November 26, 2024

# Natural Capsules Limited: Ratings downgraded to [ICRA]BBB- (Stable)/[ICRA]A3

## Summary of rating action

| Instrument^ | Previous Rated Amount (Rs. Crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| **Long Term-Fund Based-Term Loan** | 30.00 | 30.00 | [ICRA]BBB- (Stable); downgraded from [ICRA]BBB (Stable) |
| **Long Term - Fund Based – Cash Credit** | 27.50 | 27.50 | [ICRA]BBB- (Stable); downgraded from [ICRA]BBB (Stable) |
| **Short Term – Fund Based** | 2.50 | 2.50 | [ICRA] A3; downgraded from [ICRA]A3+ |
| **Short Term – Non-Fund Based** | 2.80 | 2.80 | [ICRA] A3; downgraded from [ICRA]A3+ |
| **Total** | **62.80** | **62.80** | |

*^ Instrument details are provided in Annexure-I*

## Rationale

To arrive at the ratings, ICRA has considered the consolidated financials of Natural Capsules Limited (NCL) and its subsidiaries, including Natural Biogenex Private Limited (NBPL).

The downgrade of ratings reflects the pressure on revenues and profits of NCL due to delays in commissioning of the lines related to the manufacturing of hydroxypropyl methylcellulose (HPMC) capsules at NCL as well as that witnessed in the new steroid active pharmaceutical ingredients (API) facility being set up in NBPL. While HPMC lines are expected to become fully operational by Q4 FY2025, the API unit awaits clearance from the Pollution Control Board and is yet to commence commercial operations. The latter has also witnessed cost-overruns, which are being funded by internal accruals of NCL. The base business of NCL is also witnessing pricing pressure, as reflected by a decline in realisations in FY2024 and H1 FY2025. These coupled with sizeable debt-funded capital expenditure towards the new projects led to a moderation in the financial profile, notwithstanding the recent raising of Rs. 29.2 crore equity via preferential issue. The liquidity position of the company has also been stretched, as evident from near full utilisation of the working capital limits. The ratings also continue to consider NCL's exposure to raw material price fluctuations, foreign exchange (forex) fluctuation risk and high competition, particularly its gelatin capsules segment, which restricts its pricing flexibility to some extent.

The ratings favourably consider NCL's established presence in the empty hard gelatin capsule (EHGC) manufacturing industry, its promoters' extensive experience in the industry and its diversified client profile as well as strong relationships with pharmaceutical majors. With NCL foraying into HPMC capsules and steroid API production, the operating profile will get diversified in the medium term. However, the same is exposed to the risk of timely commencement and effective utilisation of capacity thereon. Timely commencement of the API plant and ramp-up of operations will be key rating monitorables.

The Stable outlook on the long-term rating reflects ICRA's opinion that NCL's credit profile will gradually improve, benefitting from its increased capacities, particularly in HPMCs as well as its growing business diversity with the API plant, once it becomes operational.

## Key rating drivers and their description

### Credit strengths

**Established presence in EHGC industry, foray into HPMC and steroidal APIs to lend revenue diversity -** NCL has an established market position with a large product portfolio in the EHGC segment. The company has an installed production capacity of 18.75 billion capsules per annum (as of March 2024), which is primarily for gelatin capsules. Further, the company is expanding its capabilities in HPMCs, which will support its revenue growth and margin profile as these capsules have higher realisation and margins over gelatin capsules.

**Extensive experience of promoters –** The promoters have extensive experience in the capsule business. NCL is owned and managed by the Mundra family, who have extensive experience of three decades in the pharmaceutical industry.

**Diversified customer profile and strong relationships with pharmaceutical majors –** NCL caters to a large number of reputed customers in the domestic as well as export markets. The customer concentration was moderate with the top-five customers accounting for 24% of its revenues in FY2024. The company has long-term relationships with customers, having been associated with 44% of its customers for more than 5 years and around 24% of its total customers for more than 10 years. NCL's key export markets include Africa, South America and West Asia with recent foray into the US and Canadian markets.

### Credit challenges

**Delay in commencement of ongoing projects –** The API facility in NBPL was earlier expected to commence operations from August 2023. However, the same is yet to commence commercial operations and is awaiting clearance from the Pollution Control board. This has also resulted in cost overruns, which are being funded via additional fund infusion from NCL. Also, API manufacturing is a complex process, and the ability of the management to ramp up API production in a timely and profitable manner is yet to be seen. NCL has also faced delays in commencement of operations of its three HPMC lines. While these were earlier expected to commence operations from FY2024, due to technical issues, only one of the lines became operational in Q4 FY2024, with the remaining two expected to become operational by Q4 FY2025.

**Moderation in financial profile –** NCL is witnessing pricing pressure in its gelatin capsules business, as reflected by a decline in realisations in FY2024 and H1 FY2025, leading to a fall in the operating profit margins (OPMs) to 12.2% in FY2024 and 11% in H1 FY2025, vis-à-vis 19.9% in FY2023. Coupled with delay in projects, this led to lower-than-estimated revenues and profits in FY2024 and H1 FY2025. Further, the subsidiary is expected to generate cash losses in FY2025. These coupled with sizeable debt-funded capital expenditure towards the new projects led to moderation in financial profile, notwithstanding the recent raising of Rs. 29.2 crore equity via preferential issue. Total debt vis-à-vis the operating profit deteriorated to 6.2 times as on March 31, 2024 and 6.0 times as on September 30, 2024 vis-à-vis 2.8 times as on March 31, 2023. NCL's coverage indicators such as DSCR are expected to moderate in FY2025 (the same stood at 0.9 times in H1 FY2025). The liquidity position of the company is also stretched, as evident by near full utilisation of the working capital limits.

**Exposure to raw material price volatility and forex fluctuation risks; high competition, particularly in EHGC segment –** NCL faces intense competition for gelatin capsules in the international markets, mainly from Chinese players, which restricts its pricing flexibility. In the domestic market, it faces competition from other established players. Owing to this stiff competition, NCL's ability to pass on the increase in raw material prices to its customers is limited. NCL imports 15-20% of its raw material (gelatin) and usually passes any increase in prices partially. With capacity addition for HPMC capsules, the raw material imports are expected to increase as that for HPMC capsules is not currently available. Also, the subsidiary will face import dependence for key raw materials (at least in the initial phase), which will keep it exposed to price volatility as well as forex fluctuation risk**.**

## Liquidity position: Stretched

NCL's liquidity position is stretched, as evident from limited headroom in working capital limits. The cash flows moderated amid pressure on realisations in the base business. There will be moderate capex of Rs. 8-10 crore in NCL for pending capacity addition for HPMC capsules, which is expected to be funded by internal accruals. Further, incremental capex of Rs. 10-12 crore in NBPL for Phase-2 fermenter, to be incurred in H2 FY2025, will be secured through incremental term debt (proposed). The company has consolidated debt repayments of Rs. 11 crore and Rs. 13.3 crore in FY2025 and FY2026, respectively. Post commencement of the API facility, there will be initial cash losses, which will require funding support from the parent.

## Rating sensitivities

**Positive factors –** ICRA could upgrade NCL's ratings if it is able to increase its scale of operations and profitability on a sustained basis through optimal utilisation of its capacities in capsules and timely commencement of operations of its API facility, while maintaining a comfortable liquidity position and satisfactory debt coverage indicators.

**Negative factors –** Negative pressure on the ratings could arise in case of continued delays in commencement of new capacities/API facility or any sharp decline in revenues leading to weakening of the liquidity position and/or credit metrics on a sustained basis. Specific credit metric that could exert negative pressure on the ratings could be DSCR of less than 1.2 times on a sustained basis.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable rating methodologies** | Corporate Credit Rating Methodology<br>Rating Methodology - Pharmaceuticals |
| **Parent/Group support** | Not Applicable |
| **Consolidation/Standalone** | For arriving at the ratings, ICRA has consolidated the financials of Natural Capsules Limited, along with its subsidiaries, Natural Biogenex Private Limited and Natural Phyto Pharma Private Limited. |

## About the company

NCL, headquartered in Bangalore, is among the leading manufacturers of empty hard gelatin capsules (EHGC) shells in India. The company has two manufacturing units with cumulative production capacity of 18.75 billion capsules per annum (BCPA) as of October 23, 2024. As per the company's FY2024 annual report, it is the second largest manufacturer of gelatin capsules in India. Although domestic market accounts for the majority of its business, NCL caters to multiple geographies like Europe, Africa, Middle East and SAARC regions. NCL manufactures 12 different types of capsules under its normal EHGC capsules. The company has also installed one new manufacturing line for hydroxypropyl methylcellulose (HPMC) capsules or vegetarian capsules in Q4 FY2024 and is in the process of installing two more lines by March 2025 with a cumulative capacity of ~1.6 BCPA.

In August 2020, the company established Natural Biogenex Private Limited (NBPL) to set up API manufacturing facility of steroids under the Central Government's Production Linked Incentive (PLI) scheme. The company has set up another wholly owned-subsidiary - Natural Phyto Pharma Private Limited for R&D purpose. Currently, this entity is non-operational, as per the management.

### Key financial indicators (audited)

| Consolidated | FY2023 | FY2024 | H1FY2025* |
|---|---|---|---|
| **Operating income** | 172.4 | 155.4 | 80.4 |
| **PAT** | 18.4 | 5.6 | (0.0) |
| **OPBDIT/OI** | 19.9% | 12.2% | 11.0% |
| **PAT/OI** | 10.7% | 3.6% | 0.0% |
| **Total outside liabilities/Tangible net worth (times)** | 0.9 | 0.7 | 0.6 |
| **Total debt/OPBDIT (times)** | 2.8 | 6.2 | 5.6 |
| **Interest coverage (times)** | 9.2 | 3.6 | 2.8 |

*Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. crore; * Limited audited result*
*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation*

### Status of non-cooperation with previous CRA: Not applicable

### Any other information:

ICRA has analysed the bank statements of NCL and NBPL for the period March 2024 till August 2024. ICRA noticed few instances of discrepancies such as "Irregular amount recovery" in the bank statements of NCL and NBPL. However, ICRA understands that the same pertain to technical issues and has received clean written feedback from the said bankers stating that there have not been any irregularities in debt servicing by NCL and NBPL.

## Rating history for past three years

| Instrument | Current rating (FY2025) | | Chronology of rating history for the past 3 years | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Type | Amount Rated (Rs. crore) | FY2025 | | FY2024 | | FY2023 | | FY2022 | |
| | | | Date | Rating | Date | Rating | Date | Rating | Date | Rating |
| **Fund based - Term loans** | Long-term | 30.00 | 26-Nov-2024 | [ICRA]BBB- (Stable) | 13-Sep-2023 | [ICRA]BBB (Stable) | | | | |
| | | | | | 22-Aug-2023 | [ICRA]BBB (Stable) | | | | |
| **Fund based - Cash Credit** | Long-term | 27.50 | 26-Nov-2024 | [ICRA]BBB- (Stable) | 13-Sep-2023 | [ICRA]BBB (Stable) | 04-Jul-2022 | [ICRA]BBB (Stable) | 09-Apr-2021 | [ICRA]BBB (Stable) |
| | | | | | 22-Aug-2023 | [ICRA]BBB (Stable) | | | | |
| | | | | | 01-May-2023 | [ICRA]BBB (Stable) | | | | |
| **Fund based – Working capital facilities** | Short term | 2.50 | 26-Nov-2024 | [ICRA] A3 | 13-Sep-2023 | [ICRA]A3+ | | | | |
| **Non-fund based – Working capital facilities** | Short term | 2.80 | 26-Nov-2024 | [ICRA] A3 | 13-Sep-2023 | [ICRA]A3+ | 04-Jul-2022 | [ICRA]A3+ | 09-Apr-2021 | [ICRA]A3+ |
| | | | | | 22-Aug-2023 | [ICRA]A3+ | | | | |
| | | | | | 01-May-2023 | [ICRA]A3+ | | | | |
| **Unallocated Limits** | Long term and short term | - | | | 22-Aug-2023 | [ICRA]BBB (Stable)/ [ICRA]A3+ | 04-Jul-2022 | [ICRA]BBB (Stable)/ [ICRA]A3+ | 09-Apr-2021 | [ICRA]BBB (Stable)/ [ICRA]A3+ |
| | | | | | 01-May-2023 | [ICRA]BBB (Stable)/ [ICRA]A3+ | | | | |

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| **Long Term-Fund Based-Term Loan** | Simple |
| **Long Term - Fund Based – Cash Credit** | Simple |
| **Short Term – Fund Based** | Simple |
| **Short Term – Non-Fund Based** | Very Simple |

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

## Annexure I: Instrument details

| ISIN | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| **NA** | **Fund based – Term loans** | FY2021 | 9.0-9.5% | FY2029 | 30.00 | [ICRA]BBB- (Stable) |
| **NA** | **Fund based – Cash Credit** | NA | 9.0-9.5% | NA | 27.50 | [ICRA]BBB- (Stable) |
| **NA** | **Fund based – Working capital facilities** | NA | NA | NA | 2.50 | [ICRA] A3 |
| **NA** | **Non-Fund Based working capital facilities** | NA | NA | NA | 2.80 | [ICRA] A3 |

*Source: Company*

*Please click here to view details of lender-wise facilities rated by ICRA*

## Annexure II: List of entities considered for consolidated analysis

| Company Name | NCL's Ownership | Consolidation Approach |
|---|---|---|
| **Natural Biogenex Private Limited (NBPL)** | 69.23% | Full Consolidation |
| **Natural Phyto Pharma Private Limited** | 100.00% | Full Consolidation |

*Source: Company*
*Note: ICRA has considered the consolidated financials of the parent (NCL), its subsidiaries while assigning the ratings.*

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