December 24, 2020

HLL Lifecare Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Term Loans	122.20	63.45	[ICRA]BBB+ (Stable) reaffirmed
Long-term Fund-based Facilities	312.00	312.00	[ICRA]BBB+ (Stable) reaffirmed
Short-term Non-fund Based Facilities	300.00	300.00	[ICRA]A2; reaffirmed
Long Term/ Short Term Unallocated Limits	26.76	85.51	[ICRA]BBB+ (Stable)/[ICRA]A2 reaffirmed
Total	**760.96**	**760.96**	

Instruments details are provided in Annexure 1

Rationale

The rating reaffirmation considers HLL Lifecare Limited's (HLL) established track record as the largest condom supplier to the Government of India (GoI), and its captive status for condoms (extended till March 2022), oral contraceptives pills (OCPs) and vaccines, which mitigate the medium-term demand risks. The ratings continue to draw comfort from the considerable experience of the company's senior management, comprising industry professionals. The ratings also consider HLL's position as one of the largest players in the domestic commercial segment for male condoms and the healthy pan-India presence of its Moods brand through its distribution network.

The ratings also consider the improvement in revenue and profit margins in FY2020, aided by continued growth in pharmaceutical retail, healthcare services and other segments. The contraceptive segment, which has witnessed contraction in last few years, also witnessed some improvement. The margin improvement was mainly driven by the increase in profit margin of the pharmaceutical retail and healthcare services segment, and some recovery in margin in the contraceptives segment, though the latter continued to make losses. ICRA notes that the company's revenue share from the condom manufacturing segment witnessed a decline in recent years as competitive pricing pressure during the L1 tender bidding process led to depressed sales realisation and subdued the performance of this segment. However, the company had petitioned for a price revision, and in FY2019 it received a price revision order for the FY2012-FY2017 period, which also aided in margin improvement. A similar price revision for FY2018 order was also received in FY2020, which improved the overall profit margins. Despite the improvement in margins, ICRA notes that they remain thin as new segments are still in the stabilization phase, by the nature of bidding for getting new contracts in retail pharma and healthcare services segment. Additional price revision in the condom segment or any changes in the pricing mechanism to cost-plus basis would be a positive for the segment; the quantum and timeliness of such revisions will be monitored.

ICRA also takes note of the large orders received by the company for procurement of Personal Protective kits (PPE) and Covid-19 related equipment, as it was designated as the nodal agency for the same. While one-time in nature, this has provided healthy revenue and profits in H1FY2021, when the core segment operation was impacted by the lockdown measures. The advances received for the large order also provided liquidity support during this period. ICRA notes that the core segments have started witnessing recovery with easing of lockdown measures, and the company also has adequate orders in the contraceptive segment in the current fiscal.

HLL's ratings are constrained by the working capital-intensive operations as the often-delayed and lumpy-nature of settling dues by the GoI has resulted in high debtors. The problem is exacerbated by the company's diversification into new business segments, where the receivable period is longer. With increasing exposure to the GoI through public private partnership (PPP) under the healthcare services segment, HLL's receivables position as on March 2020 has increased further and is likely to remain stretched. The ratings also consider the significant investment exposure to some of its subsidiaries—HLL Biotech Ltd (HBL, rated [ICRA]D) and HLL Medipark Limited (HML, rated [ICRA]BB (Stable) amongst others, totaling to ~Rs. 298 crore as on March 31, 2020. Further, HLL has also extended corporate guarantees extended to its subsidiaries—HLL Infra Tech Services Limited (HITES) and Hindustan Latex Family Planning Promotion Trust (HLFPPT) and also provided funding support to HBL in the form of loans and advances. Timely recovery of the investments and loans, any additional funding support to HBL or HML and any devolvement of the corporate guarantees extended are key rating sensitivities.

ICRA also notes the GoI's strategic stake divestment of HLL, whereby it is looking at divesting its entire stake in HLL. Though the process has witnessed considerable delays since initiation in FY2019, the ongoing developments related to the divestment will be a key credit concern, since ICRA draws comfort from HLL being a 100%-GoI entity and its associated benefits (such as captive orders and funding access). The process has witnessed delays and is a key monitorable.

The Stable outlook on the [ICRA]BBB+ rating reflects ICRA's opinion that HLL will continue to benefit from being a 100% GoI-owned enterprise, its healthy market position and adequate contraceptive orders from the GoI in the current fiscal. Further, ICRA expects HLL's financial profile to witness moderate improvement in the near to medium term, driven by expansion of its pharmaceutical chain and healthcare service segments, and stabilisation of its operations. Further, going forward, any additional price revision orders for the condom segment or any changes in the pricing mechanism to cost-plus basis would be a positive for the overall profitability for the company and will be a key rating sensitivity.

Key rating drivers and their description

Credit strengths

GoI-owned enterprise with captive unit status - HLL is a 100% GoI-owned enterprise. It has an experienced management and a considerable track record of nearly five decades in the contraceptives space with operations since 1969. HLL is the largest contraceptive supplier to the GoI for distribution under the free distribution and social marketing schemes of the National Family Welfare Programme (NFWP). HLL enjoys captive status for such supplies (recently extended till March 2022), which ensures a minimum offtake of 75% of the production or the GoI's requirement in a given year, thereby mitigating demand and marketability risks to an extent. HLL also sells its products in the international market and has witnessed healthy exports in the recent fiscals. In the current fiscal, HLL has received adequate orders for condoms from the GoI, which along with moderate domestic and export sales is expected to sustain the company's segment revenue for FY2021.

Diversified business segment and product portfolio - HLL has significantly diversified its business and at present operates in contraceptives, retail pharmacy chain, healthcare services, healthcare products and trading, consultancy and contract segments. It has witnessed healthy sales from its retail pharmacy chain segment, wherein the network is still being expanded. HLL is also focussing on healthcare services and won tenders to provide pathology and imaging services in Maharashtra, Assam and Uttar Pradesh under the PPP model. The share or revenue from both these segments improved significantly to 65% of the total sales in FY2020 (PY: 65%), compared to 20% in FY2015. Though the profitability in the healthcare services segment is modest as the company is yet to reach break-even in the state of UP, strong sales growth in the pharmacy segment aided the profitability improvement in FY2020.

Further, the company's profitability in FY2020 was also supported by a large recovery, received on the back of a retrospective increase in prices of condoms supplied in FY2018. While the company had earlier petitioned for a price revision for the contraceptives supplied during FY2012-FY2017 period and received some recovery in FY2019, HLL continued to receive a large recovery of margin for the second time in FY2020 for the contraceptives supplied in FY2018. Nonetheless, without considering the retrospective price recovery, the contraceptive segment continued to incur losses, though the losses in FY2020 were curtailed to an extent on account of increased export orders.

Established brand and healthy market share in commercial contraceptives segment – HLL's Moods brand of condom is one of the largest players in the domestic commercial male contraceptives segment and enjoys a good brand recall, benefitting from a pan-India presence through the extensive distribution network.

Credit challenges

GoI's intention to divest 100% stake in HLL - Earlier in FY2018, the GoI had identified HLL as one of the PSUs from which it would disinvest through a 100% strategic stake sale. However, the process has witnessed significant delays because of the Covid-19 pandemic. Though the extension of the captive status by the GoI till March 2022 provides some comfort, ongoing developments related to the divestment will be a key credit concern, since ICRA draws comfort from HLL being a 100%-GoI entity and the associated benefits (such as captive orders and funding access) it is entitled to. Further, ICRA notes the plans to hive off subsidiaries—HML and HBL. Nonetheless, the timelines of the hiving off process will be monitored and any incremental support from HLL to these subsidiaries remains a sensitivity factor.

Working capital intensive operations because of high receivables and inventory position - HLL's operations remain working capital intensive as often-delayed and lumpy-nature of settling dues by the GoI results in high debtors. Furthermore, it maintains a high inventory for meeting the ageing requirements of latex and increasing the retail pharmacy operations. With increasing exposure to the GoI through the PPPs in the healthcare services segment, HLL's receivables position as on March 2020 has increased further and is likely to remain stretched. However, it enjoys a high credit period from suppliers, mitigating the intensity to some extent.

Large investments and funding support to subsidiaries - HLL had taken significant investment exposure to some of its subsidiaries HLL Biotech Ltd, HLL Medipark Limited amongst others, totaling to ~Rs. 298 crore as on March 31, 2020. Further, HLL has also extended corporate guarantees to Hindustan Latex Family Planning Promotion trust (HLFPPT) and HLL Infratech Services Ltd (HITES) and has also provided funding support to HBL in the form of loans and advances. The timeliness of recovery of the investments and loans, any additional funding support to HBL or HML and any devolvement of these corporate guarantees remain key rating sensitivities.

Liquidity position - Adequate

In FY2021, the company's fund flow from operations is expected to improve considerably, aided by PPE kits procurement order from the GoI and the significant advances received to support the procurements. Further, healthy retained cash flows are expected to keep the free cash flow of the company robust, supported further by moderate long-term debt obligations of Rs. 21.8 crore and maintenance capex of Rs. 20-30 crore.

Going forward, though the company's cash flow is expected to be impacted by large working capital requirements in the form of high debtors and inventory requirements, HLL's liquidity position is expected to be adequate, supported by healthy buffer in working capital limits, ability to stretch payments to its creditors and moderate long-term det obligations and low capex requirements of ~Rs. 25 crore per year expected in the next three years. Further, HLL's ability to draw short-term loans from banks against sizeable cash balances (under a trust account representing client advances for projects as collateral security) also provides additional comfort.

Rating sensitivities

Positive triggers – ICRA could upgrade HLL's rating if there is sustained improvement in revenue and profitability, favourable pricing policy for contraceptive products and better working capital management leading to healthy improvement in capital structure and coverage indicators. Specific credit metrics that could lead to an upgrade is Total debt/OPBDITA of less than 2.0 times (including corporate guarantee amounts and OPBITDA of entities where HLL has extended corporate guarantees) on a sustained basis.

Negative triggers – Negative pressure on HLL's rating could emerge if significant moderation in revenue and profitability or stretch in working capital intensity on a sustained basis deteriorates the financial risk profile. Besides these, divestment from the GoI, large write-off of receivables, and significantly higher-than-expected debt-funded capex could also exert negative pressure on the company's ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Parent/Group: The Government of India
Consolidation/Standalone	The rating is based on full consolidation with subsidiaries where Corporate Guarantee has been extended to Hindustan Latex Family Planning Promotion trust (HLFPPT) and HLL Infratech Services Ltd (HITES); and limited consolidation with subsidiaries where limited funding support is being extended or planned

About the company

HLL Lifecare Limited, a 100% GoI-owned entity, was incorporated in 1966 to produce male contraceptive sheaths, and commenced operations in 1969. Traditionally, HLL has manufactured condoms, steroidal and non-steroidal OCPs etc. Since 1992, HLL started a process of diversification by manufacturing other products, such as blood bags, hydrocephalus shunts, sutures, rapid test kits etc. While condoms remain its largest product, HLL's current product portfolio can be broadly segmented into contraceptive products, healthcare products, pharmaceutical chain and other traded products, contract and consultancy, and healthcare services.

The company also has multiple subsidiaries. HBL is setting up an integrated vaccines complex and HML is developing a medical park for players to set up facilities for manufacturing and R&D in the pharma space. Its other subsidiary, Goa Antibiotics and Pharmaceuticals Limited, markets lifesaving drugs catering to major Central/state government institutions across the country. HITES provides services in designing, engineering and execution of construction projects, and consultancy and procurement primarily for the GoI entities.

Key financial indicators – HLL (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	1444.4	1677.8
PAT (Rs. crore)	18.5	110.5
OPBDIT/OI (%)	5.4%	9.1%
Total Outside Liabilities/Tangible Net Worth (times)	5.0	3.9
Total Debt/OPBDIT (times)	5.4	2.5
Total Debt/OPBDIT (times) (adjusted*)	4.1	2.1
Interest Coverage (times)	2.2	4.2
DSCR	1.6	3.6

*(Amounts in Rs. crore) *including* corporate guarantee amounts and OPBITDA of entities where HLL has extended CG

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

			Current Rating (FY2021)			Chronology of Rating History for the past 3 years		
			Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018
	Instrument	Type			24-Dec-2020	15-Jul-2019	24-Sep-2018	14-Jul-2017
1	Cash Credit	Long Term	312.00	312.00	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Negative)	[ICRA]A (Negative)
2	Non-fund Based	Short Term	300.00	300.00	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2+
3	Term Loan	Long Term	63.45	63.45	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Negative)	[ICRA]A (Negative)
4	Unallocated Limits	Long Term/ Short Term	85.51	-	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]BBB+ (Negative)/ [ICRA]A2	[ICRA]A (Negative)/ [ICRA]A2+

Source: HLL Lifecare Limited

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	Cash Credit	NA	NA	NA	312.00	[ICRA]BBB+(Stable)
NA	Term Loan 1&2	FY2017	8.45%	FY2027	51.78	[ICRA]BBB+(Stable)
NA	Term Loan 3	FY2014	8.30%	FY2023	11.67	[ICRA]BBB+(Stable)
NA	Non-fund Based Facilities	NA	NA	NA	300.00	[ICRA]A2
NA	Short-term/Long-term Unallocated Limits	NA	NA	-	85.51	[ICRA]BBB+ (Stable)/ [ICRA]A2

Source: HLL Lifecare Limited

Annexure-2: List of entities considered for consolidated analysis:

Company name	Ownership	Consolidation Approach
HLL Infratech Services Ltd	100%	Full consolidation
Hindustan Latex Family Planning Promotion trust	Sponsor: HLL	Full consolidation
HLL Biotech Limited	100%	Limited consolidation
HLL Medipark Limited	100%	Limited consolidation

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About ICRA Limited:

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