Emcure Pharmaceuticals Limited (Revised)

January 23, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term bank facilities	1000.08 (reduced from 1052.90)	CARE A-; Stable (Single A minus; Outlook: Stable)	Revised from CARE A; Negative (Single A; Outlook: Negative)
Short term bank facilities	98.00	CARE A2+ (A Two Plus)	Reaffirmed
Long term / Short term bank facilities	661.00 (enhanced from 586.00)	CARE A-; Stable/CARE A2+ (Single A minus; Outlook: Stable/A Two Plus)	Revised from CARE A; Negative/ CARE A2+ (Single A; Outlook: Negative/ A Two Plus)
Total Facilities	**Rs.1,759.08 (Rupee Seventeen hundred and Fifty Nine crore and Eight lakh only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings to the bank facilities of Emcure Pharmaceuticals Limited (Consolidated, hereafter referred to as EPL/ Group) takes into cognizance the deterioration in operating performance and cash flow position of the group during 8MFY20 (refers to April 1 to November 30) marked by stagnant total operating income, continuing lower profitability margins, continued moderation in the debt coverage indicators and liquidity parameters. The group continues to remain exposed to weak operating performance of the group company viz. Heritage Pharmaceuticals Inc. This apart, the revision also takes into account the elevated debt level on account of intense fund based working capital utilization. Further, the operating performance of the company in FY20 is expected to remain weak vis-à-vis FY19, owing mainly to declining sales in US markets with continued 'import alert' by United States Food and Drugs Administration (USFDA) on EPL's Hinjewadi facility coupled with significant decline in the profitability margins from US market on account of company facing stiff competition from new entrants. Further, CARE Ratings believes, the uncertainty revolving around ongoing USFDA investigations and pending approvals for new launches is expected to keep the US sales volume and overall profitability under pressure in medium term.

Nevertheless, the rating continues to derive strength from long track record and promoters' vast experience of over three decades in the pharmaceutical industry, accredited manufacturing facilities along with diversified product portfolio across therapeutic segments; different geographies, long-term contracts with the pharmaceutical majors, completion of capex for Sanand unit to major extent and the unit being operational during FY20, growth in sales in the Domestic, Emerging, Canada and European markets.

The rating strengths continue to remain constrained by delay in new product launches and cost incurred on revamp of processes at its plants in the wake of the 'import alert' by USFDA impacting profit margins, EPL's exposure to regulated markets, especially US market, which is witnessing increased competition resulting into pricing pressure in the generics space, heightened regulatory scrutiny and exposure to foreign exchange fluctuations. However, with the completion of Sanand (USFDA approved) unit, ability to successfully shift operations from Hinjewadi unit to said unit and ramp up operations through new product launches remains to be seen.

Rating Sensitivities

Positive Factors

- Resolution of pending regulatory issues and realization of envisaged benefits out of expenditure incurred on Research and Development activities and capex across group companies
- Significant improvement in the free liquidity buffer of the company.
- Resolution of USFDA import alert and thereby improvement in overall PBILDT margin above 18-20% and interest coverage ratio on a sustained basis.

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

- Repayment of debt to major extent through equity infusion resulting into significant improvement in the capital structure and overall debt coverage metrics

Negative Factors

- Any deterioration in capital structure as a result of incremental debt constraining debt coverage metrics below 1.20x and overall gearing ratio rising to 1.40x on sustained basis at consolidated level.
- PBILDT margin remaining below 12-13% on a sustained basis.
- Any regulatory action other than ongoing, against the group, significantly impairing the credit profile of the group.
- Decline in free liquidity buffer from the current level on continued basis.

Detailed description of the key rating drivers
Key Rating Strength
Experienced management and successful track record of the group in pharmaceutical industry
The promoters have more than three decades of experience in the pharmaceutical industry. The CEO of the company, Mr. Satish Mehta is a first generation entrepreneur with an experience of over 3 decades in the field of pharmaceuticals. Ms. Namita Thapar (CFO), Chartered Accountant and MBA, is actively involved in the marketing and distribution division and finance division and overlooking human resources division of the company. Mr. William S Marth, President & CEO, North America & Europe region and board member for HPI, and Emcure Pharma UK Ltd. The group has team of highly qualified and experienced professionals in the field of pharmaceuticals.

Diversified product portfolio with the new launches, operations in India, USA and various emerging markets and focus on chronic high-value segments
The group is vertically integrated, manufacturing APIs and formulations and is also involved in the bio-technology drugs. Under formulations, EPL has presence in the high value chronic therapy as well as in acute segments. Under chronic segment, the company's products are diversified across Cardiology, Oncology, Nephrology, Anti-HIV, etc. Acute products are diversified across Anti-infective, Pain Management, Anemia, Gynaecology, Anti Retrovirals, Pediatrics, etc. The group has launched various new products during FY18 and FY19 particularly within the Oncology/Antileukamics, Gynaec, hormones, Neuro/CNS, Anti-infectives and HIV segments.

Accredited manufacturing facilities with well-equipped R&D facility
In the group, EPL, Heritage Pharma Labs Inc (HPL), Gennova Biopharmaceutical Limited (GBL) and Zuventus Healthcare Limited (ZHL) have manufacturing facilities while other subsidiaries are engaged in warehousing and marketing of drugs manufactured by EPL in various geographies.
EPL has five manufacturing facilities (four in Pune and one located at Jammu), out of which three are approved by UK Medicines & Healthcare Products Regulatory Agency (MHRA, UK), Geneva WHO, South African Medicine Control Council (MCC) and ANVISA, Brazil while four of them are approved by USFDA. Furthermore, the group has six state of art R&D centres in India, all recognized by the Department of Scientific & Industrial Research (DSIR) and one in USA under HPL.
GBL's manufacturing facility is located at Pune while those of ZHL are located at Jammu, Sikkim and Bengaluru. HPL has a manufacturing facility along with R&D centre located at New Jersey, USA.

Strong marketing network in domestic and international markets
The group has a strong sales and marketing team both within India and outside the country. The group has an established marketing network through channel partners in the international markets and C&F agents within domestic market.

Geographical diversification coupled with growth in domestic and Canadian markets
The group has a wide geographical presence with sales primarily to regulated markets like USA and UK, and has an overall healthy mix of exports, providing the group geographic diversification. The group is further expanding its presence in various emerging markets and Canada.
The geographically diversified nature of revenues significantly reduces the exposure of the company towards any adverse economic slowdown in any single geography. Over the years, the group has established its presence in domestic markets through EPL, GBL, and ZHL and in international markets through overseas acquisitions. The group has seen reasonable growth in sales in domestic region and in Canada over the past few years.
Key Rating Weaknesses

Moderation in overall financial risk profile marked by lower profitability margin, deterioration in debt coverage indicators and liquidity parameters

The overall operational and financial risk profile of the company continues to remain moderate with decline in PBILDT margin and PAT margin during 8MFY20 to 14.03% and 1.69% vis-à-vis 16.91% and 4.38% in FY19 respectively. The company earlier witnessed shrinking in PBILDT margin during FY19 from 18.86% in FY18. The decline in overall profitability margins is mainly attributable to reduction in margins in US region due to pricing pressure. Further, the gross cash accruals during 8MFY20 stood moderate at Rs.257.33 crore. The capital structure of the company continued to remain moderate represented by increase in overall gearing as on November 30, 2019 which stood at 1.32x as against 1.23x and 1.25x as on March 31, 2019 and March 31, 2018 respectively. The elevation in gearing is mainly on account of increase in total debt owing to increase in working capital utilization. The working capital borrowing has increased as on November 30, 2019 to Rs.1319.10 crore from Rs.1086.84 crore and Rs.762.82 crore as on March 31, 2019 and as on March 31, 2018 respectively. The operating cycle of the company is also expected to increase due to increase in collection period in US region on account of lower bargaining power due to firm competition.

The debt service coverage ratio remained moderate with higher loan repayments due in the current year. Further, the company has maintained moderate liquidity with cash and bank balances at Rs.138 crore as on December 31, 2019. The current ratio of the company slightly declined from 1.02 in FY18 to 0.97 in FY19. Any equity infusion in the company and consequent reduction in the overall debt levels would remain crucial from the credit perspective.

USFDA Import Alert at Hinjewadi Plant continues, impacting operations in USA and delaying new product launches, while additional costs burden profitability

In July 14, 2015, US-Food and Drug Administration (USFDA) has barred imports of drugs manufactured at the Hinjewadi, Pune plant of Emcure Pharmaceuticals Ltd. (EPL) due to violations of certain standard manufacturing process and documentation. The import alerts named 'Detention without physical examination of drugs from firms which have not met drug Good Manufacturing Practices (GMPs)' have been issued against the plant of the company. The said ban is also delaying EPL's new product launches in the USA markets and impacting the group's scale of operations and profitability.

Further, the Company is recently issued a warning letter by USFDA which cites the observations and significant violations of current good manufacturing practice (CGMP) regulations for finished pharmaceuticals which remains in continuation with the said ongoing USFDA investigation. However, EPL continues to manufacture and export 9 exempted products from the plant.

Intense competition and exposure to regulatory risk inherent in pharmaceutical industry

The company faces intense competition in the domestic as well as international markets. Pricing pressure, increasing regulation, increased sensitivity towards product performance are the key issues in the pharmaceutical industry. The pharmaceutical industry has been a highly regulated industry worldwide by virtue of its direct bearing on public health. In India too, government policies have played key role in performance of companies such as explicit control on drug prices in the form of drug price control order (DPCO). Further, the patent laws and related regulations might hamper company's plans to launch new products and cater to new markets.

Indian pharmaceutical companies are expected to continue to experience growth from US markets over medium term backed by sizeable generic opportunities over next two years, strong product pipeline of ANDAs with increasing proportion of complex generic. However, US markets are facing multiple challenges such as increased scrutiny by USFDA, consolidation of supply-chain and need for higher investments in R&D to tap complex segments. Companies with growing portfolio comprising niche or complex products and high levels of backward integration are likely to be better positioned considering above challenges.

Foreign exchange fluctuation risk

The group generates majority of its overall revenues in foreign currency mainly denominated in USD, Euro and GBP. Large portion of outflows in foreign currency is hedged naturally against the foreign currency receivables. As on March 31, 2019, foreign currency receivables stood at ~Rs.203 crore against which the group had debt in the form of ECB (External Commercial Borrowings) and other payables denominated in USD/EUR/GBP amounting to ~Rs. 281 crore as on March 31, 2019 thus offsetting the movement in foreign exchange rate to much extent.

Industry outlook: **Stable**

Outlook for The Indian pharmaceutical industry (IPI) remains stable in medium to long term backed by growth opportunity in terms of capitalization on major blockbuster drugs coming off-patent paving the way for entry of generics, especially in the USA market, geographical diversification into emerging markets, steady growth of governments' spending on healthcare, increasing awareness and accessibility of healthcare. However, the industry players are facing headwinds in terms of structural reforms by governments, stringent regulation both in regulated and semi regulated market, intensification of competition in generic and channel consolidation which has led to pricing pressure to the company together impacting the profitability of the industry players. Recent rupee depreciation against USD benefits the export oriented pharma sector however intense competition in USA markets offsets this benefit.

Liquidity - Adequate

The Group's liquidity remains adequate with the cash and bank balance of Rs.138 crore as on Dec 31, 2019 and unutilized fund based working capital limits. The cash and bank balance has improved from Rs. 104.29 crore as on March 31, 2019 though continued to remain moderate as against the financial flexibility enjoyed in the past with cash and bank balances of Rs.269.00 crore as on March 31, 2018. EPL's and HPI's average working capital utilization on standalone level was seen high at around 93.50% and 95% for the past 12 months ended Oct 31, 2019. While the working capital utilization for GBL, MPI, and ZHL remained comfortable in the range of 7%-35% during the past 12 months ended Oct 31, 2019. Nevertheless, group's internal cash accruals, cash and bank balance and unutilized working capital limits provide adequate buffer to cover the scheduled debt obligations in medium term.

Analytical Approach – Consolidated*

CARE Ratings has considered consolidated financials of the Emcure Group including EPL and its 12 direct and 9 indirect subsidiaries as on November 30, 2019 (10 indirect subsidiaries as on March 31, 2019) on account of exposure of EPL to group companies in terms of corporate guarantee and similar line of business and management. Furthermore, the majority of the subsidiaries of EPL are engaged in the trading and marketing of products manufactured by EPL across various geographies. As a result of similar line of business and inter group transactions, consolidated view has been considered.

Applicable Criteria

Criteria on assigning 'outlook' and 'credit watch'
CARE Ratings' Policy on Default Recognition
Criteria for Short Term Instruments
Financial ratios – Non-Financial Sector
Rating Methodology - Manufacturing Companies
Rating Methodology-Pharmaceutical Sector
Rating Methodology-Consolidation and Factoring Linkages in Ratings

About the Company

Emcure Pharmaceuticals Limited (EPL) was incorporated in April 1981 as a Private Limited Company and is engaged in manufacturing of pharmaceuticals products (mainly formulations) either on Loan License or Principal to Principal basis. Subsequently, in August 2001, the company was converted to public limited company (unlisted).EPL is managed by a Eight member Board of Directors comprising four promoter/executive members and four non-executive and independent directors.

Brief Financials (Consolidated) (Rs. crore)#	FY18 (A)	FY19 (A)	8MFY20 (UA)
Total operating income	4263.37	4775.04	3233.20
PBILDT	804.27	807.56	453.70
PAT	174.19	209.19	54.70
Overall gearing (times)	1.25	1.23	1.32
Interest coverage (times)	4.64	3.65	2.90

A: Audited
 # Based on IND-AS

Status of non-cooperation with previous CRA – Not Applicable

Any other information- Not Applicable

Rating History (Last three years): Please refer Annexure II

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-Term Loan	-	-	Dec 24	950.08	CARE A-; Stable
Non-fund-based - ST-BG/LC	-	-	-	98.00	CARE A2+
Fund-based - LT/ ST-Working Capital Demand loan	-	-	-	529.00	CARE A-; Stable / CARE A2+
Fund-based/Non-fund-based-LT/ST	-	-	-	132.00	CARE A-; Stable / CARE A2+
Fund-based - LT-Proposed fund based limits	-	-	-	50.00	CARE A-; Stable

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 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.	Fund-based - LT-Term Loan	LT	950.08	CARE A-; Stable	1)CARE A; Negative (16-Sep-19)	1)CARE A+; Stable (05-Dec-18)	1)CARE A+; Stable (09-Oct-17)	1)CARE AA-; Stable (10-Feb-17)
2.	Non-fund-based - ST-BG/LC	ST	98.00	CARE A2+	1)CARE A2+ (16-Sep-19)	1)CARE A1 (05-Dec-18)	1)CARE A1 (09-Oct-17)	1)CARE A1+ (10-Feb-17)
3.	Fund-based - LT/ ST-Working Capital Demand loan	LT/ST	529.00	CARE A-; Stable / CARE A2+	1)CARE A; Negative / CARE A2+ (16-Sep-19)	1)CARE A+; Stable / CARE A1 (05-Dec-18)	1)CARE A+; Stable / CARE A1 (09-Oct-17)	1)CARE AA-; Stable / CARE A1+ (10-Feb-17)
4.	Fund-based/Non-fund-based-LT/ST	LT/ST	132.00	CARE A-; Stable / CARE A2+	1)CARE A; Negative / CARE A2+ (16-Sep-19)	1)CARE A+; Stable / CARE A1 (05-Dec-18)	1)CARE A+; Stable / CARE A1 (09-Oct-17)	1)CARE AA-; Stable / CARE A1+ (10-Feb-17)
5.	Non-fund-based - LT-Letter of credit	LT	-	-	-	1)Withdrawn (05-Dec-18)	1)CARE A+; Stable (09-Oct-17)	1)CARE AA-; Stable (10-Feb-17)
6.	Fund-based - LT-Proposed fund based limits	LT	50.00	CARE A-; Stable	1)CARE A; Negative (16-Sep-19)	1)CARE A+; Stable (05-Dec-18)	-	-

Annexure-3: List of Subsidiaries considered for consolidation

The 12 direct subsidiaries and 9 indirect subsidiaries as on November 30, 2019 (10 indirect subsidiaries as on March 31, 2019) are as given below:

Direct Subsidiaries	
1	Gennova Biopharmaecuticals Ltd
2	Zuventus Healthcare Ltd
3	Emcure Nigeria Ltd
4	Emcure Pharmaceuticals Mena FZ LLC
5	Emcure Pharmaceuticals South Africa Pty Ltd
6	Emcure Brasil Farmaceutical Ltd
7	Heritage Pharma Holdings Inc
8	EmcurePharma UK Ltd
9	EmcurePharma Peru SAC
10	EmcurePharma Mexico S.A DE C.V
11	Emcure Pharmaceuticals Pty Ltd
12	Marcan Pharmaceuticals Inc
Indirect Subsidiaries	
13	Heritage Pharma Labs Inc
14	Heritage Pharmaceuticals Inc
15	Tillomed Laboratories Ltd
16	TilomedPharma Gm
17	LaboratoriosTilomed Spain SLU
18	Tillomed Italia SRL
19	Emcure NZ Limited
20	Tillomed France SAS
21	HACCO Pharma Inc
22	Tillomed Holdings Ltd*

***Tillomed Holdings Ltd. UK has been dissolved on April 16, 2019

***Note on complexity levels of the rated instrument:** CARE Ratings 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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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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