September 27, 2019

Hikal Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based-Term Loan	234.00	234.00	[ICRA]A (Stable); reaffirmed
Fund-based- Working Capital Facilities	224.00	224.00	[ICRA]A (Stable); reaffirmed
Long Term: Term Loan (USD million)	18.00	15.36	[ICRA]A (Stable); reaffirmed
Short Term-Fund Based	202.90	202.90	[ICRA] A1; reaffirmed
Short Term Non-fund Based	70.00	70.00	[ICRA] A1; reaffirmed
Total	**730.90 USD 18 million**	**730.90 USD 15.36 million**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of ratings takes into account the healthy growth in Hikal Limited's (Hikal) revenues, at a CAGR of 12.8%, during FY2015-2019 and stable operating margins leading to healthy accruals and improvement in coverage indicators. Hikal has a healthy pipeline of products under development for proprietary and contract manufacturing, which is expected to support its future growth especially in the export market. The ratings are supported by its existing strong product profile and entrenched relationship with leading pharmaceutical and agro-chemical (crop protection segment) companies in the world. Gabapentin, an active pharmaceutical ingredient (API), continues to fetch a significant share of pharmaceutical segment revenues with an established market share of ~40%. The company's coverage indicators improved in FY2019 with TD/OPBDITA, interest coverage and TOL/TNW of 2.2 times, 5.2 times and 1.2 times, respectively, compared to 2.6 times, 5.0 times and 1.3 times, respectively, in FY2018. However, it is undertaking significant debt-funded capex worth ~Rs. 600 crore over FY2020-FY2022 to scale up its pharmaceutical and crop protection business (contract manufacturing and proprietary products). The capital expenditure is likely to be funded with a mix of internal accruals and debt, though healthy accruals from same remain a key monitorable.

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

Favourable demand and realisations for existing products supporting revenue growth and margins – Hikal is receiving new business from developed countries like Japan, Europe and USA due to the strong demand from the customers for both segments, scalability of production, technological knowhow and sound business practices of non-compete practices with customers. Its operating income (OI) grew at a healthy rate of 22.6% YoY in FY2019, primarily due to increased realisations and healthy volume offtake. The pharmaceuticals and crop protection segment grew by 25% YoY and 19%

YoY, respectively, in FY2019. Hikal's pharmaceutical segment grew as a result of increased offtake for the existing products, while its realisations improved backed by increase in of raw material prices that were passed onto consumers. The crop protection segment witnessed stable demand from the existing products. This growth in pharmaceutical and crop protection segments supported the margin profile that remained stable at 19.0% and 6.5%, respectively, in FY2019 versus 18.9% and 6.0%, respectively, in FY2018. Going forward, it expects an improvement in its financial profile from increased capacity expansions, new product introduction, geographical expansion and established presence and technological knowhow.

Reputed and diversified client base – The customer base for the pharmaceutical division is diversified with the top three customers comprising ~40-45% of the total pharmaceutical revenue. The company is a market leader for Gabapentin that is supplied to various companies including the innovator. Hikal has well-established relationships with the buyers of Gabapentin. In the crop protection segment, there are a few large companies, as a result of which the concentration is skewed. Along with building its own portfolio of products, Hikal enjoys exclusive supplier status for some molecules.

Dominant position in Gabapentin API segment – Gabapentin contributes to a significant percentage of Hikal's revenue in the pharmaceutical segment and Hikal continues to maintain its market leader position with ~40% market share. The growth in revenues for Gabapentin was driven by robust increase in realisations (raw material costs passed on) and volume, despite being off-patent, which has supported the company's growth. Going forward, further growth is projected for this API with Hikal's large installed capacity and stable demand from its customers.

Healthy coverage indicators and capitalisation structure – Hikal has maintained a healthy financial profile with a gearing of 0.9 times in FY2019, coupled with an improvement in the Total Debt/OPBITDA to 2.2 times in FY2019 versus 2.6 times in FY2018, supported by healthy accruals. The interest coverage and TOL/TNW stood at 5.2 times and 1.2 times, respectively, in FY2019, compared to 5.0 times and 1.3 times, respectively, in FY2018.

Credit challenges

Significant near-term debt-funded capex; achieving desired level of profitability remains to be seen – The company is undertaking significant debt-funded capex of ~Rs. 600 crore over FY2020- FY2022 to scale up its pharmaceutical and crop protection business (contract manufacturing and own products). With a gestation period of 18-24 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 confirmed contract manufacturing orders and proven track record of successful implementation of such projects.

High working capital intensity – Hikal's working capital requirement remained elevated at 36% in FY2019. The working capital remains high on account of its high level of inventory due to 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 many raw materials (mainly from China), Hikal must maintain stock as the supplies are not regular leading to higher inventory days.

Profitability vulnerable to adverse movement in foreign exchange rates and raw material prices – The company's profitability is exposed to adverse movement in foreign exchange as ~70% of the revenues are derived from exports. Hikal enjoys some natural hedge from its imports (~35-40% of raw materials) as well as foreign currency debt, though it is exposed to adverse movement in foreign currency rates. Its margins remain vulnerable to any adverse movement in raw material prices. However, the company can pass on the increased costs to its customers, as witnessed from the FY2019 margins, which remained stable despite an increase in raw material prices owing to production issues in China.

Liquidity position: Adequate

Hikal's liquidity is **adequate** with healthy accruals of Rs. 180.1 crore and cash flow from operations of nearly Rs. 80-100 crore despite moderately high NWC/OI of 36%. The liquidity is supported by healthy accruals, cash and cash equivalents of Rs. 31.5 crore in FY2019 (Rs. 27.2 crore in FY2018) and unutilized fund based limits. Hikal's average working capital limit utilisation (working capital and bill discounting) for FY2019 is approximately 69% of sanctioned limits and ~53% of its drawing power (excluding bill discounting facility).

The company has a capex commitment of Rs. 300 crore in FY2020 to be financed by its internal accruals and long-term debt, of which Rs. 150 crore has been sanctioned. The remaining capex of Rs. 300 crore in FY2021 will be financed by its internal accruals and additional long-term debt. Therefore, its free cash flows are constrained by the high working capital intensity and significant debt-funded capex.

Rating sensitivities

Positive triggers – ICRA could upgrade Hikal's rating if the company demonstrates diversification in its pharmaceutical and crop protection businesses, coupled with improved revenue performance and stable operating margins in the range of 17%-20%. Specific credit metrics that could lead to an upgrade of Hikal's rating include (1) Total Debt/ OPBITDA below 2.0 times on a sustained basis; and (2) DSCR greater than 2.25 times on a sustained basis.

Negative triggers – Negative pressure on Hikal's rating could arise if its working capital deteriorates or the debt-funded capacity expansion without the desired level of accruals weakens the cash flows. Specific credit metrics that could lead to a downgrade of Hikal's rating include Total Debt/OPBITDA exceeding 2.5 times and a weakening in DSCR to below 1.7 times on a sustained basis.

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 March 31, 2019, the company had 1 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 & 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. The company 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 US FDA certified for advanced intermediates. The Jigani (Karnataka) facility manufactures key APIs for the pharmaceutical industry and has been approved by the US FDA, PMDA (Japan) and

the European Union authorities. Hikal is expanding its facilities at Panoli to include manufacturing of APIs and specialised biocides and fungicides 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)

	FY2018	FY2019
Operating Income (Rs. crore)	1296.1	1589.6
PAT (Rs. crore)	77.2	103.1
OPBDIT/OI (%)	18.9%	19.0%
RoCE (%)	14.0%	16.5%
Total Debt/TNW (times)	0.9	0.9
Total Debt/OPBDIT (times)	2.6	2.2
Interest coverage (times)	5.0	5.2

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

		Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs.crore)	Date &Rating 27-Sept 2019	Date & Rating in FY2019 26-July 2018	Date & Rating in FY2018 18-Aug 2017	Date & Rating in FY2017 08-Nov 2016
1	Term Loan	Long Term	234.00	191.10	**[ICRA]A (Stable)**	[ICRA]A (Stable)	[ICRA] A- (stable)	[ICRA] BBB+ (stable)
2	Working Capital facility	Long Term	224.00	-	**[ICRA]A (Stable)**	[ICRA]A (Stable)	[ICRA] A- (stable)	[ICRA] BBB+ (stable)
3	Term Loan: USD million	Long Term	15.36	15.36	**[ICRA]A (stable)**	[ICRA]A (stable)	[ICRA] A- (stable)	[ICRA] BBB+ (stable)
4	Bill Discounting	Short Term	148.00	-	**[ICRA]A1**	[ICRA]A1	[ICRA] A2+	[ICRA] A2
5	Non- Fund Based Limit	Short Term	105.00	-	**[ICRA]A1**	[ICRA]A1	[ICRA] A2+	[ICRA] A2

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	Term loan 1	28-Sep-15	NA	31-Mar-23	31.2	[ICRA] A (Stable)
NA	Term loan 2	28-Sep-15	NA	31-Mar-23	58.5	[ICRA] A (Stable)
NA	Term loan 3	28-Sep-15	NA	31-Mar-23	23.4	[ICRA] A (Stable)
NA	Term loan 4	28-Sep-15	NA	31-Mar-23	7.8	[ICRA] A (Stable)
NA	Term loan 5	24-Sep-15	NA	31-Mar-23	50.7	[ICRA] A (Stable)
NA	Term loan 6	24-Sep-15	NA	31-Mar-23	15.6	[ICRA] A (Stable)
NA	Term loan 7	24-Sep-15	NA	31-Mar-23	15.6	[ICRA] A (Stable)
NA	Term loan 8	Dec-15	NA	Dec-23	USD 15.36 million	[ICRA] A (Stable)
NA	Working capital limits	NA	NA	NA	304	[ICRA] A (Stable)
NA	Bill discounting	NA	NA	NA	148	[ICRA] A1
NA	Non-fund based	NA	NA	NA	105	[ICRA A1

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Acoris Research Limited	100.00%	Full Consolidation

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