

April 10, 2023

Shodhana Laboratories Private Limited: Long-term rating upgraded to [ICRA]A; short-term rating reaffirmed and outlook revised to Stable from Positive

Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|-------------------------------------|-----------------------------------|----------------------------------|---|
| Long-term/ Short-term – Unallocated | 10.45 | 10.45 | Long-term rating upgraded to [ICRA]A from [ICRA]A-; short-term rating reaffirmed at [ICRA]A2+ and outlook revised to Stable from Positive |
| Total | 10.45 | 10.45 | |

*Instrument details are provided in Annexure-I

Rationale

The rating action factors in the expected improvement in the of Shodhana Laboratories Private Limited (SLPL)'s healthy performance in FY2023 and expected sustained performance given the ramp-up in the production at the Visakhapatnam unit. SLPL incurred Rs. 60-65 crore capex till March 2023 towards setting up the Visakhapatnam plant; it commenced part operations with 75 kilolitres per day (KLPD), while the full capacity (of 200 KLPD) is expected to become operational by the end of FY2024. The entire project of Rs. 85-90 crore is being funded through internal accruals. Increasing share of exports and demand from existing customers, coupled with enhanced capacity are expected to support growth in the company's revenues and earnings over the medium term. The company witnessed revenue growth of ~16% in 9M FY2023 on the back of higher sales from its major products and improvement in revenue from overseas markets. SLPL is estimated to record revenue growth of ~15% in FY2023 and ~10% further in FY2024 on account of healthy sales volumes and higher demand from overseas clients. The company's financial risk profile remains comfortable with negligible debt levels, strong coverage indicators, and adequate liquidity position. The ratings continue to favourably factor in the established presence of the company spanning over two decades in the pharmaceutical industry and its established customer base of reputed pharmaceutical majors.

The ratings are, however, constrained by the high product concentration risk with SLPL's top five products accounting for more than 80% of its revenues in the last three years. Further, its existing portfolio comprises mature molecules and SLPL may witness volatility in sales owing to high dependence on customer production schedules. The ratings are also constrained by intense competition in the highly fragmented active pharmaceutical ingredient (API) industry from both domestic and Chinese players, affecting the pricing flexibility of the company.

The Stable outlook on the [ICRA]A rating reflects ICRA's opinion that the company's financial profile will remain comfortable with a strong capital structure and gradual ramp-up in operations at its Visakhapatnam plant.

Key rating drivers and their description

Credit strengths

Established presence of the company in the pharmaceutical industry – The company has an established presence in the pharmaceutical industry, spanning over two decades. The promoters have more than three decades of experience in the industry and continue to provide operational as well as technical guidance for managing SLPL's operations.

Reputed customer base – The company has a reputed customer profile, including Aurobindo Pharma Limited, Mylan Laboratories Limited, Dr. Reddy's Laboratories Limited, etc. Further, established relationships with its customers and being

their preferred and approved source have supported SLPL's revenues over the years. The customer concentration risk remained moderate over the last three years, with its top 10 customers generating 55-60% of its revenues.

Comfortable financial risk profile – The company's financial profile is healthy as its net debt position is negative and its coverage indicators continue to remain strong with an interest coverage ratio of 141.2 times, and Total Debt/OPBITDA of 0.0 time in FY2022. Going forward, the coverage metrics are expected to remain strong in the near term given no additional plans for the company to external debt. Also, SLPL's liquidity position remains healthy with sizeable free cash and liquid investments and minimal debt repayment obligations. In addition, the capex towards the new plant is almost in the final stages of completion and the ramp-up is further expected to boost the revenue growth, going forward.

Credit challenges

Moderate scale of operations – The company's scale of operations is moderate despite the healthy revenue growth of 13-15% expected in FY2023. However, the addition of new products, customers, and regulatory approvals is expected to support the scale up of SLPL's operations in the medium term. The company has received approvals from PMDA Japan and KFDA Korea in FY2023 in addition to the WHO-GMP, EU-GMP, and TGA Australia certifications, which it had already received. This is expected to support growth in export revenues. The ramping up of the new unit in Visakhapatnam would also support its revenue growth from FY2024.

High product concentration risk – The company's product profile primarily consists of APIs and intermediates in the antidepressant and antihypertensive segments, which together accounted for ~60% of its revenues in FY2022 and 9M FY2023. Given that the existing portfolio comprises mature molecules and intense competition in the industry, the company would need to constantly develop new molecules to reduce its revenue concentration risk. SLPL may witness volatility in sales owing to its high dependence on customer production schedules. However, the demand from overseas markets has improved significantly, which is expected to diversify the customer base, going forward.

Intense competition with fragmented market structure – The business remains exposed to competition from both domestic and Chinese players, limiting its pricing flexibility and constraining its margins over the years. Pricing pressure is further heightened by SLPL's limited presence in the export markets and highly fragmented domestic market structure, affecting its margins.

Liquidity position: Adequate

The liquidity position of the company is adequate with unencumbered cash balances of ~Rs. 53.1 crore as on February 28, 2023, against repayment obligations of Rs. 0.5 crore and capex of ~Rs. 20-25 crore over the next 12 months. Further, the company is expected to generate retained cash flows of about Rs. 20-30 crore per annum, which will support the capex and working capital requirements, going forward.

Rating sensitivities

Positive factors: Ratings of SLPL may be upgraded if there is significant improvement in scale of operations and cash accruals along with diversification of the product and customer profile.

Negative factors: The ratings may be downgraded if there is substantial decline in revenues or significant reduction in profitability resulting in weakened coverage indicators and pressure on liquidity position. Any sizeable, debt-funded capex impacting its liquidity position could also lead to a rating downgrade for SLPL.

Analytical approach

| Analytical Approach | Comments |
|---------------------------------|---|
| Applicable rating methodologies | Corporate Credit Rating Methodology Rating methodology - Pharmaceuticals |
| Parent/Group support | Not Applicable |
| Consolidation/Standalone | For arriving at the ratings, ICRA considered the standalone financials of SLPL. |

About the company

Shodhana Laboratories Private Limited was incorporated in September 2000 by Dr. Giridhar Thota, a Doctorate in Chemistry with an experience of over 20 years in the pharma industry. Prior to this, Dr. Thota was associated with Dr. Reddy's Laboratories (DRL) from 1984 to 2000. SLPL primarily manufactures intermediates and APIs for formulation majors in both the domestic and export markets. The company's manufacturing facilities are at Jeedimetla (Hyderabad) and Visakhapatnam (Andhra Pradesh). The sale of intermediates accounts for the major portion of its revenues, while the rest is contributed by the sale of APIs. SLPL primarily caters to formulation majors in India, while ~25% of its revenues come from exports to semi-regulated markets, which increased to 39% in 9M FY2023.

Key financial indicators (audited)

| | FY2021 | FY2022 |
|--|--------|--------|
| Operating income | 262.3 | 272.8 |
| PAT | 20.4 | 23.8 |
| OPBDIT/OI | 11.5% | 14.0% |
| PAT/OI | 7.8% | 8.7% |
| Total outside liabilities/Tangible net worth (times) | 0.3 | 0.6 |
| Total debt/OPBDIT (times) | 0.1 | 0.0 |
| Interest coverage (times) | 83.1 | 141.2 |

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs. crore

Source: Company, ICRA Research; All ratios as per ICRA's calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

| Instrument | Type | Current rating (FY2024) | | Chronology of rating history for the past 3 years | | | |
|-------------------------|---------------------------|-----------------------------|---|---|--------|----------------------------------|--------------------|
| | | Amount rated (Rs. crore) | Amount o/s as of Dec 31, 2022 (Rs. crore) | Date & rating in FY2024 | FY2023 | FY2022 | FY2021 |
| | | | | Apr 10, 2023 | - | Jan 31, 2022 | Oct 30, 2020 |
| 1 Unallocated | Long term / Short term | 10.45 | 10.45 | [ICRA]A(Stable) /[ICRA]A2+ | - | [ICRA]A-(Positive)/ [ICRA]A2+ | - |
| 2 Cash credit | Long term | -- | -- | - | - | - | [ICRA]A-(Positive) |
| 3 Fund based | Short term | -- | -- | - | - | - | [ICRA]A2+ |
| 4 Non fund based | Short term | -- | -- | - | - | - | [ICRA]A2+ |

Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|------------------------------------|----------------------|
| Long-term/Short term – unallocated | Not applicable |

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: [Click Here](#)

Annexure I: Instrument details

| ISIN | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook |
|------|-----------------|------------------|-------------|----------|--------------------------|----------------------------|
| NA | Unallocated | NA | NA | NA | 10.45 | [ICRA]A(Stable)/[ICRA]A2+ |

Source: Company

Annexure II: List of entities considered for consolidated analysis – Not applicable

ANALYST CONTACTS

Shamsher Dewan

+91 124 4545328

shamsherd@icraindia.com

Srikumar Krishnamurthy

+91 44 4496 4318

ksrikumar@icraindia.com

Nithya Debbadi

+91 40 4067 6515

nithya.debbadi@icraindia.com

Akshay Dangi

+91 40 4067 6528

akshay.dangi@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



Branches



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