NEULAND
WHERE OPPORTUNITY BECOMES REALITY

Neuland Laboratories Limited
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August 18, 2021

To
BSE Limited
Phiroze Jeejeebhoy Towers,
25th Floor, Dalal Street,
Mumbai - 400 001

Scrip Code: 524558

To
The National Stock Exchange of India Ltd
Exchange Plaza,
Bandra Kurla Complex
Bandra (E), Mumbai - 400 001

Scrip Code: NEULANDLAB; Series: EQ

Dear Sirs,

Sub: Intimation under Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

Pursuant to Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, we would like to inform you that India Ratings and Research Private Limited has affirmed the credit rating assigned to the Company as under:

Type of Credit Rating	Rating	Rating Action
Term Loan	IND A-/Stable	Affirmed
Fund-Based Limits	IND A-/Stable/IND A2+	Affirmed
Non-Fund Based Limits	IND A2+	Affirmed

This is for your information and records.

Yours faithfully,
For **Neuland Laboratories Limited**

NEULAND LABORATORIES LTD. HYDERABAD

Sarada Bhamidipati
Company Secretary

India Ratings & Research

A Fitch Group Company

India Ratings Affirms Neuland Labs at 'IND A-'/ Stable

18

AUG 2021

By Krishnanath Munde

India Ratings and Research (Ind-Ra) has affirmed Neuland Laboratories Limited's (NLL) Long-Term Issuer Rating at 'IND A-'. The Outlook is Stable. The instrument-wise rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (INR million)	Rating/Outlook	Rating Action
Term loan			December 2024-July 2026	INR 1,886 (increased from INR 1,174)	IND A-/Stable	Affirmed
Fund-based limits				INR2,200	IND A-/Stable/IND A2+	Affirmed
Non-fund based limits				INR1,314	IND A2+	Affirmed

Analytical approach: The agency has taken a consolidated view of NLL and its two wholly owned subsidiaries - Neuland Laboratories Inc., USA and Neuland Laboratories K.K., Japan - engaged in the manufacturing and selling of pharmaceutical active pharmaceutical ingredients (APIs).

KEY RATING DRIVERS

Strong Sales and Operating Performance over FY20-FY21: NLL's sales grew at a strong 22.8% yoy to INR9,369 million in FY21 (FY20: up 14.4% yoy), due to a 42.9% yoy rise (up 106% yoy) in the sales of its contract manufacturing solutions (CMS) division to INR2,690 million. The contribution of this division to the total sales increased to 28.3% in FY21 (FY20: 25%), driven by the 20 molecules in this segment. Over the next three-to-four years, the management expects this division to contribute 30%-35% to the total annual sales. Also, the EBITDA margin expanded around 231bp yoy to 15.7% in FY21 on an improved product mix. The sales from the niche/specialty segment grew 18.1% yoy to INR2054 million in FY21 and its contribution to the total sales stood at 22% in FY21 (FY20: 23%). The low-margin prime segment's contribution was stable yoy at 47% of the sales in FY21 and its sales grew 25.3% yoy to INR4,449 million in FY21.

In the CMS segment, the number of projects increased to 78 in FY21 from 76 in FY20 (FY19: 56). The inflow of late-stage projects increased during the year under review. These projects have the potential to boost the overall revenue over the next 18-24 months. NLL is 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. These measures are likely to help the company in further margin improvement.

Business Mix Transformation towards High-margin Segments over FY14-FY21: NLL has three business segments, namely 1) prime API, 2) niche API, and 3) CMS. Over the years, NLL has shifted its focus from the high-volume, low-margin segment (prime API) to high-margin complex products (niche API), which was visible during FY14-FY21. The revenue contribution of the prime API segment reduced to 47% in FY21 (FY20: 46%; FY19: 55%) from 71% in FY14, while niche API's revenue contribution increased to 22% (23%; 25%) from 18%. The revenue contribution of the CMS API segment increased to 28% in FY21 (FY20: 25%; FY19: 14%) from 11% in FY14. According to the management, the revenue contribution from the high-margin and low-volume segments niche API and CMS will be 25% and 35%, respectively, over the next three years while that of the low-margin and high-volume prime API segment will be 40%. With this transformation, NLL expects the consolidated EBITDA margin to be 18%-20% over the next three-to-four years (FY21 EBITDA margin: 15.7%; FY20: 13.4%).

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 78 molecules in 1QFY22 (pre-clinical: 22, phase-I: 7, phase-II: 9, phase-III: 3, development: 20 and commercial: 17) from 21 molecules in FY16. NLL has increased focus on phase-III and development stage molecules as they are the probable candidates to drive the company's revenue growth. Over the past few years, NLL has added many projects in development stages (1QFY22: 20, FY16: 2), which could contribute significantly to the revenues over the medium term.

Comfortable Credit Metrics and Debt Structure: The agency expects NLL's net adjusted debt/EBITDA to be around 1.47x in FY22 (FY21: 1.2x FY20: 2.4x) due to the subdued operating performance during 1QFY22 (EBITDA margin at 12.8%). The company's EBITDA/gross interest improved to 8.2x in FY21 (FY20: 4.7x), led by an improvement in the operating profit. The fund flow from operations also increased to INR1,244 million in FY21 (FY20: INR 878 million). 0.2 million of NLL's shares owned by the promoter are pledged against the consortium loan facility. Ind-Ra believes NLL has sufficient financial flexibility to absorb partially debt-funded capital expenditure of INR1,100 million planned for FY22 and INR1,000 million for FY23.

Liquidity Indicator - Adequate: NLL had free cash balances of INR38 million at FYE21 (FYE20: INR188 million). Its average utilisation of fund-based limits was 32% and that of the non-fund-based limits was 58% over the 12 months ended June 2021. The free cash flow turned positive to INR656 million in FY21. The agency expects the annual cash flow from operations (FY21: INR1,736 million; FY20: INR386 million) to be above INR900 million over FY22-FY25 with the rising EBITDA. However, the free cash flow is likely to remain negative in FY22, led by high capex (INR 1.1 billion).

The net working capital cycle improved to 113 days in FY21 (FY20: 148 days), driven by an increase in the payable days to 100 from 76. 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 IT park at the company's land in Nanakramguda, Hyderabad. This investment property carries a book value of INR189.1 million; the management expects that a much higher fair value (i.e. 4x-6x of the current book value) might accrue to NLL when the construction is completed. This asset sale amount can be then used to provide for the guided capital expenditure.

Regulatory Risk: Clean Track Record till date: The regulated markets such as the US, Europe and Japan contributed around 83% to NLL's total sales in FY21. NLL has two United States Food and Drug Administration (USFDA) approved API facilities (unit-1 and unit-2) and a research and development laboratory which have cleared 15 consecutive USFDA audits. NLL has filed several drug master files to regulated market such as the US (57), Canada (30), Japan (10), Europe (495) and Australia (22). In FY19, NLL started the commercialisation of products (intermediate for captive consumption) from Block 1 of unit-3, a multi-product manufacturing facility acquired in December 2017. The management expects the USFDA inspection to take place post the filing of a drug master file from unit-3. NLL is generating only a small revenue from the unit-3. In recent times, the agency has seen increased USFDA scrutiny of Indian manufacturing facilities. Ind-Ra highlights that non-compliance or data integrity issues with any manufacturing facility may affect new product approvals from several regulatory agencies or a shutdown of the facility.

Standalone Financials: NLL's standalone revenue rose 22.8% yoy to INR9,369 million in FY21, EBITDA surged 44.3% yoy to INR1,464 million and EBITDA margin expanded 231bp yoy to 15.7%. The interest coverage improved to 8.2x in FY21 (FY20: 4.7x). At end-1QFY22, the standalone revenue stood at INR2,009 million (1QFY21: INR2,054 million) and EBITDA was INR256 million (INR337 million) that translates to a 362bp yoy fall in the EBITDA margins to 12.8%.

RATING SENSITIVITIES

Positive: A strengthening of the business profile, sustainable operating profitability, along with the net adjusted leverage sustaining below 1.5x could be positive for the ratings.

Negative: Future developments that could, individually or collectively, lead to a negative rating action include a dip in the profitability or liquidity or an increase in the net debt levels due to large debt-funded acquisitions and/or capex, leading to net adjusted leverage increasing and staying above 2.5x.

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, with the current name, in 1994. NLL is pure-play API manufacturer for several domestic and international pharmaceutical companies. The company has two USFDA-approved facilities that manufacture over 75 APIs addressing 36 therapies. NLL's APIs are primarily marketed in highly regulated markets such as the US, Europe and Japan (accounting for over 75% of its sales).

FINANCIAL SUMMARY (CONSOLIDATED)

Particulars	FY21	FY20
Revenue (INR million)	9,369	7,627
EBITDA (INR million)	1,468	1,019
EBITDA margin (%)	15.67	13.3
Operating EBITDA/Gross interest expense (x)	8.2	4.7
Net debt/Operating EBITDA (x)	1.2	2.4
Total debt (INR million)	1,823	2,637
Source: Company, Ind-Ra		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook	
	Rating Type	Rated Limits (million)	Rating	9 November 2020	20 March 2020
Issuer rating	Long-term		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
Fund-based limits	Long-term/short term	INR2,200	IND A-/Stable/IND A2+	IND A-/Stable/IND A2+	IND A-/Stable/IND A2+
Non-fund based limits	Short-term	INR1,314	IND A2+	IND A2+	IND A2+

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.