

July 04, 2022

## Natural Capsules Limited: Ratings reaffirmed

### 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
Short-term Non-fund based	1.29	1.29	[ICRA]A3+; reaffirmed
Long-term/short-term Unallocated	4.70	4.70	[ICRA]BBB(Stable)/[ICRA]A3+; reaffirmed
<b>Total</b>	<b>12.49</b>	<b>12.49</b>	

*\*Instrument details are provided in Annexure-1*

### Rationale

The reaffirmation of ratings continues to consider Natural Capsules Limited's (NCL / the company) established presence in the Empty Hard Gelatin Capsule (EHGC) manufacturing industry, its promoters' extensive experience in the industry and its diversified product profile as well as strong relationships with its key customers. The ratings also factor in improvement in the company's top line and bottom line in FY2022, attributable to increase in volume of orders and higher operational efficiency from the ongoing modernisation of its in-house facility. ICRA notes NCL's plan to foray and diversify into the Active Pharmaceutical Ingredient (API) business by setting up a manufacturing facility under its subsidiary, Natural Biogenex Private Limited (NBPL). ICRA also notes the Performance Linked Incentive (PLI) scheme awarded for its key APIs, Betamethasone, Dexamethasone and Prednisolone. However, the same is exposed to the risk of timely commencement and utilisation of capacity based on market demand.

The ratings also consider the high utilisation of working capital limits and limited free cash and bank balance, which have impacted the liquidity position of the company. ICRA also expects the ongoing capex towards enhancing the company's capsule manufacturing capacity enhancement and setting up API manufacturing facility to moderate NCL's debt coverage indicators in the near term. The total outlay for NCL's ongoing capital expenditure (capex) is estimated at ~Rs 134.0 crore (for the API facility and capsule capacity expansion and modernisation), which is to be funded by a term loan of Rs. 66.0 crore (Rs. 48.0 crore and Rs. 18.0 crore, for the API and capsule projects, respectively). The rating factors in the project risks associated with these large capex undertakings in terms of commercialisation and revenue generation from them. ICRA notes that the API project is at a nascent stage and with the production process for APIs being a relatively untested process in India, timely project completion and ramping of operations will be a key rating monitorable. Given the stretched liquidity, the scaling up of operations would entail timely funding requirement in the form of either equity infusion, internal accruals, or incremental working capital lines apart from sanctioned term loans. The ratings also continue to consider NCL's exposure to high competition, 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 benefit from its proposed capex over the long term.

## Key rating drivers and their description

### Credit strengths

**Extensive experience of NCL in EHGC industry** – The promoters have extensive experience in the capsule segment, while NCKL 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 production capacity of 16.7 billion capsules per annum in FY2022, which it is in the process of enhancing up to 24.1 billion per annum.

**Diversified customer profile** – NCL caters to a large number of reputed customers. It has a vast customer base in the domestic as well as export markets. In the past few years, the company has penetrated into the European, West Asian and South American markets. The company's focus on quality has led to repeat orders from many of its key clients. Further, it has added new customers in the domestic market, which has supported its revenue growth in FY2021 and FY2022.

**Healthy revenue growth and significant improvement in operating margins in FY2022** – NCL's operating income grew significantly by ~70% in FY2022 to Rs. 135.1 crore. In the past, the capsules capacity of 7.2 billion/annum acted as a constraining factor for the company's revenue scale up. The recent capacity expansion cum modernisation exercise for enhancing its capsules capacity to 24.1 billion per annum is likely to support NCL in meeting the increased demand. The healthy revenue growth in FY2022 was primarily aided by a mix of volume growth, price revision and better efficiency. The company's operating margin stood at 18% in FY2022 over 14% in FY2021. The company has replaced older machines with latest, high-speed machines along with the installation of new ones, which has reduced operational costs with reduced manpower, energy consumption, wastage and downtime.

**Diversification into API business** – NCL is in the process of setting up a manufacturing facility for manufacturing APIs under its subsidiary, NBPL. The company will focus on the three APIs of Betamethasone, Dexamethasone and Prednisolone along with their associated intermediaries and derivative products. NCL will be the only producer for Betamethasone and Dexamethasone in India and one of the only two producers for Prednisolone. The API facility is expected to commence operations from April 1, 2023. The company has also been awarded a PLI scheme for the same, making it eligible to avail incentives in the range of 10–20% with a cap of Rs. 10.0 crore/year for each of the APIs. The PLI scheme is for seven years, commencing from FY2024, and is expected to support NCL's profitability under its API operations. The installed manufacturing capacity for the API facility (for PLI approved APIs) will be 37 MT. With these APIs being import substitutes, ICRA expects NCL's business prospects to be healthy. However, the same will continue to remain a key rating monitorable.

### Credit challenges

**Project risks associated with ongoing expansion plans** – The company is in the process of enhancing and modernising its capsule manufacturing capacity up to 24.1 billion p.a., at a cost of around Rs. 38.0 crore. The company has incurred ~Rs. 20 crore under the same in FY2022, funded through internal accruals and term loans. NCL has been sanctioned a term loan of Rs. 18 for its capsule-capacity expansion project. The modernisation exercise is expected to enable improved manufacturing efficiency and reduced cost of production. The company is also setting up a facility for API manufacturing under its subsidiary, NBPL (incorporated in August 2020) at a cost of ~Rs. 96.0 crore. The company has availed a term loan of Rs. 48.0 crore to partially fund the same, with the rest coming in through internal accruals and rights issue. Moreover, given the greenfield capex, 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.

**Capital structure and coverage indicators to moderate in near term owing to sizeable debt-funded capex** – NCL's capital structure stood comfortable at 0.6 time as on March 31, 2022, on the back of its limited reliance on external borrowings. The company's borrowings until FY2021 had been skewed towards short-term loans availed to meet the working capital requirements. However, with ongoing capex, the company has availed long-term debt to fund the capex. This in turn impacted

the company's coverage indicators. Going forward, given the sizeable debt-funded capex plans envisaged by the company, its capital structure and coverage indicators are likely to witness further moderation in the near term. The company's ability to generate adequate accruals to meet its debt obligations will remain a key monitorable in the near term. The company's ability to commence operations at its API facility on a timely basis and to optimally utilise the capacity in its API as well as capsules segment and improve its revenues and profitability will be critical to ensure adequate availability of accruals to service the repayment obligations on the proposed term loans.

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

### Liquidity position: Stretched

NCL's liquidity position is stretched as characterised by high utilisation of working capital limits. The average working capital utilisation stood at 85% of the sanctioned limit for the period April 2021 to May 2022. Given the considerable debt-funded capex towards capacity expansion and establishment of an API manufacturing facility, any delays in scale up of operations and/or steep decline in profitability can further tighten the liquidity position. Besides, the company's ability to meet any funding shortfall in terms of capex requirements and its incremental working capital requirement in line with the expected increase in scale up of operations would remain critical from the liquidity perspective.

### Rating sensitivities

**Positive factors** – ICRA could upgrade NCL's ratings if it is able to increase its scale of operations and profitability on a sustained basis through optimal utilisation of its expanded and modernised capacity in its capsules segment, coupled with timely commencement of operations in its API segment.

**Negative factors** – Negative pressure on the ratings could arise if higher-than-anticipated capex and/or delays in equity infusion or financial closure leads to project delays resulting in weakening of the company's liquidity position and/or capital structure. 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	<a href="#">Corporate Credit Rating Methodology</a>
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 EHGC and Empty Hard Cellulose Capsule (EHCC) shells. The company has a manufacturing unit in Bangalore and the another in Pondicherry, with an aggregate production capacity of 16.7 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 up to 24.1 billion capsule shells per annum.

NCL set up a 100% subsidiary, Natural Biogenex Private Limited, in August 2020 for manufacturing APIs, such as Betamethasone, Dexamethasone and Prednisolone, along with their intermediates and derivatives. The commercial operation of NCL's API facility is expected to commence from April 2023.

#### Key financial indicators

NCL	FY2021	FY2022
Operating Income (Rs. crore)	79.5	135.1
PAT (Rs. crore)	6.9	13.9
OPBDIT/OI (%)	14.0%	18.0%
PAT/OI (%)	8.7%	10.3%
Total Outside Liabilities/Tangible Net Worth (times)	0.6	1.0
Total Debt/OPBDIT (times)	0.9	2.1
Interest Coverage (times)	20.4	11.7

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ^Provisional.

#### Status of non-cooperation with previous CRA: Not Applicable

#### Any other information: None

#### Rating history for past three years

Instrument	Current Rating (FY2023)				Chronology of Rating History for the Past 3 Years			
	Type	Amount Rated (Rs. crore)	Amount Outstanding as on Mar 31, 2022 (Rs. crore)	Date & Rating on	Date & Rating on FY2022	Date & Rating on FY2021	Date & Rating in FY2020	
				July 04, 2022	April 09, 2021	-	February 18, 2020	May 31, 2019
1 Fund-based – Cash Credit	Long Term	6.50	-	[ICRA]BBB (Stable)	[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+&	[ICRA]A3+
3 Unallocated bank facilities	Long Term /Short Term	4.70	-	[ICRA]BBB (Stable)/[ICRA]A3+	[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

Instrument	Complexity Indicator
Fund-based Limits	Simple
Non-fund Based Limits	Very Simple
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: [www.icra.in](http://www.icra.in)

### Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund-based Limits	NA	NA	NA	6.50	[ICRA]BBB(Stable)
NA	Non-fund Based Limits	NA	NA	NA	1.29	[ICRA]A3+
NA	Unallocated	NA	NA	NA	4.70	[ICRA]BBB (Stable) / [ICRA]A3+

Source: Company

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

Company Name	Ownership	Consolidation Approach
Natural Biogenex Private Limited	100.00%	Full Consolidation
Natural Phyto Pharma Private Limited	100.00%	Full Consolidation

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