March 03, 2020

Hexagon Nutrition Private Limited: Rating reaffirmed; Rated amount reduced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term, Fund-based – Cash Credit	7.00	10.00	[ICRA]BBB+(Stable); Reaffirmed
Long-term, Fund-based – Term Loans	8.00	7.00	[ICRA]BBB+(Stable); Reaffirmed
Short-term, Fund-based	9.00	9.00	[ICRA]A2; Reaffirmed
Short-term, Non-fund based	6.00	3.00	[ICRA]A2; Reaffirmed
Total	**30.00**	**29.00**	

**Instrument details are provided in Annexure-1*

Rationale

To arrive at the ratings, ICRA has consolidated the business and financial risk profiles of Hexagon Nutrition Private Limited (HNPL), and its subsidiaries Hexagon Nutrition (Exports) Private Limited (HNEPL), Hexagon Nutrition (International) Private Limited (HNIPL) and Nutralytica Research Private Limited (NRPL), together referred as the Hexagon Group.

The reaffirmation of the rating continues to factor in the extensive experience of the Hexagon Group's promoters in the nutraceutical and dietary supplements segment. It also takes account of the Group's affiliation with reputed international organisations like Global Alliance for Improved Nutrition (GAIN) and the UN World Food Programme (WFP) coupled with its established network of large hospital chains in India to recommend and sell disease-specific, company-branded dietary supplements. ICRA also notes the recent listing of the Tuticorin plant as UNICEF-approved facilities, which widens its scope for bidding in international tenders. Further, ICRA takes cognisance of the Group's ongoing plans to diversify its presence in international markets by setting up subsidiaries or by entering into joint ventures that are likely to aid the near-term revenue growth. The ratings continue to factor in the Group's comfortable capital structure and strong coverage indicators, coupled with its adequate liquidity position, supported by its sizeable free cash bank balance and undrawn sanctioned limit.

The ratings, however, remain constrained by the Group's moderate scale of operations in an intensely competitive dietary supplements-and-nutraceutical segment comprising some of the large, established multinational players and various small, unorganised players. Further, the Group's operating income witnessed a decline in 9M FY2020 owing to the planned shutdown of one of its facilities to undertake necessary changes to comply with international standards. The ratings also remain constrained by the Group's high working capital intensity of operations, as a result of high storage of raw materials against the backdrop of its product profile, along with an elongated receivables cycle. The ratings also take note of the vulnerability of the Group's profitability to volatility in raw material prices and foreign currency exchange rates. In the near-term, ICRA expects the debt to increase at the consolidated level due to its debt-funded capex towards overseas expansion wherein the stabilisation of operations on commencement remains critical. Further, any cascading impact of the coronavirus outbreak in China leading to any supply disruptions will be monitored, although the company has undertaken certain measures to mitigate this risk to an extent.

The Stable outlook on the [ICRA]BBB+ rating reflects ICRA's opinion that HNPL will continue to benefit from the extensive experience of its promoters and, as well as its established position in the nutraceuticals industry.

Key rating drivers and their description

Credit strengths

Extensive experience of the promoters in the field of micronutrient premixes and dietary supplements – Incorporated in 1993, HNPL is a part of the Mumbai-based Hexagon Group, promoted by the Kelkar family, which has been in the business of manufacturing micronutrient premixes and dietary supplements for over three decades. The promoters are professionally qualified in their field of operation and have prior experience of working with multinational FMCG companies.

Affiliation with international organisations like GAIN and WFP – HNPL is one of the 21 premix blenders in the world (one of the seven Indian premix blenders in the list) selected by GAIN under its GAIN Premix Facility (GPF) initiative. The company partners with WFP and other international NGOs in supplying them with vitamin and mineral premixes for their food fortification initiatives in developing and underdeveloped nations.

Relationship with large hospital chains in India to recommend and sell disease-specific branded dietary supplements – The Group has established a relationship with large hospital chains, and developed long associations with many reputed doctors in the country for prescribing its dietary supplement products. The Group also has an e-commerce portal, 'mynutrishop.co.in', to expand its reach.

Comfortable capitalisation and debt coverage indicators; adequate liquidity position – The company's capital structure is comfortable at present, as reflected by a gearing of 0.26 time as on December 31, 2019 (0.30 time as on March 31, 2019). The debt coverage indicators also remain adequate as reflected by an interest cover of 9.34 times in 9M FY2020 (7.71 times in FY2019), TD/OPBDITA of 1.14 times as on December 31, 2019 (0.98 time as on March 31, 2019) and NCA/Total debt of 78% as on December 31, 2019 (69% as on March 31, 2019). The liquidity position remains adequate supported by adequate cushion available in the form of its undrawn working capital limits and a healthy free cash and bank balance as on December 31, 2019.

Expansion into overseas markets and receipt of UNICEF approval to help expand its revenue base over the medium term – HNPL is setting up manufacturing facilities in Uzbekistan and Nigeria, with an installed capacity for each of 600 tonne/year, to be operational by FY2020 and FY2021, respectively. It also plans to expand into South Africa by setting up a sales office there by the end of March 2020. Along with the receipt of UNICEF approval for its Tuticorin plant in January 2020, this is expected to improve its order inflows in the near-future and help expand its revenue base.

Credit challenges

Moderate scale of operations, decline in operating revenues and weakening of profitability in 9M FY2020 – At a consolidated level, the company reported revenues of Rs. 148.29 crore, an ~18% decline over Rs. 180.38 crore in 9M FY2019, due to lower order inflows as well as the planned shutdown of its Tuticorin plant for about four months in the current fiscal for modifications relating to UNICEF's approval of the facility. The operating profitability was also lower at 13.23% during 9M FY2020 compared to 15.72% during 9M FY2019 due to lower sales.

Vulnerability of profitability to fluctuations in raw material prices and foreign exchange rates – The primary raw materials for the Group's products are vitamins, the prices of which are highly volatile. Given the fixed price nature of most of the contracts, the Group's profitability remains exposed to adverse fluctuations in raw material prices. Further, the Group derives a sizeable portion of its revenues through exports which exposes its export sales to currency risks. The risk is partly mitigated by way of a natural hedge offered by import purchases. In FY2019, the Group's exports stood at Rs. 145.73 crore as against import purchases of Rs. 63.71 crore. Although the Group partially hedges its net forex exposure by way of forward covers, its profitability remains exposed to exchange rate fluctuations to the extent of unhedged forex exposure.

High working capital intensity of operations – At a consolidated level, the working capital intensity of the Group's operations continues to remain on a higher side, given the high inventory requirements and elongated receivable days, and stood at 25% in FY2019 (32% in FY2018). The Group maintains an inventory of 90-120 days due to high lead time for the import of vitamins and offers 60-120 days of credit to its direct export customers. Debtors outstanding over six months remained moderate at Rs. 4.43 crore in FY2019. Timely recovery of the receivables remains important from a credit perspective.

Strong competition from the established multinational and other unorganised players in the dietary supplements and nutraceutical segments – The global feed and food nutrition ingredient market is dominated by a few multinational companies such as Kerry, DSM, Cargill, FMC and DuPont, among others. Moreover, the market consists of numerous small-sized companies catering to the niche requirements of the end users or these aforementioned conglomerates. The company continues to face strong competition and pricing pressures from such organised as well as unorganised suppliers. Further, the branded dietary segment entails strong competition from established brands such as PediaSure from Abbott Laboratories and HiOwna from Himalaya Herbal Healthcare.

Anticipated rise in debt levels towards overseas expansion; profitability from overseas subsidiaries upon commencement of operations remains to be seen – HNPL plans to invest ~Rs. 11.9 crore, with a breakup as follows: ~$1 million for overseas expansion, Rs. 1.2 crore towards warehouse and Rs. 2.9 crore towards NRPL. The same is planned to be funded by ~Rs. 5.3 crore of bank debt and the rest through internal accruals. This is expected to increase its overall debt levels in the near-term. Further, the profitability from the overseas expansion on commencement of operations remains to be seen.

Cascading impact of coronavirus outbreak on pharma industry with state of emergency declared in key import destinations may lead to severe supply disruptions – China is the major exporter of vitamins, which is the key raw material for the Hexagon Group. HNPL sources ~40% of its raw material requirements from Chinese suppliers. With the recent outbreak of coronavirus in China, and with the state of emergency declared in key import destinations, the impact of any supply disruptions on the operations of the company in the near-to-medium term remains to be seen.

Liquidity position: Adequate

At a consolidated level, the Group had term loans of Rs. 16.31 crore outstanding as on December 31, 2019, against which it has moderate annual repayments of Rs. 2.94 crore in FY2020, Rs. 3.11 crore in FY2021 and Rs. 3.29 crore in FY2022. The Group's fund flow from operations has remained positive over the last five fiscals because of healthy profitability. The liquidity position has remained **adequate** and is supported by moderate average monthly utilisation of fund-based working capital limits of 19% in HNPL, 49% in HNEPL and 30% in HNIPL during the January 2019–December 2019 period. At a consolidated level, the Group had free cash and liquid investments of Rs. 18.94 crore as on December 31, 2019, which supports liquidity.

Rating sensitivities

Positive triggers – Improvement in the financial risk profile supported by significant improvement in scale, ability to ramp up operations in newly established subsidiaries, and sustenance of profitability margins, as well as improvement in working capital intensity will be key for higher rating. Other factors that may lead to upgrade include TD/OPBDITA less than 1.5 times on sustained basis.

Negative triggers – Downward pressure on the ratings could emerge if cash accrual is lower than expected, or if higher-than-anticipated debt-funded capex, or a stretch in the working capital cycle, weakens the liquidity position. Any supply disruption from its dependence on China for raw material procurement leading to weakening of the cash flows may also adversely impact the ratings. Other factors that may lead to downgrade include TD/OPBDITA over 2.0 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Pharmaceutical Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on consolidated financial statements of HNPL, HNEPL, HNIPL and NRPL.

About the company

Hexagon Nutrition Private Limited (HNPL or the company), incorporated in 1993 by Mr. Arun Kelkar and family, is the flagship company of the Mumbai-based Hexagon Group. HNPL has three wholly owned subsidiaries, namely, Hexagon Nutrition (Exports) Private Limited (HNEPL), Hexagon Nutrition (International) Private Limited (HNIPL) and Nutralytica Research Private Limited (NRPL) which are also into similar line of business. The Group manufactures and sells micronutrient premixes for human as well as veterinary consumption, therapeutic food and dietary supplements (branded products). The Group, besides any domestic sales, also exports its vitamin and mineral premixes to more than 70 countries, primarily through its collaboration with WFP[1], GAIN[2], and other international organisations and NGOs. HNPL is one of the 21 companies in the world selected by GAIN under GAIN Premix Facility (GPF) which is aimed at easing the procurement of good quality premixes for the organisations manufacturing food items. The dietary supplements, which are the branded nutraceutical products, are being sold primarily in the domestic market through ethical promotion.

The Group has its manufacturing facilities at Dindori near Nashik (under HNPL, catering to domestic and export markets), Chennai (in MEPZ[3] SEZ, under HNEPL, catering to export markets) and Tuticorin (in Food Processing Zone of Pearl City Food Port SEZ, under HNIPL, catering mainly to export markets), with a total capacity to blend approximately 18,000 tons of premix products per annum. All the manufacturing facilities are ISO 22000:2005, FSSC (Food safety system certification) 22000:2010, GMP Australia and HALAL certified. HNPL also has a food testing laboratory-cum-research centre at Nashik under the name of Nutralytica Research Private Limited.

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[1] *WFP: United Nations' World Food Programme*

[2] *GAIN: Global Alliance for Improved Nutrition, Geneva*

[3] *MEPZ: Madras Electronic Processing Zone*

On a consolidated basis, the Group reported a Profit After Tax (PAT) of Rs. 15.45 crore on an operating income (OI) of Rs. 235.96 crore in FY2019 as compared to a PAT of Rs. 2.88 crore on an OI of Rs. 209.43 crore in FY2018. As per provisional financials, the group has reported a PAT of Rs. 12.66 crore on an OI of Rs. 148.29 crore in 9M FY2020.

Key financial indicators (Consolidated)

	FY2018 (Audited)	FY2019 (Audited)	9M FY2020 (Provisional)
Operating Income (Rs. crore)	209.43	235.96	148.29
PAT (Rs. crore)	2.88	15.45	12.66
OPBDIT/ OI (%)	5.95%	13.11%	13.23%
RoCE (%)	5.64%	18.25%	14.43%
Total Outside Liabilities/Tangible Net Worth (times)	1.22	0.90	0.26
Total Debt/ OPBDIT (times)	3.96	0.98	1.14
Interest Coverage (times)	3.93	7.71	9.34
DSCR	2.14	3.93	NA

Source: HNPL

Status of non-cooperation with previous CRA: None

Any other information: None

Rating history for the past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 years		
		Type	Amount Rated	Amount Outstanding	Rating	FY2019	FY2018	FY2017
					03-Mar-20	27-Mar-19	07-Nov-17	03-Aug-16
1	Term Loan	Long-term	7.00	6.98*	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)
2	Cash Credit	Long-term	10.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)
3	PCFC	Short-term	9.00	-	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A3+
4	LC/BG	Short-term	3.00	-	[ICRA]A2	[ICRA]A2	[ICRA]A2	-

Amount in Rs. crore
** as on December 31, 2019*

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loan	FY2014	8.90%	FY2023	7.00	[ICRA]BBB+ (Stable)
NA	Cash Credit	-	-	-	10.00	[ICRA]BBB+ (Stable)
NA	PCFC	-	-	-	9.00	[ICRA]A2
NA	LC/BG	-	-	-	3.00	[ICRA]A2

Source: HNPL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Hexagon Nutrition Private Limited	-	Full Consolidation
Hexagon Nutrition (Exports) Private Limited	100.00%	Full Consolidation
Hexagon Nutrition (International) Private Limited	100.00%	Full Consolidation
Nutralytica Research Private Limited	100.00%	Full Consolidation

Analyst Contacts

K. Ravichandran
+91 44 4596 4301
ravichandran@icraindia.com

Suprio Banerjee
+91 22 6114 3443
supriob@icraindia.com

Srinivas Menon
+91 22 6169 3354
srinivas.menon@icraindia.com

Harshit Shah
+91 22 6169 3362
harshit.shah@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:

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For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
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Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999