



# 5 MINUTE STOCK IDEA

BY SMART SYNC INVESTMENT ADVISORY SERVICES

## NATURAL CAPSULES LTD (NCL)

### WHAT WE LIKE

#### COMPANY OVERVIEW

##### Introducing Natural Capsules Limited (NCL)

Natural Capsules Limited (NCL) is a hard capsule shell manufacturer, who pioneered manufacturing of vegetarian capsules in India and is the second largest Indian manufacturer for gelatin capsules. The company was incorporated as a Public Limited Company in 1994 at Bangalore, and it further expanded its operations to Pondicherry in 2020. The company is now foraying into API manufacturing with complete high end patented technology developed in-house, under its subsidiary company Natural Biogenex Private Limited.

NCL prides itself on its abilities to provide turnkey solutions to all its customers.



**VISION**  
To become the global leader for supply of capsules, providing impeccable services all across the globe.

**MISSION**  
To consistently innovate and manufacture products key to market's and customer's expectations.  
• To consistently provide highest quality products to its customers across the globe.  
• To become an integrated enterprise of global distribution.

<b>1994</b> Used on test	<b>150</b> Countries across 4 continents
<b>250+</b> Team Members	<b>02</b> Manufacturing Units
<b>18.0 BCPA*</b> Capacity in Q1FY23	<b>19%</b> Exports Revenue in FY22

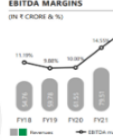
### CAPSULE SEGMENT

#### Capsules Segment

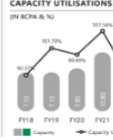


With almost three decades of experience in the industry, Natural Capsules Limited is a leading manufacturer of hard capsules in India, its products are exported to regulated and unregulated markets across the globe, following stringent applicable rules and regulations.

##### REVENUES & EBITDA MARGINS (IN ₹ CRORE & %)



##### CAPACITY & CAPACITY UTILISATIONS (IN BCPA & %)



- Higher sales in unregulated markets led to volatility in margins.
- Old technology machines resulted in lower operating efficiencies.

##### MANUFACTURING FACILITIES APPROVED BY



- 2nd largest Indian manufacturer of gelatin capsule
- 2 manufacturing facilities at Bangalore and Pondicherry
- 18.0 BCPA Capsules per annum manufacturing capacity as at Q1FY23
- 1st manufacturer Of vegetarian capsules in India

### API SEGMENT

Natural Capsules Limited is now foraying into the API business segment through its subsidiary - Natural Biogenex Private Limited (NBPL) incorporated in 2020. The APIs that will be manufactured are: Prednisolone, Betamethasone and Dexamethasone and their derivatives.

##### KEY DEVELOPMENTS

AUG 2018	JUL 2019	OCT 2019	AUG 2020	FEB 2021
Started R&D center for Steroidal fermentation and synthesis technology to manufacture Steroidal APIs using	Achieved 90% scale-up of production of hydrocortisone from SCMOAD.	Started second fermentation for manufacture of Prednisolone.	Filed patent for innovative manufacture of SCMOAD.	Achieved three PI applications for Steroidal APIs: Betamethasone, Dexamethasone and Prednisolone.
				Completed process improvement over existing knowledge in respect of effluent and de-watering system. Cleared Test Drug treatment for Steroidal APIs.

##### Greenfield Capex at

Tamilnadu spread across 5 acres

1st integrated facility in India for manufacturing of Steroidal API's using fermentation and synthesis chain of reactions

Facilities are being set up in compliance with WHO GMP (General), USFDA and EU GMP certification guidelines

Zero Liquid Discharge manufacturing facility

3 approvals for steroidal API's under the PLI scheme of Government of India for bulk drugs

### BUSINESS TRANSITION: VALUE CREATION

- NCL's core business of capsule manufacturing is getting overhauled with older, less efficient, obsolete production lines being replaced by newer, energy-efficient, high-capacity manufacturing lines. Leads to 3x capacity rise since FY19 & 800bps increase in margins.
- By FY26, plans to manufacture 3 APIs - all 3 are critical & are imported into India. The Steroidal API production via the fermentation pathway has been internally validated since 2018- resulting in a low risk of failure for investors. Expect a 2x-2.2x asset turns on 115 crores capex by FY26.

### FERMENTATION-BASED NICHE APIS & R&D HEAVY

- One of the select few companies chosen for PLI schemes under "fermentation-based niche KSMs/Drug Intermediates/APIs" - resulting in incentives of ~60% of capex outlay over 6 years. This creates the production lines effectively for free.
- NCL is turning into an R&D heavy company for its size and scale, which can create a long drug pipeline for future years. The company is available at 19x earnings, with significant ROE expansion expected in the coming years.

### WHAT WE DON'T LIKE

#### IMPLEMENTATION & TIMELY EXECUTION RISKS

NCL has already pushed the timeline of operationalizing the API plants twice - from Q3'FY23 to Q1'FY24. In spite of the best intentions, creating a greenfield plant is subject to implementation/timely execution risks. We at SSS believe, NCL is no different.

#### SCALABILITY RISK

While NCL has spent a considerable amount of time & resources in validating the biochemistry, we can't rule out the possibility that producing at scale may lead to challenges which may prevent steady ramp up.

#### PAST RECORD SUGGESTS EQUITY DILUTION RISK

Management has underestimated the cost of the API setup once, resulting in an equity infusion of 18cr in its subsidiary to tide over the difference. Any further slippages can result in further shareholder dilution.

#### CAPSULE SEGMENT BEING HIGHLY COMPETITIVE

The industry is characterized by a high level of competition having the presence of many small and big players. The company may never be able to position its capsule offerings as a viable alternative to the current incumbent, thus capping its effective serviceable market. This creates a massive headwind for the overall valuations of the capsule segment. The capsule business may keep requiring further investments to stay technologically relevant in the face of competition with a much larger international incumbent and may turn into a business with limited free cash flow.

#### INCONSISTENT CASH FLOW CONVERSION

Particulars	FY19	FY20	FY21	FY22
PAT (INR Cr)	2	1	7	14
CFO (INR Cr)	2	7	6	1
CFO/PAT (%)	100%	700%	85%	7%

While the CF conversion looks like a roller coaster ride, we at SSS note that in FY22 the main reason for the low conversion of CF is loans provided to subsidiaries for capex. Hence, it is prudent to monitor this piece closely.

