

December 16, 2021

Hikal Limited: Long-term rating upgraded to [ICRA]A+ (Stable); short-term rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based-Term loan	508.10	460.1	[ICRA]A+ (Stable); upgraded from [ICRA]A (Positive)
Fund-based- Working capital	254.00	254.0	[ICRA]A+ (Stable); upgraded from [ICRA]A (Positive)
Long term: Term loan (USD million)*	11.84	9.28	[ICRA]A+ (Stable); upgraded from [ICRA]A (Positive)
Short term-Fund based	212.90	240.5	[ICRA]A1; reaffirmed
Short-term Non-fund based	115.00	115.0	[ICRA]A1; reaffirmed
Total	1090.00 USD 11.84 million	1069.6 USD 9.28 million	

*Instrument details are provided in Annexure-1

*Though a part of the long-term loans of Hikal are denominated in foreign currency, ICRA's ratings for the same are on national rating scale, as distinct from an international rating scale

Rationale

The long-term rating upgrade for Hikal Limited (Hikal) factors in the healthy growth in operating income (OI) and operational efficiencies resulting in improved profitability coupled with healthy pipeline of products and launches geared toward high margin molecules, which are expected to benefit the company over the medium term. The revenue growth and healthy profitability across the pharmaceutical and crop protection verticals have led to an improvement in the financial risk profile in FY2021 and H1 FY2022. ICRA notes that, Hikal is undertaking a significant debt-funded capex of ~Rs. 600-650 crore over a two-year period of FY2022–FY2023 and the same will be funded by mix of internal accruals, customer advances and long-term debt. The above capex is to scale up its pharmaceutical and crop protection business (contract manufacturing and proprietary products). While this will exert pressure on debt protection matrix, ICRA expects the same to remain comfortable. However, achieving the desired levels of scale-up in capacities remains a key sensitivity.

The company recorded revenue growth of 14.1% YoY in FY2021 and 27.8% YoY in H1 FY2022 driven by growth in both segments. The robust growth in OI in H1 FY2022 is partly because of a low base effect in the corresponding period last year given the onset of the pandemic and deferment of orders in the crop protection vertical during H1 FY2021. The OI is expected to grow steadily over FY2022–FY2024 supported by expected increase in offtake for existing molecules and expansion of product portfolio for both its segments supported by increased capacities.

The operating and net margins improved to 18.8% and 7.7%, respectively, in FY2021 from 18.1% and 5.6%, respectively, in FY2020 driven by improved revenue profile, product mix, operating efficiency and cost optimisation measures. ICRA expects the margins to remain under pressure for the pharma business in H2 FY2022, led by higher input prices. Nevertheless, overall margins are expected to remain healthy supported by presence in diversified business segments. Further, the company can pass on higher input prices with some lag effect to its end-customers, which will cushion long-term operating margins.

Hikal faces product concentration risk in its pharmaceutical segment, which is mitigated by its leading position in the Gabapentin active pharmaceutical ingredient (API) and diversified customer profile, since the API is supplied to various global generic companies and the innovator. Also, the elevated working capital intensity is a result of minimum inventory levels required to maintain uninterrupted flow of supplies for the generic portfolio and contract manufacturing. Hikal is also exposed

to adverse movement in foreign currency rates, although it enjoys some natural hedge from its imports and foreign currency debt.

The Stable outlook reflects ICRA's expectation that Hikal will continue to benefit from the established operational track record, new product pipeline in both segments, and favourable growth in the existing products leading to stable accruals and a comfortable financial profile.

Key rating drivers and their description

Credit strengths

Diversified presence in the pharmaceutical and crop protection industries; dominant position in few products such as Gabapentin – The company has a diversified presence in the pharmaceutical and crop protection sectors. The pharmaceutical segment contributes ~60% to the company's revenues, while the remaining is driven by the crop protection segment. This diversification augers well for the revenue and profitability of the company as it offsets any negative impact of industry trends on any particular sector. The company enjoys a strong product profile and entrenched relationships with leading multinational pharmaceutical as well as agro-chemical (crop protection segment) companies in the world. It is the exclusive supplier for various off-patent and on-patent chemicals to innovators. In the pharmaceutical segment, Hikal derives most of its revenues from the sale of Gabapentin API. It continues to maintain its global market leader position, with ~35-40% market share in Gabapentin in FY2021.

Healthy pipeline of generic APIs and favourable growth prospects in pharmaceuticals and crop protection support growth – Hikal has a healthy pipeline of products under development for proprietary and contract manufacturing, which is expected to support its future growth and profitability, especially in the export market. The company, at present, has seven to eight products in the development stages in the pharmaceutical division (generic products and custom development) and four to six products in development stages in the crop protection division (generic products and custom development). Hikal continues to diversify its presence in the pharmaceutical vertical to cater to animal healthcare. In Q1 FY2022, it entered into a 10-year multi-product deal with a global animal healthcare company to develop and manufacture a portfolio of molecules and APIs, which bodes well for overall revenue visibility. Hikal's favourable growth prospects in FY2022-FY2024 are driven by receipt of new inquiries from global customers aiming to diversify their supply chain, expected increase in offtake for existing molecules and expansion of product portfolio for both its segments, supported by increased capacities.

Reputed and diversified client base – The customer base for the pharmaceutical division is diversified with the top three customers driving ~30% of revenues in FY2021 and <35% of revenues in H1 FY2022. The company is a market leader for Gabapentin, which is supplied to various global generic companies as well as the innovator. In the crop protection segment, its top three customers accounted for 50-55% of its revenues in FY2021 and H1 FY2022. The customer concentration risk is mitigated by the established presence and large size of Hikal's customers and its exclusive supply contracts for products with these companies.

Comfortable financial profile and coverage indicators with healthy profitability– Hikal's operating and net margins improved to 18.8% and 7.7%, respectively, in FY2021 from 18.1% and 5.6%, respectively, in FY2020, driven by an improved revenue profile and product mix geared towards higher margin products, operating efficiency and cost optimisation measures. The OPM is expected to moderate slightly in FY2022 from 20.2% OPM in H1 FY2022 because of rising raw material prices. Nevertheless, overall margins are expected to remain healthy supported by Hikal's diversified business segments. ICRA notes the improvement in Hikal's financial profile, which continues to remain comfortable as depicted by net debt/OPBDITA and interest coverage of 1.9 times and 8.9 times, respectively, in FY2021 and net/OPBDITA and interest coverage of 1.6 times and 11.7 times, respectively, in H1 FY2022. During FY2022-FY2023 despite the sizable debt-funded capex, the financial profile is expected to remain comfortable.

Credit challenges

Significant near-term debt-funded capex; achieving desired level of scale-up in capacities remains to be seen – Hikal is undertaking a significant debt-funded capex of ~Rs. 600-650 crore over a two-year period of FY2022-FY2023. The capex will be funded by customer advances for some projects, internal accruals and long-term debt that has been partly sanctioned and drawn down. The planned capex is to scale up its pharmaceutical and crop protection businesses (contract manufacturing and proprietary products). With a gestation period of 12-18 months for the capex, achieving the desired levels of profitability and accruals remains a key sensitivity. The risk is mitigated, to an extent, by the long tenure of debt, ballooning mechanism of repayments, confirmed contract manufacturing orders and proven track record of successful implementation of such projects.

Elevated working capital intensity – Hikal's working capital requirement remains elevated on account of the nature of the end-contracts, specifically in contract manufacturing. The company is bound to maintain a minimum inventory for various raw materials and finished goods as per the contract to maintain uninterrupted flow of supplies. Since it imports ~45% of its raw materials (30-35% of total raw material costs from China), Hikal maintains stock leading to higher inventory days. The working capital intensity (NWC/OI) was recorded at 32.5% in FY2021 led by an increase in receivable period offset by lower inventory levels (75 days) as on March 31, 2021. The receivable period normalised to 85-90 days as on September 30, 2021, while inventory levels also increased slightly. With the ongoing raw material price increases the company is strategically maintaining inventory levels for key raw material to prevent production disruptions. The inventory levels are expected to normalise by March 2022 to 90-100 days.

Profitability vulnerable to adverse movement in foreign exchange rates and raw material prices – Hikal is exposed to adverse movement in foreign currency rates, however since exports contribute to nearly 65-70% of the company's revenues, it enjoys a natural hedge on its imports as well as foreign currency debt and it benefits from the overall rupee depreciation. Its margins remain vulnerable to rising raw material prices for key intermediates and chemicals. The company can pass on raw material costs to customers with a lag of three to six months, which mitigates the pricing risk partly.

Liquidity position: Adequate

Hikal's liquidity is adequate with healthy estimated funds flow from operations of ~Rs. 220-250 crore in FY2022. The liquidity was supported by healthy accruals, free cash and cash equivalents of Rs. 28.4 crore and unutilised fund-based limits of Rs. 202.9 crore as on September 30, 2021. The company has annual repayments of ~Rs. 90-100 crore in FY2022. Cash accrual generation is expected to be more than sufficient to meet the debt servicing obligations over the medium term and the debt service reserve account (DSRA) of Rs. 19.8 crore as on September 30, 2021 also provides some cushion. It has a capex commitment of Rs. 600-650 crore over a two-year period (FY2022-FY2023) to be financed by internal accruals, customer advances and long-term debt, which has been partially sanctioned and also drawn down. Hikal is also in discussion with other bankers and financial institutions to sanction additional debt for funding the proposed capex in FY2022-FY2023.

Rating sensitivities

Positive factors – ICRA could upgrade Hikal's rating if it continues to demonstrate further diversification in its pharmaceutical and crop protection divisions, continued improvement in revenue growth and sustained margin performance at current levels. Specific credit metrics that could lead to an upgrade of Hikal's rating is Total Debt/ OPBITDA below 1.5 times on a sustained basis.

Negative factors – Negative pressure on Hikal's rating could arise if its working capital intensity deteriorates or the debt-funded capacity expansion fails to generate the desired level of accruals, thus weakening the cash flows. Moreover, Total Debt/OPBITDA exceeding 2.25 times, on a sustained basis, may trigger a rating downgrade. Inability to maintain a healthy liquidity buffer may also impact the ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Pharmaceutical Industry Rating Methodology for Entities in the Agrochemicals Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of Hikal Limited. As on September 30, 2021, the company had two subsidiaries, which are listed in Annexure-2.

About the company

Hikal was incorporated on July 8, 1988 as the private limited company, Hikal Chemicals Industries Private Limited, by the Hiremath family and Surajmukhi Investments & Finance Limited, a wholly-owned subsidiary of Kalyani Steels Limited. The company was listed in 1995; and subsequently, in 2000, it was renamed as Hikal Limited.

The company has a commercial production facility at Mahad (Maharashtra) for intermediates used in dyes, pharmaceuticals and agrochemicals. The plant at Taloja (Maharashtra) which manufactures crop protection chemicals is the only fully integrated plant in the world to produce Thiabendazole. The facility at Panoli (Gujarat) produces key intermediates and regulatory starting materials for the pharmaceutical industry and is USFDA, PMDA (Japan) and EUGMP certified. The Bangalore facility manufactures key APIs for the pharmaceutical industry and has been approved by the USFDA, PMDA (Japan) and EU Authorities. The company has a research and development center in Pune (Maharashtra), which provides end-to-end services from APIs and AIs, custom synthesis, analytical development and scale up from development to commercial manufacturing.

Key financial indicators (audited)

Hikal Consolidated	FY2020 (Audited)	FY2021 (Audited)	H1 FY2022 (Limited Audit)
Operating Income (Rs. crore)	1507.3	1720.4	925.8
PAT (Rs. crore)	84.4	133.1	94.6
OPBDIT/OI (%)	18.13%	18.77%	20.16%
PAT/OI (%)	5.60%	7.74%	10.22%
Total Outside Liabilities/Tangible Net Worth (times)	1.2	1.0	1.0
Total Debt/OPBDIT (times)	2.4	1.9	1.7
Interest Coverage (times)	5.2	8.9	11.7

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

Note: Amount in Rs. crore; All calculations are as per ICRA Research

Source: Company, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years				
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)*	Date & Rating in Dec 16, 2021	Date & Rating in FY2021		Date & Rating in FY2020		Date & Rating in FY2019
					Mar 05, 2021	Dec 21, 2020	Oct 18, 2019	Sept 27, 2019	
1 Term loan	Long Term	460.1	460.1	[ICRA]A+ (Stable)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
2 Working capital facility	Long Term	254.00	-	[ICRA]A+ (Stable)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
3 Term loan USD million	Long Term	9.28	9.28	[ICRA]A+ (Stable)	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)
4 Working capital facility	Short Term	240.5	-	[ICRA] A1	[ICRA] A1	[ICRA] A1	[ICRA] A1	[ICRA] A1	[ICRA] A1
5 Non- fund based facility	Short Term	115.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1

*Outstanding as on September 30, 2021

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based-Term loan	Simple
Fund-based- Working capital	Simple
Long term: Term loan (USD million)*	Simple
Short term-Fund based	Simple
Short-term Non-fund based	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 analyzing 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, is available on ICRA's 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 1	28-Sep-15	NA	31-Mar-23	12.00	[ICRA]A+ (Stable)
NA	Term loan 2	31- Dec-2015	NA	31-Mar-23	22.50	[ICRA]A+ (Stable)
NA	Term loan 3	15-Feb-2016	NA	31-Mar-23	9.0	[ICRA]A+ (Stable)
NA	Term loan 4	26-Feb-2016	NA	31-Mar-23	3.0	[ICRA]A+ (Stable)
NA	Term loan 5	24-Sep-15	NA	31-Mar-23	19.50	[ICRA]A+ (Stable)
NA	Term loan 6	26-Feb-2016	NA	31-Mar-23	6.00	[ICRA]A+ (Stable)
NA	Term loan 7	03 Mar-2016	NA	31-Mar-23	6.00	[ICRA]A+ (Stable)
NA	Term loan 8	5-Sep-2018	NA	05-Jun-26	65.40	[ICRA]A+ (Stable)
NA	Term loan 9	6-Feb-2019	NA	02-Jun-2027	66.70	[ICRA]A+ (Stable)
NA	Term loan 10	15-Sept-2020	NA	01-Jun-2028	250.0	[ICRA]A+ (Stable)
NA	Term loan 11	10-Dec-2015	NA	11-Dec-2023	USD 9.28 million	[ICRA]A+ (Stable)
NA	Working capital limits	NA	NA	NA	254.00	[ICRA]A+ (Stable)
NA	Fund-based facilities	NA	NA	NA	240.5	[ICRA] A1
NA	Non-fund based	NA	NA	NA	115.00	[ICRA] A1

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Acoris Research Limited	100.00%	Full Consolidation
Hikal LLC, USA	100.00%	Full Consolidation

Source: Hikal Q2 FY2022 Result Update

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About ICRA Limited:

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