ICRA NEPAL

Deurali Janta Pharmaceuticals Private Limited: [ICRANP] LBBB+/A2 assigned

July 13, 2020

Summary of rated instruments

Instrument*	Rated Amount	Rating Action
Fund based; long term limits-proposed	NPR 265.8 million	[ICRANP] LBBB+ (Assigned)
Fund based; short term limits	NPR 322.5 million	[ICRANP] A2 (Assigned)
Non-fund based; short term limits	NPR 170.0 million	[ICRANP] A2 (Assigned)
Total	**NPR 758.3 million**	

** Instrument details are provided in Annexure-1*

Rating action

ICRA Nepal has assigned the long-term rating of [ICRANP] LBBB+ (pronounced ICRA NP L triple B plus) to the proposed NPR 265.8-million long-term loans of Deurali Janta Pharmaceuticals Private Limited (DJPL or the company). ICRA Nepal has also assigned the short-term rating of [ICRANP] A2 (pronounced ICRA NP A two) to the fund-based short-term limits of NPR 322.5 million and non-fund based short term limits of NPR 170 million.

Rationale

The assigned ratings factor in DJPL's established track record and its strong brand recognition in the domestic pharmaceutical industry along with the experience of its promoters. The ratings factor in the strong financial profile of the company, characterised by healthy operating margins and a low gearing, which results in comfortable debt coverage ratios. The company has retained a healthy portion of its profit on an ongoing basis, which helped maintain a low gearing and comfortable debt coverage indicators. DJPL has a wide therapeutic coverage across multiple product lines, which remains a positive for the future revenue growth and its sustainability. The ratings also take comfort from the company's established supply chain with 200+ distributors and a diversified customer base.

The ratings, however, remain constrained by the moderate liquidity profile of the company on account of periodic capital expenditure from profit accruals and short-term funds coupled with periodic dividend distribution (albeit nominal vis-à-vis profits), which is evident from its weak current ratio. The working capital intensity for the company also remains relatively high amid high inventory holding period as well as the debtor recovery period, also affecting its liquidity position, which could exacerbate given the expected disruption in supply chain amid the recent pandemic. The ratings concerns also arise from intensely competitive domestic pharmaceutical arena given the presence of multiple players, low entry barriers and low duty protection against cheaper imports, which could challenge the future scalability and profitability of the company. This could be a negative given the debt-funded capex being carried out by the company in the recent years. The company also remains dependent on imports for almost its entire raw material requirement, which exposes it to supply chain risk. The pharmaceutical sector also remains vulnerable to the regulatory risk, which remains a key rating sensitivity.

Key rating drivers

Credit strengths

Established track record of the company and its experienced promoters – Incorporated in 1991, DJPL has an established track record of around three decades and enjoys a good brand recall in the domestic market. The major promoters of the company are highly reputed in the domestic business arena and have a long experience in the pharmaceutical industry.

Good financial profile characterised by healthy profitability and comfortable debt coverage indicators – DJPL, one of the leading pharmaceutical sector players, reported a CAGR of ~13% in sales between FY2016 and FY2019, with a healthy operating margin (25-32%) which indicates a healthy demand and DJPL's strong market positioning. This has also helped the company maintain a good financial profile. Good profitability, cash generation and healthy retention of profit accruals helped the company maintain an overall low gearing ratio and comfortable coverage indicators. Notwithstanding a relatively high working capital intensity, DJPL's cash accruals remained adequate to support its reinvestment strategy as well as periodic dividend distribution.

Established supply chain, diversified product range and customer base – DJPL has an established and tested distribution network comprising over 200 distributors. The traction developed by DJPL with its distributors and other stakeholders in the local market remains a positive for the incremental growth and its sustainability. DJPL's customer base is fairly diversified with its top 10 distributors accounting for ~23% of total FY2019 revenue. In addition, the company has also been expanding its product range across different therapeutic segments over the years by reinvesting the major portion of its profit. Increasing diversity in the product range also remains a comfort.

Credit challenges

Stretched liquidity arising from high working capital intensity and periodic capex – DJPL's liquidity profile remained moderate because of the high working capital intensity because of its high debtor and inventory days. DJPL's high working capital intensity is evident from NWC/OI[1] increasing to 55% in H1 FY2020 from 36% in FY2018 with a rise in debtor days. Its liquidity also remained stretched because of periodic capex for capacity expansion and technological upgradation partly through short-term loans, and periodic dividend outflow. As a result, DJPL's current ratio remained weak at 0.85 times in FY2019 and 0.84 times in H1 FY2020, indicating a weak liquidity position. Liquidity concerns could exacerbate given the Covid-19 related disruptions in demand and supply chain, which could lead to delayed debtor realisation and inventory liquidation period besides causing a slowdown in the future demand and therefore, the revenues of the company.

Fragmented market, low entry barriers and exposure to cheaper imports – The domestic pharmaceutical industry remains competitive and fragmented with over 50 active players. The industry is also expected to witness fresh capacity creation over the medium term, which is likely to intensify the competition, exert pricing pressure and moderate margins of all players. At the same time, low import barriers on pharmaceutical products also expose the domestic players to competition from cheaper imports. All these factors remain challenges to the scalability and profitability of the domestic players.

Exposure towards supplier chain and regulatory risks – DJPL is completely dependent on imports of all its raw materials like active pharmaceutical ingredients (API), excipients, packing materials etc., which exposes the company to supply-chain disruption risk. The sector also remains vulnerable to regulatory risks. Therefore, issues like price ceiling on certain products could affect the company's revenue and profitability.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:
[Corporate Credit Rating Methodology]

[1] *Net working capital to operating income ratio*

About the company

Incorporate in 1991, Deurali Janta Pharmaceuticals Private Limited (DJPL) is among the leading players in the business of pharmaceuticals molecules formulation (using reverse engineering) and therapeutic drugs production. It produces a wide range of general and specialised medications for cardiovascular, diabetic, gynaecology and childcare, gastrologic and hepatology, dermatology ailments, among others. DJPL currently produces over 250 products across 20 different categories.

As of mid-July 2020, DJPL's stake is owned mainly by Mr. Hari Bhakta Sharma, Executive Director and Chairperson (71%) with the remaining stake held by his family members and associates.

Key financial indicators

	FY2018 (Audited)	FY19 (Audited)	H1FY2020 (Provisional)
Operating Income-OI (NPR Million)	1,405.9	1,534.5	592.6
OPBDITA/OI (%)	32.1%	26.4%	26.2%
Total Debt/Tangible Net Worth-TNW (times)	0.4	0.5	0.50
Total Outside Liabilities/ TNW (times)	0.8	1.7	1.53
Total Debt/OPBDITA (times)	0.7	0.8	1.23
Interest Coverage (times)	15.6	11.8	9.06
Current Ratio	1.4	0.85	0.84
WC Intensity (NWC/OI)	36%	41%	55%

Annexure-1: Instrument Details

Instrument	Limit	Rating Action
Fund-based, Long-term-Proposed	NPR 265.8 million	[ICRANP] LBBB+
Fund-based, Short-term (Overdraft)	NPR 87.9 million	[ICRANP] A2
Fund-based, Short-term (Cash Credit/TR/ Standby line of credit)	NPR 234.6 million	[ICRANP] A2
Non-fund based, Short-term (Letter of Credit/Bank Guarantee)	NPR 170.0 million	[ICRANP] A2
Total	**NPR 758.3 million**	

Analyst Contacts

Mr. Kishor Prasad Bimali, (Tel No. +977-1-4419910/20)
kishor@icranepal.com

Mr. Sailesh Subedi, (Tel No. +977-1-4419910/20)
sailesh@icranepal.com

Relationship Contacts:

Ms. Barsha Shrestha, (Tel No. +977-1-4419910/20)
barsha@icranepal.com

About ICRA Nepal Limited:

ICRA Nepal Limited, the first Credit Rating Agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, technical and analytical skill augmentation.

Our parent company, 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.

For more information, visit www.icranepal.com

ICRA Nepal Limited,
Sunrise Bizz Park, 6th Floor, Dillibazar, Kathmandu, Nepal.
Phone:+977 1 4419910/20
Email: info@icranepal.com
Web: www.icranepal.com

ICRA Nepal ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. The ICRA Nepal ratings are subject to a process of surveillance which may lead to a revision in ratings. Please visit our website (www.icranepal.com) or contact ICRA Nepal office for the latest information on ICRA Nepal ratings outstanding. All information contained herein has been obtained by ICRA Nepal from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Nepal in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Nepal shall not be liable for any losses incurred by users from any use of this publication or its contents