Sai Life Sciences Limited

February 20, 2020

Ratings

Facilities	**Amount (Rs. crore)**	**Rating[1]**	**Rating Action**
Long term Bank Facilities	296.81	**CARE A+; Stable (Single A Plus; Outlook: Stable)**	Reaffirmed
Short term Bank Facilities	80.60	**CARE A1 (A One)**	Reaffirmed
Total Facilities	**377.41 (Rs. Three Hundred Seventy Seven crore and Forty One lakh only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Sai Life Sciences Limited (Sai life) continuous to derive strength from experienced promoters with long track record in the pharmaceutical industry, equity investment from TPG capital during FY19, company's presence across CRAMS value chain and various therapeutic segments with a diversified revenue base, healthy flow of repeat business at the back of being a preferred vendor for global pharmaceutical and biotechnology companies, strong product portfolio along with reputed clientele base who are involved in developing innovator molecules, healthy growth in total operating income and profitability margins during FY19 (Refers to period April 01 to March 31), improvement in capital structure and debt coverage indicators. The ratings are, however, constrained by risks associated with volatility in raw material prices and foreign exchange fluctuations, debt funded capex, working capital intensive nature of operations and regulatory risks associated with the pharmaceutical industry.

Rating Sensitivities

A. Positive factors:

- Improvement in the PBILDT margins on a sustained basis over 25%.
- Maintaining operating cycle days consistently below 100 days
- Utilization of working capital limits at moderate levels of about 60% thus providing sufficient liquidity cushion
- The ability of the company to derive benefit from the capex undertaken and further expand the scale of operations, while maintaining the profit margins and capital structure.

B. Negative factors:

- Overall gearing going beyond 0.60x on sustained basis
- Deterioration in the PBILDT margins on a sustained basis below 20%.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters and management team

The promoters of Sai Life have been involved in the pharmaceutical industry for more than two decades. The company is headed by Dr. K. Ranga Raju, Chairman, who has a Ph.D. in Pharmacy from U.S.A, and the business operations of Sai Life have benefited from his long established track record in the pharmaceutical industry and the vast industry network developed over the years. He is well supported by a team of qualified and experienced management team.

Entry of TPG capital during FY19

Sai Life has been able to attract equity investments from major Private Equity investment and Venture Capital firms over the years; including Sequoia Capital, MPM Capital and Tata Capital Group. During FY16, Tata Capital Group acquired 46.60% of the equity stake in Sai Life through its managed funds. During Q1FY19, however, the group sold 39.49% of its stake in Sai Life (already envisaged during the period) through four of the five managed funds through secondary market transaction to TPG Capital's 'TPG Asia VII SF Pte Limited'. Tata Capital Group's managed fund, HBM Private Equity India, however, continues to hold 6.37% of the equity stake in Sai Life.

Significant infusion of funds from the private equity investor during Q4FY19

In addition to acquiring minority shareholding in the company, TPG Capital has further invested Rs.256 crore in Sai Life in the form of equity share capital/share premium. Furthermore, Tata Capital Group's HBM Private Equity India has invested Rs. 19 crore in Sai Life in the form of equity. The equity shares have been allotted at an issue price of Rs.1275 per share (including premium of Rs.1265 per share), each on preferential basis. The total investment aggregating Rs.275.42 crore and accretion of profits during the year has significantly increased the Networth of the company from Rs. 360.09 crore as on March 31, 2018 to Rs. 714.31 crore as on March 31, 2019. The funds are being utilized towards capex related activities to further expand the scale of operations of the company.

Presence across CRAMS value chain with a diversified revenue base across manufacturing and development
Life is an integrated CRAMS provider offering end-to-end integrated service across pharmaceutical life cycle. Hence, the company has presence across the life cycle viz. pre-clinical drug discovery, clinical development phase, commercial manufacturing and also generic API and formulation development & supply upon the product going off-patent. Process Chemistry and manufacturing (PCM) continues to be the major business segment for the company, with revenue contribution of 76.00% of the total revenue during FY19 as against 75.07% during FY18. The other two business segments viz. Discovery stage services and API/formulation development accounted for 22.52% and 1.48% of the total revenue respectively during FY19.

USFDA approved research and manufacturing facilities
Sai Life has a total of five manufacturing and R&D units in Hyderabad, Pune and Bidar, all of which are USFDA approved. Majority of the manufacturing is undertaken at the Bidar (Karnataka) unit and Bollaram (Hyderabad) unit. The units can support the manufacturing of clinical trial materials and commercial products from a few kilograms up to multi ton level.

Preferred vendor for global innovator pharmaceutical and biotechnology companies
The categorization of preferred partners has become integral to the outsourcing process in the pharmaceutical industry. Global pharmaceutical companies usually have a formal and rigorous process for conferring preferred status on a vendor. Sai Life has been awarded 'preferred partner' status by globally established innovator pharmaceutical and biotechnology companies resulting in healthy flow of repeat business. The established relationships with major global players also acts as a major risk mitigating factor due to the high commercial and regulatory costs for the clients involved in switching a supplier.

Strong presence in Contract Research products
Sai Life executes contract research projects for numerous global pharma majors such as AbbVie Inc., GlaxoSmithKline Plc, Pfizer Inc., Bayer AG, Faes Farma S.A, Allergan Plc, etc. The company has served more than 100 clinical stage products. The company has handled 16 molecules from clinical phases through to commercialization and is serving the companies whose 13 products are in phase III. Further, the company has 29 process validation completed with 18 APIs and 11 intermediaries. Sai Life has a strong talent pool of more than 2000 employees with more than 700 employees with scientific background working in the Research & Development area for development of molecular drugs. The company is engaged in the entire molecular process with the aforementioned clients. Hence, commercialization of any of the products by its client upon clearing Phase-III would provide significant manufacturing opportunities and margin upside for the company. The company is engaged in the entire molecular process with the aforementioned clients.

Healthy growth in total operating income and profitability margins during FY19
The size and scale of company's operation has been increasing over the years. The scale of operations of the company witnessed substantial improvement in FY19, with Sai Life registering a y-o-y growth of 31.47% in total operating income during the year to Rs. 700.71 crore from Rs.533.0 crore during FY18. The improvement was at the back of commencement of commercial supply of Elagolix and Glecaprevir drugs during August 2017 and July 2018 respectively. Elagolix treats moderate to severe endometriosis pain in women and Glecaprevir is used in treatment of Hepatitis-C. Both the drugs are developed for company's major client, AbbVie. Revenue contribution from Abbvie stood at Rs. 147.55 crore during FY19 (21.56% of TOI during FY19) as against Rs. 86.79 crore during FY18 (16.80% of TOI during FY18). Further, the PBILDT margin of the company improved by 334 bps and stood at 23.42% during FY19 as against 20.09% during FY18. This was mainly due to economies of scales witnessed on account of commercialisation of Elagolix and Glecaprevir drugs.

Improvement in capital structure and debt coverage indicators
The capital structure of the company has significantly improved as on March 31, 2019 marked by both debt-equity and overall gearing ratio. The overall gearing stood at 0.38 as on March 31, 2019 which improved from 0.73x as on March 31, 2018. The improvement was due to infusion of funds by the TPG Capital and Tata Capital Group's HBM Private Equity India. TPG Capital and Tata Capital Group's HBM Private Equity India has infused Rs. 256 crore and Rs. 19 crore respectively in Sai Life as growth capital in the form of equity share capital/share premium. Further, the debt coverage indicators viz. interest coverage and Total Debt/GCA improved and stood at 8.41x and 2.55x as on March 31, 2019 as against 6.15x and 3.58x as on March 31, 2018 respectively.
Stable industry outlook: The outlook of the pharma industry is stable in light of healthy prospects for the domestic as well as the export markets. Exports to regulated markets along with emerging markets would drive the growth for Indian Pharmaceutical Industry (IPI) on the back of patent expiries and increasing government emphasis on generics in these markets.

Key Rating Weaknesses

Debt funded capex

Sai Life has been strategically planning to enhance its production capabilities to provide end-to-end integrated service offerings across the pharmaceutical life cycle. The company has planned to spend Rs. 900 crore spread over 5 years starting from FY19 to FY23. The said capex is to be funded through infusion of funds from PE investors aggregating to Rs. 275 crore, term loans of Rs. 195 crore and internal accruals of Rs. 430 crore. The company has already incurred Rs. 299.91 crore till Dec 31, 2019.

Foreign exchange fluctuation risk

The company has recorded forex exchange gain of Rs. 4.61 crore during FY19 as against Rs.6.35 crore in FY18. The company is exposed to foreign exchange fluctuation risk in view of large volume and high value transactions of export and import, a phenomenon common to the players in the industry. However, the company uses derivative instruments primarily to hedge foreign exchange. The company evaluates the impact of foreign exchange rate fluctuations by assessing its exposure to exchange rate risks. It hedges a part of these risks by using derivative financial instruments in line with its risk management policy. Sai Life usually hedges its forex exposure by entering into forward contracts, currency swaps, call-put options and interest rate swaps. The company had an aggregate derivative financial instruments of USD 23.93 mn as on March 31, 2019 (as against USD 47.85 mn as on March 31, 2018). The company registered net forex gain of Rs.6.35 crore in FY19 (as against Rs.10.89 crore in FY18) on foreign currency transactions.

Working capital intensive nature of business with elongated operating cycle

Sai Life operates in a working capital intensive industry and the operating cycle continues to remain high. However, the operating cycle of the company has improved and stood at 102 days in FY19 as against 153 days in FY18, at the back of improved collection period, which improved to 130 days in FY19 (vis-à-vis 171 days in FY18). The company undertakes significant portion of its sales in the last quarter which results in high receivables as on March 31, 2019. Furthermore, the business operation of Sai Life involves significant exports, and in order to have long withstanding relationship with major global clients, the company continues to provide high credit period to its customers. However, the outstanding trade receivables witnessed reduction as on March 31, 2019 and stood at Rs. 233.63 crore as against Rs.261.63 crore as on March 31, 2018. Nevertheless, Sai Life manages its working capital requirement, with average utilization of fund based limits being moderate at about 79% during the 12 months ended Nov 2019.

Regulatory risks

Regulatory challenges have been an integral part of the pharma industry. Over the past few years, India's drug makers have faced increased scrutiny from the USFDA, which is the pharma regulator in the USA. The USA imports around 40% of the finished drugs and 80% of the API it needs. With the proportion of imports from overseas sources rising, the FDA has become more vigilant about regulatory adherences. With the Indian regulator as well as the USFDA becoming more active about quality and price controls, challenges will persist.

Liquidity profile (Comfortable)

The liquidity of the company remains comfortable. The company has been generating sufficient cash flow from operations (Rs. 100.14 crore during FY19) vis-à-vis the repayment obligations, and had free cash & bank balance of Rs. 116 crore as on November 30, 2019. The current ratio of the company stood at 2.07 as on March 31, 2019 as against at 1.38x as on March 31, 2018. Further, the company is expected to generate sufficient cash accruals to meet the debt obligations of Rs. 26.98 crore during FY20.

Analytical Approach Followed – Standalone

Applicable Criteria

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

About the Company

Sai Life Sciences Limited (Sai Life), incorporated in January 1999, started with medicinal chemistry services in 1999, and later in 2002 expanded its service offerings to include process research development services. In 2005, the company entered into contract manufacturing services with the acquisition of Prasad Drugs Limited, followed by acquisition of Merrifield Pharma

(US FDA approved unit) in Bidar in Karnataka in 2006 for expanding manufacturing capabilities. The company currently is an integrated CRAMS services provider, and provides drug discovery, development, and manufacturing services to leading global pharmaceutical and biotechnology companies. This apart the company is also engaged in generic API (Active Pharmaceutical Ingredients) and formulation supply upon the product going off-patent. The company has manufacturing and research & development facilities in the states of Telangana, Karnataka and Maharashtra. During June 2018, TPG Capital, one of the largest private equity and venture capital investment firms in the world, through its subsidiary, TPG Asia VII SF Pte Limited, acquired 39.49% of the stake in Sai Life from four of the five funds managed by Tata Capital Group through secondary market transaction. The exit for the four funds was already envisaged to be completed in Q1FY19. HBM Private Equity India, however, continues to hold 6.37% of the equity stake in Sai Life.

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

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	533.00	700.71
PBILDT	107.06	164.14
PAT	41.69	73.28
Overall gearing (times)	0.73	0.38
Interest coverage (times)	6.15	8.41

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

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 2025	102.81	CARE A+; Stable
Fund-based - LT-Cash Credit	-	-	-	194.00	CARE A+; Stable
Non-fund-based - ST-BG/LC	-	-	-	75.00	CARE A1
Non-fund-based - ST-Credit Exposure Limit	-	-	-	5.60	CARE A1

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	102.81	CARE A+; Stable	-	1)CARE A+; Stable (06-Mar-19)	1)CARE A; Stable (13-Mar-18)	1)CARE A; Stable (27-Jan-17)
2.	Fund-based - LT-Cash Credit	LT	194.00	CARE A+; Stable	-	1)CARE A+; Stable (06-Mar-19)	1)CARE A; Stable (13-Mar-18)	1)CARE A; Stable (27-Jan-17)
3.	Non-fund-based - ST-BG/LC	ST	75.00	CARE A1	-	1)CARE A1 (06-Mar-19)	1)CARE A2+ (13-Mar-18)	1)CARE A2+ (27-Jan-17)
4.	Non-fund-based - ST-Credit Exposure Limit	ST	5.60	CARE A1	-	1)CARE A1 (06-Mar-19)	1)CARE A2+ (13-Mar-18)	-

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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