September 18, 2023

Meril Healthcare Private Limited: Ratings assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long term - Fund Based – Term loan	44.50	[ICRA]AA (Stable); Assigned
Short term - Fund Based	106.00	[ICRA]A1+; Assigned
Short term - Non-Fund Based	150.50	[ICRA]A1+; Assigned
Short Term - Fund Based/Non Fund Based	108.50	[ICRA]A1+; Assigned
Total	**409.50**	

**Instrument details are provided in Annexure I*

Rationale

ICRA has taken a consolidated view of Micro Life Sciences Private Limited (Micro) and its subsidiaries Meril Life Sciences Private Limited (MLSPL), Meril Healthcare Private Limited (MHPL), Meril Life Sciences India Private Limited (MLSIPL), Meril Endo Surgery Private Limited (MEPL) and Meril Diagnostics Private Limited (MDPL) while assigning the ratings, given the common management and significant financial linkages between the entities. These entities are considered to share a common credit profile because these subsidiaries are an extended arm of the parent with separate legal existence only because of operational reasons.

The rating reaffirmation factors in Micro Life Sciences Private Limited's (Micro) established market position in the medical devices industry (mainly in the cardiovascular and orthopaedic implant segments), and its diversified product portfolio. The company's brand presence is also aided by product approvals from the US Food and Drug Administration (USFDA) and the European regulatory authority. The ratings also consider the extensive experience of the promoters, Bilakhia Group, in the industry. The promoter group has supported the company in the past, and is expected to continue its support, in case of any further requirements.

The company witnessed strong revenue growth of 41.3% during FY2023 supported by increasing penetration across both domestic and export markets, which resulted in strong volume growth for its products. The favourable demand scenario amid increased health awareness following Covid-19 also augured well for the company. The operating margin of the company remained stable at 20.8% during FY2023 over 20.5% during FY2022. The company is expected to continue its strong revenue growth momentum during FY2024 supported by healthy demand for its products coupled with its increasing footprint in export markets in addition to expansion of its product portfolio. Despite incremental investments in R&D, the company is expected to witness healthy operating margins on the back of better operating leverage. During FY2023, the company received significant equity infusion of Rs. 1,427.5 crore and investment of Rs. 472.5 crore in the form of compulsory convertible preference shares (CCPS), from a group of private equity (PE) investors (Warburg Pincus LLC, Anchorage Capital Partners, and Volrado Venture Partners). The company's debt metrics substantially improved in FY2023 backed by debt reduction from the aforementioned equity proceeds. The company had free cash and liquid investments of Rs. 804.4 crore as on March 31, 2023. Further, over the longer term, increasing incidence of lifestyle diseases, increased health awareness and improving affordability are expected to support the company's business prospects.

The ratings, however, remain constrained by the high working capital-intensive nature of operations (45.2% during FY2023) due to the high inventory and debtor cycles. Further, exposure of the company to regulatory risks inherent to the healthcare industry, coupled with the ongoing patent infringement litigation against Meril Life Sciences Private Limited (MLSPL), a wholly-owned subsidiary of Micro (which handles the cardiovascular segment), constrains the ratings. ICRA notes that till FY2023, the company has incurred significant legal expenses of ~Rs. 280 crore towards this litigation. Any adverse outcome of the litigation, which could impact the company's future business prospects and credit profile, remains a key monitorable. Further, to support business expansion, the company had incurred ~Rs. 300 crore capital expenditure (capex) in FY2023 and is expected to incur

~Rs. 400-450 crore capex in FY2024.The company had funded its capex in FY2023 largely through internal accruals and minimal term loans. Its capex in FY2024 is expected to be funded largely through incremental term loans, which will be drawn down in FY2024. While this is expected to result in increased leverage levels, the overall debt and coverage metrics are expected to remain healthy, supported by its strong accruals. The ratings also consider the moderate scale of operations and low profitability of the diagnostic and endo-surgery businesses, and the stiff competition from other established players in the industry. The company derives more than 50% of its consolidated revenues from the export markets. As the company is expected to focus more on the export markets over the near term, any adverse fluctuations in foreign currency will have an impact on the profitability of the company.

During FY2023, the company incorporated a new subsidiary, Meril Medical Innovations Private Limited (MMIPL) to carry out various backward integration activities for Group companies, and MMIPL is also expected to house manufacturing capacities for peripheral and neurovascular segments. Additionally, the company increased its stake in one of the JVs from 45% to 51%, making it a subsidiary of the company. Any further increase in stake joint ventures/associates or other entities, impacting the Group’s credit metrics or liquidity position, shall remain an event risk and would be evaluated on a case-by-case basis.

The Stable outlook on the long-term rating reflects ICRA’s expectation that the company will continue to benefit from its established presence in the medical devices industry, coupled with its strong financial profile characterised by healthy revenue growth and operating margins, and strong liquidity position.

Key rating drivers and their description

Credit strengths

Established presence in the medical products and devices industry with diversified product portfolio – Micro operates in four major business segments in the medical device industry through its wholly-owned subsidiaries. At a consolidated level, the vascular intervention segment (which includes stents, heart valves and balloon catheter) contributes ~40-45% of the company’s revenues, followed by the orthopaedic segment (~35-40%) and the diagnostics and endo-surgery segments (~15-25%). In addition, Micro also commenced trading in surgical robots from FY2021. ICRA notes that the company has designed and manufactured India’s first indigenous heart valve—Myval. The product is approved by the Drug Controller General of India (DCGI) and CE-certified. At present, Micro sells this product in various European markets apart from the domestic market, where it commands a strong brand position. Export contribution from Myval increased significantly during FY2023 and the company expects this to increase further on account of the higher market size for Myval in export markets. Further, many of its knee implants are also CE-certified and USFDA approved, which has supported the market penetration in the recent past. Meril Diagnostics Private Limited (MDPL), a subsidiary of Micro, is a registered vendor with the World Health Organization (WHO) for providing various diagnostic kits. The established brand position of the company is expected to support healthy revenue growth and margins, over the medium term. The company’s products (mainly cardio and orthopaedic) are sold in over 100 countries (exports contributed ~58% of the company’s revenues in FY2023). Going forward, the company expects the share from export sales to increase with increasing focus on capturing potential opportunities in such markets.

Experienced and strong promoter group – Bilakhia Holdings Private Limited (BHPL) is the holding company of the Bilakhia Group, which entered the healthcare sector in 2006. The promoter group had infused funds into Micro in the past, by way of non-convertible preference shares and unsecured loans for supporting its operational/debt servicing requirements, which were completely repaid in FY2023, following PE investments. ICRA expects similar support from the promoter group in case of any need for the same. At present, BHPL owns 89.06% stake in Micro (on a fully diluted basis, post-CCPS conversion of PE investors and promoter group stake will be either 84.50% or 85.95%, depending on the outcome of the trigger event for CCPS). Going forward, the extensive experience of the promoters and the management team will continue to support Micro’s operations.

Strong financial profile characterised by strong revenue growth, healthy margins and robust debt metrics – The company witnessed strong revenue growth of 41.3% during FY2023 supported by increasing penetration across both domestic and export markets, which resulted in strong volume growth for its products. Although its scale of operations improved during

FY2023, the operating margin remained stable at 20.8% during FY2023 over 20.5% during FY2022, mainly due to higher R&D expenses toward product development and various backward integration processes. The company is expected to continue its strong revenue growth momentum during FY2024 supported by healthy demand for its products and increasing footprint in export markets. Despite incremental investments in R&D, improving operating leverage and backward integration are expected to result in stable operating margins. The company also received substantial investments of Rs. 1,900 crore from PE investors in FY2023, which led to a sharp improvement in its debt metrics. Of the total investments, ~Rs. 950 crore was utilised to repay promoter debt (preference shares and unsecured loans) while the balance is being held in the form of bank fixed deposits. The same is expected to be utilised as growth capital for expansion requirements (including clinical trials for product development and launches). Although the company has planned for debt-funded capex, the debt metrics are expected to remain healthy, backed by healthy accruals and strong liquidity over the near term.

Healthy long-term industry outlook – The company operates in an industry that is generally considered to be resistant to inflation and primarily consists of non-discretionary products. The demand for healthcare products and devices is expected to remain high due to increasing lifestyle diseases. Further, increased health awareness and improving affordability of treatments are expected to drive industry growth. In the domestic market, the increasing penetration of health insurance will support the industry. Further, export markets also present a sizeable growth opportunity for the company and the broader industry.

Credit challenges

High working capital intensity of operations – Micro's net working capital (NWC) intensity (NWC/operating income) remained high at 39.1% in FY2022 and 45.2% in FY2023, primarily owing to high inventory stocking requirements and moderately high receivable days. In FY2023, the company increased its inventory of key raw materials as a precautionary measure to mitigate the supply chain challenges caused by certain suppliers' inability to meet the increasing demand. Also, as the company operates in multiple segments of medical devices, and has a wide range of products, Micro needs to maintain multiple stock keeping units (SKUs) to meet customer requirements. This led to high inventory holding of 204 days and 217 days as of March 31, 2022, and March 31, 2023, respectively. Further, the company's debtor days remained high at 107 and 103 as of March 31, 2022, and March 31, 2023, respectively, thereby increasing the working capital cycle. Going forward, the working capital intensity is expected to remain high, in view of the higher inventory requirements and moderately high debtor cycle, to support growth.

Exposure to regulatory risks – Akin to other industry players, Micro is exposed to regulatory risks pertaining to pricing restrictions, medical liabilities due to faulty products, approval timelines for new product developments and various compliance norms. The pricing for stents and knee implants is capped by the National Pharmaceutical Pricing Authority (NPPA) in the domestic market. Last notification from the NPPA for orthopaedic knee implants was issued on September 10, 2021, which was applicable till September 15, 2022. The same was further extended for one year by the NPPA. The inclusion of products on the NPPA list reduces the company's pricing flexibility and any future inclusion of key products on the list will likely affect the company's profitability. Further, any medical liabilities from patients/hospitals, due to faulty implants could impact Micro's accruals. However, Micro has a product liability insurance cover in place, which mitigates such liability to a certain extent.

Ongoing patent infringement litigation – MLSPL, a wholly-owned subsidiary of Micro, is involved in a patent infringement lawsuit filed by one of its competitors in the US and certain European countries for the heart valve (MyVal). The dispute began in April 2019 when the competitor accused MLSPL of infringing on trademark and multiple patents; however, the company has claimed that it is not in violation of any patents and is contesting the lawsuit. The company has incurred significant legal expenses amounting to ~Rs. 280 crore till FY2023 towards this litigation and expects to incur legal cost of ~Rs 60 crore per annum over the near term. In August 2023, in the Netherlands, the ruling was in the company's favour; and as per the court ruling, the company is expected to receive reimbursement for the legal expenses incurred in the Netherlands. The outcome of the ongoing litigations in other geographies remains a key monitorable, as any adverse outcome could lead to revenue loss of MyVal, thereby impacting the company's profitability. Further, any significant settlement claims could impact the liquidity position of the company.

Sizeable capex plans; some businesses are still in early stages of operations – The company had incurred ~Rs. 300 crore capex in FY2023 and is expected to incur ~Rs. 400-450 crore capex in FY2024, to support its business expansion. While the company had funded its capex in FY2023, largely through internal accruals and minimal term loans, capex in FY2024 is expected to be funded largely through incremental term loans, which will be drawn down in FY2024. While ICRA does not expect significant impact of the same on Micro's debt protection metrics due to expected healthy accruals and strong liquidity position of the company, timely commencement and ramp-up of operations for the expanded capacity and the impact of the same on the credit metrics remain key monitorables. Further, in terms of revenues and profitability, Micro's diagnostic (MDPL) and endo-surgery (Meril Endo-Surgery Private Limited, or MEPL) businesses are in their early stages of operations, incurring operating/net losses (endo surgery is incurring PAT losses and diagnostic business is yet to breakeven at the operating level). While the diagnostic business had improved substantially in FY2021 and FY2022, backed by Covid-19 tests, operating losses were incurred in FY2023 due to reduction in scale. The company has deployed its salesforce to build its brand position, which is expected to support the ramp-up in revenues from these businesses in the near-term; however, the turnaround of operations in these segments remains monitorable.

Stiff competition in the industry – The company is exposed to stiff competition from other domestic as well as established international players in the medical devices industry. Further pricing pressures, if any, could impact the profitability. However, ICRA notes that the company has been able to establish a healthy market position, demonstrated by its strong growth and expansion in operating profit margins over the years.

Susceptibility of profit margin to forex fluctuations in industry – Micro's margins remain vulnerable to adverse forex movements as it derives more than 50% of its revenues from exports (~58% during FY2023). However, the risk is partially mitigated by a natural hedge through imports.

Liquidity position: Strong

The company's consolidated liquidity position was characterised by free cash and liquid investments of Rs. 804.4 crore as of March 31, 2023. Further, the company had undrawn available working capital limits of ~Rs. 313.0 crore as on July 31, 2023. Average working capital utilisation remained at ~72% for the 12-month period ending July 2023. Micro's capex plans are high at ~Rs. 400-450 crore in FY2024, which is expected to be funded predominantly through incremental term loans, to be drawn down in FY2024. The company's long-term repayment obligations are moderately low in the near term at Rs. 30.2 crore, Rs. 20.6 crore and Rs. 92.2 crore during FY2024, FY2025 and FY2026, respectively, on the existing and proposed term debt. Going forward, ICRA expects the liquidity position to remain strong, backed by anticipated healthy accruals from its business operations.

Rating sensitivities

Positive factors – The ratings can be upgraded, if there is any significant improvement in the company's scale of operations, aided by strengthened market position in addressable segments along with greater business diversity. In addition, the company's ability to generate healthy profitability indicators, while improving working capital intensity and maintaining strong credit metrics, will also be critical.

Negative factors – Pressure on the ratings could arise with contraction in profit margins and/or deterioration in working capital intensity, which could impact the company's credit profile, liquidity position or debt metrics. Any material adverse impact of the alleged patent infringement litigation will also trigger a rating downgrade. A specific metric for a downgrade could be Net Debt/OPBDITA becoming greater than 1.0 time, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	NA
Consolidation/Standalone	For arriving at the ratings, ICRA has taken the consolidated financial statements of Micro, which includes its subsidiaries and associate companies (see Annexure II for complete list), while assigning the credit ratings, given the common management and significant operational and financial linkages among them.

About the company

MHPL, incorporated in April 2011, is a wholly owned subsidiary of Micro Life Sciences Private Limited (rated [ICRA]AA (stable)/A1+) and is involved in the manufacturing of various types of knee implants, hip implants, and trauma implants. The knee and hip replacement products and trauma implants of MHPL are also CE-marked and USFDA-approved. Through its foreign subsidiary, Maxx Orthopaedics, INC (Maxx), US, the Micro is also engaged in the processing and selling of knee and hip replacement joints under the brand 'Freedom Total Knee System' (approved by USFDA), which is also imported and sold in India.

About the parent

Micro is the holding company for the healthcare segment of the Bilakhia Group. It is a subsidiary of BHPL, the ultimate holding company of the Group. At present, BHPL owns 89.06% stake in Micro. The company received PE investment of Rs. 1,900 crore in H1 FY2023, of which Rs. 1,427.5 crore was equity infusion and Rs. 472.5 crore was in the form of CCPS. The CCPS is expected to be converted into equity at a predetermined conversion ratio, depending on a mutually agreed milestone achievement. On a fully diluted basis (considering CCPS conversion, post-milestone achievement), BHPL will either hold 84.50% or 85.95% in Micro, depending on the outcome of the trigger event for CCPS. There are no terms attached to the PE investment, viz., repayment, exit terms, buy back, or guaranteed returns.

Through its wholly-owned, domestic subsidiaries, Micro is involved in the design and development of medical products and devices. The company caters to segments like cardiovascular, orthopaedic, diagnostic and endo-surgery. It has marketing offices in various countries—viz., Germany, Türkiye, the US, Russia, South Africa, Brazil, Bangladesh, Australia, China, and the UK—which are handled by its foreign subsidiaries.

Key financial indicators

Micro Consolidated	FY2022	FY2023
Operating income (Rs. crore)	1669.6	2358.6
PAT (Rs. crore)	151.7	494.1
OPBDITA/OI (%)	20.5%	20.8%
PAT/OI (%)	9.1%	21.0%
Total outside liabilities/Tangible net worth (times)	21.9	0.6
Total debt/OPBDITA (times)	3.2	1.8
Net debt/OPBDITA (times)	3.0	0.1
Interest coverage (times)	4.5	9.9

PAT: Profit after Tax; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation; All amounts as per ICRA calculations

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 Mar 31, 2023 (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					Sep 18, 2023	-	-	-
1	**Long term - Fund Based – Term loan**	Long-term	44.50	13.8	**[ICRA]AA (Stable)**	-	-	-
2	**Short term - Fund Based**	Short-term	106.00	NA	**[ICRA]A1+**	-	-	-
3	**Short term - Non-Fund Based**	Short-term	150.50	NA	**[ICRA]A1+**	-	-	-
4	**Short Term - Fund Based/Non Fund Based**	Short-term	108.50	NA	**[ICRA]A1+**	-	-	-

Amount in Rs. Crore

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long term - Fund Based – Term loan	Simple
Short term - Fund Based	Simple
Short term - Non-Fund Based	Very Simple
Short Term - Fund Based/Non Fund Based	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: Click Here

Annexure I: Instrument details

ISIN No	Instrument Name	Date of Issuance	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long term - Fund Based – Term loan	FY2024	NA	FY2030	44.50	[ICRA]AA (Stable)
NA	Short term - Fund Based	NA	NA	NA	106.00	[ICRA]A1+
NA	Short term - Non-Fund Based	NA	NA	NA	150.50	[ICRA]A1+
NA	Short Term - Fund Based/Non Fund Based	NA	NA	NA	108.50	[ICRA]A1+

Source: Company; Note: Amounts in Rs. crore

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

Annexure II: List of entities considered for consolidated analysis

Company Name	Micro Ownership	Consolidation Approach
Meril Life Sciences Private Limited	100%	Full Consolidation
Meril Life Sciences India Private Limited	100%	Full Consolidation
Meril Diagnostics Private Limited	100%	Full Consolidation
Meril Healthcare Private Limited	100%	Full Consolidation
Meril Endo Surgery Private Limited	100%	Full Consolidation
Meril Medical Innovations Private Limited	100%	Full Consolidation
Meril GmbH, Germany	100%	Full Consolidation
Doc Med Comercio Importacao Exportacao LTDA, Brazil	99.99%	Full Consolidation
Meril Tibbi Cihazlar Imalat Ve Ticaret Anonim Sirketi, Turkey	100%	Full Consolidation
Meril INC, USA	100%	Full Consolidation
Meril Medical LLC, Russia	100%	Full Consolidation
Meril Bangladesh Pvt Ltd	99.99%	Full Consolidation
Meril SA Pty Ltd, South Africa	100%	Full Consolidation
Meril Australia Pty Ltd., Australia	100%	Full Consolidation
Meril Cardiology Pty Ltd., South Africa	100%	Full Consolidation
Meril (China) Co. Limited, China	100%	Full Consolidation
Meril UK Limited	100%	Full Consolidation
Meril Malaysia Sdn. Bhd.	100%	Full Consolidation
Meril South Korea Limited	100%	Full Consolidation
Meril (Vietnam) Company Limited	100%	Full Consolidation
Safe Interact Pty Ltd	100%	Full Consolidation
PT Meril Medical Indonesia	100%	Full Consolidation
Meril Medical Hungary LLC	100%	Full Consolidation
Meril Italy Srl	100%	Full Consolidation
Meril Medical Devices Egypt	100%	Full Consolidation
Meril Mexico S.A. De C.V.	100%	Full Consolidation
Maxx Medical Pte Ltd, Singapore	51%	Full Consolidation
Maxx Orthopedics Inc.	51%	Full Consolidation

Source: company annual report FY2023

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About ICRA Limited:

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