Press Release

Sun Pharma Advanced Research Company Limited

June 21, 2021

Rating Assigned

Total Bank Facilities Rated*	Rs. 200.00 Cr.
Long Term Rating	ACUITE AA/ Outlook: Stable (Assigned)

** Refer Annexure for details*

Rating Rationale

Acuité has assigned its long-term rating of '**ACUITE AA**' **(read as ACUITE double A)** on the Rs. 200.00 Cr bank facilities of Sun Pharma Advanced Research Company Limited (SPARC). The outlook assigned is **'Stable'**.

The rating reflects SPARC's established operational track record and experienced management, robust R&D pipeline and parent support from Shanghvi Finance Private Limited (SFPL) in the form of corporate guarantee. SPARC is a part of the Sun Pharma Group (SPG) headed by Mr. Dilip Shanghvi. Mr. Shanghvi also holds directorship position in SPARC. The rating also draws comfort from business synergies SPARC has with Sun Pharmaceutical Industries Limited (SPIL) – flagship of SPG. The above-mentioned strengths are partly offset by long gestation periods and capital-intensive nature of drug research and development process. Continued support from promoters and timely commercialization of key products under development key rating sensitivity factors for SPARC.

About the Company

SPARC is a Mumbai based - clinical stage bio-pharmaceutical company and is part of the Sun Pharma Group. It was incorporated in 2006 when the innovative product group was carved out of Sun Pharma Industries (SPIL). It is primarily engaged in pharmaceutical research and development activity and earn their revenue from license fee / royalty on technology / R&D services. It undertakes research in the field of Oncology, Neuro Degeneration, Ophthalmology and Dermatology. It has its office in Mumbai, Maharashtra and R&D centers at Vadodara, Gujarat and New Jersey, USA. Mr. Dilip Shanghvi is the Chairman of the entity and Mr. Anil Raghavan is the CEO. Mr. Dilip Shanghvi and other individuals in the promoter Group along with Shanghvi Finance Private Limited (SFPL) own a majority stake in SPARC (68.46 percent as on March 31, 2021).

About the Guarantor

Shanghvi Finance Private Limited (SFPL) is an investing company of the promoter family. It has been listed as promoter entity as per the disclosures on the stock exchange. SFPL held 40.30 per cent of the total shareholding of Sun Pharma Industries Limited (SPIL) as on March 2021. The rated bank facilities will be secured by corporate guarantee of SFPL. SFPL has also extended a letter of comfort to support SPARC in its debt obligations.

Analytical Approach

Acuite has considered the standalone business and financial risk profile of SPARC while arriving at the rating. Acuite has also factored in the financial support SPARC will receive from Shanghvi Finance Private Limited (SFPL) on account of the Letter of Comfort extended by the later.

Key Rating Drivers

Strengths

- **Extensive experience and established track record in pharma R&D**
  SPARC is a Mumbai based - clinical stage bio-pharmaceutical company and is part of the SPG. It was incorporated in 2006 when the innovative product group was carved out of SPIL. Mr. Dilip Shanghvi and other individuals in the promoter Group along with Shanghvi Finance Private Limited (SFPL) own a majority stake in SPARC (68.46 percent as on March 31, 2021). Currently Mr. Dilip Shanghvi is also the

Chairman. He is supported by a highly qualified and experienced senior management team. Mr. Anil Raghavan is the CEO and has an experience of over two decades in the pharmaceutical industry. The rest of the senior management team also have extensive experience in the pharmaceutical industry working in past for companies such as Merck, Sanofi-Aventis, Glaxo Smith Kline and Dr. Reddy's amongst others. The team is also supported by a scientific advisory board consisting of experienced professors from leading medical education institutions across the globe.

Acuité believes that SPARC will derive benefits from its established track record and experienced management in the pharmaceutical industry.

• **Robust R&D Pipeline and synergies with SPIL**

SPARC is engaged in research & development activity and generate their revenue primarily from license fee, royalty on technology and R&D services. It has undertaken research in the field of Oncology, Neuro Degeneration, Ophthalmology and Dermatology It focuses on developing new chemical entities (NCEs) as well as New Drug Delivery Systems (NDDS). It currently has 2 USFDA approved products. In the past it had another USFDA approved product. They also have a robust R&D pipeline with 9 products at various stages of development. These target epilepsy, glaucoma, different kinds of cancer, and Parkinson's disease. Besides these it has more than 10 pre-clinical assets. Earlier the company relied more on NDDS (New Drug Delivery System). NDDS formed 81 percent of its pipeline while NCEs (New Chemical Entity) were just 19 percent in 2014. By 2020 the focus has shifted to NCEs which forms 62 percent and NDDS remains around 19 percent of the research pipeline. Acuite believes that NCEs with higher revenue potential provides better revenue visibility. As the product progresses towards the end of its development process SPARC commercializes the same with various pharmaceutical companies. It regularly partners with SPIL - its Group Company which has a robust presence in the overseas market. The company in the past has licensed many of its product to SPIL currently also has licensing agreements with SPIL for products which are developed such Bevetex and Xelrpos. This synergy with SPIL makes it a key entity for SPG.

SPIL is one of the leading listed Pharmaceutical companies in India with consolidated revenues of was Rs. 33,498 Cr. on which it posted a net profit of Rs. 2,904 Cr. for FY2021. The company has a presence in about 100 countries (including USA, Europe, Emerging Markets, Canada, Japan and Australia & New Zealand) with product portfolio more than 2000 products. The company generates around 73 per cent of its total consolidated revenue is from overseas markets. SPIL is the 8th Largest Specialty Generic Company in USA. The market capitalization of the company is more than Rs. 150,000 Cr. as on May 31, 2021. Its investor base includes leading domestic and foreign institutional investors. The Promoter Group hold ~54.48 per cent as on March 2021. Out of the promoter holding, Shanghvi Finance Private Limited holds ~40.30 per cent and balance 14.18 is held by Promoter Group in individual capacity and through other entities. It has presence in specialty medications for ophthalmology, dermatology and oncology, in generic medications for psychiatry, anti-infective, neurology, cardiology, orthopedic, diabetology, gastroenterology, ophthalmology, nephrology, urology, dermatology, gynecology, respiratory, oncology.

• **Strong resource mobilization ability on account of support from promoters and access to capital markets**

SPARC is part of the SPG. It is was carved out SPIL in 2006. SFPL - which is the holding company for the SPIL - holds ~58 percent in SPARC. SPARC's bank facilities have been secured by corporate guarantee from SFPL. SFPL holds 40.30 percent of SPIL as on March 31, 2021 amounting to Rs. 70,000 Cr. SFPL's net cash accruals stood at Rs. 516.03 Cr for FY2020 against cash loss of Rs. 73.44 Cr in the previous year. The significant improvement in cash accruals is on account of increased dividend flow from SPIL. SPIL has been declaring dividend in a range of 100 per cent to 350 per cent over the past five years. SFPL's outstanding debt as on 31 March 2020 stood at Rs.865.91 Cr. SFPL's financial flexibility is derived from the value of its unencumbered shares in SPIL viz-a-viz its borrowings and other contingent exposures. However, SFPL's obligations to other Group entities in the Group is likely to restrict the support available to some extent. Strength can be drawn from the fact that the SFPL's cash accruals in FY2020 are 2.58 times SPARC's bank facilities. SFPL has also infused significant unsecured loans in SPARC for supporting its operations. They stood at Rs. 60.00 Cr as on March 31, 2020. SPARC also has access to capital markets to raise funds. Currently it is planning to raise ~1200 Cr by issue of preferential warrants. Out this Rs. 300 Cr will be infused upfront at time of allotment thereafter the warrants can be converted into equity share within eighteen months of issue. 50 percent will be allotted to Mr. Dilip Shanghvi and rest to other HNIs and institutional investors. Acuité expects that SFPL will continue to generate robust cash flows from its investments in SPIL and will maintain its debt at prudent levels. Since the revenue flows of SFPL are highly dependent on SPIL's performance and dividend policy, the financial performance and position of SPIL will be a key credit monitorable.

Acuité believes continued support from the promoter through fund infusion to cover SPARC's losses will remain a rating sensitivity.

Weaknesses

• **Long gestation periods, capital intensive nature of operations and susceptibility stringent regulatory environment**

SPARC is a clinical stage bio-pharmaceutical company which undertakes pre-clinical and clinical stage research and development. Drug development process involves long gestation periods with constant investments. Heavy costs have to be incurred to carry out research, conduct clinical trials and compensate a highly qualified work force every year. However the major payouts come when a product is near commercialization and a licensing agreement is signed. There is an inherent mismatch of cash flows in the R&D segment. SPARC has some regular revenues which it earns as royalty and fees for carrying out research activities. Although they are low compared to the cost that the company incurs for carrying out the R&D activities. On account of this SPARC has generated losses for all the three years under study. Its revenue and operating loss stood at Rs. 76.85 Cr and Rs. 309.98 Cr in FY2020, Rs. 183.80 Cr and Rs. 148.26 Cr in FY2019 and Rs. 78.27 Cr and Rs. 242.46 Cr in FY2018 respectively. This necessitates periodically capital infusion from the promoters.

The company also faces significant regulatory risks. Since it is engaged in new drug development it has to adhere to a stringent compliance and regulatory environment. Costs incurred on products under development for a long time may get impacted by any adverse regulatory action. However this is mitigated to some extent on account of the strong support and resource mobilization ability of the promoters.

Acuité believes completion of product development without significant time overruns or regulatory setbacks will remain a key monitorable.

Liquidity Position: Strong

SPARC's product development cycles have long gestation periods. The company has to make significant investments in R&D before returns can be generated from the products. The company has external borrowing for funding these requirements. Its repayment obligations would be in the range of Rs. 40 -45 Cr per quarter for year FY2023. However, SPARC's liquidity is supported by strong financial flexibility of the promoters and promoter group. The company is listed on the stock exchanges and has demonstrated ability to raise funds directly from the capital markets. SPARC's liquidity is expected to be strong on account of access to capital markets and strong financial flexibility of the promoters and promoter Group.

Rating Sensitivities

- Credit quality of SPIL and SFPL
- Any unexpected increase in debt levels in SFPL
- Completion of product development without significant time overruns or regulatory setbacks

Material Covenants

None

Outlook: Stable

Acuité believes that SPARC will maintain a 'Stable' outlook over the medium term on account of extensive experience of management, robust R&D pipeline and its strong resource mobilization ability. The outlook may be revised to 'Positive' in case of faster than expected development of key products and completion of licensing agreement. Conversely, the outlook may be revised to 'Negative' in case significant cost and time overruns in product development or deterioration in credit quality of SFPL or SPIL.

About the Rated Company - Key Financials

	Unit	FY20 (Actual)	FY19 (Actual)
Operating Income	Rs. Cr.	76.85	183.80
Profit after Tax (PAT)	Rs. Cr.	(312.40)	(145.43)
PAT Margin	(%)	(406.53)	(79.12)
Total Debt/Tangible Net Worth	Times	(1.42)	0.01
PBDIT/Interest	Times	(112.25)	(1,467.35)

Status of non-cooperation with previous CRA (if applicable)
Not applicable

Any other information

Not Applicable

Applicable Criteria
• Default Recognition - https://www.acuite.in/view-rating-criteria-52.htm
• Financial Ratios And Adjustments - https://www.acuite.in/view-rating-criteria-53.htm
• Entities in Services Sector– https://www.acuite.in/view-rating-criteria-50.htm
• Criteria for Group and Parent Support - https://www.acuite.in/view-rating-criteria-47.htm

Note on complexity levels of the rated instrument
https://www.acuite.in/view-rating-criteria-55.htm

Rating History (Upto last three years)
Not Applicable

***Annexure – Details of instruments rated**

Name of the Facilities	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
WCDL*	Not Applicable	Not Applicable	Not Applicable	50.00	ACUITE AA/Stable (Assigned)
Term Loan	January 2021	8.00	December 2022	150.00	ACUITE AA/Stable (Assigned)

* WCDL has sublimit of CC of Rs. 20.00 Cr and BG of Rs. 10.00 Cr each

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About Acuité Ratings & Research:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 6,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Mumbai.