Alembic Pharmaceuticals Limited

June 22, 2021

Ratings

Instruments	Amount (Rs. Crore)	Ratings[1]	Rating Action
Commercial Paper (CP) Issue (Standalone)	750.00 **(Rupees Seven Hundred and Fifty crore only)**	**CARE A1+ (A One Plus)**	**Reaffirmed**

Details of Instrument in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to the instrument of Alembic Pharmaceuticals Limited (APL) continues to derive strength from its experienced and qualified management in pharmaceutical industry, its long track record and established presence in the domestic formulation market with strong formulation portfolio, growing export presence in the major regulated markets and its diversified revenue profile with vertically integrated operations. The rating further derives comfort from its healthy financial risk profile marked by growing scale of operations, healthy profitability, low leverage, comfortable debt coverage indicators and strong liquidity.

The above rating strengths are, however, partially off-set by continued delay in commencement of commercial operations of its various new projects; along with salability risk associated it. The rating is further constrained on account of its exposure to inherent regulatory risk associated with the pharmaceutical industry coupled with intense competition and resultant pricing pressure in both domestic and export markets.

Rating Sensitivities

Negative Factors

- Significantly larger than envisaged capex or acquisition adversely affecting its free cash flows and debt coverage indicators
- Increase in the overall gearing ratio above unity on a sustained basis
- Decline in PBILDT margin below 15% along with significant adverse impact on its ROCE on a sustained basis on account of inordinate delay in commissioning its ongoing large-size capex and realizing envisaged benefits therefrom

Detailed description of the key rating drivers

Key Rating Strengths

Qualified and experienced management: Since its incorporation in the year 1907 (earlier known as Alembic Chemical Works) by Mr. B.D. Amin, the Amin family has driven the operations of APL. Mr. Chirayu Amin (Chairman) is a third-generation entrepreneur and has more than three decades of experience in the Indian pharmaceutical industry. Mr. Pranav Amin (MD) and Mr. Shaunak Amin (MD), sons of Mr. Chirayu Amin, also possess experience of more than a decade in the pharmaceutical industry. Further, APL has well-qualified and experienced second tier management with well-defined organisational structure and strong management information system.

Diversified and vertically integrated operations: APL's business is mainly divided into three broad business segments i.e. (i) Branded formulations (sales of formulations in the domestic market) (ii) International generic formulations (sale of formulations in the export markets) and (iii) Active Pharmaceutical Ingredients (API; catering to both domestic and export markets). These segments contributed around 28%, 54% and 18% of its consolidated total operating income (TOI) respectively during FY21 (FY; refers to the period of April 01 to March 31) indicating fairly diversified revenue stream. Revenue profile of APL is also geographically diversified with presence in all the major regulated and semi-regulated markets; albeit there is greater focus on the United States of America (US; generic formulation sales in US contributed around 40% of its TOI). APL's top 10 brands in the domestic market contributed around 79% of its branded formulation sales during FY21 (51% during FY20) mainly due to sizable growth in some brands used in the treatment of Covid-19. However, its top 10 generic formulations in the US market contributed around 42% of its US generic formulation sales which indicates fair diversification.

APL has vertically integrated operations as it captively meets its API requirement for its key final products apart from selling API to customers. APL's ability to manufacture API for its key formulations partially protects it from the supply uncertainties and volatility in the prices of API.

Long track record and established position in the domestic formulation market: APL has an operational track record of over a century in the Indian pharmaceutical industry. APL has a portfolio of over 185 formulation brands out of which two formulation brands are among the top 300 domestic formulation brands in India (source: company's AR for FY21). APL has

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

a field force of over 5,000 executives reaching out to over 1,75,000 medical practitioners across India. Despite its long track record and its established presence, sales of its formulations in the domestic market grew slower than the industry average during FY18 to FY20 primarily due to high share of revenue from acute therapeutic segment at around 50% of its domestic sales. However, it grew higher than industry average during FY21 on account of better sales of few brands used in the treatment of Covid-19. It is expected that APL's domestic formulation sales will grow at a higher rate compared to industry average in near to medium term backed by introduction of more products in the chronic therapeutic segments.

Increasing presence in the regulated export markets backed by increasing R&D focus, albeit sales growth in regulated markets is expected to moderate in near term: APL's generic formulations sales (mostly in the regulated markets) which grew at a Compounded Annual Growth Rate (CAGR) of around 35% during last three years ended FY21, exhibited growth of around 19% during FY21 over FY20. APL's strong operational performance in the regulated markets was on account of its increasing product approvals, new product launches, and capitalizing upon several supply opportunities arising due to shortage of Sartan group of formulations in the US market. During the last three years ended FY21, APL made sizable investments in its R&D capabilities (annual R&D spend of around 12% to 14% during the last three years ended FY21) to grow its presence in the regulated markets. Its higher R&D outlay has helped to enlarge its product portfolio for the US market. Up to March 31, 2021, APL had filed 212 Abbreviated New Drug Applications (ANDA) out of which 139 were approved and 86 products were launched. APL expects to launch 10 to 15 new products every year in the US market over next 3 years backed by strong product pipeline and ANDA filings.
Shortages in the Sartan group of formulations have, however, receded which is likely to adversely impact APL's generic formulation sales in US (contributed around 74% of its total generic formulation sales during FY21) during FY22. Although generic formulation sales in the remaining geographies is expected to grow, the overall generic formulation sales growth may remain stable during FY22. However, once the company operationalizes the newly set-up manufacturing plants, the sales growth is likely to accelerate.

Growth in its scale of operations along with improvement in profitability during FY21; albeit envisaged moderation in profitability in the medium-term: APL's scale of operations marked by its TOI grew at a CAGR of around 12% during last five years ended FY21 including growth of 17% in FY21 over FY20. Further, its PBILDT margin and PAT margin improved by 143 bps and 343 bps respectively during FY21 on Y-o-Y basis. Share of sales of its international generic division (yielding better operating profitability margin compared with domestic branded formulation division) has consistently increased during the last three years ended FY21. Further, APL continued to capitalize on the shortage of the Sartan group of formulations in the US market which also contributed to superior PBILDT margins during FY21. However, shortage of Sartan group of formulations has receded in the US market which is likely to impact its PBILDT margin adversely in the near to medium term. Further, APL is currently capitalizing majority of its interest cost and pre-operating expenses related to its new manufacturing facilities. These new manufacturing facilities are expected to commence commercial operations by H1FY23. Till the time these new manufacturing facilities start meaningful contribution in the total revenue, APL's PBILDT margin is expected to decline by around 300 bps to 500 bps in near to medium term.

Improvement in leverage and comfortable debt coverage indicators aided by equity infusion through qualified institutional placement (QIP) and healthy operating cash flows: APL raised equity capital of Rs.750 crore through QIP during FY21 which has further strengthened its net worth base to Rs.5,067 crore as on March 31, 2021. APL also generated healthy cash flow from operations of around Rs.1,527 crore during FY21. With these cash-flows it significantly reduced its debt by around Rs.1,200 crore during FY21 resulting in improvement in its overall gearing ratio to 0.12x as on March 31, 2021 compared with overall gearing ratio of 0.55x as on March 31, 2020. APL does not envisage any major capex or acquisition till its new manufacturing facilities stabilizes. Further, its expected cash accruals are adequate to meet its envisaged capex and working capital requirement. Hence, APL's overall gearing is expected to remain below 0.25 times in the medium term. APL's debt coverage indicators also remain comfortable marked by total debt/PBILDT of 0.37x and total debt/GCA of 0.44 years during FY21. The debt coverage indicators are expected to remain comfortable due to APL's healthy profitability and no major increase in total debt envisaged in the near to medium term.

Stable demand growth prospects for Indian pharmaceutical Industry (IPI): Outlook for IPI is envisaged to remain stable in medium to long term backed by growth opportunity in terms of capitalizing on major blockbuster drugs coming off-patent paving the way for entry of generics, especially in the USA market, and geographical diversification into emerging markets. In the domestic market, the growth in formulations segment is expected to be led by rise in chronic diseases, increasing per capita income, government initiatives like new national health protection scheme & Ayushman Bharat program, improvement in access to healthcare facilities along with growing penetration of health insurance.

Key Rating Weaknesses
***Continued delay in commencement of commercial operations of its various new capex projects*:** Few years back APL had initiated setting-up of four new manufacturing facilities, including one under a Joint Venture (JV; Aleor Dermaceuticals Limited), targeted for catering the regulated markets. One manufacturing facility (under JV) for dermatology therapeutic

segment could start commercial operations during FY20. APL's management has articulated that all other new manufacturing facilities are ready to be put to use, however, there is delay in commencement of their commercial operations due to delay in regulatory approvals from the USFDA (one facility was audited in February 2021 and remaining two facilities are yet to be audited). The delay in USFDA audit is mainly hampered by outbreak of the Covid-19 pandemic. APL now expects all manufacturing facilities to start commercial operations by FY23. Furthermore, after the commencement of commercial operations, the optimum capacity utilization and deriving envisaged benefits remain key monitorables given the highly regulated and competitive US generic market and delays in product approvals. Timely commercialization of its new manufacturing facilities along with generating adequate returns on the capital deployed in the ongoing capex will be crucial for maintaining healthy financial risk profile of APL.

***Inherent regulatory risk associated with pharmaceutical Industry*:** APL derives around 28% of its revenue from domestic formulation business. Around 19% of its formulations feature in the National List of Essential Medicine (NLEM). Inclusion of any fresh formulations in NLEM and consequently in Drug Price Control Order (DPCO) may restrict the pricing flexibility for APL. It is also exposed to regulatory changes in global markets (primarily USA) as international generic business contributes nearly 55% to its revenue. Continuous efforts by the US government to bring down drug prices, intense competition in US generic market and consolidation of US pharmaceutical distributors, may pose vulnerability to its profitability. Moreover, any non-compliance with Good Manufacturing Practice (GMP) and subsequent adverse action by USFDA may also pose threat to the revenue and profitability of the company. However, APL has establishment inspection report (EIR) in place for all its operational manufacturing facilities. APL's new injectable manufacturing facility was issued five audit observation by USFDA during its audit in February 2021. However, the company management has indicated that all the observations were procedural in nature and the company has already replied to USFDA.

Liquidity: Strong
APL's liquidity remains strong marked by almost nil utilization of its fund based working capital limits during last six months ended May 2021, liquid surplus of around Rs.285 crore as on March 31, 2021 and healthy cash-flow from operations of around Rs.1,528 crore during FY21 (cash flow from operations of Rs.381 crore during FY20). APL has scheduled term-debt repayment obligation of around Rs.300 crore and Rs.200 during FY22 and early FY23 respectively. Further, it expects to incur capex of around Rs.600 crore to Rs.670 crore p.a. during next three years ended FY24. APL's internal accruals are expected to remain adequate to meet its term-debt repayment obligation, and capex requirement. Further, its un-utilized working capital limits imparts additional liquidity cushion. This apart, its healthy net worth base and comfortable leverage provides significant financial flexibility to APL.
Analytical approach: Consolidated. For the purpose of analysis, CARE has considered the consolidated financials of APL because of operational and financial linkages with its subsidiaries/JVs/associates. List of entities consolidated in APL as on March 31, 2021 are mentioned in **Annexure 4**.

Applicable Criteria
Criteria for Short Term Instruments
CARE's Policy on Default Recognition
CARE's methodology for manufacturing companies
Rating Methodology - Pharmaceutical Sector
Rating Methodology: Consolidation
Financial ratios – Non-Financial Sector
Liquidity analysis of Non-financial sector entities

About the Company
APL is engaged in the manufacturing and marketing of branded formulations (in the domestic market), generic formulation (in overseas market) and API/ bulk drug in domestic and overseas markets. With effect from April 1, 2010, the core pharmaceutical business of Alembic Limited (which was originally incorporated in 1907 as Alembic Chemical Works) was demerged in to APL. APL caters to several therapeutic segments, which include anti-infective, gynaecology, cardio, diabetes, dermatology and oncology, wherein the anti-infective segment contributes the most to its revenue in the domestic market. Further, USA forms major share of APL's revenue in its export market.

Brief Financials - Consolidated (Rs. crore)	FY20 (A)	FY21 (A)
Total Operating Income	4,617	5,506
PBILDT	1,280	1,593
PAT	801	1,147
Overall Gearing (times) *	0.55	0.12
PBILDT Interest Coverage (times)	46.60	99.43

*A: Audited, *Considering intangible assets and goodwill, being core part of pharmaceutical operations as part of tangible net-worth*

Status of non-cooperation with previous CRA: Not Applicable
Any other information: Not Applicable
Rating History for last three years: Please Refer Annexure 2
Complexity level of various instruments rated for this company: Annexure-3

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
Commercial Paper Issue (Standalone)	-	-	7 to 364 days	750.00	CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument	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.	Commercial Paper Issue (Standalone)	ST	750.00	CARE A1+	-	1)CARE A1+ (25-Jun-20)	1)CARE A1+ (22-Jul-19)	1)CARE A1+ (29-Oct-18)

Annexure 3: Complexity level of various instruments rated for this Company

Sr. No.	Name of the Instrument	Complexity Level
1.	Commercial Paper Issue (Standalone)	Simple

Annexure-4: List of entities consolidated in APL as on March 31, 2021

Sr. No.	Name of the entity	% of Holding as on March 31, 2021	Relationship
1	Alembic Global Holding SA (AGH)	100%	Subsidiaries of APL
2	Alembic Pharmaceuticals (AP INC.)	100%	
3	Aleor Dermaceuticals Limited	60%	
4	Alembic Pharmaceuticals Europe Limited	100%	Step down subsidiaries
5	Alembic Pharmaceuticals Canada Limited	100%	
6	Alembic Pharmaceuticals Australia Pty Limited	100%	
7	Alnova Pharmaceuticals SA	100%	
8	Genius LLC	100%	
9	Alembic Labs LLC	100%	
10	Okner Realty LLC	100%	
11	Incozen Therapeutics Pvt. Ltd.	50%	Associate of APL
12	Rhizen Pharmaceuticals SA (RPSA)	50%	Associate of AGH
13	Dahlia Therapeutics SA	50%	Subsidiary of RPSA
14	Rhizen Pharmaceuticals Inc.	50%	

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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