Emcure Pharmaceuticals Limited

December 05, 2018

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term bank facilities	1052.90 (enhanced from 988.62)	CARE A+; Stable (Single A Plus; Outlook: Stable)	Reaffirmed
Long term bank facilities (Non Fund Based)	- (reduced from 20.20)	-	Withdrawn
Short term bank facilities (Non-Fund based)	98.00 (Reduced from 148.00)	CARE A1 (A One)	Reaffirmed
Long term / Short term bank facilities (Fund based)	586.00 (Enhanced from 536.00)	CARE A+; Stable /CARE A1 (Single A Plus; Outlook: Stable/ A One)	Reaffirmed
Total Facilities	**Rs. 1,736.90 (Rupee Seventeen hundred and Thirty Six Crore and Ninety lakh only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of ratings to the bank facilities of Emcure Pharmaceuticals Limited (Consolidated, hereafter refers to EPL/Group)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 and long-term contracts with the pharmaceutical majors.
The ratings take a note of moderation in EPL's financial risk profile during FY18 (refers to April 1 to March 31), marked by marginal improvement in scale of operations, moderate capital structure and slight deterioration in debt coverage indicators.EPL's capital structure as on March 31, 2018 remained moderate in FY18.
The ratings further take into account improvement in scale of operations and profitability during H1FY19 (Unaudited, refers to April 1 to September 30).
The rating strengths are partially offset by delay in new product launches and cost incurred on revamp of processes at its plants in the wake of the 'import alert' by The Food and Drug Administration of United States of America (USFDA) impacting profit margins, intense competition in the generic formulations industry along with regulatory risk inherent in the pharmaceutical industry.
The rating 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 ,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 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, Marcan Pharmaceuticals Inc and Emcure Pharma UK Ltd has served as President & CEO for Albany Molecular Research Inc (AMRI) till January 2018 and was President & CEO for Teva Pharmaceuticals USA till 2012. Mr. Fakrul Sayeed, COO 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.

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

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 H1 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 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 ,Sikkim and Bengaluru. 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 group is also 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, ZHL and in international markets through overseas acquisitions.

Liquidity

Although internal cash accruals are partially used for capex; Group's liquidity indicator derives comfort from cash and bank balance of Rs.203 crore as on September 30, 2018 and unutlised fund based working capital limits. Average working capital utilization (sanctioned limits of Rs.525 crore on standalone level) stands at 77% for last 12 months ended October 2018, giving cushion of around Rs.120 crore. So group's internal cash accruals, cash and bank balance and unutilised working capital limits remains adequate against scheduled term loan repayments coming up in FY19 & FY20.

Moderation in financial risk profile during FY18 marked by marginal improvement in scale of operations, moderate capital structure and slight deterioration in debt coverage indicators owing to pricing pressure in US market along with impact of import alert; improvement in total income and profitability during H1FY19

Consolidated total operating income remained stagnant at Rs.4263.37 crore during FY18 as against Rs.4,192.29 crore during FY17 and PBILDT margin declined by ~158 bps to 18.86% during FY18 as against 20.44% during FY17. The decline was mainly attributable to higher employee costs and higher fixed overheads vis a vis lower sales in Q1FY18 (refers to April 1 to June 30) due to GST implementation; finance costs remained on the similar level as debt has remained at the similar level in FY18 vis a vis FY17 . Furthermore, during FY18, the group booked extra ordinary expenses to the tune of Rs.118.82 crore (FY 17: Rs.186.07 crore), which pertained to the consultancy fees (Rs.105.59 crore) regarding 'import alert' issued by USFDA and loss on sale of assets and investments at Rs.13.32 crore. Lower PBILDT, higher depreciation corresponding to the capital expenditure and extra tax expense (around Rs.116 crore in FY 18 as compared to Rs.44.2 crore in FY 17) resulted in significant reduction in PAT. PAT margin for FY18 has been lower at 4.09% as compared to 5.99% during FY17.

Capital structure as on March 31, 2018 remained moderate with overall gearing (including contingent consideration payable) of 1.22x as on March 31,2018 (1.25x as on March 31, 2017). Overall gearing remained moderate due to debt funded capex and higher reliance on external debt to fund working capital requirements.

Also interest coverage, though satisfactory, slightly deteriorated to 4.64x during FY18 (PY: 4.95x), while TDGCA for FY18 deteriorated to 5.03x (PY: 4.07x).

Total income increased by about 21% from Rs. 2,007 crore in H1FY18 to Rs.2437 crore in H1FY19. Similarly, PBILDT margin also increased to 22.10% in H1FY19 from 16.70% in H1FY18. Improvement in operating income and PBILDT margin has reflected in improvement in interest coverage at 5.19x as on September 30, 2018.

Key Rating Weaknesses

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. 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, 2018, foreign currency receivables stood at ~Rs.302 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, 2018 thus offsetting the movement in foreign exchange rate to much extent.

Ongoing Debt funded capex

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.500 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.

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.

Analytical Approach – Consolidated*

CARE has considered consolidated financials of the Emcure Group including EPL and its 12 direct and 8 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. As a result of similar line of business and inter group transactions, consolidated view has been considered.

The 12 direct subsidiaries and 8 indirect subsidiaries 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	Tillomed Holdings Ltd
17	TilomedPharma Gm
18	LaboratoriosTilomed Spain SLU
19	Tilomed Italia SRL
20	Emcure Newziland PharmaCeuticals Limited

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)#	FY17 (A)	FY18 (A)	H1FY19 (UA)
Total operating income	4192.29	4263.37	2437.07
PBILDT	856.78	804.27	538.31
PAT	251.25	174.19	199.48
Overall gearing (times)	1.22	1.25	0.78
Interest coverage (times)	4.95	4.64	5.19

A:Audited, UA :(Unaudited)
 # Based on IND-AS
Status of non-cooperation with previous CRA – Not Applicable
Rating History (Last three years): Please refer Annexure II
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	-	-	March 2023	1002.90	CARE A+; Stable
Non-fund-based - ST-BG/LC	-	-	-	98.00	CARE A1
Fund-based - LT/ ST-Working Capital Demand loan	-	-	-	479.00	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	-	-	-	0.00	Withdrawn
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 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Fund-based - LT-Term Loan	LT	1002.90	CARE A+; Stable	-	1)CARE A+; Stable (09-Oct-17)	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)
2.	Non-fund-based - ST-BG/LC	ST	98.00	CARE A1	-	1)CARE A1 (09-Oct-17)	1)CARE A1+ (10-Feb-17)	1)CARE A1+ (09-Mar-16) 2)CARE A1+ (19-Jan-16) 3)CARE A1+ (Under Credit Watch) (23-Jul-15)
3.	Fund-based - LT/ ST-Working Capital Demand loan	LT/ST	479.00	CARE A+; Stable / CARE A1	-	1)CARE A+; Stable / CARE A1 (09-Oct-17)	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)
4.	Fund-based/Non-fund-based-LT/ST	LT/ST	107.00	CARE A+; Stable / CARE A1	-	1)CARE A+; Stable / CARE A1 (09-Oct-17)	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)
5.	Non-fund-based - LT-Letter of credit	LT	-	-	-	1)CARE A+; Stable (09-Oct-17)	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)
6.	Fund-based - LT-Proposed fund based limits	LT	50.00	CARE A+; Stable	-	-	-	-

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