August 22, 2023

Natural Capsules Limited: Ratings reaffirmed; assigned for enhanced amount

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based – Term Loan	-	25.50	[ICRA]BBB (Stable); assigned
Long-term – Fund-based – Cash Credit	6.50	20.00	[ICRA]BBB (Stable); reaffirmed/assigned
Short-term – Non-fund Based	1.29	2.80	[ICRA] A3+; reaffirmed/assigned
Long-term/ Short-term Unallocated	4.70	1.70	[ICRA]BBB (Stable)/ [ICRA]A3+; reaffirmed
Total	**12.49**	**50.00**	

**Instrument details are provided in Annexure-I*

Rationale

To arrive at the ratings, ICRA factors in the consolidated financials of Natural Capsules Limited (NCL) and its key subsidiaries, including Natural Biogenex Private Limited (NBPL). The reaffirmation of ratings reflects ICRA's expectation that NCL's foray into Hydroxypropyl methylcellulose (HPMC) capsules and steroid Active Pharmaceutical Ingredients (API) production will lend diversity to its operating profile in the medium term. The company has been able to mobilise substantial funding for its capex plans, which include rights issue, private equity (PE) fund as well as institutional investors and lenders. The rating continues to consider NCL's established presence in the Empty Hard Gelatin Capsule (EHGC) manufacturing industry, its promoters' extensive experience in the industry and its diversified client profile as well as strong relationships with pharmaceutical majors. However, the same is exposed to the risk of timely commencement and utilisation of capacity, based on market demand.

The ratings are, however, constrained by the ongoing capex for the API manufacturing facility, which is expected to moderate NCL's return and debt coverage indicators in the near term. ICRA notes that the API project faced time and cost overruns and is yet to commence operations. The timely project completion and ramp up of operations will be key rating monitorables. ICRA also notes that NBPL has been shortlisted under the Performance Linked Incentive (PLI) scheme for its proposed API production. Apart from having moderately high working capital intensity, the company is also exposed to raw material fluctuations as was witnessed during Q1 FY2024. The ratings also continue to consider NCL's exposure to high competition, particularly its gelatin capsules segment, which restricts its pricing flexibility to some extent.

The Stable outlook on the long-term rating reflects ICRA's opinion that NCL will continue to benefit from its increased capacities, particularly in HPMCs as well as its growing business diversity with the API plant.

Key rating drivers and their description

Credit strengths

Extensive experience in EHGC industry – The promoters have extensive experience in the capsule business, while NCL has an established market position with a large product portfolio in the EHGC segment. The company has an installed production capacity of 18 billion capsules per annum (as of March 2023), which is primarily for gelatin capsules. Further, the company is expanding its capabilities in HPMCs, which will enable it to improve its presence as a capsule manufacturer.

Diversified customer profile – NCL caters to a large number of reputed customers in the domestic as well as export markets. The customer concentration stood low with its top five customers accounting for 10% of its domestic revenues in FY2023 over

26% in FY2022. NCL has been able to strengthen its relationships with existing customers as well as diversify its customer base with its product range in the gelatin capsule segment. In FY2023, the company witnessed healthy growth in exports resulting in 28% YoY revenue growth. NCL's key export markets include Africa, West Asia and South America.

Foray into HPMC and steroidal APIs to lend revenue diversity and support growth prospects –The company is in the process of adding new capacities for HPMCs, which will support its revenue growth and margin profile as these capsules have higher realisation and margins over gelatin capsules. Further, the subsidiary NBPL's greenfield API facility is in the process of receiving drug approvals and expected to commence production from Q3 FY2024. The ramp-up of the facility will support revenues and cash accruals in the long term.

Sizeable funding mobilised through rights issue and PE infusion to fund capex – The greenfield API facility, which was expected to commence operations from April 2023, witnessed delays primarily due to heavy rains at the project site and delay in delivery of equipment. In addition, with inclusion of certain manufacturing/R&D areas, their related machinery and pre-operative costs, the total capex overlay increased to ~ Rs. 160 crore from the estimated Rs. 95–100 crore. However, NCL secured funding in NBPL for the whole capex outlay with Rs. 75 crore from the PE fund, Somerset Indus Healthcare, Rs. 25 crore from HNI investors, and Rs. 48 crore of term loans. NCL also raised around Rs. 22 crore through rights issue in FY2023 and infused Rs. 20 crore in NBPL. In addition, the company received working capital sanction at the subsidiary level and enhancements at the parent level. Thus, NCL's consolidated cash accruals and recent funds are adequate to address its ongoing capex and working capital requirements.

Credit challenges

Project risks associated with greenfield facility; ability to ramp-up API production is yet to be seen – The API facility is expected to commence operations from Q3 FY2024, delayed from April 2024 as per expectations, in a pilot phase wherein NBPL will manufacture APIs in small batches, with large-scale production expected from FY2025. The company is in the process of completing drug inspections after which it will receive the license to sell APIs in the domestic market. Thus, the timeliness of drug approval is critical for the ramp-up of the facility. Also, API manufacturing is a complex process, and the company does not have significant experience in commercial API manufacturing. Thus, its ability to ramp up API production in a timely and profitable manner is yet to be seen.

Return and coverage indicators to moderate in near term owing to sizeable debt-funded capex – NCL witnessed a revenue growth of 28% in FY2023 and its consolidated operating margins also improved to 20% in FY2023 owing to efficiency improvement resulting from machinery upgradation leading an improvement in its cash accruals. The subsidiary is expected to generate cash losses in FY2024, which would reduce going forward. Thus, the consolidated margins are expected to moderate and improve gradually thereafter with ramp-up of high margin HPMC capacities and the API plant. NCL's return metrics will remain under pressure owing to ongoing capex and gradual returns ramp up. Similarly, while the company's debt levels have risen, capital structure has been supported by equity infusion. NCL's coverage indicators such as DSCR is expected to witness moderation in FY2024 and will start improving from FY2025, the extent of which will remain dependent on NCL's ability to generate adequate returns.

Exposure to raw material price volatility risks; high competition, particularly in EHGC segment – NCL faces intense competition for gelatin capsules in the international markets, mainly from Chinese players, which restricts its pricing flexibility. In the domestic market as well, it faces competition from other established players. Owing to this stiff competition, NCL's ability to pass on the increase in raw material prices to its customers is limited. Currently, NCL imports around 15-20% of its raw material (gelatin) and usually passes any increase in prices partially. In Q1 FY2024, the margins declined to 16% owing to increased gelatin costs as NCL's key raw material suppliers faced production issues that were subsequently resolved. With HPMC capacity addition, the raw material imports are expected to increase as that for HPMC capsules is not currently available. Also, the subsidiary will face import dependence for key materials, which keep it exposed to price volatility.

Liquidity position: Adequate

NCL's liquidity position is adequate as supported by enhancement in working capital limits in NCL as well as fresh sanction of working capital limits in NBPL apart from operational cash flows of Rs. 25-30 crore. Although, the average working capital utilisation stood high for the last 12-month period ending July 2023, the enhancement will provide liquidity buffer. There will be moderate capex of Rs. 8-10 crore in NCL for HPMC capacity addition funded by internal accruals. Also, all the funding required for the remaining capex of Rs. 60-65 crore for the API project has been secured. The company has consolidated debt repayments of Rs. 5.2 crore and Rs. 9.1 crore in FY2024 and FY2025, respectively, which would be primarily supported by NCL's operational cash flows.

Rating sensitivities

Positive factors – ICRA could upgrade NCL's ratings if it is able to increase its scale of operations and profitability on a sustained basis through optimal utilisation of its capacity for capsules and timely commencement of operations of its API facility, while maintaining a comfortable liquidity position.

Negative factors – Negative pressure on the ratings could arise if there are material delays in commencement of new capacities for HPMCs and/or the new API facility leading to weakening of the liquidity position and/or credit metrics on a sustained basis. Specific credit metric that could exert negative pressure on the ratings could be DSCR of less than 1.6 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	For arriving at the ratings, ICRA has consolidated the financials of Natural Capsules Limited, along with that of its subsidiaries, Natural Biogenex Private Limited and Natural Phyto Pharma Private Limited.

About the company

NCL, headquartered in Bangalore, is among the leading manufacturers of EHGC shells in India. The company has two manufacturing units with a cumulative production capacity of 18.0 billion capsules per annum (BCPA). As per the company's FY2023 annual report, it is the second-largest manufacturer of gelatin capsules in India. Although the domestic market drives most of its business, NCL caters across multiple geographies like Europe, Africa, West Asia and SAARC regions. NCL manufactures about 10 different types of EHGC shells. The company is also installing three new manufacturing lines for HPMC capsules with a cumulative capacity of ~2.7 BCPA, expected to commence production from FY2024.

In August 2020, the company established Natural Biogenex Private Limited to set up an API manufacturing facility for steroids under the Government of India's PLI scheme. The API plant will focus on manufacturing three steroidal APIs—Betamethasone, Dexamethasone and Prednisolone—along with their associated intermediaries and derivative products. The API plant is expected to commence operations from Q3 FY2024.

Key financial indicators (audited)

Consolidated	FY2022	FY2023
Operating income	135.1	172.4
PAT	13.9	18.4
OPBDIT/OI	18.7%	19.9%
PAT/OI	10.3%	10.7%
Total outside liabilities/Tangible net worth (times)	1.0	0.9
Total debt/OPBDIT (times)	2.1	2.8
Interest coverage (times)	12.1	9.2

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)					Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of (Rs. crore)	Date & rating in FY2024		Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Aug 22, 2023	May 01, 2023	Jul 04, 2022	Apr 09, 2021	-
1	**Fund Based- Term Loan**	Long term	25.50	25.50	**[ICRA]BBB (Stable)**	-	-	-	-
2	**Fund-based – Cash Credit**	Long term	20.00	-	**[ICRA]BBB (Stable)**	**[ICRA]BBB (Stable)**	**[ICRA]BBB (Stable)**	**[ICRA]BBB (Stable)**	-
3	**Non-fund based – Working capital facilities**	short term	2.80	-	**[ICRA]A3+**	**[ICRA]A3+**	**[ICRA]A3+**	**[ICRA]A3+**	-
4	**Unallocated Limits**	Long term and short term	1.70	-	**[ICRA]BBB (Stable)/ [ICRA]A3+**	**[ICRA]BBB (Stable)/ [ICRA]A3+**	**[ICRA]BBB (Stable)/ [ICRA]A3+**	**[ICRA]BBB (Stable)/ [ICRA]A3+**	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term-Fund Based-Term Loan	Simple
Long Term - Fund Based – Cash Credit	Simple
Short Term – Non-Fund Based	Very Simple
Long-term/short-term Unallocated	Not applicable

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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Fund Based-Term Loan**	2021	9.0-9.5%	2029	25.50	[ICRA]BBB (Stable)
NA	**Fund Based – Cash Credit**	NA	9.0-9.5%	NA	20.00	[ICRA]BBB (Stable)
NA	**Non-Fund Based**	NA	NA	NA	2.80	[ICRA]A3+
NA	**Unallocated**	NA	NA	NA	1.70	[ICRA]BBB (Stable)/ [ICRA]A3+

Source: Company

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

Annexure II: List of entities considered for consolidated analysis

Company Name	NCL's Ownership	Consolidation Approach
Natural Biogenex Private Limited (NBPL)	75.00%	Full Consolidation
Natural Phyto Pharma Private Limited	100.00%	Full Consolidation

Source: Company
Note: ICRA has taken a consolidated view of the parent (NCL), its subsidiaries and associates while assigning the ratings.

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About ICRA Limited:

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