April 09, 2021

Natural Capsules Limited: Ratings reaffirmed; ratings removed from watch with developing implications and 'Stable' outlook assigned

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based/CC	6.50	6.50	[ICRA]BBB (Stable); reaffirmed; rating removed from watch with developing implications and 'Stable' outlook assigned
Short-term Non-fund based	1.29	1.29	[ICRA]A3+; rating removed from watch with developing implications
Long-term/short-term Unallocated	4.70	4.70	[ICRA]BBB (Stable)/[ICRA]A3+; reaffirmed; ratings removed from watch with developing implications and 'Stable' outlook assigned
Total	**12.49**	**12.49**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation in ratings positively factors in the favourable improvement in the company's revenues and profitability in 9MFY2021, aided by the robust demand from its export customers, the optimal utilisation of the enhanced capacity and the higher manufacturing efficiency rendered by the ongoing modernisation of its in-house facility. ICRA expects the company's cash accruals to grow at a healthy pace, driven by the recent capacity expansion and modernisation and the favourable demand environment. ICRA also makes note of the company's diversification into the API business by setting up a manufacturing facility under its subsidiary, Natural Biogenex Private Limited (NBPL), and the recent Performance Linked Incentive (PLI) scheme approval that it has received for its key APIs—Betamethasone, Dexamethasone and Prednisolone. The aforesaid diversification is expected to aid further revenue scale up over the long term, while protecting the overall profitability. The ratings continue to consider NCL's long presence in the Empty Hard Gelatin Capsule (EHGC) manufacturing industry, its diversified product profile and the established relationship with its key customers.

However, the ratings are constrained by the anticipated moderation of its capital structure and coverage indicators in the near term because of the sizeable debt-funded capital expenditure undertaken by the company to enhance its capsules capacity and set up a facility to manufacture API. The total outlay for ongoing capital expenditure is estimated at ~Rs 120.0 crore (for API facility and capsule capacity expansion and modernization), which is proposed to be funded by a term loan of Rs. 72.0 crore (Rs. 48.0 crore and Rs. 24.0 crore, for API and capsules project, respectively). The rating factors in the project risks associated with these large capital expenditure undertakings such as funding tie-up risk and cost/time overrun risks, among others. ICRA notes that the API project is in nascent stages and with the production process for API being a relatively untested process in India, timely project completion and ramping of operations in the API segment will be a key rating monitorable. The ongoing capital expenditure and the resulting scaling up of operations would entail timely funding requirement in the form of asset monetisation and equity infusion (apart from the proposed term loans).

The ratings also continue to factor in the highly working capital intensive operations, as characterised by NWC/OI of 43.0% as on March 31, 2020 and 36.4% as on December 31, 2020. The ratings continue to be constrained by the intense competition faced by the company, particularly its 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 proven operational track record in the capsules segment and its proposed capex is expected to benefit the company over the long term. The ratings were placed on watch with developing implications in February 2020, when NCL planned for inorganic expansion. Now the company has a dropped the plan for inorganic expansion and has finalised the internal capex plans.

Key rating drivers and their description

Credit strengths

Improvement in business performance and financial profile in 9MFY2021 – NCL's operating income grew by nearly 21% on a YoY basis in 9MFY2021, aided by improved demand, especially from the exports market, coupled with increased price realisation of the capsules. The recent capacity enhancement, which is being undertaken by the company in its capsule's capacity, has facilitated its healthy revenue growth. Its operating margin improved to 13.1% in 9MFY2021 from 8.3% in 9MFY2020, owing to increased proportion of revenues from margin-accretive exports coupled with cost optimisation achieved by the ongoing modernisation in its in-house capsules manufacturing facility. Its working capital intensity improved to 36.4% as on December 31, 2020 from 43.0% as on March 31, 2020, aided by better collection efficiency. While the sustainability of the improved profitability and working capital intensity remains to be seen, ICRA expects the company's healthy profitability to be supported by improved demand condition and operational efficiencies.

Diversification into API business – NCL is in the process of setting up a manufacturing facility to undertake API manufacturing under its subsidiary, Natural Biogenex Private Limited. The company would focus on three APIs – Betamethasone, Dexamethasone and Prednisolone and associated intermediaries and derivative products. It has received approval under the PLI scheme for the same, whereby it would be eligible to avail incentives varying between 10% and 20% with a cap of Rs. 10.0 crore/year for each of the APIs (contingent upon the company producing around 80% of the overall targeted capacity for each API). The PLI scheme is for seven years, commencing from April 2023, and is expected to support the company's profitability under its API operations. The installed capacity for the API facility (for the PLI approved API's) would be 37 MT and the commercial operations are expected to commence from April 2022 as per the management. With these APIs being import substitutes, ICRA expects the company to achieve quick scaling up of operations.

Diversified customer profile – The company has a wide customer base in the domestic as well as the export markets. It has established relationship with the customers, which results in repeat orders from them. Further, it has added new customers in the domestic market, which supported the revenue growth in FY2020 and 9MFY2021. In the past few years the company penetrated the Middle East and the South American markets.

Extensive experience of NCL in EHGC industry – The promoters have extensive experience in the capsule segment and the company has an established market position with a large product portfolio in the EHGC segment. NCL's product profile also includes Hydroxypropyl Methylcellulose (HPMC) vegetarian capsules. The company had an installed capacity to produce 7.2 billion capsules per annum in FY2019 and it is in the process of enhancing its capacity.

Credit challenges

Project risks associated with ongoing expansion plans - The company is in the process of enhancing and modernising its capsule capacity at a cost of around Rs. 36.0 crore. The company has incurred ~Rs. 12.0 crore under the same in FY2021, entirely funded through internal accruals and proceeds from divestment of its stake in Supreem Pharmaceuticals Mysore Private Limited for Rs. 7.25 crore. Besides, the company has applied for a term loan of Rs. 24.0 crore and enhancement of its working capital limits to Rs. 12.0 crore for its capsule-capacity expansion project.

The company is also setting up a facility to undertake manufacturing of API under its subsidiary NBPL (incorporated in August 2020) at a cost of ~Rs. 83.0 crore. For funding, it has applied for a term loan of Rs. 48.0 crore, while the rest would be through proceeds from the sale of a land held by the company, its internal accruals and near-term equity. Further**,** given the nascent stages of execution of the API project, the rating factors in the cost/time overrun risks associated with the ongoing capex. Further, as the fermentation-based production process is a relatively untested technology in India, stabilisation and ramping up of operations will be a monitorable**.** With financial closure yet to be obtained for both the projects (API and capsule capacity expansion), the company is exposed to funding risks.

Likely moderation of key credit metrics in near term- NCL's capital structure and coverage indicators were comfortable with no long-term debt and moderate working capital borrowings. The gearing stood low at 0.11 times and 0.10 times as on March 31, 2020 and December 31, 2020, respectively. The interest coverage, DSCR and total debt/OPBIDTA stood at 6.9 times, 7.3 times and 1.2 times, respectively, in FY2020. However, the same is expected to deteriorate in the near term, given the significant debt-funded capital expenditure envisaged by the company towards setting up the API facility and enhancement and modernization of its capsule capacity; the gearing (total debt/tangible net-worth) is expected to increase to ~1.5 times and its total debt/OPBIDTA expected to increase to ~6.0 times in FY2022. Quick scaling up of operations and healthy profitability would remain imperative to improve its debt protection metrics over the medium term.

High working capital intensity - The working capital intensity of NCL, as measured by NWC/OI, remains high, characterised by NWC/OI of 43.0% as on March 31, 2020, owing to high inventory levels and elongated receivables. Although its working capital intensity improved to 36.4% as on December 31, 2020, aided by better collection efficiency, the sustainability of the same remains to be seen. However, ICRA notes that the company's working capital limits have been moderately utilised, thereby supporting its liquidity. Besides, the company has also applied for an enhancement of its cash credit facility from Rs. 6.5 crore to Rs. 12.0 crore to meet the incremental working capital requirements in its capsules segment as it anticipates healthy revenue growth.

Intense industry competition - NCL faces intense competition in the international markets, mainly from Chinese players, which restricts the company's pricing flexibility. In the domestic market as well, it faces competition from other established players. Owing to stiff competition, NCL's ability to pass on the increase in raw material prices to its customers gets limited.

Liquidity position: Adequate

NCL's liquidity position is adequate, characterised by moderate buffer availability in its working capital facilities. The average working capital utilisation stood at 53.8% of the sanctioned limit from December 2019 to February 2021. Besides, the expected enhancement in its working capital facilities is likely to provide comfort. However, given the considerable debt-funded capital expenditure envisaged by the company towards capacity expansion and setup of a facility for undertaking API manufacturing, any delays in scale up of operations and/or steep decline in profitability can tighten the liquidity position. Besides, the company's ability to meet any funding shortfall in terms of the capital expenditure and incremental working capital requirement in line with the expected increase in scale of operations would remain critical from the liquidity perspective. ICRA expects the company to meet the funding shortfall through asset monetisation, raise of fresh equity and further enhancement of its working capital facilities.

Rating sensitivities

Positive factors: ICRA could upgrade NCL's ratings if the company is able to expand its scale of operations and increase its profitability on a sustained basis, leading to an overall improvement in its credit metrics. Moreover, optimal utilisation of the expanded capacity in its capsules segment and the timely commencement of operations and ramp of scale in its API segment are credit positives.

Negative factors: Negative pressure on the ratings could arise if higher-than-anticipated capital expenditure or working capital intensity, or delays in equity infusion, or financial closure leads to project delays, resulting in weakening of the company's liquidity position and credit metrics. Specific credit metrics 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
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, primarily manufactures Empty Hard Gelatin Capsule (EHGC) shells and Empty Hard Cellulose Capsule (EHCC) shells. The company has one manufacturing unit in Bangalore and the another in Pondicherry, with an aggregate capacity of 7.2 billion capsule shells per annum and caters to both domestic and international markets. NCL's product mix comprises various capsule shells such as Hard Gelatin Capsule Shells, Hard Cellulose Capsule Shells, BSE/TSE Free Gelatin Capsule Shells, Shiny Gelatin Capsule Shells, SLS free Gelatin Capsule Shells, Halal Certified Gelatin Capsule Shells, Fortified Gelatin Capsule Shells, Sweet Gelatin Capsule Shells and Fast Release Gelatin Capsule Shells. The company is in the process of enhancing its capsules capacity from 7.2 billion capsule shells per annum.

NCL setup a 100% subsidiary, Natural Biogenex Private Limited, in August 2020 to set up a facility for API manufacturing, including three key APIs – Betamethasone, Dexamethasone and Prednisolone—along with its intermediates and derivates. The commercial operation of its API facility is expected to commence in April 2022.

Key financial indicators (Audited)

NCL	FY2019	FY2020	9M FY2021 Prov.
Operating Income (Rs. crore)	60.01	61.55	56.40
PAT (Rs. crore)	1.90	0.86	5.28
OPBDIT/OI (%)	8.75%	8.62%	13.14%
PAT/OI (%)	3.17%	1.39%	9.36%
Total Outside Liabilities/Tangible Net Worth (times)	0.34	0.34	0.35
Total Debt/OPBDIT (times)	1.03	1.18	0.31
Interest Coverage (times)	9.92	6.92	35.29

(Source: NCL)

Prov. – Provisional financials; 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: Not Applicable

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on February 28, 2021 (Rs. crore)	Date & Rating in	FY2021	FY2020		FY2019
					April 09, 2021	--	February 18, 2020	May 31, 2019	--
1	Fund-based – Cash Credit	Long-term	6.50	4.88	[ICRA]BBB (Stable)	-	[ICRA]BBB&	[ICRA]BBB (Stable)	-
2	Non-fund based – Working capital facilities	Short-term	1.29	-	[ICRA]A3+	-	[ICRA]A3+&	[ICRA]A3+	-
3	Unallocated bank facilities	Long-term/short-term	4.70	-	[ICRA]BBB (Stable)/ [ICRA]A3+	-	[ICRA]BBB&/ [ICRA]A3+&	[ICRA]BBB (Stable)/ [ICRA]A3+	-

& - placed under rating watch with developing implications

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	Fund-based – Cash Credit	NA	NA	NA	6.50	[ICRA]BBB (Stable)
NA	Non-fund Based	NA	NA	NA	1.29	[ICRA]A3+
NA	Unallocated	NA	NA	NA	4.70	[ICRA]BBB (Stable)/ [ICRA]A3+

Source: *NCL*

Annexure-2: List of entities considered for consolidated analysis

Company Name	NCL's Ownership	Consolidation Approach
Natural Biogenex Private Limited	100%	Full Consolidation
Natural Phyto Pharma Private Limited	100%	Full Consolidation

Source: *NCL, ICRA research*

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About ICRA Limited:

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