Sai Life Sciences Limited

March 06, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	296.81 (reduced from 315.76)	**CARE A+; Stable (Single A Plus; Outlook: Stable)**	Revised from CARE A; Stable (Single A; Outlook: Stable)
Short term Bank Facilities	80.60	**CARE A1 (A One)**	Revised from CARE A2+ (A Two Plus)
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 revision in the ratings assigned to the bank facilities of Sai Life Sciences Limited (Sai life) takes into account entry of a major Private Equity (PE) investor, TPG Capital, which acquired 39.49% equity stake in Sai Life from Tata Capital Group during Q2FY19, proposed substantial equity infusion of about Rs.275 crore from PE investors, significant growth in scale of operations of the company over last few years with substantial improvement in operating income during FY18 (refers to the period April 1 to March 31) & 9MFY19, and comfortable profit margins. The ratings continue to draw strength from the experienced promoters and management team, long and established track record of operations of the company with a strong brand image backed by global investors, established market position of the company in the Contract Research and Manufacturing Services (CRAMS) industry, healthy flow of repeat business at the back of being a preferred vendor for global pharmaceutical and biotechnology companies, strong presence of the company in products in phase-II and phase-III stages indicating high revenue potential upon commercialization of the same, robust financial & liquidity position with comfortable capital structure and stable industry prospects. The ratings are, however, constrained by risks associated with risks associated with volatility in raw material prices and foreign exchange fluctuations, elongated operating cycle due to stretched collection period and regulatory risks associated with the pharmaceutical industry. 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 comfortable capital structure are the key rating sensitivities.

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.

Strong brand image backed by global investors; entry of TPG Capital during Q1FY19: Sai Life has been able to attract regular equity investments from major Private Equity (PE) firms over the years; including Sequoia Capital Investments and MPM Capital. During FY16, Tata Capital group (through four of its managed funds) and HBM Private Equity India acquired about 46% equity stake in Sai Life. Subsequently during July 2018, TPG Capital, one of the largest private equity and venture capital investment firms in the world, acquired 39.49% of equity stake in Sai Life from Tata Capital group managed funds. The exit by Tata Capital group was already envisaged during the period, and the stake was acquired by TPG Asia VII SF Pte Limited through secondary market transaction. HBM Private Equity India, continues to hold 6.37% of the equity stake in Sai Life.

Proposed substantial equity infusion from PE investors: In addition to acquiring minority shareholding in the company, TPG Capital has committed to invest further Rs.255.84 crore in Sai Life as growth capital in the form of equity share capital/share premium, with issuance of 20,09,730 shares of the company. Furthermore, HBM Private Equity India has also committed to invest further Rs.19.26 crore in Sai Life in the form of equity share capital/share premium, with issuance of 1,51,270 shares. The equity shares are expected to be allotted at an issue price of Rs.1273 per share (including premium of Rs.1263 per share), each on preferential basis. The same was approved at the Extra-ordinary General Meeting (EGM) held on February 11, 2019, and the funds are expected to be infused within 30 days from the date of the meeting i.e. by March 11, 2019; with allotment of shares to be completed within a period of 60 days from the same.

The total investment will primarily be utilized for capex related activities over the next 2-3 years to further expand the scale of operations of the company. The said infusion is envisaged to improve the capital structure of the company significantly as on March 31, 2019.

Presence across CRAMS value chain with a diversified revenue base across manufacturing and development: Sai 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.
USFDA approved research and manufacturing facilities: Sai Life has a total of five manufacturing and R&D units across Hyderabad, Pune, and Bidar; with majority of manufacturing being undertaken at the Bidar (Karnataka) unit. Further, four of the five units are USFDA approved and Bollaram (Hyderabad) unit is cGMP certified. The manufacturing 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 vendor’ 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 in Phase II and III stages: Sai Life has a highly qualified research team with about 115 employees having a PhD degree. The company executes contract research projects for numerous global pharma majors and is engaged in the entire molecular process with its clients. Hence, commercialization of any of the products upon clearing phase-III provides significant manufacturing opportunities and margin upside for the company.

Growing scale of operations with improvement in revenue during FY18 and 9MFY19: The size and scale of company’s operation has witnessed gradual improvement over the last few years. Sai Life reported strong financial performance in FY18 & 9MFY18, with y-o-y growth of about 16% in total operating income during FY18 (to Rs.533 crore). The improvement was led by commencement of commercial supply of a new drug during Q2FY18, post USFDA granting approval for the same during July 2017. The commercial supply of the said drug resulted in substantial y-o-y growth in the Contract manufacturing business segment (by 24.3%) during FY18. The profitability level of the company remains at a comfortable level, with PBILDT margin at 20.09% in FY18. The GCA also remained at a satisfactory level, witnessing marginal y-o-y growth of 2.0% (to Rs.73.67 crore) during FY18.
The improvement in operating income continued during 9MFY19, with the company registering total income and PAT of Rs.431.21 crore and Rs.21.79 crore respectively during the period. The same was at the at the back of commencement of commercial supply of another drug during Q2FY19.

Robust financial & liquidity position: Sai Life has a favourable capital structure with both debt-equity and overall gearing ratio below unity as on March 31, 2018 and December 31, 2018. Furthermore, the company continues to have a satisfactory liquidity profile with adequate gross cash accruals (Rs.73.67 crore during FY18) vis-à-vis the repayment obligations, and efficient management of working capital requirements. Despite an extended collection period, the working capital utilization has been at a moderate level. Further, as on March 31, 2018, the company had free cash and bank balance to the tune of Rs.7.27 crore.

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
Foreign exchange fluctuation risk: Sai Life has exposure to forex risk on account of external commercial borrowings (ECB loans) and trade receivables from overseas clients. Furthermore, the business operation of Sai Life involves substantial imports which expose the company to risk associated with volatility in foreign exchange rates. The same is, however, partially mitigated by the natural hedge on account of high exports vis-à-vis imports.

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 (174 days in FY18), at the back of stretched collection period, which increased to 171 days in FY18 (vis-à-vis 165 days in FY17). The company undertakes significant portion of its sales in the last quarter which results in high receivables as on March 31, 2018. 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.

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.

Analytical approach: Standalone

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
CARE's methodology for Manufacturing Companies
Rating Methodology- Pharmaceutical Sector
Financial ratios – Non-Financial 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.

Brief Financials (Rs. Crore)	FY17 (A)	FY18 (A)
Total operating income	460.93	533.00
PBILDT	95.25	107.06
PAT	47.05	41.69
Overall gearing (times)	0.70	0.73
Interest coverage (times)	7.68	6.15

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
Fund-based - LT-Term Loan	-	-	May 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 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	102.81	CARE A+; Stable	-	1)CARE A; Stable (13-Mar-18)	1)CARE A; Stable (27-Jan-17)	1)CARE A- (18-Feb-16) 2)CARE A- (04-May-15) 3)CARE A- (09-Apr-15)
2.	Fund-based - LT-Cash Credit	LT	194.00	CARE A+; Stable	-	1)CARE A; Stable (13-Mar-18)	1)CARE A; Stable (27-Jan-17)	1)CARE A- (18-Feb-16) 2)CARE A- (04-May-15) 3)CARE A- (09-Apr-15)
3.	Non-fund-based - ST-BG/LC	ST	75.00	CARE A1	-	1)CARE A2+ (13-Mar-18)	1)CARE A2+ (27-Jan-17)	1)CARE A2+ (18-Feb-16) 2)CARE A2+ (04-May-15) 3)CARE A2+ (09-Apr-15)
4.	Non-fund-based - ST-Credit Exposure Limit	ST	5.60	CARE A1	-	1)CARE A2+ (13-Mar-18)	-	-

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