December 14, 2023

Unichem Laboratories Limited: Ratings upgraded to [ICRA]A; removed from Rating Watch with Developing Implications and Stable outlook assigned; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term, Fund-based/ Non-fund Based Facilities	176.00	130.00	[ICRA]A; ratings upgraded from [ICRA]A-; Removed from Rating Watch with Developing Implications and Stable outlook assigned
Long-term – Unallocated Limits	0.00	50.00	[ICRA]A; Ratings upgraded from [ICRA]A-; Removed from Rating Watch with Developing Implications and Stable outlook assigned; Assigned for enhanced limits
Total	**176.00**	**180.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating upgrade and removal of rating watch with assignment of a Stable outlook factor in the expected improvement in the credit profile of Unichem Laboratories Limited (ULL) from a favourable change in its ownership and closure of the acquisition process by IPCA Laboratories Limited (IPCA). In August 2023, IPCA acquired 52.65% stake in the company. ULL is expected to leverage its parent's reach and market penetration, while gaining from IPCA's operational and financial support wherever needed. ULL is expected to derive synergistic benefits from IPCA's Active Pharmaceutical Ingredient (API) franchises and enjoy financial flexibility as IPCA's subsidiary. ICRA also draws comfort from ULL's adequate liquidity profile as well as expected improvement in its scale of operations. The same is driven by capacity enhancement through its recently completed capex and associated margin benefits through better scale economics as well as integration benefits by being part of IPCA.

The rating, however, remains constrained by subdued margin levels, given pricing pressures in its key markets, which has also impacted the debt protection metrics in FY2023 as well as in H1 FY2024. The company reported losses in FY2023 on account of pricing pressures in the US market and underutilisation of the Ghaziabad plant launched in FY2023. Although the margins improved in the current fiscal over FY2023 levels, the elevated freight costs and other expenses resulted in subdued profitability in H1 FY2024. The margins are expected to improve gradually over the near to medium term driven by the synergies of being part of IPCA, as well as expected returns from the recently completed capex. The scaling up of operations, profits and return on capital employed from the same, will remain a key monitorable for its credit profile, going forward.

After hiving off its core business of domestic formulations, which drove ~55% of its consolidated revenues in FY2017, ULL has focused on the US market, supported by the ongoing capacity expansions of its manufacturing facilities. Most of its facilities are approved by the United States Food and Drug Administration (USFDA), and its growing number of Abbreviated New Drug Application (ANDA) filings. ICRA favourably notes its clean track record with respect to regulatory inspections.

ICRA also notes that ULL's appeal against the order of the European Commission imposing a fine of €13.9 million on the company and its UK subsidiary, was rejected by the General Court of EU in FY2019 and the aforesaid fine was confirmed. Although ULL has filed for an appeal before the EU Court of Justice, the outcome is still awaited. While the same is reported as contingent liability (Rs. 123 crore, as of March 2023), the auditor has qualified its opinion to provision the same as per auditor comments in FY2023. However, as per the management, given the status quo in terms of the outcome of the appeal, no such provision was provided. Any unfavourable outcome on this matter remains critical from a credit perspective, given the large value at dispute.

The Stable outlook assigned to the long-term rating factors in the ramp up of operations from the recently concluded capex and expected integration and synergies from being subsidiary of IPCA.

Key rating drivers and their description

Credit strengths

Strengthening of promoter profile with acquisition by IPCA – ULL is an integrated pharmaceutical company, founded by Late Amrut Mody in 1944. Before its stake sale to IPCA, ULL's operations were overseen by Dr. Prakash Amrut Mody, son of the founder, a postgraduate from the University of Mumbai and an alumni of the Harvard Business School. In August 2023, IPCA acquired 52.65% stake in ULL, making it the subsidiary of IPCA. IPCA is a much larger and diversified, integrated pharmaceutical company producing branded and generics formulations, and APIs. It is also one of the leading pharma companies in India.

Expected synergies as part of IPCA Group to support operational as well as credit profile – IPCA has a strong API franchise, with backward integration that will enable ULL to scale up its global generic portfolio and also increase its market share with cost efficiency and competitiveness. With IPCA being present in almost 45 countries with close to 1,200 personnel working on the field, ULL will be able to expand to new geographies, especially in rest of world (RoW) markets. Further, IPCA is also expected to provide operational as well as financial support on a need basis and leverage the financial flexibility IPCA enjoys in the banking and financial channels.

Backward integrated capabilities to support in-house formulations manufacturing – Following the sale of its domestic formulations business in FY2017, the company had enhanced its focus on its international formulations business, especially in the US, which has been growing at a healthy rate over the past few years. ULL's extensive experience in APIs and formulations as well as its cost advantage from backward integration is a positive factor. Accordingly, the company has invested in capacity expansion of its API facilities, and its expected integration with IPCA will support its ramp-up in formulations. ICRA also notes the company's clean track record with respect to regulatory inspections.

Credit challenges

Pricing pressures in export markets to keep margin under check in near term – The company reported operating losses of ~Rs. 42 crore in FY2023, on a consolidated basis, due to pricing pressures in its key generics market in the US, which command a sizeable revenue share. Further, the margins were impacted by the underutilisation of the Ghaziabad plant launched in FY2023, coupled with a delay in the commercialisation of Unit 2 at Goa, as the validation process got delayed, resulting in higher fixed overheads with no significant revenue contribution, exacerbating the losses. Although profitability improved in the current fiscal to around 4.4% in H1 FY2024, it continues to remain at a subdued level. The debt protection metrics, which were negative in FY2023 due to losses, posted a rise in H1 FY2024, with positive operating profitability, though remaining lower than FY2021 levels. ICRA, however, expects margins to improve over the medium term with IPCA undertaking initiatives for cost efficiencies and rationalisation. Therefore, a material recovery in margins in the medium term, on a sustained basis, leading to improvement in the financial profile on an overall basis, will remain a key monitorable.

Capability to efficiently manage and generate returns from enhanced capacities remains critical from credit perspective – The company has been incurring considerable capex to enhance its manufacturing capacities and has been investing in its R&D capabilities to capitalise on certain identified opportunities. ULL has incurred a cumulative capex of ~Rs. 857 crore over FY2020–FY2023. The capex has been funded by a term loan of Rs. 125 crore and the rest through its liquid balances on books. Due to losses incurred in FY2023, the debt coverage metrics were also impacted in FY2023. Further, as the facilities were commercialised in FY2023, the company's ability to efficiently manage and generate adequate returns from such high investments by profitably scaling up its operations on the back of successful product launches remains critical from a credit perspective.

Working capital-intensive nature of operations – The company's business remains working capital intensive, given the elongated receivable days as well as high raw material inventory requirements in the business. The working capital intensity as reflected by (NWC/OI) has been over 75% during the last two fiscals. On a consolidated level, the although the inventory days improved, it remained high at 197 days in FY2023 over 230 days in FY2022, due to inventory build-up following the operationalisation of its Goa Unit II plant. Given the recently concluded capex, the Inventory levels are expected to remain elevated and will be one of the key monitorable in terms of turnaround, going forward.

Environment and Social Risks

Environmental considerations: The company does not face any major physical climate risks. However, it remains exposed to tightening environmental regulations on breach of the waste and pollution norms, which can lead to an increase in operating costs and new instalment costs. To minimise the impact of environmental risks on its operations, ULL has an environmental policy in place that emphasises protecting the environment by complying with applicable regulations to prevent pollution in all its operations. The company continues to adopt energy conservation initiatives and to provide quality products while making concerted efforts to minimise the environmental impact. The company focuses on reducing waste at source and finds ways to maximise recycling. The company also handles and disposes waste in an environmentally responsible way and complies with the applicable regulations. The waste generated in the company's operations is either recycled or disposed safely. Every manufacturing facility has its own Effluent Treatment Plant (ETP), which ensures that the discharge of treated effluent is within the limits stipulated by the respective pollution control boards. To conserve water, the company has devised various water saving methods, which are monitored daily. About 80% of the wastewater generated in plants is recovered, recycled, and reused, thereby saving usage of fresh water. Treated water is used for gardening and sanitation.

Social considerations: The industry faces social risks related to product safety and associated litigation risks, access to qualified personnel for R&D and process engineering, and maintenance of high manufacturing compliance standard. Quality and safety have been implemented across the value chain of the company, right from raw materials procurement to product delivery. Further, governmental, and regulatory intervention related to price caps/ control also remains a social risk faced by entities in the pharmaceutical industry.

Liquidity position: Adequate

The liquidity position remains adequate with liquid investments and free cash and equivalents of ~Rs. 63.14 crore as on September 30, 2023, on a consolidated basis. It also had a cushion available in the form of undrawn working capital limits, wherein limits of Rs. 207 crore at the standalone level were utilised on an average of 14.41% for the past 12 months ended October 2023. The company has repayment obligations of ~Rs. 26 crore p.a., which are expected to be adequately covered by the liquidity available on its books, coupled with cash accruals. Further, in December 2023, ULL sold its remaining stake of 0.02% in Optimus Drugs Private Limited for Rs. 67.47 crore, which is also expected to provide comfort to its liquidity position. It is expected to receive GST input credit accumulated over the years as well, which will likely support its working capital needs and capex requirements as well as act as a cushion in case of any exigencies.

Rating sensitivities

Positive factors – The rating can be upgraded if there is a significant increase in scale and material improvement in profitability, while maintaining a healthy liquidity position on a sustained basis, leading to sustainable improvement in debt protection metrics. Improvement in the credit profile of the parent company could also be a positive rating trigger.

Negative factors – ULL's rating could be downgraded if the company fails to scale up from present levels and generate adequate returns from the recently concluded large capex, thereby impacting the financial profile. Any significant deterioration in ULL's liquidity profile or any adverse observations by any regulatory authorities impacting its revenues and profitability would also be a negative trigger. Moderation in the credit profile of the parent company or weakening in linkages with the parent company could also be a negative rating trigger.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Pharmaceutical Industry
Parent/Group support	Parent: IPCA Laboratories Limited IPCA is expected to provide need-based funding as well as operational support to ULL.
Consolidation/Standalone	The rating is based on consolidated financial profile of the company. As on September 30, 2023, ULL had six subsidiaries, which are enlisted in Annexure-II.

About the company

Unichem Laboratories Limited is an integrated pharmaceutical company, founded by Late Amrut Mody in 1944. ULL manufactures and markets a large basket of APIs as well as pharmaceutical formulations as branded and simple generics in several regulated and unregulated markets around the world. The company's products cater to a diverse range of therapeutic areas such as cardiology, gastroenterology, diabetology, psychiatry, neurology, anti-bacterial, anti-infective and pain management. Historically, ULL has focused on its domestic formulations business, which drove almost 55% of its total consolidated revenues in FY2017. In November 2017, it entered an agreement with Torrent Pharmaceuticals Limited for sale of its formulations business in India and Nepal through a slump sale, for a total consideration of Rs. 3,600 crore. The company took its first major step towards entering the regulated markets in 2002, following its acquisition of equity stake in Niche Generics Limited, UK. Further, in August 2023, IPCA Laboratories Limited picked up 52.65% stake in ULL, effectively making it a subsidiary of IPCA. As on date, the company has formulations manufacturing facilities in Goa, Baddi (Himachal Pradesh) and Ghaziabad (Uttar Pradesh), while its APIs manufacturing facilities are in Pithampur (Madhya Pradesh), Roha and Kolhapur (Maharashtra).

Key financial indicators (audited)

Consolidated	FY2022	FY2023
Operating income	1,269.8	1,343.0
PAT	34.1	(202.2)
OPBDIT/OI	6.3%	(3.1%)
PAT/OI	2.7%	(15.1%)
Total outside liabilities/Tangible net worth (times)	0.3	0.3
Total debt/OPBDIT (times)	4.4	-7.5
Interest coverage (times)	13.2	-2.4

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)					Chronology of rating history for the past 3 years				
		Type	Amount rated (Rs. crore)	Amount outstanding as of Sept 30, 2023 (Rs. crore)	Date & rating in FY2024		Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021	
					Dec 14, 2023	May 03, 2023	Mar 22, 2023	Sept 16, 2022	Nov 25, 2021	Jan 22, 2021 Jan 07, 2021	Jul 06, 2020
1	Fund based/ Non fund based	Long-term	130.0	-	[ICRA]A (Stable)	[ICRA]A- @	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Negative)
2	Commercial paper programme	Short term	-	-	-	-	-	-	-	-	[ICRA]A1; withdrawn
3	Unallocated limits	Long-term	50.0	-	[ICRA]A (Stable)	-	-	-	-	-	-

@: Rating Watch with Developing Implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term - Fund based/ Non fund based	Simple
Long-term - Unallocated limits	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	**Long-term, Fund-based / Non-fund Based Facilities**	NA	NA	NA	130.00	[ICRA]A (Stable)
NA	**Unallocated limits**	NA	NA	NA	50.00	[ICRA]A (Stable)

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA]

Annexure II: List of entities considered for consolidated analysis

Company Name	Unichem Ownership	Consolidation Approach
Niche Generics Ltd, UK	100.00%	Full Consolidation
Unichem S.A. Proprietary, SA	100.00%	Full Consolidation
Unichem Farmaceutica Do Brasil Ltda, Brazil	100.00%	Full Consolidation
Unichem Pharmaceuticals (USA) Inc, USA	100.00%	Full Consolidation
Unichem Laboratories Limited, Ireland	100.00%	Full Consolidation
Unichem (China) Pvt. Ltd.	100.00%	Full Consolidation

Source: Unichem Laboratories Limited

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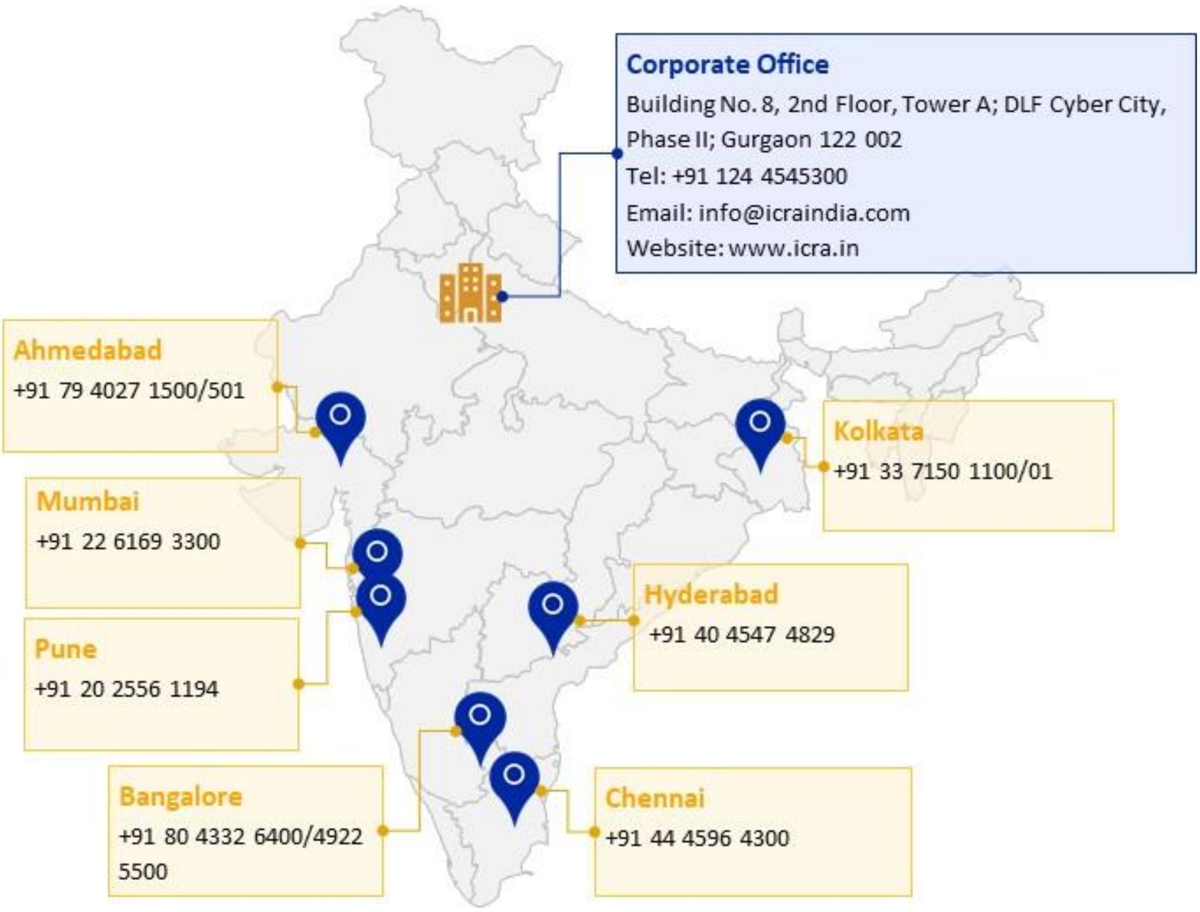

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