

## Hester Biosciences Limited

November 11, 2020

### Ratings

Facilities	Amount (Rs. crore)	Rating <sup>1</sup>	Rating Action
Long Term Bank Facilities	24.21 (Enhanced from Rs.21.34 crore)	CARE A-; Stable (Single A Minus; Outlook: Stable)	Reaffirmed
Long Term / Short Term Bank Facilities	50.00	CARE A-; Stable / CARE A2 (Single A Minus; Outlook: Stable/ A Two)	Reaffirmed
Short Term Bank Facilities	3.97	CARE A2 (A Two)	Reaffirmed
<b>Total Facilities</b>	<b>78.18</b> <b>(Rupees Seventy-Eight Crore and Eighteen Lakhs Only)</b>		

*Details of facilities/instruments 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 its healthy profitability margins, comfortable capital structure and debt coverage indicators, and adequate liquidity. CARE also takes cognizance of turnaround in its operations in Nepal during FY20 (FY; refers to the period from April 01 to March 31); albeit it continues to be susceptible to the inherent volatility in production and sales volumes due to tender driven competitive nature of business.

The above ratings strengths are, however, tempered by HBL's large working capital requirement due to inherent high inventory holding requirement of its business, presence in regulated vaccine industry and implementation and salability risk associated with its ongoing large size capital expenditure in Africa. The ratings also factor moderation in operating profitability (PBILDT) margin and ROCE during FY20 and H1FY21 along with elongation in debtor collection.

### 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 net 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 on-going 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
- 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 in three segments, i.e. Poultry Healthcare (vaccines and healthcare products), Animal Healthcare (vaccines and healthcare products), and Veterinary Social Business. HBL manufactures vaccine and health products mainly for poultry apart from sheep, goat, cattle and buffalo. HBL through Veterinary Social Business division is creating a vaccine distribution network in the backward districts of Chhattisgarh, Jharkhand, Odisha, Uttar Pradesh and Bihar; as well as in Nepal with the aim of

<sup>1</sup>Complete definitions of the ratings assigned are available at [www.careratings.com](http://www.careratings.com) and in other CARE publications.

increasing the awareness for vaccines along with feed supplement in small farmers. 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. With the government's initiative to control outbreak of diseases in animals & poultry, HBL decided to increase the level of scientific diagnosis which diagnoses the diseases at an early stage and assists technical team to comprehend changing disease pattern and develop solution accordingly. Apart from existing diagnostic lab at Ahmedabad, HBL opened up another diagnostic lab in Hyderabad during FY20 to cater its clients in Southern region.

#### ***Diversified revenue stream with increasing focus on large animal division and healthcare products***

As on March 31, 2020, the product portfolio of HBL comprises of 49 vaccines (including both poultry and large animal vaccines) and 60 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 FY20, HBL manufactured 72% (FY19: 56%) of healthcare products in-house at its TLPL plant. HBL is planning to gradually manufacture most of its health products at TLPL 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. HBL also has presence across 25 countries in Asia, Africa and European region. During FY20, HBL added 60-70 personnel in sales and marketing team to grow sales by covering larger territories and expand presence in the market through additional field force including hiring of few people for development of distribution network in Africa region. During FY19, HBL had 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 African region. Development of distribution network coupled with upcoming vaccine manufacturing facility in Tanzania is expected to create synergy in African market.

#### ***Comfortable capital structure and debt coverage indicators***

The total debt on a consolidated level increased from Rs.89.85 crore as on March 31, 2019 to Rs.126.20 crore as on March 31, 2020 largely due to on-going capital expenditure in Tanzania, Africa coupled with higher working capital borrowings as on balance sheet date. However, capital structure of the company continues to remain comfortable marked by overall gearing ratio of 0.61 times as on March 31, 2020 on the back of its strong net worth base. The debt coverage indicators like PBILDT interest coverage continued to remain comfortable at 7.47 times during FY20 while total debt to GCA although increased from 1.67 years during FY19 to 2.92 years during FY20, it too remained comfortable.

#### ***Turnaround of operations in Nepal; albeit expectation of volatile production and sales volumes due to tender driven competitive nature of business***

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 FY20, HBNPL's performance exhibited improvement whereby it earned a revenue of Rs.19.43 crore (FY19: Rs.9.14 crore) with a PBILDT of Rs.10.15 crore (FY19: Rs.4.41 crore). Consequently, HBNPL reported PAT of Rs.3.91 crore during FY20 as against net loss of Rs.3.00 crore during FY19. Growth in revenue was backed by pick up in flow of tenders coupled with development of distribution network in Nepalese market. HBNPL receives FAO (Food and Agriculture Organization) tenders as well as independent country tender. Despite improvement in performance, production and sales continue to remain sub-optimal and it is expected to remain volatile due to tender driven nature of business.

#### ***Technology collaborations and development of vaccines against Covid-19***

HBL is currently manufacturing and supplying the conventional Brucella Abortus S19 vaccine. During September 2020, the company has signed technology license agreement with ICAR-IVRI (Indian Council of Agriculture Research – Indian Veterinary Research Institute) for Brucella Abortus S19 Delta Per vaccine. The S19 Delta Per vaccine has enhanced safety, immunogenicity, as well as assurance of lifelong immunity with a single shot in calf-hood. HBL expects to launch Brucella Abortus S19 Delta Per vaccine by March 2022.

During February 2020, HBL entered into a technical collaboration agreement with Novapharma, Egypt under which HBL would offer technology to Novapharma to manufacture veterinary vaccines. HBL would receive technology transfer fee, royalty on sales and would have exclusive international marketing rights for the full range of vaccines manufactured at Novapharma, including vaccine for the Avian Influenza which is an emerging disease in the poultry sector. Presently, this vaccine is not being produced by HBL or HBNPL, while the company has no plans to produce the same in Tanzania, Africa. Access to the Avian Influenza vaccine would open up a new market for HBL.

HBL in collaboration with IIT Guwahati is developing vaccine against Covid-19. Till now, HBL has shared technology know-how and made minor changes in its infrastructure and has not spent significant amount. HBL has neither commenced any clinical trials for vaccine nor applied to Drugs Controller General of India (DCGI) for conducting clinical trials. As informed by the management, development of vaccine is at nascent stage and cost of project and funding of the same is not finalized yet. Moreover, as informed by the management, HBL has received offers from many Human vaccine manufacturing companies to collaborate with HBL on COVID-19 vaccine development. Any significant cost incurred by HBL on vaccine development or setting up manufacturing facility for human vaccine would remain crucial from the credit perspective.

#### ***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 launched National Animal Disease Control Programme (NADCP) 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. Government of India is expected to spend around Rs.90 crore per annum for five years on Brucella vaccine under NADCP. HBL is one of the two suppliers for this vaccine.

#### **Liquidity: Adequate**

Despite elongated operating cycle of 240 days in FY20, the liquidity of the company remains adequate marked by healthy cash flow from operation of Rs.31.38 crore during FY20, current ratio of 2.07 times as on March 31, 2020 and modest average fund based working capital utilizations at 67% in the last 12 month ended September 2020. HBL had unencumbered cash and bank balance of Rs.23.09 crore as on March 31, 2020 part of which is to be utilized towards the on-going capital expenditure in Tanzania, Africa.

HBL had opted for moratorium on interest and principal repayment for all its outstanding term loans and working capital limits for the period of March-August 2020 as part of the Covid relief measures announced by the RBI. Further, HBL has availed Covid-19 emergency credit line (CECL) of Rs.5 crore from bank.

#### **Key Rating Weaknesses**

##### ***Modest scale of operation with moderation in profitability margins witnessed during FY20 and H1FY21; albeit it continued to remain at relatively healthy levels***

Total operating income (TOI) of the company, which registered a compounded annual growth rate (CAGR) of 21% during FY17-FY19, remained largely stable during FY20 over FY19. Revenue from poultry healthcare business was impacted due to lower demand of poultry vaccine from farmers during the year as the affordability of farmers was impacted. There was a sharp rise in feed cost i.e. maize de-oiled cake (DOC) which are used by farmers to feed their poultry birds which led to lower spend on healthcare products by farmers. Moreover, revenue declined during Q4FY20 largely due to spreading of rumour that eating chicken and eggs would spread coronavirus coupled with delay in 3-4 export consignments due to national lockdown imposed by Government of India to contain Covid-19 in the latter half of March 2020. The contribution from export in total sales which remained in the range of 10%-12% in past three years ended FY19, increased to 38% during FY20 which offset lower sales in domestic market.

Further, PBILDT margin which witnessed improving trend over past four years ended FY19, declined by 867 bps to 31.02% during FY20 due to higher proportion of relatively lower margin products coupled with higher employee expenses on the back of increase in marketing team. PAT margin also declined by 603 bps albeit stood healthy at 16.79% in FY20. Decline in profitability margins with largely stable TOI led to lower gross cash accruals of Rs.43.15 crore during FY20 as against gross cash accruals of Rs.53.95 crore in FY19.

The scale of operation of the company remained modest marked by total operating income of Rs.185 crore during FY20 and tangible net-worth of Rs.206 crore as on March 31, 2020 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.

**Large working capital requirement which is further accentuated during FY20 on the back of elongation in debtor collection**

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. The gross operating cycle elongated during FY20 to 280 days (FY19: 238 days) on the back of increase in inventory holding period to around 190 days (173 days) and collection period of around 90 days (65 days). Collection period increased during the year as company has extended relatively higher credit period to its customers to push the demand of its products amidst challenging industry scenario. Moreover, due to relatively higher execution of tender based business, mainly in Nepal during the year, also impacted the overall credit period. The gross operating cycle remained elongated at around 280 days in H1FY21.

**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. Manufacturing facility of HBAL is being constructed on lease land acquired from Government of Tanzania. Total cost of project is \$18 million (approximately Rs.125 crore) which is being funded through equity capital of \$4 million by HBL and, 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.

Till August 15, 2020, HBAL has already received equity of \$4.00 million, capital grant of \$3.18 million and soft loan of \$10.00 million from Bill & Melinda Gates Foundation. As on August 15, 2020, the company had incurred total cost of about Rs.89 crore towards the project. The project was earlier expected to be commissioned in December 2020. However, the project has been delayed by around 2 months due to Covid-19 pandemic. As travel restrictions are relaxed and movement of contractors has begun, management expects project to commission by mid Q4FY21. 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 as its subsidiaries 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. *The list of subsidiaries whose financials have been consolidated in HBL is mentioned in Annexure-3.*

**Applicable Criteria**

[Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings](#)

[CARE's Policy on Default Recognition](#)

[Criteria for Short Term Instruments](#)

[Rating Methodology: Consolidation](#)

[Financial ratios – Non-Financial Sector](#)

[CARE's methodology for manufacturing companies](#)

[Rating methodology – Pharmaceutical Sector](#)

[Liquidity Analysis of Non-Financial Sector Entities](#)

**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 in manufacturing of vaccine and healthcare products mainly for poultry apart from sheep, goat, 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, 2020.

(Rs. Crore)

Brief Financials of HBL	Consolidated		Standalone	
	FY19 (Audited)	FY20 (Audited)	FY19 (Audited)	FY20 (Audited)
Total operating income	179.09	184.61	173.56	171.64
PBILDT	69.28	57.27	70.28	54.93
PAT	40.69	31.00	43.85	31.22
Overall gearing (times)	0.50	0.61	0.21	0.23
PBILDT Interest coverage (times)	10.44	7.47	19.84	10.91

As per the un-audited consolidated results, HBL earned a PAT of Rs.11.73 crore on a total operating income (TOI) of Rs.94.20 crore during H1FY21 as against a PAT of Rs.14.29 crore on a TOI of Rs.90.23 crore during H1FY20.

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

**Any other information:** Not Applicable

**Rating History (Last three years):** Please refer Annexure-2

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

#### Annexure-1: Details of Instruments/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	24.21	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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT/ ST-Cash Credit	LT/ST	50.00	CARE A-; Stable / CARE A2	-	1)CARE A-; Stable/CARE A2 (10-Jan-20) 2)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)
2.	Fund-based - LT-Term Loan	LT	24.21	CARE A-; Stable	-	1)CARE A-; Stable (10-Jan-20) 2)CARE A-; Stable (27-Sep-19)	1)CARE A-; Stable (25-Dec-18)	1)CARE A-; Stable (03-Jan-18)
3.	Fund-based - ST-Working Capital Demand loan	ST	3.75	CARE A2	-	1)CARE A2 (10-Jan-20) 2)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 (10-Jan-20) 2)CARE A2 (27-Sep-19)	1)CARE A2 (25-Dec-18)	-
5.	Fund-based - LT-Term Loan	LT	-	-	-	-	-	1)Withdrawn (03-Jan-18)

## Annexure 3: List of subsidiaries of HBL getting 'consolidated'

Sr. No	Name of the company	Relationship with HBL	% shareholding of HBL as on March 31, 2020
1	Hester Biosciences Nepal Private Limited	Subsidiary	65%
2	Hester Biosciences Africa Limited	Wholly owned subsidiary	100%
3	Hester Biosciences Kenya Limited	Wholly owned subsidiary	100%
4	Texas Lifesciences Private Limited	Subsidiary	54.80%

## Annexure 4: Complexity level of various instruments rated for this Company

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Term Loan	Simple
2.	Fund-based - LT/ ST-Cash Credit	Simple
3.	Fund-based - ST-Working Capital Demand loan	Simple
4.	Non-fund-based - ST-Credit Exposure Limit	Simple

**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](http://www.careratings.com). Investors/market intermediaries/regulators or others are welcome to write to [care@careratings.com](mailto:care@careratings.com) for any clarifications.

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### About CARE Ratings:

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Our ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.

**\*\*For detailed Rationale Report and subscription information, please contact us at [www.careratings.com](http://www.careratings.com)**