

March 04, 2024

Hikal Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Term Loan	484.70	396.00	[ICRA]A+ (Stable); Reaffirmed
Long-term – Fund-based – Working Capital	254.00	254.00	[ICRA]A+ (Stable); Reaffirmed
Long-term Term Loan (\$ million) #	5.44	-	-
Long-term – Unallocated (\$ million) #	0.83	6.27	[ICRA]A+ (Stable); Reaffirmed
Short-term – Fund-based	230.50	280.50	[ICRA]A1; Reaffirmed
Short-term – Non-fund Based	115.00	40.00	[ICRA]A1; Reaffirmed
Short-term – Unallocated	10.00	123.70	[ICRA]A1; Reaffirmed
Total	1,094.20 \$6.27 million	1,094.20 \$6.27 million	

*Instrument details are provided in Annexure-I

#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 reaffirmation of ratings of Hikal Limited (Hikal) factors in its established business position and diversified presence in manufacturing active pharmaceutical ingredients (APIs) for pharmaceutical and crop protection industries and increasing presence in the animal healthcare segment. The ratings continue to take into consideration Hikal's wide customer base which includes several reputed and leading global innovator companies. The ratings also factor in Hikal's adequate financial risk profile and liquidity position and ICRA's expectations of gradual improvement in its revenues and margins with normalisation of the challenges in the industry.

In 9M FY2024, Hikal registered revenues of Rs. 1,270.5 crore, representing YoY decline of 14% after a muted 4.1% YoY growth in FY2023. It witnessed a marginal improvement in its operating profit margin (OPM) to 13.6% in 9M FY2024 against 12.7% in FY2023. The degrowth in revenues can primarily be attributed to high channel inventory in the crop protection segment, whereas lower margins in the pharma business from pricing pressure impacted its margins over the last two years. However, ICRA expects Hikal's performance to steadily improve over the near to medium term with gradual correction in channel inventory for the crop protection segment expected to result in better offtake of its products and the softening of raw material prices over the last few quarters expected to support margin improvement in the pharmaceutical APIs segment.

Hikal has undertaken a sizeable debt-funded capital expenditure (capex) of more than Rs. 700 crore over FY2022 to FY2024 for multipurpose crop protection and animal healthcare facilities in addition to capacity enhancement in its pharmaceutical business. Since this capex was partly funded through long-term debt, the overall debt position of the company has remained elevated with total debt (including lease liability) of Rs. 773.5 crore as on September 30, 2023. Coupled with moderation in the company's internal accruals, this has resulted in moderation of its coverage indicators. While the animal healthcare facility was commissioned in December 2023, the multipurpose crop protection facility will be commissioned over the next few quarters. Thus, Hikal's coverage metrics are expected to strengthen with improved financial performance of the base business and scale up of revenues from these new facilities.

Hikal's OPM remains vulnerable to adverse movement in key raw material prices, which is also demonstrated by the volatility in its OPM in the recent past. Its margins also remain vulnerable to volatility in foreign currency rates, which is partly mitigated by the natural hedge on account of its imports. The ratings are also constrained by its high working capital intensity due to the

high inventory levels required for its generics portfolio and contract manufacturing. While there has been some improvement in the company's working capital intensity in FY2023, sustenance of the same over the near to medium term shall be monitorable. Hikal also faces product concentration risk in the pharmaceutical segment wherein its key API, Gabapentin, generates a sizeable part of its revenues. However, the risk is mitigated by its leadership position in the global Gabapentin market and a diversified customer profile since the API is supplied to various global generic and innovator companies.

ICRA notes the ongoing developments including the ongoing legal proceedings related to the company's involvement in a gas leak accident at Surat (Sachin GIDC area) in Gujarat, the penalty of Rs. 17.5 crore imposed on Hikal by the National Green Tribunal (NGT) on alleged violation of environmental laws for which the company is seeking appropriate legal remedies and the communication from Gujarat Pollution Control Board (GPCB) during July 2023 to cease operations in its manufacturing plant at Panoli, which was subsequently revoked for an initial period of three months. Despite these developments, since the resumption of its operations at the Taloja (Maharashtra) plant during Q2 FY2023, Hikal's operations have remained uninterrupted. However, ICRA will continue to monitor these developments and their impact on Hikal's operations and financial profile.

ICRA also notes the suit filed by Hikal's promoters, Mr. Jaidev Hiremath and Mrs. Sugandha Hiremath, under the Specific Relief Act, 1963, in the High Court Judicature at Mumbai on March 18, 2023, seeking specific performance of obligations cast on the BNK Group (Mr. Babasaheb N Kalyani, Kalyani Investment Company Limited (KICL), BF Investment Limited (BFIL), and Mr. Amit Kalyani) pursuant to a family arrangement between Mr. Babasaheb N Kalyani and his parents, whereby the shares of the company held by KICL and BFIL were required to be transferred to the Hiremath family. Subsequently, in December 2023, Hikal's board voted against a resolution regarding continuation of Mr. Babasaheb Kalyani as a director in the company, after which Mr. Kalyani resigned from his position as a non-executive non-independent director on the company's board. Based on the discussion with Hikal's management, ICRA understands that these developments have not had any adverse impact on the company's operations or its banking arrangements. However, ICRA will continue to monitor the developments in this regard and its possible impact on the credit risk profile of the company, if any.

The Stable outlook on the long-term rating reflects ICRA's expectation that Hikal will report improvement in its cash flows, supported by a pipeline of generic APIs, timely commissioning and scale up of revenues from the crop protection and animal healthcare facilities, thus supporting the improvement in its credit metrics.

Key rating drivers and their description

Credit strengths

Diversified presence in pharmaceutical and crop protection industries supported by increasing presence in animal healthcare – During 9M FY2024, the pharmaceutical segment contributed 60.0% to Hikal's revenues while the remaining 40.0% came from the crop protection segment. The diversification has helped Hikal in offsetting the negative impacts in a particular industry. During 9M FY2024, high channel inventory in the industry has led to a significant impact on the revenues of companies in the crop protection industry with Hikal also witnessing a 32.2% decline in its crop protections business over the period. However, improvement in demand in the generic APIs segment over the last few quarters have moderated its impact to an extent. While margins of the pharmaceutical APIs segment have remained suppressed, there was a quarter-on-quarter improvement in Q3 FY2024 following the softening and stabilisation of raw material prices; and margins are expected to improve further over the near to medium term. Margins for the crop protection segment have remained relatively stable. Hikal is also increasing its presence in the animal healthcare segment. Consequently, its new plant at Panoli for the animal healthcare vertical was commissioned in December 2023. The increasing contribution from the animal healthcare business after commercialisation will result in further diversification of Hikal's portfolio over the next few years.

Reputed and diversified client base – Hikal has a reputed clientele, which includes several reputed and leading global innovator companies. The top three customers in the pharmaceutical segment contributed ~23% to its revenues in FY2023, and ~19% during 9M FY2024. 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 generated ~45% of its revenues

in FY2023 and ~42% in 9M FY2023. The customer concentration risk in the crop protection segment is mitigated by its established presence, leadership position in the Thiabendazol market, and exclusive supply contracts with large customers.

Adequate financial risk profile – While there has been some moderation in Hikal's coverage indicators on account of elevated debt levels (on account of funding the capex over the last few years through long-term debt) and moderation in scale and margins, its financial risk profile remains adequate, supported by healthy capitalisation indicators and an adequate liquidity position. Further, steady improvement in the base business coupled with scaling up of revenues from the newly commissioned facility over the medium term shall support improvement in its financial profile.

Credit challenges

Profitability vulnerable to competitive pressures, adverse movement in raw material prices and forex rates – Hikal's margins remain vulnerable to competitive pressures in the industry along with volatility in raw material prices. This is also evidenced by the reduction in its operating margins to 12.7% in FY2023 and 13.6% in 9M FY2024 against historical levels of 17-19% because of the rising costs of key raw materials in the pharma segment, for which it is significantly dependent on China. However, its ability to pass on raw material costs to customers with a lag of three to six months mitigates the pricing risk partly. Hikal is also exposed to adverse movement in foreign currency rates; however, it enjoys a natural hedge on account of its imports.

High working capital intensity – The working capital intensity of Hikal has historically remained high with net working capital/operating income of 30-35%. Its working capital intensity was recorded as 29.8% in H1 FY2024 and 25.1% in FY2023. The nature of contracts, especially in contract manufacturing, requires Hikal to maintain a minimum inventory level to ensure uninterrupted flow of supplies to customers in addition to stocking requirements on account of a significant dependence on China. While there has been some improvement in the company's working capital intensity over FY2023, sustenance of the same over the near to medium term shall be monitorable.

Significant debt-funded capex likely to keep coverage indicators moderate over near term; achieving desired level of scale-up in capacities remains to be seen – Hikal has incurred significant debt-funded capex over FY2022 to FY2024 with a capex of ~Rs. 320 crore in FY2023 and expected capex of up to Rs. 200 crore in FY2024. As the capex was partly funded through long-term debt, the debt levels of the company have remained elevated with total debt (including lease liability) of Rs. 773.5 crore as on September 30, 2023. Coupled with suppression of its margin profile, this has led to moderation of its coverage indicators with total debt/OPBDITA and interest cover of 3.6 times and 4.0 times, respectively, in H1 FY2024 against 2.9 times and 5.4 times, respectively in FY2023. However, an expected recovery in its sales, coupled with improvement in the margin profile of the base business and scale up of the newly commissioned facilities over the medium term, is expected to improve its coverage indicators over the medium term. That said, commercialisation on the manufacturing facilities and scale up of revenues from the same remains to be seen and shall remain key for the improvement in Hikal's financial risk profile.

Product concentration risk, especially in the pharmaceuticals segment – Though partly mitigate by its leadership position, the significant contribution of Gabapentin (~50-60% of revenues from the pharmaceutical segment over last few quarters) creates a product concentration risk. In the crop protection segment, the top three products contributed 62% to segmental revenues in 9M FY2024 (57% in FY2023). The risk is partly mitigated by the established track record of the company and its leadership position as a supplier of Thiabendazole.

Environmental and Social Risks

Environmental considerations: Hikal does not face any major physical climate risk. However, it remains exposed to tightening environmental regulations regarding the breach of waste and pollution norms, which can lead to an increase in operating costs and new capacity instalment costs. This can also require capital investments to upgrade its effluent treatment infrastructure to reduce the carbon footprint and waste generation. There has been increased scrutiny of its operations by the Maharashtra Pollution Control Board (MPCB), GPCB and NGT, while the committee nominated by the NGT had also recommended a fine of

Rs. 17.5 crore on Hikal against which the company is seeking appropriate legal remedies. Any financial liability arising out of these issues cannot be ascertained at the moment.

To address the associated risks Hikal is strengthening its compliance policies and Standard Operating Procedures. It has started using GPS tracking for all the trucks used for material transportation along with several other initiatives to address the concerns related to the Surat incident. To address the larger environmental considerations, Hikal started its first materiality assessment in FY2023, which will help it in defining a sustainability roadmap. Hikal has also entered multiple power purchase agreements to procure renewable energy.

Social considerations: The industry faces social risks related to product safety and associated litigation risks, access to qualified personnel for R&D and process engineering, and maintenance of high manufacturing compliance standards. Further, Government interventions related to product bans and price caps/control also remain a social risk.

Liquidity position: Adequate

Hikal's liquidity is adequate with estimated funds flow from operations of ~Rs. 160-180 crore in FY2024. The liquidity is supported by steady accruals, free cash and cash equivalents of Rs. 15.2 crore and unutilised fund-based limits of ~Rs. 150 crore as on December 31, 2023. The company has annual repayments of ~Rs. 85 crore in FY2024 and ~Rs. 99 crore in FY2025. Cash accrual generation is expected to be sufficient to meet its debt servicing obligations and partially fund its capex plans over the medium term. Hikal has a capex commitment of ~Rs. 150-200 crore per annum in FY2024 and FY2025, to be financed by internal accruals and by long-term debt, which has been sanctioned by the lenders and partly drawn down as well.

Rating sensitivities

Positive factors – ICRA could upgrade Hikal's ratings if it demonstrates healthy revenue growth and internal accrual generation, resulting in strengthening of its debt protection metrics and liquidity profile. Specific credit metrics that could lead to an upgrade of Hikal's rating include Total Debt/ OPBITDA below 1.5 times on a sustained basis.

Negative factors – Negative pressure on Hikal's ratings could arise if considerable decline in revenue and internal accrual generation, and/or stretch in working capital cycle results in weakening of the company's liquidity position. Any adverse impact of the ongoing litigations on the company's operations or financial profile may also result in a rating downgrade. Moreover, lower than anticipated accrual generation from the ongoing capacity expansion over the next few years, resulting in Total Debt/OPBITDA exceeding 2.25 times, on a sustained basis, may also trigger a rating downgrade.

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 December 31, 2023, the company had two subsidiaries, who are listed in Annexure-II.

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, it was renamed as Hikal Limited in 2000.

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 certified by the US FDA, PMDA (Japan) and EUGMP. The Bangalore facility manufactures key APIs for the pharmaceutical industry and has been approved by the US FDA, PMDA (Japan) and EU Authorities. The company has an R&D centre at Pune (Maharashtra), which provides end-to-end services for APIs, custom synthesis, analytical development and scale up from development to commercial manufacturing.

Key financial indicators

Hikal - Consolidated	FY2022	FY2023	9M FY2024*
Operating income	1942.7	2023.0	1270.5
PAT	160.5	78.4	35.6
OPBDIT/OI	17.5%	12.7%	13.6%
PAT/OI	8.3%	3.9%	2.8%
Total outside liabilities/Tangible net worth (times)	1.1	1.1	-
Total debt/OPBDIT (times)	2.0	2.9	-
Interest coverage (times)	10.9	5.4	-

Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. Crore; 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 (FY2024)				Chronology of rating history for the past 3 years							
		Type	Amount rated (Rs. crore)	Amount outstanding as of Dec 31, 2023 (Rs. crore)	Date & rating in FY2024		Date & rating in FY2023		Date & rating in FY2022			Date & rating in FY2021	
					Mar 04, 2024	April 3, 2023	Mar 14, 2023	Jun 20, 2022	Mar 8, 2022	Jan 21, 2022	Dec 16, 2021	Mar 5, 2021	Dec 21, 2020
1	Term loans	Long-term	396.00	361.00	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+@	[ICRA]A+&	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Positive)	[ICRA]A (Stable)
2	Working Capital Facility	Long-term	254.00	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+@	[ICRA]A+&	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Positive)	[ICRA]A (Stable)
3	Term loan (USD million)	Long-term	-	-	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+@	[ICRA]A+&	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A (Positive)	[ICRA]A (Stable)
4	Term loan Unallocated (USD million)	Long-term	6.27	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-	-	-	-	-	-
5	Working Capital Facility	Short-term	280.50	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1@	[ICRA]A1&	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1

6	Non- fund Based Facility	Short-term	40.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1@	[ICRA]A1&	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1
7	Unallocated fund-based	Short-term	123.70	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	-	-	-	-	-	-

@: Rating watch with Negative Implications

&: Rating Watch with Developing Implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term term loan	Simple
Long-term fund-based – Working capital	Simple
Long-term - Unallocated (USD million)	NA
Short-term fund-based	Simple
Short-term non-fund based	Very Simple
Short-term - Unallocated	NA

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	Term Loan-I	FY2019	9.20%	Feb 2027	41.00	[ICRA]A+ (Stable)
NA	Term Loan-II	FY2019	10.35%	Sep 2026	36.00	[ICRA]A+ (Stable)
NA	Term Loan-III	FY2021	10.20%	June 2028	219.00	[ICRA]A+ (Stable)
NA	Term Loan-IV	FY2023	8.95%	June 2030	100.00	[ICRA]A+ (Stable)
NA	Term loan - Unallocated	NA	NA	NA	USD 6.27 million	[ICRA]A+ (Stable)
NA	Working capital Facilities	NA	NA	NA	254.00	[ICRA]A+ (Stable)
NA	Fund based facilities	NA	NA	NA	280.50	[ICRA]A1
NA	Non-fund-based facility	NA	NA	NA	40.00	[ICRA]A1
NA	Unallocated	NA	NA	NA	123.70	[ICRA]A1

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

Source: Hikal quarterly results, December 31, 2023

ANALYST CONTACTS

Shamsher Dewan

+91 124 4545 328

shamsherd@icraindia.com

Kinjal Shah

+91 22 6114 3400

kinjal.shah@icraindia.com

Deepak Jotwani

+91 124 4545 870

deepak.jotwani@icraindia.com

Gaurav Kushwaha

+91 40 45474829

gaurav.kushwaha@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar

+91 22 6114 3406

shivakumar@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

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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



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