Neuland Laboratories Limited

February 27, 2018

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities	350.53 (enhanced from 230.53)	**CARE BBB+; Stable (Triple B Plus; Outlook: Stable)**	Reaffirmed
Short-term Bank Facilities	118.90 (enhanced from 113.90)	**CARE A3+ (A Three Plus)**	Reaffirmed
Total Facilities	**469.43 (Rs. Four Hundred Sixty Nine crore and Forty Three Lakh only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Neuland Laboratories Limited (NLL) continues to derive strength from experienced management, approved manufacturing facilities, capacity expansion through acquisition of manufacturing facility of Arch Pharma Labs Limited (APL), diversified product portfolio and reputed clientele, improvement in total operating income during FY17 (refers to the period April 1 to March 31), improvement in profitability margins, improved overall gearing and other debt coverage indicators. The rating is, however, tempered by deterioration in operating cycle, deterioration in financial performance during H1FY18, expected weakening of capital structure due to majorly funding of acquisition by debt, risk associated with exchange rate fluctuation and exposure to regulatory risk.

The ability of the company to grow its revenue base and sustain profitability margins, to manage working capital requirements and ability to timely complete repairs & refurbishment, obtain regulatory approval and commence operation from newly acquired manufacturing facility of Arch Pharma Labs Limited (APL) are the key rating sensitivities.

Detailed description of the key rating drivers

Key rating strengths

Experienced management and approved manufacturing facilities

NLL is led by Dr. Davuluri Rama Mohan Rao, the Chairman and MD of the company, who has more than four decades experience in industry. He has a Masters in Science from Andhra University, Post Graduate Diploma in Technology from IIT Kharagpur. He is well supported by vast experience of its management team. The company has manufacturing facilities compliant with health and regulatory agencies cGMP certifications namely, Food and Drug Administration (USA), Canada (HC), Pharmaceuticals and Medical Devices Agency (Japan), Ministry Of Food And Drug Safety (Korea), European Medicines Agency (European Union), European Directorate for the Quality of Medicines (COS), Brazilian Health Regulatory Agency (Brazil) and others (ROW).

Capacity expansion through acquisition of manufacturing facility of Arch Pharma Labs Limited

The company has acquired one manufacturing facility of Arch Pharma Labs Limited (APL) on December 13, 2017 with an installed capacity of 197 KL from JM Financial Asset Reconstruction Company Limited under SARFAESI Act. The total cost of acquisition is Rs.105.30 crore and repairs, refurbishment and transaction cost of Rs.24.70 crore. The entire cost of Rs.130 crore has been funded through term loan of Rs.100 crore, monetisation of non-current investment

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

(Nanakramguda property, Hyderabad) of Rs.25 crore and internal accrual of Rs.5 crore. Post-acquisition, total installed capacity of the NLL has increased from 532.70 KL (222.50 KL in unit I and 310.20 KL in unit II) to 729.70 KL and APL will help NLL to support business development of CMS segment and towards backward integration in to advance intermediates.

Healthy growth in total operating income with improved profitability margin

The total operating income of company has improved by 12.22% from Rs.511.18 crore in FY16 to Rs.573.65 crore in FY17 backed by increase in revenue from APIs/bulk drugs and CMS segment. The revenue from CMS segment has increased from Rs.90.25 crore in FY16 to Rs.134.67 crore in FY17. The PBILDT margin of the company has increased by 17 bps from 14.16% in FY16 to 14.33% in FY17 primarily due to increase in revenue contribution from CMS segment, increased focus on niche products and cost leadership for all molecules. The PAT margin of the company has increased by 48 bps from 5.17% in FY16 to 5.65% in FY17 due to reduction in interest expense.

Diversified product portfolio and reputed clientele

NLL has portfolio of 78 products (largely APIs) as on March 31, 2017 (as against 75 as on March 31, 2016). The top 10 product has contributed about 64.89% in FY17 (64.67% in FY16). Ciprofloxacin, the flagship product of NLL continued to remain the major revenue contributor in FY17 with 15.13% share in total operating income. NLL has presence across 24 Therapeutic segments with anti-bacterial therapeutic segment (21.74%) has contributed major revenue followed by antidepressant therapeutic segment (9.33%), Bronchodilator (9.25%), Anticonvulsant (7.19%), Antipsychotics (6.82%), etc. Top 5 therapeutic segments have contributed 54.33% of total operating income in FY17 (62.18% in FY16). The company has been generating revenue from customers with long standing relation with an average age of 15 years of association. The company enjoys dependable relationships with major global and Indian pharma majors. Top 10 clients of the company accounted for 64.89% in FY17.

Improvement in financial risk profile

The overall gearing including LC backed creditors has improved from 1.22x as on March 31, 2016 to 1.14x as on March 31, 2017 due to schedule repayment of existing term loan coupled with accretion of profit into Net worth. The other debt coverage indicator such as total debt to GCA has improved to 4.89x in FY17 from 5.49x in FY16 due to increase in GCA level. The PBILDT interest coverage ratio of the company has improved and remained satisfactory at 5.66x in FY17 as against 4.60x in FY16.

Key rating Weaknesses

Deterioration in operating cycle

The operating cycle of the company has deteriorated from 110 days in FY16 to 126 days in FY17 due to deterioration in average receivable and average creditor's period. In order to enjoy the credit discounts, the company has to reduce its creditors leading to deterioration in average creditor's period from 84 days in FY16 to 76 days in FY17.

Deterioration in financial performance during H1FY18

The total operating income of the company has deteriorated from Rs.303.96 crore in H1FY17 to Rs.246.33 crore in H1FY18. Due to decline in operating income combined with lower absorption of fixed costs along with increase in operational expenses has resulted in decline in PBILDT margin by 515 bps from 16.51% during H1FY17 to 11.37% during H1FY18. In line with the same PAT margin of the company has declined from 6.49% to 1.99%.

Expected weakening of capital structure due to majorly funding of acquisition by debt

The capital structure of the company is expected to deteriorate on account of increase in term loan of Rs.100 crore to fund acquisition of manufacturing facility of Arch Pharma Labs Limited (APL).

Risk associated with exchange rate fluctuation

The total operating income of the company constitutes about 76% from export sales during FY17 (as against about 75% during FY16). Further the company has imported raw material of Rs.106.61 crore which is about 39% of total raw material purchases during FY17 against export sales of Rs.435.60 crore. Accordingly NLL has natural hedge against exchange rate fluctuations to certain extent. Further, towards its hedging policy, the company issuing bill discounting and Pre-shipment Credit in Foreign currency (PCFC) to cover about 90% of the total risk while 10% remains open, which the company reviews and evaluates the same on a quarterly basis.

Exposure to regulatory risk

The pharmaceutical industry is highly regulated and requires various approvals, licenses, registrations and permissions for business activities. Given, India's significant share in the US's generic market, the USFDA has increased its scrutiny of manufacturing facilities and other regulatory compliances of the Indian pharma companies supplying APIs and generic drugs to the US. Non-compliance may result in regulatory ban on products/facilities and may impact a company's future approvals from USFDA. However, manufacturing facility of NLL is already successfully inspected Unit I by USFDA in 2018.

Analytical approach: Standalone

Applicable Criteria

[Criteria on assigning Outlook to Credit Ratings](#)
[CARE's Policy on Default Recognition](#)
[Criteria for Short Term Instruments](#)
[Rating Methodology-Manufacturing Companies](#)
[Financial ratios – Non-Financial Sector](#)
[Rating Methodology – Pharmaceutical Sector](#)

About the Company

Neuland Laboratories Ltd (NLL) was set up as a private limited company in 1984 by Dr D R Rao and Mr. G V K Rama Rao and it was reconstituted as a public limited company, with the current name, in 1994. NLL is primarily into manufacturing of active pharmaceutical ingredients for global pharmaceutical companies and also provides end-to-end solutions for the pharmaceutical industry for chemistry-related services from synthesis of library compounds to supply of New Chemical Entities (NCEs) and intermediates at various clinical phases up to commercial scale.

NLL has two manufacturing facilities in Hyderabad, Telangana with total installed capacity of 532.70 Kilo Litre as on March 31, 2017 (222.50 KL in unit I and 310.20 KL in unit II). The manufacturing facilities are compliant with health and regulatory agencies cGMP certifications namely, Food and Drug Administration (USA), Canada (HC), Pharmaceuticals and Medical Devices Agency (Japan), Ministry Of Food And Drug Safety (Korea), European Medicines Agency (European Union), European Directorate for the Quality of Medicines (COS), Brazilian Health Regulatory Agency (Brazil) and others (ROW). This apart, the company also provides Custom Manufacturing Solutions (CMS) to develop and manufacture pharmaceutical ingredients and intermediates in line with customer expectations. The company has portfolio of around 75 products with presence in 24 therapeutic segments including Antibacterial, Antidepressant, Bronchodilator, Anticonvulsant, Antipsychotics, Antiparkinsonian, Antihypertensive and Anatomical. NLL is listed on the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). The company in order to expand its operations has acquired manufacturing facility of Arch Pharma Labs Limited (APL) in December 2017.

Brief Financials (Rs. crore)	FY16 (A)	FY17 (A)
Total operating income	511.18	573.65
PBILDT	72.36	82.18
PAT	26.41	32.43
Overall gearing (times)	1.22	1.14
Interest coverage (times)	4.60	5.66

A: Audited

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
Term Loan – Long term	-	-	December 2025	130.53	CARE BBB+; Stable
Fund-based – LT – Working capital Limits	-	-	-	220.00	CARE BBB+; Stable
Non-Fund-based-ST-BG/LC	-	-	-	112.50	CARE A3+
Non-Fund-based-ST-Forward Contract	-	-	-	6.40	CARE A3+

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.	Term Loan – Long term	LT	130.53	CARE BBB+; Stable	1) CARE BBB+; Stable (07-Feb-18) 2)CARE BBB+; Stable (11-Apr-17)	1)CARE BBB (26-Aug-16) 2)CARE BBB- (29-Apr-16)	1)CARE BBB- (16-Sep-15) 2)CARE BBB- (07-Aug-15)	1)CARE BBB- (04-Jul-14)
2.	Fund-based – LT – Working capital Limits	LT	220.00	CARE BBB+; Stable	1) CARE BBB+; Stable (07-Feb-18) 2)CARE BBB+; Stable (11-Apr-17)	1)CARE BBB (26-Aug-16) 2)CARE BBB- (29-Apr-16)	1)CARE BBB- (16-Sep-15) 2)CARE BBB- (07-Aug-15)	1)CARE BBB- (04-Jul-14)
3.	Non-Fund-based-ST-BG/LC	ST	112.50	CARE A3+	1) CARE A3+ (07-Feb-18) 2)CARE A3+ (11-Apr-17)	1)CARE A3+ (26-Aug-16) 2)CARE A3 (29-Apr-16)	1)CARE A3 (16-Sep-15) 2)CARE A3 (07-Aug-15)	1)CARE A3 (04-Jul-14)
4.	Non-Fund-based-ST-Forward Contract	ST	6.40	CARE A3+	1) CARE A3+ (07-Feb-18) 2)CARE A3+ (11-Apr-17)	1)CARE A3+ (26-Aug-16) 2)CARE A3 (29-Apr-16)	1)CARE A3 (16-Sep-15) 2)CARE A3 (07-Aug-15)	1)CARE A3 (04-Jul-14)

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