Alembic Pharmaceuticals Limited

June 25, 2020

Ratings

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

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, improved profitability, healthy debt coverage indicators and strong liquidity.

The above rating strengths are, however, partially off-set by delay in commencement of commercial operations of its various new projects; along with salability risk associated with the formulations planned to be manufactured therein, restricted free cash-flow during last 2-3 years ended FY20 (FY refers to period April 1 to March 31) due to ongoing large-size capex resulting in increased reliance on external debt. 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 0.8x on a sustained basis
- Decline in ROCE below 20% on a sustained basis on account of inordinate delay in realizing the envisaged benefits from its recent large-size capex

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.

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 and is among the top 20 players in the domestic formulation market. APL has a portfolio of over 185 formulation brands out of which three formulation brands are among the top 300 domestic formulation brands in India (source: company's AR for FY20). APL has 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 at a Compounded Annual Growth Rate (CAGR) of around 4% during the last four years ended FY20 against the near double-digit growth in the industry sales during the same period. However, the company undertook certain portfolio and incentive rationalization exercise during the last two years to improve its performance in the domestic formulation market. Hence, APL expects its domestic formulation sales growth to improve going forward.

Growing presence in the regulated export markets backed by increasing R&D focus: APL has sizably increased its presence in the export markets during the past couple of years as evidenced by Y-o-Y growth in sales of its generic formulations in the export market by 48% during FY19 and 39% during FY20 mainly driven by growth in sales of formulations in the United States of America (US) which contributed around 80% of its international formulations revenue during FY20. APL's strong operational performance in the US market 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

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

formulations in the US market. During the last four years ended FY20, APL has made sizable investments in its R&D capabilities to grow its presence in the US market. Around 90% of its R&D expenses are targeted towards the US market. APL's R&D expenses as a % of its consolidated revenue stood around 13% to 15% during the last two years ended FY20 which is significantly higher compared with the amount spent on R&D by some of its peers in India. Its higher R&D outlay has helped to enlarge its product portfolio for the US market. Up to March 31, 2020, APL had filed for 183 Abbreviated New Drug Applications (ANDA) out of which 119 were approved.

Diversified and vertically integrated operations: APL's business is mainly divided into three broad business segments i.e. (1) Branded formulations (sales of formulations in the domestic market) 2) International generic formulations (sale of formulations in the export markets) and (3) Active Pharmaceutical Ingredients (API; catering to both domestic and export markets). These segments contributed around 31%, 54% and 15% of its consolidated TOI respectively during FY20 indicating fairly diversified revenue profile. Also, the contribution of generic formulations in total sales has consistently increased during the last two years ended FY20. Revenue profile of APL is also geographically diversified with presence in all the major regulated and semi-regulated markets; albeit there is greater concentration in US. USA and India contributed around 43% and 35% of APL's consolidated revenue respectively during FY20. Further, APL's sales in the domestic market is moderately concentrated towards a few brands as its top 10 domestic brands generated around 50% sales of the revenue from branded formulations. Further, top 5 generic formulations generated around 35% of the generic formulation sales in the US market which also indicates moderate product concentration.
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.

Growing scale of operations along with significant improvement in profitability during FY20: APL's scale of operations marked by its total operating income (TOI) grew by CAGR of around 17% during last five years ended FY20 including the growth of 17% in FY20 over FY19. Further, its PBILDT margin and PAT margin improved by 567 bps and 257 bps respectively during FY20 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 two years ended FY20. 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 FY20. However, APL is currently capitalizing majority of its interest cost and operating expenses related to its new manufacturing facilities. These new manufacturing facilities are expected to commence commercial operations from late FY21 or early FY22. Till the time, these new manufacturing facilities start meaningful contribution in the total revenue, profitability may moderate in near to medium term due to charge of operating expenses and interest cost (which are being capitalized presently) to P&L from FY21-FY22 onwards apart from uncertainty regarding continued supply opportunities of Sartan group of formulations in the US market at very favorable rates.

Moderate leverage backed by strong net-worth base and healthy debt coverage indicators: Despite increase in its total debt level arising from ongoing capex as well as greater working capital requirement, APL's leverage remains moderate marked by overall gearing ratio of 0.60x as on March 31, 2020 due to its healthy net-worth base of Rs.2,891 crore. APL expects to incur higher than previously envisaged capex at around Rs.700 crore during FY21 (including further capitalization of the interest cost and operating expenses arising from delay in commercialization of its new manufacturing facilities) which the company expects to be entirely funded through internal accruals. Hence, in absence of any additional debt, APL's capital structure is expected to improve in the near to medium term. APL's debt coverage indicators also remain healthy marked by total debt/PBILDT of 1.37x and total debt/GCA of 1.83 years during FY20 (1.30x and 1.66 years respectively during FY19). The debt coverage indicators are expected to remain healthy due to APL's healthy profitability and very meager/no increase in total debt in near to medium term.

Stable demand growth prospects for Indian pharmaceutical Industry (IPI): Outlook for Indian Pharmaceutical Industry (IPI) remains 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 formulations segment is expected to grow 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

Delay in commencement of commercial operations of its various new projects: APL has planned setting-up of four new manufacturing facilities including one under a Joint Venture (JV; Aleor Dermaceuticals Limited) company targeted for catering the regulated markets. APL's management has articulated that all the 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 which is mainly hampered by outbreak of the Covid-19 pandemic. However, one manufacturing facility (under JV) for dermatology therapeutic segment could start commercial operations during FY20. APL now expects one more manufacturing facility to start commercial operations during H2FY21 and the remaining two manufacturing facilities to start commercial operations by end of FY21 or early FY22. Furthermore, subsequent to the commencement of commercial operations, the optimum capacity utilization and deriving resultant benefits remain key moniterables given the highly regulated and competitive US generic market and delays in product approvals.

Restricted free cash flow and increased debt level: APL's total debt increased from Rs.708 crore as on March 31, 2018 to Rs.1,747 crore as on March 31, 2020. APL incurred capex of around Rs.2,300 crore during the last three years ended FY20 which includes capex for setting up new manufacturing facilities, capex for routine maintenance and capitalization of interest and operating expenses relating to its new manufacturing facilities. Further, its net working capital cycle also elongated to 121 days during FY20 (76 days in FY18) due to its increasing presence in the export markets. Together these factors led to higher capital requirement and resultant negative free cash flow despite healthy generation of cash flow from operations during FY20. The elongation in debtor collection in March 2020 was largely due to significant growth in revenue of around 30% in Q4FY20 on y-o-y basis. Further, due to imposition of the lockdown in key geographies (India and US), collection efficiency was adversely impacted during latter part of March 2020 which resulted in sizable increase in its trade receivables as on March 31, 2020. However, the management has confirmed that the collection efficiency has improved during April-June 2020 resulting in lower trade receivables and lower working capital borrowing by around Rs.300 crore as of mid-June 2020 compared to March 31, 2020.
Further, APL expects to incur capex of around Rs.700 crore during FY21 which also is likely to restrict its free cash-flow during the year. APL also distributed large size dividend during FY20 which was on the higher side compared with earlier years; however, the management does not foresee such large dividend distribution going forward. APL's management expects generation of sizable free cash flow from FY22 onwards in absence of major capex plans and expected benefits from introduction of new launches apart from benefits derived from commencement of new manufacturing facilities.

Inherent regulatory risk associated with pharmaceutical Industry: APL derives around 31% of its revenue from domestic formulation business. Around 14% of its formulations (including top selling formulation Azithromycin) 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. APL is also exposed to regulatory changes in global markets (primarily USA) as international generic business contributes nearly 54% to its revenue. Moreover, continuous efforts by the US government to bring down drug prices, intense competition in US generic market and consolidation of US pharmaceuticals distributors, may pose vulnerability to its profitability.
The pharmaceuticals companies were affected temporarily in terms of supply disruption of key raw material due to Covid-19 outbreak in China. However, the companies like APL were less impacted due to sufficient inventory of raw materials and its lower direct dependency on China (for around 15% of total raw material requirement). Further, the operations of the pharmaceutical companies, being an essential activity were relatively less impacted compared with operations of the entities operating in many other industries during the period of nation-wide lockdown in the light of Covid-19 outbreak. However, as there was a drastic decline in the foot fall of out-patients during the period of lockdown, the sale of prescription acute drugs (APL's 35% domestic formulation sales are of acute therapeutic segments), OTC products and surgical drugs were impeded to a certain extent. However, CARE Ratings expects that there will not be any major adverse impact on the financial performance of the companies in the sector.

Liquidity: Strong
APL's liquidity remains strong marked by healthy generation of cash flow from operation and moderate utilization of working capital limits at around 56% (including outstanding commercial papers) during the last 12 months ended April 2020. Moreover, absence of term debt repayment obligation and sizable undrawn working capital limits provides ample cushion to its liquidity. CARE also notes that the company has not availed any moratorium as a Covid relief measure under the guidelines of RBI towards the interest payment or principal repayment on its existing bank facilities.
APL had cash flow from operation of Rs.403 crore in FY20 (Rs.621 crore in FY19). The decline in cash flow from operation during FY20 was largely due to sizable increase in its trade receivables.
APL does not have any term-debt repayment obligation during FY21, although it expects to incur capex of around Rs.700 crore. APL's internal accruals are expected to be sufficient to meet its capex and incremental working capital requirement. Moreover, its large net worth and low leverage provides financial flexibility to raise necessary resources in case of any contingencies.

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, 2020 are mentioned in **Annexure 3**.

Applicable Criteria
[Criteria for Short Term Instruments]
[CARE's Policy on Default Recognition]
[CARE's methodology for manufacturing companies]
[Rating Methodology - Pharmaceutical Sector]
[Consolidation and Factoring Linkages in rating]
[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 (AL; 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)	FY19 (A)	FY20 (A)
Total Operating Income	3,949	4,617
PBILDT	871	1,280
PAT	583	801
Overall Gearing (times)	0.46	0.60
*Adjusted Overall Gearing**	*0.42*	*0.55*
Interest Coverage (times)	47.30	47.11

*A: Audited, *Considering intangible assets and goodwill, being core part of pharmaceuticals 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

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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Commercial Paper Issue (Standalone)	ST	750.00	CARE A1+	1)CARE A1+ (22-Jul-19)	1)CARE A1+ (29-Oct-18)	-	-

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.*

Contact Us

Media Contact
Mr. Mradul Mishra
Contact No.: +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact – 1
Name: Krunal Modi
Tel: 079 - 40265614
Mobile # 8511190084
Email: krunal.modi@careratings.com

Analyst Contact - 2
Name: Ranjan Sharma
Tel: 079 - 40265617
Mobile # 9824021823
Email: ranjan.sharma@careratings.com

Business Development Contact
Mr. Deepak Prajapati
Contact No.: +91-79-4026 5656
Email ID – deepak.prajapati@careratings.com

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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