

March 05, 2021 ^{Revised}

Hikal Limited: Ratings reaffirmed; outlook revised to Positive from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based-Term loan	527.10	508.10	[ICRA]A; reaffirmed and outlook revised to Positive from Stable
Fund-based- Working capital	254.00	254.00	[ICRA]A; reaffirmed and outlook revised to Positive from Stable
Long term: Term loan (USD million)*	12.64	11.84	[ICRA]A; reaffirmed and outlook revised to Positive from Stable
Short term-Fund based	212.90	212.90	[ICRA] A1; reaffirmed
Short-term Non-fund based	115.00	115.00	[ICRA] A1; reaffirmed
Total	1109.00 USD 12.64 million	1090.00 USD 11.84 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 revision in outlook to Positive from Stable for Hikal Limited (Hikal) factors in the healthy growth in its operating income (OI) and profitability in Q3 FY2021, which is expected to sustain over the near to medium term leading to improved coverage indicators. It also continues to reflect ICRA's opinion that Hikal will continue to benefit from the established track record of its operations, healthy pipeline of generic APIs, new product introductions in both segments, along with the favourable growth prospects for the existing products.

The company continues to maintain a strong product profile and entrenched relationship with leading pharmaceutical as well as agrochemical (crop protection segment) companies in the world. Gabapentin, an active pharmaceutical ingredient (API), continues to fetch a significant share of the pharmaceutical segment revenues with an established market share of ~35% in FY2020. Hikal has a healthy pipeline of products under development for proprietary and contract manufacturing, which is expected to support its growth prospects especially in the export market.

It is undertaking a significant debt-funded capex of ~Rs. 415 crore that includes fresh capex of ~Rs. 350.0 crore over a two-year period (FY2021-FY2022). The capital expenditure will be funded by internal accruals and long-term debt of Rs. 250.0 crore that has been sanctioned and partially drawn down. The above capex is to scale up its pharmaceutical and crop protection business (contract manufacturing and proprietary products). However, achieving the desired levels of profitability and accruals remains a key sensitivity.

The ratings are constrained by the high product concentration for its pharmaceutical and crop protection businesses, as well as by the high working capital intensity. The key rating sensitivities are pressure on margins for key APIs leading to lower cash accruals and achieving the desired level of benefits for the planned capex.

Key rating drivers and their description

Credit strengths

Established track record in pharmaceutical and crop protection industry; dominant position in few products such as Gabapentin – The company has a strong existing product profile and entrenched relationship 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 crop protection chemicals to innovators. Hikal continues to maintain its market leader position with ~35% market share in Gabapentin in FY2020. The pharmaceuticals division witnessed a growth of 8.3% YoY in Q3 FY2021 and 15.4% YoY in 9M FY2021, supported by an expansion in the product portfolio and geographical diversification in the generic and contract manufacturing divisions. The crop protection segment grew by 24.8% YoY in Q3 FY2021, led by growth in new products, higher volume offtake for the existing products and fulfilment of deferred sales of Rs. 40 crore (deferred by Hikal's customer) from the previous quarter. The revenues from the crop protection segment declined by 8.9% YoY in 9M FY2021 due to the initial impact of the pandemic in H1 FY2021.

Healthy pipeline of generic APIs and favourable 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 three to four generic products in the development stages in the pharmaceutical division and two products under development in the crop protection division. It has several products under development for contract manufacturing under the pharmaceutical and crop protection segments. Hikal's favourable growth prospects in FY2021-FY2022 are driven by an expected increase in volume offtake for new product launches, ramp-up in production of high gross margin molecules, continuous development of new molecule pipeline and receipt of new inquiries from global customers aiming to diversify their supply chain.

Reputed and diversified client base – The customer base for the pharmaceutical division is diversified with the top three customers contributing to ~38.3% of revenues in FY2020 and 34.1% of revenues in H1 FY2021. The company is a market leader for Gabapentin, which is supplied to various global generic companies including the innovator. In the crop protection segment, the top three customers accounted for 55.7% and 54.4% of the revenues in FY2020 and H1 FY2021, respectively. The customer concentration risk is mitigated by the established presence of Hikal's crop protection customers and its exclusive supply contracts for multiple products with these companies.

Comfortable financial profile with healthy profitability and adequate coverage indicators – Hikal's operating and net margins improved to 19.7% and 8.7%, respectively, in Q3 FY2021 and 18.0% and 6.9%, respectively, in 9M FY2021 because of higher yield and production throughput improvements, business excellence initiatives and optimisation in interest costs. The company's coverage indicators remain comfortable as depicted by TD/OPBDITA, interest coverage and TOL/TNW of 2.4 times, 5.2 times and 1.2 times, respectively, in FY2020 and 2.6 times, 6.7 times and 1.1 times, respectively in H1 FY2021. In FY2021-FY2022, despite the sizable debt funded capex, the leverage ratios are expected to remain comfortable given the envisaged improvement in revenues and profitability indicators.

Credit challenges

Significant near-term debt-funded capex; achieving desired level of profitability remains to be seen – The company is undertaking a significant debt-funded capex of ~Rs. 415 crore that includes fresh capex of ~Rs. 350.0 crore over a two-year period (FY2021-FY2022). The capex will be funded by internal accruals and long-term debt of Rs. 250.0 crore that has been sanctioned and partially drawn down. The above capex is to scale up its pharmaceutical and crop protection business (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.

High working capital intensity – Hikal’s working capital requirement remains high 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 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) moderated to 32.4% in FY2020 from 35.9% in FY2019 because of inventory optimisation in the pharmaceutical segment, resulting in an overall reduction by 10-12 days. In H1 FY2021, the working capital intensity increased to 40.7%, driven by an increase in the receivable cycle amid the pandemic, which is expected to normalise by March 2021.

Profitability vulnerable to adverse movement in foreign exchange rates and raw material prices – Hikal is exposed to adverse movement in foreign currency rates though it enjoys some natural hedge from its imports as well as foreign currency debt. Since exports contribute to nearly 70-75% of the company’s revenues, it benefits from the overall rupee depreciation. Its margins remain vulnerable to adverse movement in raw material prices. However, it can pass on the increased costs to its customers, with a lag effect of three to six months.

Liquidity position: Adequate

Hikal’s liquidity is **adequate** with healthy estimated funds flow from operations of ~Rs. 190-200 crore in FY2021. The liquidity is supported by healthy accruals, free cash and cash equivalents of Rs. 30.9 crore in FY2020 (Rs. 8.6 crore in H1 FY2021) and unutilised fund-based limits. Hikal’s average working capital limit utilisation (working capital and bill discounting) for 12 months that ended in December 2020 is approximately 51.1% of the sanctioned limits and ~33.8% of its drawing power (excluding bill discounting facility) providing additional liquidity cushion. It has a capex commitment of Rs. 415 crore that includes a fresh capex of ~Rs. 350.0 crore over a two-year period (FY2021-FY2022) to be financed by internal accruals and long-term debt of Rs. 250 crore, which has been sanctioned and partially drawn down.

Rating sensitivities

Positive factors – ICRA could upgrade Hikal’s rating if it demonstrates diversification in its pharmaceutical and crop protection businesses, coupled with continued improvement in revenue and margin performance. Specific credit metrics that could lead to an upgrade of Hikal’s rating is Total Debt/ OPBITDA below 2.0 times on a sustained basis.

Negative factors – Negative pressure on Hikal’s rating could arise if its working capital 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 2.5 times, on a sustained basis, and a weakening in DSCR to below 1.7 times, on a sustained basis, may 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, 2020, the company had one subsidiary, which is listed in Annexure-2.

About the company

Hikal Limited was incorporated on July 8, 1988 as a private limited company with the name Hikal Chemicals Industries Private limited, by the Hiremath family and Surajmukhi Investments and Finance Limited, a wholly-owned subsidiary of Kalyani Steels Limited as the shareholders. Subsequently in 2000, the name was changed to Hikal Limited, while the company got listed in 1995. It started commercial production in 1991 at Mahad (Maharashtra) facility for manufacturing intermediates for dyes, pharmaceuticals and agrochemicals. The plant at Taloja (Maharashtra) was built in technical collaboration with Merck and is the only fully-integrated plant to produce Thiabendazole in the world. The facility at Panoli (Gujarat) was acquired from Novartis in 2000 and produces key intermediates and regulatory starting materials for the pharmaceutical industry and is USFDA certified for advanced intermediates. The Jigani (Karnataka) facility manufactures key APIs for the pharmaceutical industry and has been approved by the USFDA, PMDA (Japan) and the European Union authorities. Hikal is expanding its facilities at Panoli to include manufacturing of APIs and specialised biocides for the crop protection sector. The company has a research and development centre in Pune, which provides end-to-end services from custom synthesis, analytical development and scale up from development to commercial manufacturing.

Key financial indicators (audited)

Hikal Consolidated	FY2019 (Audited)	FY2020 (Audited)	H1 FY2021 (Limited Audit)
Operating Income (Rs. crore)	1589.6	1507.3	724.7
PAT (Rs. crore)	103.1	84.4	42.0
OPBDIT/OI (%)	19.0%	18.1%	16.9%
PAT/OI (%)	6.5%	5.6%	5.8%
Total Outside Liabilities/Tangible Net Worth (times)	1.3	1.2	1.1
Total Debt/OPBDIT (times)	2.2	2.4	2.6
Interest Coverage (times)	5.2	5.2	6.7

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 (FY2021)				Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in		Date & Rating in FY2020		Date & Rating in FY2019	Date & Rating in FY2018
					March 05, 2021	21-Dec-2021	18-Oct-2019	27-Sept-2019	26-Jul-2018	18-Aug-2017
1	Term loan	Long Term	508.10	298.10	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)
2	Working capital facility	Long Term	254.00	-	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)
3	Term loan USD million	Long Term	11.84	11.84	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)
4	Working capital facility	Short Term	212.90	-	[ICRA] A1	[ICRA] A1	[ICRA] A1	[ICRA] A1	[ICRA] A1	[ICRA] A2+
5	Non- fund based facility	Short Term	115.00	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A2+

Amount in Rs. crore; Amount Outstanding as on February 19, 2021

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 [click here](#)

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	18.00	[ICRA] A (Positive)
NA	Term loan 2	31- Dec-2015	NA	31-Mar-23	33.75	[ICRA] A (Positive)
NA	Term loan 3	15-Feb-2016	NA	31-Mar-23	13.50	[ICRA] A (Positive)
NA	Term loan 4	26-Feb-2016	NA	31-Mar-23	4.50	[ICRA] A (Positive)
NA	Term loan 5	24-Sep-15	NA	31-Mar-23	29.25	[ICRA] A (Positive)
NA	Term loan 6	26-Feb-2016	NA	31-Mar-23	9.00	[ICRA] A (Positive)
NA	Term loan 7	03 Mar-2016	NA	31-Mar-23	9.00	[ICRA] A (Positive)
NA	Term loan 8	5-Sep-2018	NA	05-Jun-26	70.60	[ICRA] A (Positive)
NA	Term loan 9	6-Feb-2019	NA	02-Jun-2027	70.50	[ICRA] A (Positive)
NA	Term Loan 10	15-Sept-2020	NA	01-Jun-2028	250.00	[ICRA] A (Positive)
NA	Term loan 11	10-Dec-2015	NA	11-Dec-2023	USD 11.84 million	[ICRA] A (Positive)
NA	Working capital limits	NA	NA	NA	254.00	[ICRA] A (Positive)
NA	Bill discounting	NA	NA	NA	212.90	[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	LTHL Ownership	Consolidation Approach
Acoris Research Limited	100.00%	Full Consolidation

Source: Company

Corrigendum

Document dated March 05, 2021 has been corrected with revisions as detailed below:

- a) Revisions on Page 4 in the Key Financial Indicators – The value for Total Outside Liabilities/Tangible Net Worth, Total Debt/OPBDIT and Interest Coverage for FY2019, FY2020 and H1 FY2021 has been corrected

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