Neuland Laboratories Limited

August 02, 2019

Ratings

Instrument*	Amount (Rs. Crore)	Ratings	Remarks
Long-term Bank Facilities	294.17	**CARE BBB+; Stable (Triple B Plus; Outlook: Stable)**	Reaffirmed
Short-term Bank Facilities	118.90	**CARE A3+ (A Three Plus)**	Reaffirmed
Total Facilities	**413.07 (Rs. Four Hundred and thirteen crore and seven lakhs Only)**		

**Details of instruments/facilities in Annexure-1*

Detailed Rationale

The ratings assigned to the bank facilities of Neuland Laboratories Limited (NLL) factors in healthy growth in total operating income during FY19 (refers to the period April 1 to March 31), improved overall financial risk profile with infusion of funds by way of qualified institutional placement (QIP) issue during May 2018. Further, the rating continues to derive strength from experienced management, approved manufacturing facilities by regulatory authorities of regulated markets, moderate liquidity profile, diversified product portfolio with perceptible presence in antibacterial, antidepressant and anticonvulsant therapeutic segments among others and reputed and geographically diverse clientele. The ratings are, however, tempered by decline in profitability margins during FY19, moderate operating cycle, risk associated with exchange rate fluctuation and exposure to regulatory risk.

The ability of the company to improve its profitability margins by reaping benefits from backward integration and reducing dependency on china for procurement of raw material, further, the ability of company to address the observations made by USFDA for its unit I and obtaining Establishment Inspection Report (EIR) would be critical and forms key rating sensitivity.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced management and approved manufacturing facilities

NLL is led by Dr. D.R. Rao, the Chairman and MD of the company, who has over four decades of industry experience. He has a Masters in Science from Andhra University, Post Graduate Diploma in Technology from IIT Kharagpur, and was awarded his PhD in Organic Chemistry from the University of Notre Dame, U.S.A. Prior to promoting Neuland in 1984, Dr. Rao has held senior positions in R&D, production, and quality assurance at Glaxo India for about ten years. He is a member of Royal Society of Chemistry. He is ably supported by Mr. Mr. Davuluri Sucheth Rao and Mr. Davuluri Saharsh Rao. NLL has manufacturing facilities compliant with health and regulatory agencies cGMP certifications namely, USFDA (USA), Canada (HC), PMDA (Japan), KFDA (Korea), EU (EMA), EDQM (COS) and others (ROW).

Diversified product portfolio with perceptible presence in Antibacterial, Antidepressant and Anticonvulsant therapeutic segments

NLL has portfolio of over 50 products (largely APIs) of which top 5 API's contribution 41% of total operating income. Further the company caters to 25 therapeutic segments of which Antibacterial contributed 19.72% to the total operating income during FY19 followed by Antidepressant (11.80% during FY19) and Anticonvulsant (10.46% during FY19). To diversify its product portfolio the company has launched new products and has entered new market regions during FY19. The company has also filed US DMF's for Posaconazole and Apremilast during FY19.

Reputed and geographically diverse clientele

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. The company has established healthy relationship with reputed clients. The established relations have also resulted in repeat orders from customers. No single client contributes more than 15% to the total operating revenue. Further, Top 5 clients of the company accounted for 36.70% during FY19 against 34.88% in FY18. The revenue from export market has decreased from 71.44% during FY18 to 70.88% during FY19 with increased domestic contribution. Major portion of export sales is streamed from Europe (contributed 43% of total revenue in FY19 compared to 45.61% in FY18) and US market (contributed 11% in FY19 compared to 12.67% in FY18).

Healthy growth in total operating income during FY19

At consolidated level, the total operating income of the company grew by 26.01% and stood at Rs. 666.82 crore during FY19 as against Rs. 529.17 crore during FY18. The total operating income of the company improved on account of strong demand for the products with improving generic API volumes during FY19. During FY19, company witnessed healthy growth of

35.48% in the revenues of generic APIs from Rs. 395 crore during FY18 to Rs. 535.18 crore during FY19. The revenue contribution from the CMS segment has declined marginally from Rs 104.50 crore during FY18 to Rs. 91.30 crore during FY19. However, the number of projects from CMS has increased from 40 as on March 31, 2018 to 56 as on March 31, 2019.

Improved financial risk profile of the company

During FY19, the overall gearing of the company has improved from 1.26x as on March 31, 2018 to 0.61x during March 31, 2019. During May 2018, to strengthen the Balance sheet of the company has issued 16,75,000 equity shares through QIP at an issue price of Rs. 750 per share amounting to Rs. 125.63 crore (including a premium of Rs. 121.68 crore). The company has utilized the aforementioned amount for pre – payment of part its long term debt amounting to Rs. 38.20 crore approx. and balance of Rs. 86.31 crore was utilized partly for working capital requirements and for capex. The total debt to GCA and PBILDT interest coverage improved from 10.92x and 2.77x as on March 31, 2018 to 5.70x and 3.93x as on March 31, 2019 respectively.

Comfortable liquidity position

The company has a satisfactory liquidity position with adequate cash accruals generation. The current ratio stood at 1.33x as on Mach 31, 2019 as against 1.17x as on March 31, 2018. Considering the cash accruals which the company is expected to generate during FY20 and the total debt obligation of about Rs. 21.69 crore during FY20, the cash accruals are expected to be adequate to meet the debt obligations comfortably. The company has cash and bank balance of Rs. 37.83 crore as on March 31, 2019 and the working capital utilization during last 12 months ending on June 2019 has been moderate at 69.42%.

Growth opportunities in Custom manufacturing solutions (CMS) Segment

NLL provides contract manufacturing solutions (CMS) to innovator pharma and biotech companies. It offers both small-scale clinical trial quantities and commercial-scale requirements. The company has well equipped facilities for Preclinical trials to Phase III for development of New Chemical Entity (NCE). The company caters to regulated markets such as US, Europe and Japan. The CMS business is in its nascent stage making the segment revenues volatile. During FY19, the revenue from CMS segment has declined from Rs. 104.50 crore during FY18 to Rs. 91.30 crore, this is on account of shift in scheduled deliveries from Q4FY19 to FY20 and lower offtake of a commercialized product during FY19. However, the number of projects has increased year-on-year from 40 as on March 31, 2018 to 56 as on March 31, 2019. The Company added 16 products (4 APIs and 12 intermediates) to its basket during the year. With increase in products under CMS segment, the company is expecting to perform better during FY20, with improved order book.

Key Rating Weaknesses

Decline in Profitability margins during FY19

During FY19, the PBILDT margin of the company has deteriorated marginally by 69 bps from 9.89% during FY18 to 9.20% during FY19. The decline in PBILDT level of the company was primarily due to increase in major raw material costs which are being sourced from China. Notwithstanding the rise in input raw material prices on one side and obligation to honour the contractual orders at predetermined price on the other side has hit the profitability margins of the company. However, foreseeing the aforementioned scenario, the company had already started backward integration for production of the intermediaries at the manufacturing facility acquired from Arch Pharmalabs Limited which earlier was approved by USFDA. The company has reduced its dependability on china as it has procured about 19.01% of the raw material from China during FY19 as against 23.82% during FY18. Further, the company has taken several operational measures to improve the profitability such as improving the recovery of solvents and reducing the costs of existing key products by optimizing the production process. The fructification of the aforementioned measures by the company will be visible from Q3 FY 20.

Moderate operating cycle

The total operating cycle of the company improved from 169 days during FY18 to 137 days during FY19 mainly due to improved collection days and inventory days which improved from 131 days and 121 days during FY18 to 100 days and 112 days during FY19 respectively. The company is maintaining inventory of regular products and raw material for 90-120 days to avoid stock-out issues and providing about 80-100 days of credit period to its customer. Further, the company receives credit period of about 60 to 90 days from its clients. The average of maximum working capital utilization of the company for the last twelve months ending on June 2019 has been moderate at 69.42%.

Risk associated with exchange rate fluctuations

The total operating income of the company constitutes about 70.88% from export sales during FY19 (71.44% during FY18). Further the company has imported raw material of Rs. 81.61 crore which is about 21.76% of total raw material purchases during FY19. Accordingly NLL has natural hedge against exchange rate fluctuations to certain extent. Further, towards its hedging policy, the company is issuing bill discounting and Pre-shipment Credit in Foreign currency (PCFC) to cover about 90-95% of the total risk while 5-10% remains open. Further 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. Each authority has its own requirement and they could delay or refuse to grant approval, even when a product has already been approved in another country. 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. The unit-2 of NLL was inspected by USFDA in November 2018. The inspection was completed without any observations. USFDA inspected NLL's Unit 1 in June 2019 and have completed the inspection with five observations given under form 483. However, no data integrity issues were observed during the inspection. The company has already initiated corrective and preventive actions for the observations, however it is yet to receive EIR from USFDA and obtaining of the same forms one of the key rating sensitivities.

Analytical approach: consolidated

The consolidated business and financial risk profiles of Neuland Laboratories Ltd (NLL) and its wholly owned subsidiaries namely Neuland labs Inc. (USA; 100% of holding by NLL as on March 31, 2019) and Neuland Labs K.K (Japan; 100% of holding by NLL as on March 31, 2019) have been considered as these companies are subsidiaries of NLL which provide marketing support services to NLL and have financial and operational linkages.

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 three manufacturing facilities in and around Hyderabad, Telangana with total installed capacity of 729.70 Kilo Litre as on March 31, 2019 (222.50 KL in unit I, 310.20 KL in unit II and 197 KL in Unit III). The manufacturing facilities are compliant with health and regulatory agencies cGMP certifications namely, FDA (USA), Canada (HC), PMDA (Japan), KFDA (Korea), EU (EMA), EDQM (COS), ANVISA (Brazil) and others. 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 50 products with presence in 25 therapeutic segments including Antibacterial, Antidepressant, Bronchodilator, Anticonvulsant, Antipsychotics, Antiparkinsonian, Antihypertensive and Anatomical.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	529.17	666.83
PBILDT	52.36	61.62
PAT	12.06	16.44
Overall gearing (times)	1.26	0.61
Interest coverage (times)	2.77	3.93

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

Covenants of rated instrument / facility: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

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	-	-	-	74.17	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 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.	Term Loan-Long Term	LT	74.17	CARE BBB+; Stable	-	1)CARE BBB+; Negative (30-Jan-19)	1)CARE BBB+; Stable (27-Feb-18) 2)CARE BBB+; Stable (07-Feb-18) 3)CARE BBB+; Stable (11-Apr-17)	1)CARE BBB (26-Aug-16) 2)CARE BBB- (29-Apr-16)
2.	Fund-based - LT-Working Capital Limits	LT	220.00	CARE BBB+; Stable	-	1)CARE BBB+; Negative (30-Jan-19)	1)CARE BBB+; Stable (27-Feb-18) 2)CARE BBB+; Stable (07-Feb-18) 3)CARE BBB+; Stable (11-Apr-17)	1)CARE BBB (26-Aug-16) 2)CARE BBB- (29-Apr-16)
3.	Non-fund-based - ST-BG/LC	ST	112.50	CARE A3+	-	1)CARE A3+ (30-Jan-19)	1)CARE A3+ (27-Feb-18) 2)CARE A3+ (07-Feb-18) 3)CARE A3+ (11-Apr-17)	1)CARE A3+ (26-Aug-16) 2)CARE A3 (29-Apr-16)
4.	Non-fund-based - ST-Forward Contract	ST	6.40	CARE A3+	-	1)CARE A3+ (30-Jan-19)	1)CARE A3+ (27-Feb-18) 2)CARE A3+ (07-Feb-18) 3)CARE A3+ (11-Apr-17)	1)CARE A3+ (26-Aug-16) 2)CARE A3 (29-Apr-16)

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities - NA

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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