India Ratings Upgrades Neuland Laboratories' Bank Facilities to 'IND A+'; Outlook Stable

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India Ratings and Research (Ind-Ra) has taken the following rating actions on Neuland Laboratories Limited's (NLL) bank facilities:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Term loan	-	-	December 2024- March 2027	INR850.2 (reduced from INR1,292.2)	IND A+/Stable	Upgraded
Fund-based limits	-	-	-	INR2,200	IND A+/Stable/ IND A1	Upgraded
Non-fund-based limits	-	-	-	INR1,314	IND A1	Upgraded
Proposed fund-based limits/Term loan	-	-	-	INR593.8	IND A+/Stable	Upgraded
Proposed fund-based limits/Term loan	-	-	-	INR442	IND A+/Stable	Assigned

Analytical Approach: Ind-Ra continues to take a consolidated view of NLL and its wholly-owned subsidiaries - Neuland Laboratories Inc., USA and Neuland Laboratories K.K., Japan – to arrive at the ratings as all three companies are engaged in the manufacturing and selling of pharmaceutical active pharmaceutical ingredients (APIs).

The upgrade reflects the continued improvement in NLL's business profile during FYFY23-1HFY24 due to a sustained rise in the share of high-margin custom manufacturing services (CMS) business, led by both development and commercial projects. Furthermore, Ind-Ra expects the EBITDA margin to remain healthy over the medium-to-long term, given the strong pipeline of molecules in the development (15) and commercial (19) stage.

Key Rating Drivers

Shift in Business Mix towards CMS Segment over FY14-1HFY24: Over the years, NLL has shifted its focus to the high-margin CMS segment from the high-volume, low-margin segment (prime API), and it has increased its product pipeline significantly in the CMS segment The revenue contribution of the high-margin CMS segment increased to 50% in 1HFY24 (FY23: 36%; FY22: 29%; FY21: 28%) from the levels of 11% in FY14; meanwhile, the revenue contribution of the low-value, high-volume prime API segment reduced to 23% (32%; 44%; 46%) from 71% over the same period.. The CMS segment's revenue increased by 57% yoy to INR4,407 million in FY23, and 149% yoy to INR3,895 million in 1HFY24, due to the strong portfolio of new chemical entity API projects for biotech companies, and revenue contribution from recently commercialised molecules as well as existing molecules. The growth in revenue from the CMS segment was also driven by significant contribution from molecules close to commercialisation.

According to the management, the revenue contribution from the CMS segment will be around 50% over the next three-to-four years. In the CMS segment, the entire revenue is derived from the regulated markets of the US, Europe and Japan. NLL's pipeline in the segment grew rapidly to 89 molecules in 2QFY24 (pre-clinical: 18, phase-I: 10, phase-II: 20, phase-III: 7, development: 15 and commercial: 19) from 21 molecules in FY16. NLL has been focusing more on phase-III and development stage molecules as they are the probable candidates to drive the company's revenue growth.

Robust Performance in FY23 and 1HFY24: With the sustained focus on increasing the share of the high-margin CMS segment, NLL's consolidated EBITDA margin rose to 30% in 1HFY24 (FY23: 22.8%; FY22: 15.0%) from the levels of 15.2% in FY14. The ROCE improved to 18.3% in FY23 (FY22: 8.1%). In FY23, the absolute EBITDA increased by 90.6% yoy to INR2,718 million, while the EBITDA margin expanded by 780bp to 22.8%, led by an improved product mix, positive operating leverage and higher capacity utilisation at Unit-III. During 1HFY24, the company's revenue grew 51.6% yoy to INR7,807 million, led by strong growth in CMS segment (up 148.6% yoy) and niche API (15.6% yoy). NLL's revenue grew by a robust 25.3% yoy to INR11,912 million during FY23 (FY22: 1.5% yoy), on account of strong growth in the niche active pharmaceutical ingredient (API) and CMS segments and higher demand for key products such as Apixaban, Paliperidone, Ezetimibe and Donepezil. NLL expects the consolidated sales to grow at a CAGR of 15% over the next three-to-four years.

Regulated market such as the US and Europe (combined sales contribution at around 83%) delivered robust performance of 25.2% and 37.2% on yoy basis in FY23. Sales from prime API, niche API and CMS reported sales growth (yoy) of negative 8.7% (FY22: negative 3.6% yoy), 49.8% (7.8%) and 57.4% (5.7%), respectively, in FY23.

Strong, Diversified API/CMS Pharma Player: NLL is a global API manufacturing and development company that caters to pharma and biotech companies. NLL is engaged in the synthesis of pre-clinical compounds to supply new chemical entities (NCEs) and advanced intermediates at various stages in the clinical life-cycle, as well as in the commercial stage. NLL cater to over 500 customers in more than 80 countries. NLL has three business segments, namely 1) prime API, 2) niche/specialty API, and 3) CMS. Overall, the API and CMS segments accounted for 46% and 50%, respectively, of the sales in 1HFY24 while the remaining 4% from others. Regulated markets contributed 91% to the revenue in 1HFY24, while semi-regulated market accounted for the balance 9%. Geography-wise, the US is the largest geography (50% of sales) for NLL, while Europe is the second-largest geography in terms of sales (38%). Rest of the world (ROW) accounted for 12% of the sales. The company's Unit-I, Unit-II and Unit-III facilities are regulatory-compliant (approved by The United States Food and Drug Administration (USFDA), European Directorate for the Quality of Medicines & HealthCare, Japan-based Pharmaceuticals and Medical Devices Agency) with product portfolio of over 100 APIs across 10 diverse therapeutic areas. NLL has been also working on lifecycle management (development of efficient and cost-effective manufacturing processes) in the prime API segment to reduce production costs/solvent consumption/cycle times of existing products, and for customer retention.

Comfortable Credit Metrics and Debt Structure: In FY24, the agency expects NLL's net adjusted debt/EBITDA to improve further below FY23's level (FY23: 0.54x FY22: 1.95x), given the strong operating performance and total debt reduction during 1HFY24. Despite higher interest expenses, the company's EBITDA/gross interest improved to 20.8x in FY23 (FY22: 10.6x), led by the improvement in the operating performance. The fund flow from operations increased to INR2,366 million in FY23 (FY22: INR1,155 million), while NLL's free cash flow turned positive at INR1,531 million in FY23 (negative INR546 million) on account of strong improvement in the operating cash flow and lower capital expenditure. Ind-Ra believes NLL has sufficient financial flexibility to absorb the partially debt-funded capital expenditure to meet the business growth over FY24-FY27.

Liquidity Indicator - Adequate: NLL had free cash balances of INR454 million at FYE23 (FYE22: INR85 million). Its average utilisation of the fund-based limits was 2% and that of the non-fund-based limits was 45% over the 12 months ended December 2023. NLL's free cash flow turned positive at INR1,531 million in FY23 (FY22: negative INR546 million) on account of a strong improvement in operating cash flow and lower capital expenditure. The agency expects the annual cash flow from operations (FY23: INR2,256 million; FY22: INR479 million) to be above INR2,500 million over FY24-FY27, with the rising EBITDA. In FY23, despite an increase in the receivable days to 111 (90), the net working capital cycle (sales basis) improved to 144 days (FY22: 147 days), due to a decrease in the inventory days to 86 days (102 days), and an increase in payable days to 52 (from 45).

NLL, on the basis of an approval received from Telangana State Industrial Infrastructure Corporation Limited, has entered into a joint agreement with a developer for the construction of an information technology park at the company's land in Nanakramguda, Hyderabad in FY21. This investment property carries a book value of INR189.1 million; the management reiterated that it expects a much higher fair value (i.e. 4x-6x of the current book value) to accrue to NLL once the construction is completed. This asset sale amount can be then used for the guided capital expenditure.

Regulatory Risk; Clean Track Record till date: The regulated markets such as the US, Europe and Japan contributed around 86% to NLL's total sales in FY23. NLL has three USFDA-approved API facilities (unit-1, unit-2, and unit-3) and a research and development laboratory that has cleared 15 consecutive USFDA audits. NLL has filed several drug master files to regulated market such as the US (65), Canada (32), Japan (10), Europe (499), China (17), Australia (27), and ROW (268) filings in including Turkey, Mexico, Brazil. The company's audits by USFDA have been delayed in the last three years on account of the pandemic-led disruptions. Hence, the agency expects the USFDA's scrutiny of Indian manufacturing facilities to increase significantly over the near term. Ind-Ra highlights that non-compliance or data integrity issues with any manufacturing facility might affect new product approvals from several regulatory agencies or could lead to the shutdown of the facility.

Standalone Financials: NLL's standalone revenue rose 25.2% yoy to INR11,912 million in FY23, EBITDA increased by 90.8% yoy to INR2,713 million and EBITDA margin expanded by 780bp yoy to 22.8%. The interest coverage improved to 20.8x in FY23 (FY22: 10.5x), while the net leverage ratio improved to 0.3x in FY23 (1.6x). At end-1HFY24, the standalone revenue stood at INR7,807 million, EBITDA was INR2,344 million and EBITDA margin at 30.0%; the interest coverage ratio stood at 35.3x.

Rating Sensitivities

Positive: Future developments that could, individually or collectively, lead to a positive rating action are:

- timely completion and ramp up of capacities, leading to a significant increase in the scale of operations and growth in operating profitability
- improvement in the business risk profile and free cash flow, leading to the consolidated net adjusted leverage remaining low on a sustained basis.

Negative: Future developments that could, individually or collectively, lead to a negative rating action are:

- a significant decline in the revenue and operating profitability and/or
- higher-than-expected debt due to increase in working capital requirements and/or large debt-funded capex and acquisitions, resulting in the consolidated net adjusted leverage exceeding 2.5x, all on a sustained basis.

Company Profile

NLL was set up as a private limited company in 1984 by Dr. D R Rao and it was reconstituted as a public limited company in 1994 with the current name. NLL is a pure-play API manufacturer for several domestic and international pharmaceutical companies. The company has two USFDA-approved facilities that manufacture over 100 APIs addressing 10 key therapies.

FINANCIAL SUMMARY (CONSOLIDATED)

Particulars	1HFY24	FY23	FY22
Revenue (INR million)	7,807	11,912	9,511
EBITDA (INR million)	2,344	2,718	1,426
EBITDA margin (%)	30.0%	22.8%	15.0%
Interest coverage (x)	35.29	20.8	10.57
Net leverage including LC (x)	-	0.54	1.95
Total debt (INR million)	-	1,912	2,871
Source: Company, Ind-Ra			

Non-Cooperation with previous rating agency

Not applicable

Solicitation Disclosures

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APPLICABLE CRITERIA

Evaluating Corporate Governance

Short-Term Ratings Criteria for Non-Financial Corporates

Corporate Rating Methodology

The Rating Process

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook			
	Rating Type	Rated Limits (million)	Rating	20 October 2023	16 November 2022	18 August 2021	9 November 2020

Issuer rating	Long-term	-	-	WD	IND A/Stable	IND A-/Stable	IND A-/Stable
Term loan	Long-term	INR 1,886	IND A+/Stable	-	IND A/Stable	IND A-/Stable	IND A-/Stable
Fund-based limits	Long-term/ short term	INR2,200	IND A+/Stable /IND A1	-	IND A/Stable/IND A1	IND A-/Stable/ IND A2+	IND A-/Stable/ IND A2+
Non-fund-based limits	Short-term	INR1,314	IND A1	-	IND A1	IND A2+	IND A2+

Bank wise Facilities Details

Click here to see the details

Complexity Level of Instruments

Instrument Type	Complexity Indicator
Fund-based working capital limits	Low
Non-fund-based working capital limits	Low
Term loan	Low

For details on the complexity levels of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

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