Emcure Pharmaceuticals Limited

October 9, 2017

Ratings

Bank Facilities	**Amount (Rs. crore)**	**Rating[1]**	**Remarks**
Long term Bank Facilities	991.07 (enhanced from 845.25)	**CARE A+; Stable (Single A Plus; Outlook: Stable)**	**Revised from CARE AA-; Stable (Double A Minus; Outlook: Stable)**
Short term Bank Facilities	148.00 (enhanced from 70.00)	**CARE A1 (A One)**	**Revised from CARE A1+ (A One Plus)**
Long term / Short term bank facilities	536.00 (enhanced from 387.00)	**CARE A+; Stable /CARE A1 (Single A Plus; Outlook: Stable/ A One)**	**Revised from CARE AA-; Stable/ CARE A1+ (Double A Minus; Outlook: Stable/ A One Plus)**
Total	**1,675.07 (Rupee Sixteen Hundred Seventy Five Crore and Seven lakh only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings take into account deterioration in Emcure Pharmaceuticals Limited (EPL, (CIN-U24231PN1981PLC024251))'s financial risk profile during FY17 (refers to period April 1 to March 31), marked by de-growth in total operating income, decline in profitability and deterioration in debt coverage indicators, owing mainly to continued 'import alert' by United States Food and Drugs Administration (USFDA) on EPL's Hinjewadi facility.

Nevertheless, the ratings continue 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, long-term contracts with the pharmaceutical majors.

The strengths are partially offset by moderate capital structure and debt coverage indicators on account of on-going debt funded capital expenditure (capex) across group companies as well as debt funded acquisitions, 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, intense competition in the generic formulations industry along with regulatory risk inherent in the pharmaceutical industry.

The ratings strengths are further constrained by EPL's exposure to regulated markets, especially the US, which is witnessing increased competition resulting into pricing pressure in the generics space and heightened regulatory scrutiny and exposure to foreign exchange fluctuations.

Going forward, EPL's ability to resolve pending regulatory issues and realize envisaged benefits out of expenditure incurred on Research and Development activities and capex across group companies remain the key rating sensitivities.

The ability of the group to increase its scale of operations by expanding its footprint in regulated & domestic markets across therapeutic segments, stabilize the operations of the recently acquired companies, while improving its capital structure and debt coverage indicators, improvement in the profit margins and efficient management of working capital on the back of 'import alert' issued by USFDA and competition in domestic as well as overseas market are the key rating monitorables. Timely resolution of USFDA import alert is critical from credit perspective.

Detailed description of the key rating drivers

Key Rating Strengths

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 30 decades in the field of pharmaceuticals. Ms. Namita Thapar (CFO), Chartered Accountant and MBA, is actively involved in the marketing and distribution division of the company. Mr. Fakrul Sayeed, CEO of HPI has a strong experience in the field of pharmaceutical industry and was associated with PTS International Inc. before joining the Emcure group in 2007. The group has team of highly qualified and experienced professionals in the field of pharmaceuticals.

Diversified product portfolio with the new launches and focus on chronic high-value segments

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

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 FY17 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 six manufacturing facilities (five 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 and Sikkim. HPL has a manufacturing facility along with R&D centre located at New Jersey, USA.

Strong marketing network coupled with strengthening presence in international markets along with long term contract with pharmaceutical majors

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 and organic as well as inorganic growth

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 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, ZHL and in international markets through overseas acquisitions.

Key Rating Weaknesses

Deterioration in financial risk profile marked by decline in total income, lower profitability, and deterioration in debt coverage indicators in FY17

Consolidated net sales declined marginally by ~4% to Rs.4,134.78 crore during FY17 as against Rs.4,322.88 crore during FY16. PBILDT margin declined ~600 bps to 20.43% during FY17 as against 26.25% during FY16. The decline was mainly attributable to higher employee costs and selling & distribution expenses. The group availed additional debt during the year in order to fund the on-going capital expenditure leading to significant increase in interest and finance costs. Furthermore, during FY17, the group booked extra ordinary expenses to the tune of Rs.186.04 crore (PY: Rs.114.72 crore), which pertained to the consultancy fees (Rs.162.67 crore) regarding 'import alert' issued by USFDA and inventory write-off for near- expiry goods Rs.23.40 crore. Higher interest costs coupled with depreciation corresponding to the capital expenditure and extraordinary expenses resulted in significant reduction in PAT. PAT margin for FY17 was seen lower at 5.33% as compared to 13.41% during FY16.

Capital structure as on March 31, 2017 remained moderate as indicated by long term debt to equity of 1.07x (1.11x as on March 31, 2016) and overall gearing of 1.39x (1.41x as on March 31, 2016). Deterioration in profitability had an impact on EPL's debt coverage indicators. Interest coverage, though satisfactory, deteriorated to 4.94x during FY17 (PY: 9.72x), while TDGCA for FY17 deteriorated to 4.63x (PY: 2.57x).

Further, during H1FY18 (refers to period April 1 to September 30), the group achieved estimated total operating income of Rs.2,040 crore and estimated PBILDT of Rs.377.00 crore.

USFDA ban at Hinjewadi Plant continues, impacting the CRAMS segment 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. However, EPL continues to manufacture and export 9 exempted products from the plant.

USFDA officials visited the facility in August 2017 and the inspection report is awaited.

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 60% 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, 2017, foreign currency receivables stood at ~Rs.240 crore against which the group had debt in the form of ECB (External Commercial Borrowings) denominated in USD/EUR/GBP amounting to ~Rs. 214 crore as on March 31, 2017, thus offsetting the movement in foreign exchange rate to much extent.

Ongoing Debt funded capex and recent acquisition under ZHL

The group has been undertaking capital expenditure in the form of R&D facilities, maintenance capex and capacity enhancement at various locations. The estimated capex to be incurred over next 2 years is Rs.1,060 crore. Majority of the projects are debt funded, leading to moderation in capital structure. Realization of envisaged benefits out of debt funded capital expenditure, acquisitions and expenditure incurred on Research and Development activities is critical from credit perspective.

Analytical approach: Consolidated

CARE has considered consolidated financials of the Emcure Group including EPL and its 13 direct and 7 indirect subsidiaries 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. Consequently, consolidated view has been considered.

Applicable criteria

Criteria on assigning Outlook to Credit Ratings
Criteria for Short Term Instruments
CARE's Policy on Default Recognition
CARE's methodology for manufacturing companies
CARE's methodology for Pharmaceutical sector
Rating Methodology: Factoring Linkages in Ratings
Financial ratios – Non-Financial Sector

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 ten member Board of Directors comprising four promoter/executive members and six non-executive and independent directors.

Brief Financials (Consolidated) (Rs. crore)#	FY16 (A)	FY17 (A)
Total operating income	4376.71	4192.29
PBILDT	1148.93	856.78
PAT	587.07	223.44
Overall gearing (times)	1.41	1.39
Interest coverage (times)	9.72	4.95

#Based on IND-AS

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating History for last three years: Please refer Annexure-2

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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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	-	-	September 2022	970.87	CARE A+; Stable
Non-fund-based - ST-BG/LC	-	-	-	148.00	CARE A1
Fund-based - LT/ ST-Working Capital Demand loan	-	-	-	429.00	CARE A+; Stable / CARE A1
Fund-based/Non-fund-based-LT/ST	-	-	-	107.00	CARE A+; Stable / CARE A1
Non-fund-based - LT-Letter of credit	-	-	-	20.20	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 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	Fund-based - LT-Term Loan	LT	970.87	CARE A+; Stable	-	1)CARE AA-; Stable (10-Feb-17)	1)CARE AA- (09-Mar-16) 2)CARE AA- (19-Jan-16) 3)CARE AA- (Under Credit Watch) (23-Jul-15)	1)CARE AA- (27-Jan-15) 2)CARE AA- (10-Oct-14) 3)CARE A+ (03-Apr-14)
2.	Non-fund-based - ST-BG/LC	ST	148.00	CARE A1	-	1)CARE A1+ (10-Feb-17)	1)CARE A1+ (09-Mar-16) 2)CARE A1+ (19-Jan-16) 3)CARE A1+ (Under Credit	1)CARE A1+ (27-Jan-15) 2)CARE A1+ (10-Oct-14) 3)CARE A1 (03-Apr-14)

							Watch) (23-Jul-15)	
3.	Fund-based - LT/ ST-Working Capital Demand loan	LT/ST	429.00	CARE A+; Stable / CARE A1	-	1)CARE AA-; Stable / CARE A1+ (10-Feb-17)	1)CARE AA- / CARE A1+ (09-Mar-16) 2)CARE AA- / CARE A1+ (19-Jan-16) 3)CARE AA- / CARE A1+ (Under Credit Watch) (23-Jul-15)	1)CARE AA- / CARE A1+ (27-Jan-15) 2)CARE AA- / CARE A1+ (10-Oct-14) 3)CARE A+ / CARE A1 (03-Apr-14)
4.	Fund-based/Non-fund-based-LT/ST	LT/ST	107.00	CARE A+; Stable / CARE A1	-	1)CARE AA-; Stable / CARE A1+ (10-Feb-17)	1)CARE AA- / CARE A1+ (09-Mar-16) 2)CARE AA- / CARE A1+ (19-Jan-16) 3)CARE AA- / CARE A1+ (Under Credit Watch) (23-Jul-15)	1)CARE AA- / CARE A1+ (27-Jan-15) 2)CARE AA- / CARE A1+ (10-Oct-14)
5.	Non-fund-based - LT-Letter of credit	LT	20.20	CARE A+; Stable	-	1)CARE AA-; Stable (10-Feb-17)	1)CARE AA- (09-Mar-16) 2)CARE AA- (19-Jan-16) 3)CARE AA- (Under Credit Watch) (23-Jul-15)	1)CARE AA- (27-Jan-15)

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