Sunil Healthcare Limited

October 07, 2019

Ratings

Facilities	**Amount (Rs. crore)**	**Rating[1]**	**Rating Action**
Long term Bank Facilities	28.00	**CARE BBB-; Negative (Triple B Minus; Outlook: Negative)**	Reaffirmed; Outlook revised from 'Stable' to 'Negative'
Short term Bank Facilities	18.35 (reduced from Rs 18.90 crore)	**CARE A3 (A Three)**	Reaffirmed
Total	**46.35 (Rs. Forty Six crore and Thirty Five lakh only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Sunil Healthcare Limited (SHL) continue to derive strength from the experienced and resourceful promoters along with long track record of operations with a highly experienced management team and satisfactory (though declining) PBILDT margins. The ratings further derive strength from its wide product profile with established brand name.

The ratings are, however, constrained by the small and declining scale of operations in FY19 (Audited; refers to April 01 to March 31), net losses in Q1FY20 (Unaudited), customer concentration risk, elongated operating cycle along with susceptibility of profitability margins to raw material price & foreign currency fluctuations and regulatory policy risk in a competitive pharmaceutical industry with increasing pricing pressure.

Going forward, the ability of the company to profitably scale-up its operations, manage its working capital requirements efficiently and improve its overall solvency position will remain the key rating sensitivities. Furthermore, any new capex and funding mix for the same impacting the credit profile will also remain a key rating sensitivity.

Outlook: Negative

The revision in the outlook factors in competitive market environment which could limit the ability of SHL to pass on increased input prices to the customers leading to moderation in the operating performance of the company in the near term. The same could further stretch the liquidity position of the company. The outlook may be revised to 'Stable' if SHL is able to achieve higher sales and profitability leading to improvement in its liquidity profile.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced and resourceful promoters along with long track record of operations: SHL is promoted by Mr. Anil Khaitan (Chairman and Managing Director) who has nearly four decades of industry experience and is involved in the overall business operations of the company. The directors of the company are assisted by a team of professionals who are highly experienced in their respective domains.

To support various business operations of the company, the promoters had infused funds in the form of unsecured loans amounting to Rs 2.67cr., as on September 27, 2019. The promoters have also infused funds in the form of redeemable non-cumulative and non-participatory preference shares amounting to Rs. 11.65 cr. in July-2019 (non-redeemable till FY40).

Established brand name: SHL is the second largest EHGC (Empty Hard Gelatin Capsules) shell manufacturer in the domestic market with installed capacity of 13 billion shells per annum, as on March 31, 2019. The company sells its products under the brand name, 'Sunloc'.

Wide product profile & revenue stream: The company's product profile is well diversified with production of double lock, triple lock, multiple groove capsules, HPMC (Hydroxy Propyl Methyl Cellulose) capsules along with liner, circular, two colour printing & 360 degree printing being offered.

Key Rating Weaknesses

Decline in scale of operations, deterioration in the profitability margins and overall solvency position along with customer concentration risk: The scale of operations of the company continued to remain at a small level and declined by ~9% on a y-o-y basis in FY19 on account of lower income achieved from trading segment which declined by ~96% on a y-o-y basis.

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

However, the income derived from the EHGC shell segment improved slightly by ~1% on account of increase in the quantity sold on a y-o-y basis though the sales realization declined due to competitive nature of industry. The PBILDT margins of the company have remained satisfactory, though declined in FY19 on a year-on-year (y-o-y) basis on account of higher raw material prices incurred which were not completely passed on to its customers due to competitive nature of industry. Further, the PAT margins of the company declined significantly in FY19 on account of lower PBILDT margins coupled with increase in interest and depreciation expenses incurred during the year.

The overall solvency position of the company deteriorated on a y-o-y basis as marked by its overall gearing ratio and total debt to GCA ratios to 1.38x and 11.42x, respectively as on March 31, 2019 from 1.34x and 6.15x, respectively, as on March 31, 2018. This was on account of increase in total debt outstanding at the end of the year and lower profitability achieved by the company in FY19. The interest coverage ratio also declined in FY19 on a y-o-y basis on account of lower profitability achieved and increase in interest expenses incurred.

In Q1FY20 (Unaudited), the scale of operations of the company declined by ~9% to Rs. 18.54 Cr., on a y-o-y basis compared to corresponding period last year mainly on account of lower quantities of EHGC shells sold coupled with lower sales realizations achieved due to competitive nature of industry. The PBILDT margins of the company declined to 14.56% in Q1FY20 (Unaudited) from 17.05% in Q1FY19 (Unaudited) on account of higher raw material prices incurred which were not completely passed on to its customers due to competitive nature of industry. Low PBILDT in absolute value terms and high interest and depreciation expenses led to losses at the net level (net loss of Rs.0.51 Cr., compared to net profit of Rs. 0.47 cr. in Q1FY19).

Further, the operations of the company remained exposed to customer concentration risk during FY19, with the proportion of income derived from top-5 clients at ~32% of total income (~46% in FY18). Top two customers contributed ~18% of the total operating income in FY19. Any change in the procurement policy of these customers may adversely impact the business of the company.

Exposure to raw material price volatility and foreign currency fluctuations risk: The raw materials, primarily gelatin, colour & chemical compounds, are obtained from both domestic and foreign suppliers. Due to competitive nature of the industry, the company is not always able to pass on any increase in costs to its customers, thus, the profitability margins are exposed to any adverse fluctuation in raw material prices.

The foreign currency exposure of SHL is hedged to an extent as the company is engaged in both import of raw material and exports of its products. The company also enters into derivative contacts to hedge some part of its unhedged portion. The remaining portion, however, remains unhedged thereby exposing the profitability margins to adverse fluctuations in foreign exchange rates. Additionally, the company supplies to several countries located in the African continent. Thus, the company is also exposed to unfavorable changes in the government policy of respective African nations.

Highly fragmented and competitive nature of industry with regulatory risks: SHL 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 a large number of small and big players. Further, pharmaceutical industry is a closely monitored and regulated industry and as such there are inherent risks and liabilities associated with the products and their manufacturing. Issues like price control of essential medicines by the Government of India through the Drug (Prices Control) Order, 2013, pose regulatory risk for the pharmaceutical industry.

Analytical approach: Standalone

Applicable Criteria

Criteria on assigning Outlook to Credit Ratings
Financial ratios – Non-Financial Sector
CARE's policy on default recognition
CARE's methodology for manufacturing companies
CARE's methodology for Pharmaceutical sector
Criteria for Short Term Instruments

Liquidity Position: Stretched- The operating cycle of the company further elongated to 164 days, as on March 31, 2019 from 136 days, as on March 31, 2018 on account of elongation of average collection and average inventory holding days. On an average, the cash credit limit has remained almost fully utilized for the 12 months period ended August-2019. The current ratio and quick ratios of the company also stood weak at 0.96x and 0.73x, respectively, as on March 31, 2019, with the company having negligible unencumbered cash & bank balance of Rs.0.98 crore, as on March 31, 2019. The company has a total debt repayment obligation of ~Rs. 10 cr. in FY20, proposed to be met through the internal accruals and funds infused by the promoters. To fund various business requirements, the promoters have infused funds in the form of unsecured loans amounting to Rs. 2.67 cr. and preference shares amounting to Rs. 11.65 cr. in FY20 (till September 27, 2019), with the company maintaining an unencumbered term deposit of Rs.7cr., as on September 27, 2019 to meet the requirements. The company is planning to undertake regular/replacement capex of ~Rs. 3.00 cr. in FY20 proposed to be met through the internal accruals generated during the year and fund infusion by promoters.

About the Company

SHL was incorporated in 1973 by Late Mr. S.N Khaitan, the father of Mr. Anil Khaitan, who is the present Chairman and Managing Director of the company. SHL was originally constituted as a closely held public limited company by the name of Sunil Synchem Limited, however, the same was changed in June-2005 to its current name. SHL is mainly engaged in the manufacturing of Empty Hard Gelatin Capsule (EHGC) shells (99.61% of income in FY19) with an installed capacity of manufacturing approximately 13 billion shells per annum, as on March 31, 2019 at its sole unit at Alwar, Rajasthan.

The company was earlier engaged in the trading (including merchant trading) of agro based commodities including raw cashew nuts, dehydrated vegetables, Almonds, pistachio, cardamom, etc. since 2013, under brand 'Sunloc foods'. However, the same has been discontinued in FY20 (since July 01, 2019) on account of continuous decline in contribution of the segment to the total operating income in FY17-FY19 period with losses incurred by the company each year from this segment during the period. The trading segment contributed only ~0.39% of the total operating income in FY19.

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

Brief Financials (Rs. crore)	FY18(A)	FY19(A)
Total operating income	90.30	81.95
PBILDT	15.49	12.96
PAT	5.32	0.18
Overall gearing (times)	1.34	1.38
Interest coverage (times)	3.08	1.85

A: Audited

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-Cash Credit	-	-	-	25.00	CARE BBB-; Negative
Fund-based - LT-Stand by Limits	-	-	-	3.00	CARE BBB-; Negative
Non-fund-based - ST-BG/LC	-	-	-	14.25	CARE A3
Non-fund-based - ST-Forward Contract	-	-	-	0.60	CARE A3
Fund-based - ST-Standby Line of Credit	-	-	-	3.50	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 (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-Cash Credit	LT	25.00	CARE BBB-; Negative	1)CARE BBB-; Stable (15-Jul-19)	1)CARE BBB-; Stable (23-Nov-18) 2)CARE BBB-; Stable (14-Nov-18)	1)CARE BBB; Stable (26-Dec-17) 2)CARE BBB; Stable (05-Oct-17)	-
2.	Fund-based - LT-Stand by Limits	LT	3.00	CARE BBB-; Negative	1)CARE BBB-; Stable (15-Jul-19)	1)CARE BBB-; Stable (23-Nov-18) 2)CARE BBB-; Stable (14-Nov-18)	1)CARE BBB; Stable (26-Dec-17) 2)CARE BBB; Stable (05-Oct-17)	-
3.	Non-fund-based - ST-BG/LC	ST	14.25	CARE A3	1)CARE A3 (15-Jul-19)	1)CARE A3 (23-Nov-18) 2)CARE A3 (14-Nov-18)	1)CARE A3+ (26-Dec-17) 2)CARE A3+ (05-Oct-17)	-
4.	Non-fund-based - ST-Forward Contract	ST	0.60	CARE A3	1)CARE A3 (15-Jul-19)	1)CARE A3 (23-Nov-18) 2)CARE A3 (14-Nov-18)	1)CARE A3+ (26-Dec-17) 2)CARE A3+ (05-Oct-17)	-
5.	Fund-based - LT-Term Loan	LT	-	-	-	1)Withdrawn (23-Nov-18) 2)CARE BBB-; Stable (14-Nov-18)	1)CARE BBB; Stable (26-Dec-17) 2)CARE BBB; Stable (05-Oct-17)	-
6.	Fund-based - ST-Standby Line of Credit	ST	3.50	CARE A3	1)CARE A3 (15-Jul-19)	1)CARE A3 (23-Nov-18) 2)CARE A3 (14-Nov-18)	1)CARE A3+ (26-Dec-17)	-

Annexure-3: Detailed explanation of covenants of the rated facilities: Not Applicable

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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