November 17, 2022

Syngene International Limited: Long-term ratings continue to be placed on watch with developing implications; short-term rating removed from watch with developing implications and reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans (External Commercial Borrowings)	600.00	600.00	[ICRA]AA+&; continues to be on watch with developing implications
Long-term Fund-based	29.00	29.00	
Short-term Fund-based	846.00	846.00	[ICRA]A1+; removed from watch with developing implications and reaffirmed
Short-term Unallocated	25.00	25.00	
Total	**1,500.00**	**1,500.00**	

**Instrument details are provided in Annexure-1 &: under rating watch with developing implications*

Rationale

On February 28, 2022, Biocon Limited (Biocon) announced that its subsidiary, Biocon Biologics Limited ('BBL'), approved the proposed acquisition of biosimilars assets of Viatris Inc. (Viatris) for a consideration of up to $3.335 billion in stock and cash, subject to necessary regulatory and other approvals. ICRA had placed Biocon's ratings on watch with developing implications pending clarity on the funding plan, completion of transaction and greater clarity on integration of operations of BBL and the acquired entity. ICRA's ratings on Syngene International Limited (Syngene) draw comfort from its strong parentage, with Biocon Limited holding a majority stake in Syngene and Syngene enjoying implicit financial and operational support from Biocon. The ratings for Syngene were placed on watch with developing implications, following the rating action on Biocon Limited.

Through the acquisition, BBL will acquire Viatris' global biosimilars business with estimated revenues and OPBDITA of $1.1 billion and $250 million respectively for CY2023, along with its portfolio of in-licensed biosimilar assets. The consideration was expected to be a mix of cash and stock, and BBL will be paying an upfront cash consideration of $2 billion on closing of the transaction and up to $335 million as additional payments in CY2024. Additionally, upon closing of the transaction, BBL will issue $1 billion of Compulsorily Convertible Preference Shares (CCPS) to Viatris, equivalent to an equity stake of ~13% in BBL, on a fully diluted basis.

ICRA now understands that the cash payment of $2 billion to Viatris is expected to be funded by $1.62 billion of debt in Biocon at the consolidated level ($1.2 billion at Biocon Biologics and $420 million at Biocon standalone through commercial paper and short-term borrowings), while the remaining is expected to be funded through internal cash flows and equity fund raise[1]. ICRA also understands that ~$200 million which forms part of $1.62 billion debt will be refinanced through equity funds in the near term, while another ~$225 million will be refinanced through issuance of NCD. The transaction is expected to close in Q3 FY2023, subject to satisfaction of closing conditions (including certain regulatory approvals).

[1] The current equity/internal cash flow portion of $380 million (of the $2 billion) is expected to be funded through proceeds of $150 million received from the stake sale in Syngene International Limited, proposed infusion of $150 million from Serum Institute Life Sciences and $80 million of internal accruals.

Accordingly, ICRA has removed the watch on the short-term rating of Biocon Limited and reaffirmed it at [ICRA]A1+ as it believes that Biocon's liquidity profile will continue to be healthy, upon receiving reasonable clarity on the company's funding plan for Viatris' acquisition and the incremental borrowings that are likely for Biocon at a consolidated level post the transaction. Accordingly, the short-term rating on the bank lines of Syngene has also been removed from watch with developing implications and reaffirmed at [ICRA]A1+. The long-term rating of Biocon continues to be on watch with developing implications, pending completion of the acquisition, and will be resolved once greater clarity emerges on the integration of operations between BBL and the acquired entity with regards to successful launch of biosimilars pipeline in regulated markets. In addition, earnings potential from BBL's recent business collaboration with Serum Institute Life Sciences for marketing a portfolio of vaccines for global markets will also be critical to evaluate group's financial profile. That said, downward pressure on long-term rating could arise from any delay in integration of operations including proposed product launches leading to sharp deterioration in the group's financial profile. Given the debt-funded acquisition, material deleveraging in a timely manner will be a key credit monitorable. Syngene's long-term rating also continues to be on watch with developing implications.

In ICRA's opinion, the acquisition is expected to accelerate BBL's direct market strategy for its biosimilars portfolio in the regulated markets including USA and Europe. BBL will also acquire complete ownership of Viatris' rights in biosimilars assets, enabling it to realise full revenues and associated profits from its partnered products, thereby expanding its operating profits. These are step-ups from its previous arrangement with Viatris. The deal is also expected to provide other advantages, including strategic agility and operational efficiencies, which could aid BBL in mitigating pricing pressures in a competitive global biosimilars landscape to an extent. However, obtaining new product approvals in a timely manner and extent of performance improvement in the light of increasing competition and pricing pressures, remain to be seen.

Key rating drivers and their description

Credit strengths

Strong business profile with integrated presence across discovery, dedicated R&D, development and manufacturing services – Syngene operates through three major verticals, namely—a) dedicated R&D centres for global majors like Brisol-Myers-Squibb (BMS), Baxter Inc., Amgen Inc., and Herbalife Ltd; b) discovery services; c) development and manufacturing services. The company's active pharmaceutical ingredient (API) facility in Mangalore has commenced production, albeit at a relatively small scale. Scaling up manufacturing and production of high-end, novel molecules upon receipt of requisite regulatory approvals is expected to diversify the company's revenue stream further and strengthen its position in the drug discovery-to-manufacture value chain.

Established client relationships; healthy client additions over last several years aids revenue visibility – The company has long-term research contracts with reputed clients like BMS, Baxter Inc., Amgen Inc., and Herbalife Ltd. The company also collaborates with major players such as Hindustan Unilever Limited (HUL) in the consumer products industry, Glaxo Smith Kline (GSK) and Johnson & Johnson (J&J) in the biopharma industry, and Zoetis in the animal health industry, to name a few. About 25% of its customers have engaged with the company for over five years. In FY2022, Syngene has extended a its research collaboration with Amgen for a period of five more years. The company has had periodic additions to itscustomer base and has more than 400 active clients currently. The deeper engagements and client additions provide revenue visibility for Syngene over the medium term.

Strong financial profile characterised by revenue growth, healthy earnings and debt metrics – Syngene reported a healthy growth of 20.8% in operating income (OI) to Rs. 2,659.0 crore in FY2022, aided by healthy revenues from both new and existing clients, scope expansions in dedicated R&D services and healthy demand in the discovery and development and manufacturing segments. Further, the revenues grew by 13.0% YoY in H1 FY2023 to Rs. 1,390.6 crore, aided by healthy organic growth, contract expansions and new client additions. Syngene's margins and profitability remained strong in FY2022, with operating margins of 30.0% (PY: 30.8%), net margins of 14.9% (PY: 18.4%) and core RoCE of 22.0% (PY: 21.9%). For H1 FY2023, the company reported operating margins of 28.0% (PY:27.8%) and net margin 12.6% (PY:11.7%) respectively. Syngene's interest coverage also remained robust at 33.1 times for FY2022 (24.5 times in FY2021). Further, as on September 30, 2022, the company was net debt negative at Rs. 95.3 crore[2]. The company's revenues are expected to witness a high-teen growth on a YoY basis in FY2023, supported by the anticipated healthy growth in the global contract research industry, Syngene's new business additions, scope enhancements and contract extensions. Further, Syngene's margins are also likely to remain healthy over the medium term.

Strong parentage as subsidiary of Biocon Limited – Syngene is a subsidiary of Biocon Limited, generating 31% of the latter's consolidated revenues and 39% of its consolidated operating profit in H1 FY2023. The company has robust infrastructure (with more than 5,200 scientists and 2 million sq. ft. of research space) and strong accruals. Thus, it does not require operational or financial support from the parent. However, Syngene enjoys implicit financial and operational support from its parentage.

Credit challenges

Significant capex plans in FY2023 – The company has a capex plan of Rs. 800.0 crore in FY2023 for its infrastructure development to support business expansion.. Of this, the company has incurred about Rs. 200 crore in H1 FY2023.. While the FY2023 capex is significant, ICRA draws comfort from the company's strong liquidity position and anticipated healthy accruals from the business.

High customer and geographic concentration risks – Syngene derives over half of its revenues from its top 10 customers, while 73% of its FY2022 revenues were from USA. This exposes the company to revenue risks arising from loss of customers to competitors and region-specific challenges. However, Syngene's periodic addition of customers, stated intent to continue diversifying its customer base and the presence of customers across the globe provide comfort to an extent.

Growing competition in the contract research space – With the industry poised for healthy growth over the next few years, several global and domestic players are expanding their presence in contract research. This is likely to increase competition and pricing pressure for Syngene, going forward. However, Syngene's healthy scale of operations, robust infrastructure, employee skillset, focus on compliance and safety, and established client relationships are likely to mitigate competitive threats to an extent.

Regulatory risks and vulnerability to unfavourable forex movement – Akin to other industry players, the company is bound by strict regulations for clinical trials for regulated markets. Although any deviation in the same could result in reputational risks and other penalties for the company, historical absence of regulatory issues in clinical trials provides comfort to a large extent. Also, with about 91% of its revenues from overseas markets, the company's revenues and margins are susceptible to risks arising from adverse forex movements including appreciation of the rupee against the dollar. However, the hedging mechanisms adopted by the company mitigate the risk to an extent.

Environment and social risks

Environmental considerations – The company does not face any major physical climate risk. However, it remains exposed to tightening environmental regulations with regard to breach of the waste and pollution norms, which can lead to an increase in operating costs and new capacity instalment costs. This can also require capital investments to upgrade its effluent treatment infrastructure to reduce the carbon footprint and waste generation. However, the company has constantly been making efforts to minimise the impact of environmental risks on its operations. Also, it remains focused on reducing its carbon footprint by constantly monitoring and reducing its emission levels and has enhanced the consumption level of energy generated through renewable resources.

Social considerations – The company faces high industry-wide social risks related to product safety and the associated litigation risks, access to qualified personnel for R&D and process engineering, and maintenance of high manufacturing compliance

[2] *Net Debt = Calculated as gross debt (including lease liabilities) minus unencumbered cash and liquid investments. As on March 31, 2022, the company had Total Debt (including lease liabilities) of Rs. 1,021.6 crore and unencumbered cash and liquid investment of Rs. 1,281.7 crore.*

standards. Further, Government intervention related to price caps/control also remains a social risk faced by entities in the pharmaceutical industry.

Liquidity position: Strong

Syngene's liquidity is strong with consolidated cash and bank balances and liquid investments of Rs. 1,104.3 crore[3] (as on September 30, 2022). Syngene has a total consolidated capex commitment of ~Rs. 600.0 crore in H2 FY2023 (to be funded through internal accruals), and term loan repayments totalling to less than Rs. 250.0 crore on existing loans in the next three years. ICRA expects Syngene meet its commitments through internal sources of cash and yet be left with healthy cash/liquid investment surplus. Further, the company enjoys exceptional financial flexibility and lender/investor comfort, which is expected to continue going forward as well.

Rating sensitivities

Positive factors – An upgrade in long term rating is unlikely as it is currently on watch with developing implications.

Negative factors – Negative pressure on Syngene's ratings could arise if there is pressure on Syngene's revenues or weakening of profit margins or profitability on sustained basis; or deterioration in the parent's (Biocon) credit profile or Syngene's operational/financial linkages with the parent, Biocon.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for implicit or explicit support from parent or group on an entity's credit rating Rating Methodology for pharmaceutical industry
Parent/Group Support	Biocon Limited (rated [ICRA]AA+&/[ICRA]A1+) holds 64.56% stake in Syngene. Syngene enjoys implicit financial and operational support by virtue of its parentage.
Consolidation/Standalone	The ratings are based on the consolidated financial statements of Syngene International Limited.

About the company

Syngene International Limited, a subsidiary of Biocon Limited, is a contract research organisation (CRO) providing integrated discovery and development services for novel molecules across multiple platforms, including small molecules, large molecules, antibody drug conjugates and oligonucleotides. The company's strengths include synthetic chemistry and molecular biology. Syngene offers outsourced services to over 400 global customers across biotechnology, nutrition, animal health, consumer goods and speciality chemical sectors, including majors such as Bristol-Myers-Squibb (BMS), Baxter Inc., Amgen Inc., and Herbalife Ltd. Syngene has 2 million sq. ft. of R&D infrastructure and more than 5,200 qualified scientists currently. In FY2018, it also incorporated a wholly-owned subsidiary, Syngene USA Inc., for providing marketing services to the company in the US market.

[3] *Only includes investments with maturity period of less than a year*

Key financial indicators (audited)

Consolidated	FY2021	FY2022	H1 FY2023*
Operating income	2,201.4	2,659.0	1,390.6
PAT	404.9	395.8	175.9
OPBDIT/OI	30.8%	30.0%	28.0%
PAT/OI	18.4%	14.9%	12.6%
Total outside liabilities/Tangible net worth (times)	0.7	0.7	0.6
Total debt/OPBDIT (times)	1.3	1.3	1.3
Interest coverage (times)	24.5	33.1	18.5

*Source: Company and ICRA Research; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; All ratios are as per ICRA's calculations; PAT: Profit after tax; OPBDITA: Operating profit before depreciation, interest, taxes and amortisation; Total debt includes lease liabilities *unaudited*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of September 30, 2022 (Rs. crore)	Date & rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
					November 17, 2022	March 21, 2022	Sep 6, 2021	Aug 10, 2020	Sep 13, 2019
1	Term loans (ECB)	Long-term	600.00	548.80	[ICRA]AA+&	[ICRA]AA+&	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA (Positive)
2	Long-term fund based		29.00	NA	[ICRA]AA+&	[ICRA]AA+&	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	-
3	Long-term/short term unallocated	Long/Short term	0.00	-	-	-	-	-	[ICRA]AA (Positive)/ [ICRA]A1+
4	Short-term fund based	Short term	846.00	220.90	[ICRA]A1+	[ICRA]A1+&	[ICRA]A1+	[ICRA]A1+	-
5	Short-term non-fund based		00.00	NA	-	-	-	[ICRA]A1+	-
6	Short-term unallocated		25.00	NA	[ICRA]A1+	[ICRA]A1+&	[ICRA]A1+	[ICRA]A1+	-

&: under rating watch with developing implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term loans (ECBs)	Simple
Long-term fund based	Simple
Short-term unallocated	Not applicable
Short-term fund based	Simple

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, is available on ICRA's website: Click Here

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Term Loan- ECB	FY2021	Libor + 1.3%	FY2026	375.00	[ICRA]AA+&
	Term Loan- ECB	FY2021	Libor + 0.87%	FY2026	225.00	
	Long Term- Fund Based- OD	NA	NA	NA	24.00	
	Long Term- Fund Based- CC	NA	NA	NA	5.00	
	Short Term- Fund Based- PCFC/WCDL	NA	NA	NA	846.00	[ICRA]A1+
	Short Term- unallocated	NA	NA	NA	25.00	

Source: *Company, ICRA Research; &: under rating watch with developing implications*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Syngene Ownership	Consolidation Approach
Syngene USA Inc	100%	Full Consolidation
Syngene Employees Welfare Trust	100%	Full Consolidation

Source: *Company, ICRA Research*

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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