

Pharmaceuticals India IPO Grading Report

Aanjaneya Lifecare Limited

Fitch IPO Grade '2(ind)'

Fitch has assigned a grade of '2 (ind)' out of a maximum of '5 (ind)' to the proposed initial public offer of Aanjaneya Lifecare Limited. The grade indicates the below-average fundamentals of the issue relative to other listed equity securities in India.

IPO Details

Aanjaneya Lifecare Limited proposes to issue 5m equity shares. The issue will constitute 39.76% of the fully diluted post issue paid-up capital of company.

Analysts

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Shareholding Pattern

	(Pre issue)		(Post issue)	
	No. of shares	(%)	No. of shares	(%)
Promoter and promoter group				
Indian individuals	2,026,687	26.75	2,026,687	16.11
Dr. Kannan K. Vishwanathan	2,026,667	26.75	2,026,667	16.11
Mr. Kashi Vishwanathan	10	Negligible	10	Negligible
Ms. Divya K. Vishwanath	10	Negligible	10	Negligible
Indian bodies corporate	5,549,950	73.25	5,549,950	44.13
Total promoter and promoter group	7,576,637	100	7,476,637	60.24
Public shareholding				
Individual shareholders holding nominal share capital up to INR100,000	30	Negligible	30	Negligible
Others	-	-	5,000,000	39.76
Total public shareholding	30	Negligible	5,000,030	39.76
Grand total	7,576,667	100.00	12,576,667	100

Source: Company, Fitch

Grading Rationale

- Aanjaneya Lifecare Limited's (ALL) initial public offering (IPO) grading of '2(ind)' out of '5(ind)' factors in its established presence in the domestic anti-malarial active pharmaceutical ingredient (API) market and in Fitch's expectations of revenue and margins growth from its new formulation and contract manufacturing business segment. The grading is supported by the sponsors' experience in the API industry through its erstwhile group company - Benzochem Lifesciences Pvt Ltd (sold to Arch Pharmalabs Ltd in 2008) - and ALL's strong revenue growth and stable credit profile in its short operating history.
- ALL ventured into the formulation segment and contract manufacturing business in FY10 (end-March 2010) after acquiring Prophyla Biologicals (P) Limited's (PBPL) assets. Fitch expects ALL's formulation business to benefit from revenue generation from PBPL's existing customers, the launch of products in branded generic segment and its entrance into new countries. Also, ALL could also see margin benefits as it is a vertically integrated player in the anti-malarial segment.
- The grading is constrained by ALL's small scale and size of operations, limited operating history, high working capital levels and subsequent liquidity risk. Furthermore, ALL's cash flows from operations were negative over FY09-FY10 due to the deterioration of its working capital cycle (FY10: 130 days, FY09: 94 days). The company's free cash flows also remained negative over FY09-FY10 due to capex incurred during the period.
- The IPO proceeds will be used to part fund ALL's INR1,166.4m capex during FY11-FY12 for expanding API and formulations capacity and for R&D activities.

Company Background

Incorporated in 2006 as API manufacturing company, Aanjaneya is now an API cum formulations manufacturer with two manufacturing facilities - one each at Mahad and Pune in Maharashtra.

ALL intends to become a vertically integrated player and launch its own brands for generic drugs. It has already launched over 11 branded generics in therapeutic segment.

Management and Sponsors

Dr Kannan Vishwanathan and Aasda Lifecare Limited (Aasda) are the sponsors of the company. Dr. Kanna Vishwanathan, who is the Managing Director/Vice Chairman, holds a majority stake directly and indirectly in ALL through Aasda.

Board of Directors

Name	Designation
Mr. Kashi Vishwanathan	Executive Chairman, Non Independent Director
Dr. Kannan K. Vishwanath	Executive Vice Chairman and Managing Director
Mr. Prabhat K. Goyal	Whole Time Director
Mr. Shashikant B. Shinde	Whole Time Director
Dr. Ullooppee S. Badade	Independent Director
Mr. Giridhar G. Pulleti	Independent Director
Mr. Balkrishna R. Parab	Independent Director
Mr. Kalidas S. Patel	Independent Director

Source: Company

The sponsors have a prior experience in the API segment via its erstwhile group company BLPL, which was engaged in the manufacture of API and intermediates in anti-cancer segment through its US FDA approved Tarapur manufacturing facility. The company was sold in 2008 at INR1,000m. In FY08, BLPL reported total revenue of INR1,500m.

Business Overview

Product Portfolio

ALL is primarily into the manufacturing second and third generation anti-malarial API-quinine salts and artemisinin-based derivatives. It also plans to make anti-cancer API, herbal API and narcotics API and niche intermediates at its Mahad plant. Herbal and narcotics API will serve as feeder to their formulations plant in Pune.

In March 2010, ALL acquired the assets of PBPL formulation unit in Pune and entered into the manufacturing of lozenges, syrups and ointment/gels/creams. PBPL was primarily a contract manufacturer, catering to big pharmaceutical companies. Through this acquisition, ALL will be benefited with readymade client base. This acquisition is in line with the vision of the company management to become a vertically integrated pharmaceutical company.

The company also intends to launch niche products like hormone replacement and anti-cancer therapies in the regulated and developed market in the next two to three years.

As of 15 September 2010, ALL had five registered patents in India. Furthermore, it has acquired rights for three patent applications, filed for an improved and non-infringing process for producing anti-cancer APIs. ALL has 98 registered trademarks in India and further applied to register 90 trademarks.

Production Facilities

The company has two manufacturing facilities at Mahad and Pune. At Mahad, ALL has an installed capacity of 450,000 kg for processing quinine, a second generation pharmaceutical API for malaria. It has already started manufacturing third generation API for malaria. It is also setting up a separate manufacturing block for anti-cancer APIs and a separate cGMP and intermediate blocks for manufacturing niche APIs, which have applications in various therapeutic segments.

PBPL's formulation unit provides ALL access to tap opportunities in finished dosage form segment, which includes liquid, lozenges, ointment etc. ALL is in the process of setting up tablet and capsule manufacturing facility at its Pune plant. It has flexible manufacturing infrastructure, which facilitates product changeover as per demand of customers.

Market Focus

ALL focus is largely on domestic and emerging markets like Kenya, South Africa, Tanzania etc, as its strategy is to expand into regions which are similar to Indian markets with lower regulatory hurdles. The company plans to explore new markets and segments, with special attention to institutional sales, branded generics, contract manufacturing and export market.

Raw Materials Dynamics

There are primarily two types of raw materials used by ALL - synthetic and natural/herbal. The primary raw material for the second generation anti-malarial API is cinchona bark, which grows in the African forests and north-east Indian forests. There is no organised farming for this kind of bark. Fitch notes that due to the limited supply, the price of the raw materials shows increasing trends. This might affect the margins adversely; however, the increase in prices of raw materials can be successfully passed on to customers. The company has no long-term contracts with any raw material suppliers. Supply of raw materials is depended on monsoon and growth of barks.

For manufacturing of API other than mentioned above, and herbal products, primary raw materials are natural extracts. ALL mostly purchases these from domestic suppliers in extracted forms like powder, and availability is generally not a constraint.

Research and Development

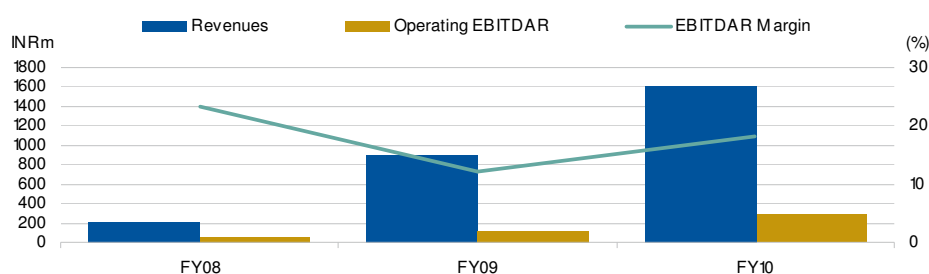
ALL has a team of four people in their research and development department. It intends to focus on its research and development capabilities. At Mahad, the company is focusing on setting up a pilot plant and facilities for process improvement and product stabilisation. At Pune, it plans to set up a facility for research on innovative combinations of products. It is also focussing on developing alternative drug delivery system. The facility is expected to be completed by October 2011.

Financial Overview

Growth & Profitability

ALL started commercial operations in September 2007 and registered revenue of INR218m during the first six months. The company primarily sells to manufacturers in the formulation segment or contract manufacturers. In FY10, its revenues grew by 79% yoy to INR1616.7m, with an improvement in EBITDA and EBITDA margins to INR292.7m and 18.1%, respectively, compared to INR108.9m and 12.1% in FY09.

Revenue and Profitability



Source: Company, Fitch

Working Capital Management

ALL's working capital cycle showed an increasing trend in FY10 to reach 130 days from 94 days in FY09, primarily due to the increase in average inventory holding period from higher stocks of raw materials and finished goods. These were required to meet the increased processing capacity and supply final products to the customers in a timely manner as per their requirements.

Working Capital Cycle

	FY10	FY09
Average inventory period (days)	73	43
Average receivables period (days)	84	87
Gross cash cycle (days)	157	130
Average payables period (days)	27	36
Cash conversion cycle (days)	130	94

Source: Fitch

Liquidity and Debt

During FY08-FY10, ALL cash flow from operation was negative due to the high working capital cycle, primarily due to the capital intensive nature of industry and growing business of ALL. As at 31 March 2010, the company's total term loans from banks were INR98.8m and fund-based working capital facilities utilised at INR397.1m.

ALL's credit metrics remained comfortable in FY10 with net debt/operating EBITDAR at 2x and operating EBITDAR/net fixed charges at 4.9x (FY09: 3.4x and 4.2x, respectively). Fitch expects the company's credit metrics to remain comfortable in the near-term, despite its significant capex plans. In addition, the agency expects liquidity to strengthen with the successful completion of its IPO.

Returns

ALL's return on capital employed (operating EBITDAR/average capital employed) increased to 36.7% in FY10 from 32.6% in FY09, primarily due to the improvement in its profit margins, with a fairly stable asset base. However, return on net worth (profit after tax/average equity) declined to 48.5% in FY10 from 61.2% in FY09, due to increase in financing and interest charges during the year on account of increased debt.

The company has been operating on relatively medium size asset base till FY10, hence the total assets turnover was over 1.2x in FY09 and FY10. However, Fitch notes that equity infusion will increase fixed assets and hence the total assets, and expects a decline in asset turnover ratio, leading to lower return on assets in the medium-term.

Annex 1

Financial Summary

	FY10	FY09	FY08
Income statement			
Revenues	1,616.7	901.3	218.8
Revenue growth	79.4	311.9	n.a.
EBIT	288.6	103.7	48.4
Interest expense net of interest income	60.0	25.7	7.8
Net income	150.7	51.1	23.2
Balance sheet			
Cash and equivalents	2.6	2.6	0.7
Total assets	1,347.6	607.1	276.0
Short-term debt	-	-	-
Senior long-term debt	596.9	376.3	124.4
Subordinated debt	-	-	-
Total debt	596.9	376.3	124.4
Off-balance sheet debt	-	-	-
Total adjusted debt	596.9	376.3	124.4
Preferred stock + minority interests	-	-	-
Common equity	497.7	123.8	43.2
Total adjusted capitalisation	1,094.6	500.1	167.6
Cash flow			
Operating EBITDAR ("op. EBITDAR")	292.7	108.9	50.7
Cash interest paid, net of interest received	60.0	25.7	7.8
Cash tax paid	23.7	6.1	-
Associate dividends	0.2	0.1	-
Other changes before funds From operations ^b	4.6	-0.2	-0.1
Funds from operations	213.8	77.0	42.8
Working capital	-269.1	-322.1	-74.1
Cash flow from operations	-55.3	-245.1	-31.3
Non-operational cash flow ^a	-	-	-0.5
Capital expenditure	388.0	29.8	103.0
Dividends paid	-	-	-
Free cash flow	-443.3	-274.9	-134.8
Receipts from asset disposals	-	-	-
Business acquisitions	-	-	-
Business divestments	-	-	-
Exceptional & other cash flow items	-0.3	-0.3	-
Net cash in/outflow	-443.6	-275.2	-134.8
Equity issuance/(buyback)	223.2	29.5	19.9
FX movement	-	-	-
Other items affecting cash flow ^b	-0.2	-4.3	-3.5
Net cash flow available for financing	-220.6	-250.0	-118.4
Closing net debt	594.3	373.7	123.7
Profitability			
Op. EBITDAR/revenues (%)	18.1	12.1	23.2
EBIT/revenues (%)	17.9	11.5	22.1
FFO return on adjusted capital (%)	25.1	20.6	30.2
Credit ratios			
Funds from operations/gross interest expense (x)	4.5	4.0	6.5
FFO fixed charge cover (x)	4.5	4.0	6.5
Op. EBITDAR/net fixed charges (x)	4.9	4.2	6.5
Adjusted leverage/FFO (x)	2.2	3.7	2.5
Total adjusted debt net of cash/op. EBITDAR (x)	2.0	3.4	2.4
Total adjusted debt/total adjusted capitalisation (%)	54.5	75.2	74.2

^a Net cash from financial investments, analyst estimate of non-operational cash flows

^b Balancing item

Source: Company, Fitch

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