Hester Biosciences Limited

January 10, 2020

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Rating Action
Long-term Bank Facilities	21.34 (enhanced from Rs.16.74 crore)	**CARE A-; Stable (Single A Minus; Outlook: Stable)**	**Reaffirmed**
Long / Short-term Bank Facilities	50.00 (enhanced from Rs.30.00 crore)	**CARE A-; Stable/ CARE A2 (Single A Minus; Outlook: Stable/ A Two)**	**Reaffirmed**
Short- term Bank Facilities	3.97 (reduced from Rs.23.97 crore)	**CARE A2 (A Two)**	**Reaffirmed**
Total Facilities	**75.31 (Rupees Seventy Five Crore and Thirty One Lakh only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Hester Biosciences Limited (HBL) continue to derive strength from its experienced promoters, established position in the poultry vaccine industry, wide marketing and distribution network and diversified revenue stream with increasing focus on large animal division and healthcare products. The ratings also factor in the consistent growth in its total operating income, improved and healthy profitability margins, comfortable capital structure and debt coverage indicators, and adequate liquidity.

The above rating strengths are, however, tempered by HBL's large working capital requirement due to high inventory holding period, presence in regulated vaccine industry, continued under-utilisation of its Nepal operations with lower than envisaged production and sales volumes due to tender driven competitive nature of business and implementation and salability risk associated with its ongoing large size capital expenditure in Africa.

Rating Sensitivities

Positive Factors:

- Increase in its scale of operations with total operating income (TOI) higher than Rs.400 crore while continuing to earn healthy PBILDT margin and greater than 25% ROCE on a sustained basis.
- Contraction in its operating cycle to less than 120 days on sustained basis
- Maintaining its overall gearing around 0.50 times along with improvement in its Total Debt/GCA to less than unity on a sustained basis
- Completion of its ongoing project in Africa within envisaged time and cost parameters along with realizing envisaged benefits therefrom

Negative Factors:

- Deterioration in its overall gearing ratio beyond 0.75 times on sustained basis
- Further elongation in its operating cycle adversely affecting its cash flow from operations and liquidity
- Continued slow ramp up in production and sales volumes at its Nepal operations
- Significant cost or time over-run in its on-going African project and/ or any adverse regulatory change having significant adverse impact on its PBILDT margin and debt coverage indicators

Detailed description of the key rating drivers

Key Rating Strengths

Wide experience of promoters: HBL was founded by Mr. Rajiv Gandhi, CEO and Managing Director, who has an experience of more than three decades in vaccine industry and looks after the overall operations of the company. The promoters are supported by qualified second tier management.

Long and established track record of operations: HBL has track record of more than three decades in manufacturing of poultry vaccine. HBL primarily operates into two segments, i.e. vaccine and animal healthcare products for poultry as well as large animals. HBL manufactures vaccine and health products mainly for poultry apart from sheep, goat, cattle and buffalo. Moreover, HBL is certified by DSIR (Department of Science and Industrial Research), WHO-GMP (World Health Organization-Good Manufacturing Practice), GLP (Good Laboratory Practice), ISO (International Organization for Standardization) 9001:2015, ISO 14001:2015 and OHSAS (Occupational Health and Safety Assessment Series) 18001:2007.

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

Diversified revenue stream with increasing focus on large animal division and healthcare products: As on March 31, 2019, the product portfolio of HBL comprises of 49 vaccines (including both poultry and large animal vaccines) and more than 50 animal healthcare products (including therapeutics, drugs, feed supplements and disinfectants). Over the years, the company has regularly launched new products as well as expanded its geographical presence in Nepal through its subsidiary Hester Biosciences Nepal Private Limited (HBNPL) which is engaged in the manufacturing of PPR (Peste Des Petits Ruminants) vaccine of Nigerian strain. Moreover, HBL through its subsidiary Texas Lifesciences Private Limited (TLPL) manufactures healthcare products such as pharma formulations, tablets, capsules, powder, oral liquid, etc. at Mehsana, Gujarat. During FY19, TLPL's plant has also received GMP/GLP certification. HBL is planning to gradually manufacture most of its animal health products in-house at its TLPL plant which would help the company in terms of better control over quality and production schedule.
Further, HBL is strategically shifting its focus on large animal division and healthcare products rather than depending solely on poultry vaccines segment in order to leverage the business benefits of a diversified product portfolio and strengthening value addition.

Established marketing and distribution network: The marketing function of HBL is supported by six owned warehouses, three C&F agents and strong network of distributors which has pan India presence. With the government's initiative to control outbreak of diseases in animals & poultry, it decided to increase the level of scientific diagnosis. During FY19, HBL has incorporated wholly owned subsidiary namely Hester Biosciences Kenya Limited (HBKL) in Kenya and step-down subsidiary namely Hester Biosciences Tanzania Limited (HBTL) in Tanzania for trading of veterinary vaccines and animal health products in Kenya, Tanzania and other Africa regions. Through these subsidiaries, HBL has also started distribution network in Tanzania and Kenya. Development of distribution network coupled with vaccine manufacturing facility is expected to create synergy in African market.

Consistent growth in total operating income with improved and healthy profitability: Total operating income of HBL at a consolidated level registered a compounded annual growth rate (CAGR) of 21% in the last three year ended FY19 and it grew by 28% on Y-o-Y basis during FY19 backed by increase in the sales volumes with increased penetration of its products in the domestic markets. Moreover, contribution from export sales to the total sales remained in the range of 10%-12% in last three years ended FY19. Further, PBILDT margin improved by 380 bps and remained healthy at 38.69% in FY19 backed by increase in margin from large animal vaccine and healthcare products. PAT margins also improved in line with PBILDT margin and stood high at 22.72% in FY19. Increased scale of operations with improvement in profitability margins led to increase in gross cash accruals to Rs.53.95 crore during FY19 as against Rs.34.00 crore in FY18.

Comfortable capital structure and debt coverage indicators: The total debt on a consolidated level increased from Rs.68.78 crore as on March 31, 2018 to Rs.89.85 crore as on March 31, 2019 largely due to debt funded on-going capital expenditure in Tanzania, Africa. However, capital structure of the company continues to remain comfortable marked by overall gearing ratio of 0.50 times as on March 31, 2019 on the back of its strong net worth base. The debt coverage indicators i.e. total debt to GCA and interest coverage continue to remain comfortable at 1.67 years and 10.44 times respectively during FY19 backed by strong profitability and cash accruals.

Liquidity - Adequate: Despite elongated operating cycle of 210 days, the liquidity of the company remains adequate with current ratio of 2.94 times as on March 31, 2019 and modest average fund based working capital utilizations at 65% for past 12 months ended December 2019. Moreover, liquidity is supported by healthy cash flow from operation which stood at Rs.34.62 crore during FY19. Further, HBL has relatively low term debt repayment obligation of Rs.9 crore to Rs.12 crore per annum during FY20 to FY22 as against envisaged annual cash accruals of around Rs.50 crore which indicate adequate cushion in its debt servicing. Furthermore, HBL had cash and bank balance of Rs.41.67 crore as on March 31, 2019 which company plans to utilise towards the on-going capital expenditure in Tanzania, Africa.

Good opportunity in the animal healthcare market: Food and Agriculture Organization (FAO) of the United Nations (UN) and OIE (World Organization for Animal Health) have embarked on a worldwide PPR disease eradication program over a period of 15 years, starting in 2015. This PPR eradication project is expected to induce high demand for the PPR vaccine. HBL through its manufacturing set-up in Nepal is engaged in manufacturing of PPR and Goat pox vaccines of Nigerian strain, thereby providing growth opportunity. Further, Government of India has taken initiative to control Foot and Mouth Disease (FMD) and Brucellosis to support the livestock rearing farmers and has allocated Rs.133.43 billion to be spent over the next five years which also provides opportunity to grow.

Key Rating Weaknesses
Lower than envisaged production and sales volumes from Nepal operations: During November 2016, HBNPL commenced its operations in Kathmandu, Nepal to manufacture PPR and goat pox vaccines of Nigerian strain with an installed capacity of 1.2 billion doses per annum. During FY19, HBNPL has earned total revenue of Rs.9.03 crore as against Rs.1.47 crore in FY18. Moreover, with improvement in operating profitability, net loss reduced from Rs.7.35 crore during

FY18 to Rs.3.02 crore during FY19. Lower revenue from operation is mainly due to slow flow of tenders. Though, there is a sign of improvement during H1FY20 where the Nepal operation has earned a total operating income of Rs.3.91 crore which grew by 160% on Y-o-Y on the back of receipt of tenders from Afghanistan and Algeria; however, it is still incurring losses. Therefore, ramp-up of the Nepal operations in order to achieve the envisaged scale of operations would remain crucial from the credit perspective.

Modest scale and large working capital requirement: Despite consistent growth in total operating income, the scale of operation of the company remained modest marked by total operating income of Rs.180 crore during FY19 and tangible net-worth of Rs.181 crore as on March 31, 2019 on a consolidated basis. Modest scale of operation of the company restricts the financial and operational flexibility of HBL against the large size multi-national and domestic pharmaceutical companies operating in similar business.
Further, the operations of HBL remained working capital intensive with high inventory requirements considering the nature of its products. High inventory days is largely due to the manufacturing process of the product which requires average two-three months of work in progress for various stages of product development for the formulation, processing, stimulations and quality check, etc.

Implementation and salability risk associated with large size capital expenditure in Africa: During FY18, HBL had incorporated its wholly owned subsidiary, Hester Biosciences Africa Limited (HBAL). HBAL is setting up a green field project for animal vaccine manufacturing in Tanzania with capacity to produce 1.5 billion doses of vaccines. Total cost of project is $18 million (approximately Rs.125 crore) which is being funded by HBL in the form of equity capital of $4 million and through capital grant of $4 million and soft loan of $10 million at interest rate of 3% from Bill & Melinda Gates foundation. The soft loan is repayable in 10 biannual installments starting from January 01, 2025 which provides sufficient time for building of cash accruals for debt servicing.
Manufacturing facility of HBAL is being constructed on lease land acquired from Government of Tanzania. As informed by the management, the progress of project is going on as per schedule and the construction of building work is going on. Till August 31, 2019, HBAL has already received equity of $2.25 million, capital grant of $1.30 million and soft loan of $4.00 million from Bill & Melinda Gates Foundation. As on October 31, 2019, the company had incurred total cost of about Rs.36 crore towards the project. The project is expected to be commissioned from December 2020 (i.e. FY21). The size of the capex is relatively large compared to the present operation of the company and the timely implementation without any major time and cost overrun along with subsequent early stabilization remains critical from the credit perspective.

Presence in regulated industry and risk related to poultry industry: The vaccine industry has very high entry barriers and is a highly regulated market in terms of intellectual property rights (IPR) and other regulatory requirements. Further, the poultry industry is exposed to the risks of outbreak of diseases, which in turn, could affect the poultry vaccine industry. Such instances cause a severe reduction in the consumption of poultry products besides causing a cascading effect on the profitability of poultry companies. Further, the demand of HBL's products is dependent upon the farmer's ability to spend on poultry vaccines and healthcare products. In case of rise in cost of animal feed, farmers may be forced to cut expenditure on healthcare products.

Analytical Approach: Consolidated; CARE has considered the consolidated financials of HBL along with its subsidiaries namely HBNPL (65% stake of HBL), HBAL (100% stake of HBL), HBKL (100% stake of HBL) and TLPL (54.80% stake of HBL) as per the audited financial result for the year ended March 31, 2019. These companies are engaged in similar line of business and are an extension of HBL in different geographies. They also have cash flow fungibility and operate under common management platform.

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
CARE's methodology for manufacturing companies
CARE's methodology for Pharmaceutical Companies
Financial ratios – Non-Financial Sector

About the Company
Incorporated in the year 1987, HBL was promoted by Mr. Rajiv Gandhi as a private limited company and subsequently converted into a public limited company in 1993. HBL is one of India's leading animal healthcare companies engaged into manufacturing of vaccine and healthcare products mainly for poultry apart from sheep, goats, cattle and buffalo. The manufacturing facility is located at Kadi in Mehsana district of Gujarat with installed capacity of 4.8 billion doses per annum as on March 31, 2019.

(Rs. Crore)

Brief Financials of HBL (Consolidated)	FY18 (Audited)	FY19 (Audited)
Total operating income	136.19	179.09
PBILDT	47.52	69.28
PAT	23.07	40.69
Overall gearing (times)	0.48	0.50
PBILDT Interest coverage (times)	11.77	10.44

As per the un-audited consolidated results, HBL earned a PAT of Rs.14.29 crore on a total operating income (TOI) of Rs.90.23 crore during H1FY20 as against a PAT of Rs.14.19 crore on a TOI of Rs.83.78 crore during H1FY19.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

Annexure-1: Details of Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT/ ST-Cash Credit	-	-	-	50.00	CARE A-; Stable / CARE A2
Fund-based - LT-Term Loan	-	-	September 2023	21.34	CARE A-; Stable
Fund-based - ST-Working Capital Demand loan	-	-	-	3.75	CARE A2
Non-fund-based - ST-Credit Exposure Limit	-	-	-	0.22	CARE A2

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT/ ST-Cash Credit	LT/ST	50.00	CARE A-; Stable / CARE A2	1)CARE A-; Stable / CARE A2 (27-Sep-19)	1)CARE A-; Stable / CARE A2 (25-Dec-18)	1)CARE A-; Stable / CARE A2 (03-Jan-18)	1)CARE A-; Stable / CARE A2 (24-Jan-17)
2.	Fund-based - LT-Term Loan	LT	21.34	CARE A-; Stable	1)CARE A-; Stable (27-Sep-19)	1)CARE A-; Stable (25-Dec-18)	1)CARE A-; Stable (03-Jan-18)	1)CARE A-; Stable (24-Jan-17)
3.	Fund-based - ST-Working Capital Demand loan	ST	3.75	CARE A2	1)CARE A2 (27-Sep-19)	1)CARE A2 (25-Dec-18)	-	-
4.	Non-fund-based - ST-Credit Exposure Limit	ST	0.22	CARE A2	1)CARE A2 (27-Sep-19)	1)CARE A2 (25-Dec-18)	-	-
5.	Fund-based - LT-Term Loan	LT	-	-	-	-	1)Withdrawn (03-Jan-18)	1)CARE A-; Stable (24-Jan-17)

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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