August 17, 2022

Healthcaps India Limited: Ratings upgraded to [ICRA] A- (Stable)/[ICRA] A2+; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-Term - Fund Based/ Cash Credit	32.00	32.00	[ICRA]A- (Stable) upgraded from [ICRA]BBB+ (Positive); outlook revised to Stable from Positive
Long-Term - Fund Based/ Term Loan	62.71	57.13	[ICRA]A- (Stable) upgraded from [ICRA]BBB+ (Positive); outlook revised to Stable from Positive
Long-Term - Fund Based/ Working Capital Term Loan	8.34	13.92	[ICRA]A- (Stable) upgraded from [ICRA]BBB+ (Positive); outlook revised to Stable from Positive
Short-Term – Non Fund Based/ Letter of Credit	7.50	7.50	[ICRA]A2+ upgraded from [ICRA]A2
Total	**110.55**	**110.55**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings upgrade factors in the significant improvement in Healthcaps India Limited's (HIL) financial risk profile, owing to growing volumes and improving product profile supported by significant pick-up in demand in the export markets, especially the US and Europe and domestic pharmaceutical market. Consequently, the company's margins and credit metrics have displayed substantial improvement in FY2022 and are expected to stay healthy in the near to medium term. The ratings continue to be supported by the company's established position as an empty capsule manufacturer in India, supported by the ability to steadily grow capacities and its established relationships with customers.

The ratings are, however, constrained by the high working capital intensity of operations owing to the long collection period offered to customers, coupled with high inventory holding levels. ICRA also notes the medium forex exposure and the raw material price fluctuation risks associated with the business. While the company has been witnessing steady growth, its scale remains relatively moderate, given the low-value nature of the product. Also, capsules as a product segment faces the risk of substitution from alternate/new drug delivery mechanisms especially in the pharmaceutical industry.

Key rating drivers and their description

Credit strengths

Established player in empty capsules industry; promoters have strong industry experience – HIL is a leading manufacturer of empty capsules in India with an installed annual production capacity of ~19 billion capsules. The promoters have more than three decades of experience in the empty capsules segment. The company started with the manufacture of EHGC capsules, and later diversified into HPMC capsules in FY2017. HPMC capsules are vegetarian capsules which have started gaining a healthy demand in the overseas and domestic markets. Further, HIL has scaled-up its capacity due to the access to in-house capsule manufacturing technology in its Group entity.

Geographically diversified customer base with clients in exports and domestic markets – The company has a wide customer base in the domestic and export markets. HIL shares good relationships with its clientele resulting in high repeat orders. In the past few years, the company has penetrated and scaled-up business in Europe, West Asia, and the South American markets. Further, HIL's Group companies (AlfaCaps LLC in the US and HealthCaps Europe Ltd in Europe) directly cater to the demands in the US and Europe through their set-up in these geographies.

Healthy ramp-up in sales, product diversification and better margin profile–HPMC capsules are gaining popularity in the US and Europe markets as these are starch-free, gluten-free, and preservative-free, and meet the strict dietary needs of customers that choose a vegetarian lifestyle. Due to the consistent increase in the HPMC capsule revenue share over the years~~,~~ HIL's return metrics have improved and are expected to stay healthy, going forward.

Healthy financial risk profile characterised by low gearing and healthy coverage indicators– HIL's debt levels have increased over the last three years in the backdrop of continued capex. Nevertheless, HIL's gearing (TD/TNW) was low at 0.6 times as of March 31, 2022, owing to an improvement in its net worth due to healthy accruals. Apart from improvement in OPBITDA, the company witnessed decline in the interest costs owing to conversion of term loans to foreign currency loans. As a result, the debt coverage indicators, such as interest cover and DSCR improved to 16.6 times and 4.6 times, respectively, in FY2022 compared with 7.7 times and 2.4 times, respectively, earlier. With the scheduled repayments and modest planned capex in the near to medium term, ICRA expects the debt indicators to remain at healthy levels.

Credit challenges

Moderate scale of operations given low-value nature of product, though established position in domestic market– Despite the continuous growth in the operating income (OI) over the past five years, the scale of HIL's operations and net cash accruals have remained relatively moderate, mainly owing to empty capsules being a low value and high-volume product. However, with continued capex, the company has become one of the leading players in the domestic market. However, the buoyant demand and the recent capacity addition should help revenues grow substantially in the medium term.

High working capital intensity with a long receivable period given high level of exports – HIL's business has remained working capital intensive. Moreover, due to increasing focus on exports, the working capital cycle has elongated mainly on account of high transit time and relatively higher credit offered to new export clients. ICRA also notes that a large part of the export business is being done through Group entities. However, the company's working capital limits have been recently enhanced, resulting in an adequate buffer to meet incremental working capital needs in addition to the cash accruals. Despite the high working capital intensity, the company's dependence on debt has been limited.

Raw material price and forex fluctuation risks, however, the company can pass on escalations to clients to a large extent– Being a net exporter, the company is exposed to forex risks. HIL hedges its GBP (British Pound currency) exposure while maintaining a natural hedge for a large part of its USD (US dollar currency) exposure. Moreover, with fluctuations in raw material process, particularly gelatin in case of EHGC capsules, the company can pass on the escalations to a partial extent, which impacts its margins.

Risk from substitutes from technological advances in other drug delivery mechanisms– The company's key product - empty capsules faces substitution risk from alternate drug delivery mechanisms such as tablets, injectables, etc., which can impact the market share and thus, growth rate of capsules. Generally, capsules have better bioavailability and masking properties over their closest oral substitutes -tablets and are preferred among consumers, as it masks the medicinal taste and odour though the shelf life is smaller. Thus, capsule manufacturers need to keep improving the quality of the capsules to meet the changing requirements of the pharmaceuticals and nutraceutical industry.

Liquidity position: Adequate

HIL's liquidity is **adequate,** supported by healthy growth in cash flows, buffer in working capital limits and modest cash levels. Given the recent capacity addition, which was funded by term loans, the company has debt repayments of Rs. 13-16 crore, and modest capex requirements in the near to medium term, which can be comfortably covered by the cash flow generation.

Rating sensitivities

Positive factors – ICRA could upgrade HIL's ratings if there is a sustained and significant scale-up in HIL's revenues, while sustaining its profitability and coverage metrics along with significant reduction in the net working cycle.

Negative factors – Pressure on HIL's ratings could arise in case of lower-than-anticipated levels of revenues and profitability, or worsened liquidity position. A specific credit metric for a downgrade is if DSCR is below 2 times, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology- Pharmaceuticals
Parent/Group Support	Not Applicable
Consolidation/Standalone	Not Applicable

About the company

HIL, incorporated in 1983, is a closely held public limited company, which manufactures EHGC capsules. HIL diversified into manufacturing HPMC capsules from FY2017 to cater to the growing demand from the pharmaceutical and nutraceutical industry, due to changing consumer preferences. The company's manufacturing facility is in Fatehpur village, Nawan Punjab. The company has sales offices in Delhi, Mumbai, and Mohali. HIL also exports the capsules to various international clients across the US, South America, Europe, and Africa. It manufactures capsules in sizes of 00, 0, 1, 2, 3 and 4. HIL has a customer base of over 400+ clients in more than 60 countries across the world.

Key financial indicators (audited)

HIL	FY2021	FY2022
Operating Income (Rs. crore)	149.8	256.0
PAT (Rs. crore)	15.0	51.8
OPBDIT/OI (%)	18.1%	30.3%
PAT/OI (%)	10.0%	20.2%
Total Outside Liabilities/Tangible Net Worth (times)	1.5	1.1
Total Debt/OPBDIT (times)	2.7	1.1
Interest Coverage (times)	7.7	16.6

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on Mar 31, 2022 (Rs. crore)	Date & Rating in	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					Aug 17, 2022	Jan 06, 2022	Dec 02, 2020	Oct 09, 2019
1	Cash Credit	Long term	32.00	18.92	**[ICRA]A- (Stable)**	**[ICRA]BBB+ (Positive)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**
2	Term Loan	Long term	57.13	47.81	**[ICRA]A- (Stable)**	**[ICRA]BBB+ (Positive)**	**[ICRA]BBB+ (Stable)**	**[ICRA]BBB+ (Stable)**
3	Working Capital Term Loan	Long term	13.92	14.90	**[ICRA]A- (Stable)**	**[ICRA]BBB+ (Positive)**	-	-
4	Letter of Credit	Short term	7.50	-	**[ICRA] A2+**	**[ICRA] A2**	**[ICRA] A2**	**[ICRA] A2**

&= Under watch with developing implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term - Fund Based/ Cash Credit	Simple
Long Term - Fund Based/ Term Loan	Simple
Long Term - Fund Based/ Working Capital Term Loan	Simple
Short Term – Non Fund Based/ Letter of Credit	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	8.5 - 9.5%	NA	32.00	[ICRA]A- (Stable)
NA	Term loans	FY2014	8.5 - 10.4%	FY2027	57.13	[ICRA]A- (Stable)
NA	Working Capital Term loans	FY2021	7-8%	FY2026	13.92	[ICRA]A- (Stable)
NA	Letter of Credit	NA	NA	NA	7.50	[ICRA] A2+

Source: *Company*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure-2: List of entities considered for consolidated analysis-Not Applicable

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545328
shamsherd@icraindia.com

Kinjal Shah
+91 22 6114 3442
kinjal.shah@icraindia.com

Sheetal Sharad
+91 124 4545374
sheetal.sharad@icraindia.com

Dishant Mahajan
+91 124 4545812
dishant.mahajan@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

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 (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches