstwhile holding company of RACPL (now merged and renamed as CLL). In February 2024, CCDs have been converted to equity. Considering the trend of GCA levels generated and the presence of unutilised credit lines, the company is in a comfortable liquidity position for meeting debt obligations, which is about ₹20 crore in FY24 and FY25. For FY24 and FY25, on a combined level, there are numerous capex (such as new capacity creation at its API-2 facility and FDF-l facilities, among others) aggregating to ₹300 crore. Of the total capex, the management plans to fund about ₹100-150 crore through external debt and the balance through internal accruals.

Assumptions/Covenants: Not applicable

Environment, social, and governance (ESG) risks: Not applicable

Applicable criteria

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

About the company and industry

Industry classification

Macro-economic Indicator	Sector	Industry	Basic Industry
Healthcare	Healthcare	Pharmaceuticals and biotechnology	Pharmaceuticals

About CLL:
CLL was incorporated on 6 July 2020. AIC, through its step-down subsidiary, AI Pharmed Consultancy India Private Limited (APC), acquired about 100% stake in RACPL in August 2022. Post this, in November 2022, RACPL amalgamated with APC and the merged entity's name was changed to Cohance Lifesciences Limited.

RACPL was initially incorporated in January 1996. It manufactures APIs and formulations and undertakes clinical research activity at its manufacturing facilities in Jaggaiahpeta, Mukuteswarapuram, Krishna district (Andhra Pradesh), Achyutapuram Industrial Area, Andhra Pradesh, and Nacharam, Jadcherla, Hyderabad, Telangana, and clinical research activity at Balanagar, Hyderabad, Telangana.

Advent expects to build a merchant API platform and, in the process, has acquired 100% stake in two other companies – ZCL (99.93% stake on August 12, 2022) and Avra (99.98% stake on September 12, 2022). The combined TOI of these entities is about ₹1,300 crore. The three entities at a combined level derived about 81% of revenue from exports and about 70% belongs to the API segment.

About ZCL:
ZCL (formerly Zandu Chemicals Limited) is an Indian pharmaceutical company established in 1991. The facilities are successfully inspected and audited by USFDA, EDQM, KFDA, WHO-GMP, COFEPRIS, and Japanese MOH with a capacity of 227,000 litre (60,000 gallons) with strong R&D capabilities. In August 2022, AIC acquired a 100% stake in ZCL (through its wholly owned step-down subsidiary – Jusmiral Holdings Limited).

About Avra:
Established in 1995, Avra is among the first in India to focus on providing high-end contract research and manufacturing of advanced intermediates and APIs, covering oncology and other therapeutic areas. Avra was founded by AV Rama Rao, a highly experienced scientist by profession. With several active process patents, the company is the only one in the world to develop and successfully commercialise a synthetic process for irinotecan (currently used in antibody drug conjugates for targeted therapies in treating cancer). In September 2022, AIC, a global PE investor, acquired 99.98% stake in Avra (through wholly owned step-down subsidiary – Jusmiral Holdings Limited).
Avra and ZCL have been merged with Cohance in Q4FY24.

The following table depicts the financial parameters at the combined level:

Brief Financials (₹ crore)	March 31, 2021 (C#)	March 31, 2022 (C#)	March 31, 2023 (C#)	9MFY24 (UA)
Total operating income	1059.49	1309.33	1358.78	892
PBILDT	287.82	356.42	380.61	263
PAT	175.72	219.38	198.84	145
Overall gearing (times)	0.14	0.15	0.26	0.36
Interest coverage (times)	25.20	25.24	5.97	4.90

#The combined audited financials of the three companies for the years FY21 and FY22 are presented considering that these 3 entities (RA Chem, ZCL and Avra). From FY23, figures includes the financials of APC, RA Chem, ZCL and Avra. In FY23 RA Chem merged with its holding company Al Pharmed (APC) and FY23 includes the combined financials of 4 companies - AI Pharmed, ZCL, RA Chem and Avra. APC did not have any business on its own and was merely an investment holding company. 9MFY24 results include the financials of Cohance, ZCL and Avra.
Note: 'the above results are latest financial results available'

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

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

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

Complexity level of 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/ ST-Working capital limits		-	-	-	296.80	CARE AA- / CARE A1+ (RWD)
Term loan-Long term		-	-	30-05-2028	112.37	CARE AA- (RWD)

Annexure-2: Rating history for 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 2023-2024	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
1	Fund-based - LT/ ST-Working capital limits	LT/ST	296.80	CARE AA- / CARE A1+ (RWD)	1)CARE AA-; Stable / CARE A1+ (01-Nov-23)	-	-	-
2	Term loan-Long term	LT	112.37	CARE AA- (RWD)	1)CARE AA-; Stable (01-Nov-23)	-	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of covenants of rated instruments/facilities: Not applicable

Annexure-4: Complexity level of instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Fund-based - LT/ ST-Working capital limits	Simple
2	Term loan-Long term	Simple

Annexure-5: Lender details

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

Note on complexity levels of 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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