Natural Capsules Limited

September 01, 2022

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term Bank Facilities	31.25	CARE BBB; Stable (Triple B; Outlook: Stable)	Assigned
Short-term Bank Facilities	0.80	CARE A3+ (A Three Plus)	Assigned
Total Bank Facilities	**32.05 (₹ Thirty two crore and five lakh only)**		

Details of instruments/facilities in Annexure-1.

Detailed rationale and key rating drivers

The rating assigned to the bank facilities of Natural Capsules Limited (NCL) derives strength from experienced promoter with long track record of operations in the pharma sector, established relations with diverse clients leading to repeat orders as well as low customer concentration risk and diversified product range. The ratings also positively factors in the improved financial risk profile marked by increase in scale of operations coupled with improvement in profitability over FY20-FY22 which continued in Q1FY23 and favourable industry outlook.

These rating strengths are partially offset by project implementation, offtake and funding risk associated with large project being undertaken by the company for expansion of capsule unit as well as setting up a new API unit. CARE Ratings Ltd however notes experience of promoters in their individual capacity in API manufacturing and distribution. Further, NCL is at an advanced stage of tying up the remaining funds for the projects thereby reducing funding risk to an extent. Nevertheless, timely completion and commercialization of the project without any cost overruns is crucial from the credit perspective. The ratings are also tempered by moderation in the liquidity position of the company with commencement of the capex programme as evidenced by increased working capital utilizations coupled with highly fragmented and competitive nature of industry.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Commencement of operations of the API segment without any time and cost overrun and optimal capacity utilization of upcoming capacities.
- Improvement in scale of operations to Rs. 200 crore while maintaining Return in Capital Employed (ROCE) above 15% and Total debt/ PBDIT of less than 2.5x.

Negative factors – Factors that could lead to negative rating action/downgrade:

- Deterioration in the credit metrics on account of any un-envisaged increase in debt to fund the capex requirement leading to overall gearing beyond unity
- Weakening of financial profile because of significant increase in working capital requirements and/ or cost overruns in the ongoing projects
- Interest coverage ratio (ICR) below 3x or overall gearing more than 1.25x.

Key rating drivers

<u>Key Rating Strengths</u>

Experienced promoters with long track record of operations in the pharma sector

NCL is promoted by Mr. Sunil Kumar Mundra (Managing Director) and his family members. Mr Mundra is a Chartered Accountant by qualification and has more than 30 years of experience in the pharma sector. Prior to incorporating NCL, the promoters were engaged in API distribution and manufacturing. The company has two manufacturing units; one in Bengaluru and one in Puducherry with a combined capacity of 13.3 billion capsules per annum as on March 31, 2022.

Low customer concentration risk on account of diversified customer base

With over three decades of experience in the pharma sector, the company has built up a strong customer based both domestically as well as rest of the world (RoW) markets which include emerging markets like South Africa, Iran, Bangladesh, Pakistan, Brazil etc. NCL supplies capsules to diversified customers both domestically as well as internationally leading to low customer concentration risk. NCL focuses on quality and timely delivery which has led to receipt of repeat orders from its clients.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Diversified product range
The company's product profile is well diversified with production of wide range of EHGC (Empty Hard Gelatine Capsule) & HPMC (Hydroxy Propyl Methyl Cellulose) having diverse applications. Over the years, NCL had adapted itself to the changing market dynamics with various forms of complex formulations as well as manufacturing of HPMC capsules (vegetarian capsules) which are used in Nutraceuticals and Herbal products.

Growing scale of operations with improved profitability margins
The total operating income of the company grew at a CAGR of 25.24% over a period of five years ending March 31,2022 with TOI of 135.07 cr achieved during FY22 as against Rs. 54.90 cr achieved during FY18. The improvement in the scale of operations started from FY20 onwards with increase in installed capacity from 7.2 billion capsules per annum to 13.3 billion capsules per annum in FY22, leading to increase in volumes sold.
Further, with increase in scale of operations, the profitability margins of the company also improved on account of better absorption of fixed cost. Further, during FY21 and FY22, NCL was able to optimize its power and manpower cost with improvements in existing machinery as well as installing new machinery with higher efficiency and lower wastage. Resultantly profitability margins of the company has improved as reflected by PBILDT and PAT margins of 9.61% and 1.38% respectively in FY20 to 18.99% and 10.30% respectively in FY22.

Key Rating Weaknesses

Project implementation, funding and offtake risk
The company is currently undertaking two projects; one for capacity enhancement to increase the existing capsule capacity from 13.3 billion capsules per annum to 22-24 billion capsules per annum. The second project pertains to setting up a new API unit in Tumkur Karnataka under its wholly owned subsidiary Natural Biogenex Pvt Ltd to manufacture three steroidal APIs namely Betamethasone, Dexamethasone and Prednisolone aggregating to total installed capacity of 37 metric tonnes.
The total project cost for capsule expansion is estimated at Rs. 46.29 crore to be funded out of Rs. 16.50 cr of debt and remaining through equity. Till June 30,2022 the company had incurred around 49% of the project cost primarily out of internal accruals and equity. Out of Rs. 16.50 cr of debt required around Rs.12 crore is still pending to be tied up. The company is in advanced stage of discussion with various banks and expects to achieve financial closure by Q2FY23.
For the API project, the total project cost is estimated to be around Rs. 107.78 crore to be funded out of Rs. 60.00 crore of debt and remaining through rights issues and internal accruals. Till June 30,2022 the company had incurred around 44% of the project cost. Out of the total debt of Rs. 60 crores required, financial closure of Rs. 48 cr have been achieved and the company is in the process of tying up of the remaining Rs. 12 crores. The company is also eligible for Production Linked Incentive (PLI) aggregating to Rs. 67 crore approximately over a period of six years commencing from FY24.
The projects are expected to be completed by Q4FY23. Timely completion and operationalization of projects within the envisaged cost is crucial and will be a key rating sensitivity.

Moderation in liquidity position as well as capital structure
With commencement of the capex programme, the working capital requirements of the company have increased as reflected by increased average fund based utilization levels of around 85% for the past 12 months ending June 30,2022. Till FY21, the debt primarily comprised of working capital loans availed by the company to fund its short-term requirements. However, during FY22, the company availed long term loans to meet its capex requirements leading to moderation in overall gearing from 0.17x as on March 31,2021 to 0.63x as on March 31,2022. Other debt coverage indicators also moderated as reflected by TDGCA and Interest Coverage ratio of 2.60x and 12.32x respectively as on March 31,2022 as against 0.92x and 20.98x respectively as on March 31, 2021.
Going forward with ongoing debt funded projects of capacity expansion and new API unit being undertaken, the capital structure and debt coverage indicators of the company are expected to moderate further.

Highly fragmented and competitive nature of industry with regulatory risks
NCL is engaged in the manufacturing of capsule shells which is a raw material (excipient) for pharmaceutical and food supplement industry. The industry is characterized by a high level of competition having presence of many small and big players. Further, the domestic capsule manufacturers also face stiff competition in the international market from Chinese players thereby restricting there pricing flexibility and thus the ability of the company to pass on the increase in prices of raw materials.

Liquidity: Stretched
The liquidity position of the company has moderated with increased working capital utilization. Average utilization was 83% for the past 12 months ending June 30,2022. Further, as on June 30,2022 the company had free cash and bank balance of Rs. 3.78 cr. The company generated GCA of around Rs. 20 crore against annual principal repayments of in the range of Rs. 2-9 crore. However, given the ongoing capex, the ability of the company to meet any funding shortfall in terms of capex requirements would remain critical from liquidity perspective.
Further, scale up of operations as envisaged to meet the debt repayment obligations as well as equity commitments towards the projects remains crucial.

Analytical approach: Consolidated
Subsidiaries Consolidated:

Natural Phyto Pharma Pvt Ltd (non-operational)	75%
Natural Biogenex Pvt Ltd (upcoming API business)	100%

Applicable criteria
Consolidation
Policy on default recognition
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Manufacturing Companies
Pharmaceutical
Policy on Withdrawal of Ratings

About the company
Natural Capsules Limited (NCL) was incorporated in September 1993 and is engaged in manufacturing of Hard Gelatine Capsule Shells and Hard Cellulose Shells to be supplied to various pharma companies in India as well as abroad (primarily un-regulated markets). The company has two manufacturing units; one in Bangalore and one in Pondicherry with a combined capacity of 13.3 billion capsules per annum as on March 31, 2022.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	June 30, 2022 (UA)
TOI	79.82	135.07	44.40
PBILDT	11.40	25.64	9.39
PAT	6.91	13.91	5.24
Overall gearing (times)	0.17	0.63	NA
Interest coverage (times)	20.98	12.32	15.15

A: Audited; UA: Un-Audited; NA: Not Available.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating history for last three years: Please refer Annexure-2

Covenants of rated instrument/facility: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	-	Feb 2029	15.75	CARE BBB; Stable
Fund-based - LT-Cash Credit	-	-	-	-	10.00	CARE BBB; Stable
Fund-based - LT-EPC/PSC	-	-	-	-	2.50	CARE BBB; Stable
Fund-based - LT-Working Capital Demand loan	-	-	-	-	2.00	CARE BBB; Stable
Fund-based - LT-Stand by Limits	-	-	-	-	1.00	CARE BBB; Stable
Non-fund-based - ST-BG/LC	-	-	-	-	0.80	CARE A3+

Annexure-2: Rating history of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Term Loan	LT	15.75	CARE BBB; Stable	-	-	-	-
2	Fund-based - LT-Cash Credit	LT	10.00	CARE BBB; Stable	-	-	-	-
3	Fund-based - LT-EPC/PSC	LT	2.50	CARE BBB; Stable	-	-	-	-
4	Fund-based - LT-Working Capital Demand loan	LT	2.00	CARE BBB; Stable	-	-	-	-
5	Fund-based - LT-Stand by Limits	LT	1.00	CARE BBB; Stable	-	-	-	-
6	Non-fund-based - ST-BG/LC	ST	0.80	CARE A3+	-	-	-	-

Annexure-3: Detailed explanation of covenants of the rated instrument/facilities:

Term Loan	Detailed Explanation
A. Financial covenants	DSCR>= 1.25x NWC to be maintained at 25$
B. Non-financial covenants	Not Specified

Annexure-4: Complexity Level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Fund-based - LT-Cash Credit	Simple
2	Fund-based - LT-EPC/PSC	Simple
3	Fund-based - LT-Stand by Limits	Simple
4	Fund-based - LT-Term Loan	Simple
5	Fund-based - LT-Working Capital Demand loan	Simple
6	Non-fund-based - ST-BG/LC	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

Note on complexity levels of the rated instrument: CARE Ratings Ltd. has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About CARE Ratings Limited:
Established in 1993, CARE Ratings Ltd. is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India (SEBI), it has also been acknowledged as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). With an equitable position in the Indian capital market, CARE Ratings Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.
With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

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