Aarti Surfactants Limited

August 11, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Ratings[1]	Rating Action
Long Term Bank Facilities	165.00	**CARE BBB+; Stable** (Triple B Plus; Outlook: Stable)	Revised from **CARE BBB; Stable** (Triple B; Outlook: Stable)
Total Bank Facilities	**165.00 (Rs. One Hundred Sixty-Five Crore Only)**		
Long Term Instruments - Preference Shares-Redeemable	18.50	**CARE BBB (RPS); Stable** [Triple B (Redeemable Preference Shares); Outlook: Stable]	Revised from **CARE BBB- (RPS); Stable** [Triple B Minus (Redeemable Preference Shares); Outlook: Stable]
Total Long-Term Instruments	**18.50 (Rs. Eighteen Crore and Fifty Lakhs Only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to bank facilities and instruments of Aarti Surfactants Limited (ASL) factors in the significant improvement in top line for FY21 (turnover growth of 42% over FY20), operating margins at 9.78% in FY21 (PY: 7.30%) and successfully achieving envisaged performance for FY21. The revision in the ratings is also supported by ASL's expansion in domestic and export surfactant market with volume growth of 37% in FY21. CARE believes that the company will continue to benefit from favorable trends in Home and Personal care market and improve its operational performance in near term.

The ratings continue derive strength from extensive experience of promoters in chemical industry through Aarti Industries Limited, healthy growth in revenue and operating margins over last 5 years, reputed client profile comprising leading multinational companies in the FMCG sector, comfortable capital structure, improvement in debt coverage indicators and favorable impact of COVID-19 pandemic on ASL's business and financial risk profile.

However, the ratings are constrained by company's presence in competitive market, susceptibility of operating performance to raw material prices and brownfield expansion project in FY21- 22.

Rating Sensitivities

Positive Factors:

- Sustainable improvement in Total Debt to PBILDT below 3.00x.
- Sustainable improvement in capital structure with overall gearing below 1.00x.
- Diversified customer base with no customer contributing to more than 15% of total revenue.

Negative Factors:

- Lower than expected revenue growth and profitability.
- Overall gearing of the company exceeding 1.75x level.
- Delay or cost overrun in upcoming capacity expansion project leading to stretched liquidity profile.

Detailed description of the key rating drivers

Key Rating Strengths

Strong background of the promoters in chemical industry via Aarti Industries Limited

Aarti Surfactants Limited (ASL) was formed in 2018 as a result of demerger of the home and personal care (HPC) division of Aarti Industries Limited (AIL), which has over a decade of experience in the manufacture and sale of surfactants and speciality chemicals used as intermediates by the HPC industry. The HPC division comprised ~7% of the overall sales of AIL and had recorded thin operating margins in the past. The management of AIL decided to demerge the HPC division to allow greater focus and to adopt relevant strategies necessary for turning around and promoting growth of the division.

ASL is managed under the guidance of Mr. Chandrakant Vallabhaji Gogri, who is the founder and the current Chairman Emeritus of AIL. Managing Director Mr. Nikhil Parimal Desai, is the son of Mr. Parimal H Desai, Whole Time Director of AIL.

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

Mr. Nikhil Parimal Desai is associated with AIL for more than 10 years. The other key management personnel of ASL are ex-employees of AIL with rich experience in the industry.

Healthy growth in revenue with improvement in margins over last 5 years.

In past, ASL being a division of AIL, revenue growth was muted and profitability margins were thin. From demerger, ASL was able unlock growth potential and registered healthy CAGR of 21% for the period FY18-FY21. The value growth was supported by volume growth as well as launch of new product categories over last 3 years. For FY21, ASL's top line grew by 42%, backed by volume growth of 37%. Apart from receiving orders from existing customers, ASL has also added new customers in domestic as well as export market during FY21. ASL's margins expanded to 9.78% in FY21 as against 7.30% in FY20 as the company has started cost rationalization post demerger from AIL. ASL has cost plus delta model, hence, was able to pass on increase to the customers. Going forward, ASL is increasing capacity for existing products as well introducing new high margin products. Hence, operating margins of ASL is expected to be around 11% for FY22-24 period.

ASL's overall capacity utilization remained around 80% in FY21. The company is expected to increase production for Mild Surfactants, Sulfocats and Formulations, which are high margin products. ASL has increased its capacity to cater growing demand for end-user industries. The company primarily caters to US, EU and Middle-East countries.

Favourable impact of COVID-19 on ASL's business profile

COVID-19 outbreak offered opportunity to ASL's health and hygiene division to expand into addressable market. ASL being a preferred supplier for home and personal care products of leading FMCG brands, the company was able to carry out normal plant operations during COVID-19 lockdown period. Consequently, ASL's top-line grew by more than 42% in FY21 to Rs.466 crore as against Rs.326 crore in FY20. ASL has continues face favourable business prospects as demand for end-user industry continues to grow and elongation of COVID-19 pandemic despite increase in vaccination. For Q1FY22, ASL has registered revenue of Rs.147 crore. Going forward, ASL is undertaking capacity expansion project to cater rising demand for home and personal care products.

Comfortable gearing with improvement in debt coverage indicators

ASL's capital structure remains comfortable with overall gearing at 1.15x as on March 31, 2021 (PY: 0.98x). ASL has undertook debt-funded capex for FY19-21 period and is expected to undertake another debt-funded capex in FY22-23 for capacity expansion. Considering this, ASL's overall gearing is expected to elevate to 1.48x by March 31, 2022. Further, in light of improved operational performance, ASL's debt coverage indicators shown improvement from interest coverage at 4.37x and TDGCA at 4.38x in FY21 (PY: 2.32x and 8.07x respectively). Same is expected to continue in light of envisaged improvement in operational performance and ASL's ability generate healthy cash accruals going forward.

Reputed client profile comprising leading multinational companies in the FMCG sector

ASL caters to reputed FMCG multinationals and domestic customers and is a preferred supplier for Hindustan Unilever, Procter & Gamble Home Products Pvt. Ltd., and Dabur as well as other reputed global brands in India. ASL's customer concentration risk is moderated as contribution of top 3 customer to total sale decreased from 55% in FY20 to 35% in FY21. Primarily, ASL has expanded into local market with continued relationship with large MNCs in FMCG. For customers like HUL and P&G, ASL has long term contracts with cost plus delta model to pass on any fluctuations in raw material prices.

Key Rating Weaknesses

Brownfield expansion project in FY21-22

ASL has started increasing capacity for its plants at Silvassa and Pithampur post demerger from AIL. ASL has increased its combined capacity from 30,525 MTA in FY18 to 92,000 MTA in FY21. ASL has completed capex of Rs.60 crore in FY19-21 period. Further, ASL has continued to increase overall capacity up to 1,30,000 MTA in FY22. For FY22, company has planned capex of Rs.40 crore, funded through mix raising debt of Rs.30 crore and balance through promoter contribution. Scope of this project is to expand capacity for existing products (AOS, SLS, SLES) as well as introduce capacity for new products such as Mild surfactants, Formulations, etc. As per the management, this project will be completed by March, 2022. ASL is in the final stage of project undertaken in FY21 and is expected to be in operations by September, 2021. Project risk is partially mitigated as the company has shown track record of successfully completing similar projects in past as well without any time or cost overruns.

Intense competition from domestic and international players

The speciality chemicals industry is highly competitive. The primary competitors of ASL are multi-national companies such as BASF Corporation, Clariant Limited, Croda International Plc, Evonik Industries, Solvay S.A., Stepan Company and The Dow Chemical Company. In the domestic market Galaxy Surfactant Limited is the largest pure play surfactant manufacturer. Flexibility to respond to changing business conditions, including research and creation capabilities, is an important element towards maintaining a competitive position in the surfactants industry. In addition to competition in the surfactants industry, ASL is also affected by competition faced by their customers, specifically manufacturers of FMCG products.

Susceptibility of operating performance to volatility in raw material prices

ASL has a high dependence on Lauryl alcohol (LA) which forms more than 45% of the raw material costs. ASL derives majority of its revenue through cost plus model (for customers such as HUL, P&G, RB etc.) while for balance through non-cost-plus model whereby it derives its revenue on the basis of the prevailing market price. The profitability margin of ASL remains susceptible to the significant volatility in the prices of key raw materials only to the extent the non-cost-plus portion of the business. Due to high demand in end-user products, prices of Lauryl Alcohol increased from around US$1000 per MT in Q4FY20 to high of US$2000-US$2200 per MT by Q4FY21. However, despite this significant increase in input material prices, ASL has improved their operating margin due to company's ability to pass on these increases through cost-plus model. Therefore, impact of raw material price fluctuations on company's operating performance is partially mitigated.

Liquidity Position: Adequate
ASL's liquidity profile marked by healthy cash and bank balance of Rs.6.57 crore and current ratio of 1.10x as on March 31, 2021. ASL's working capital utilization remains high at 89% for 12-month period ending in May-2021. Further, the company has availed enhancement of Rs.15 crore in working capital limits to meet its incremental working capital needs going forward. With overall gearing at 1.15x as on March 31, 2021, ASL has sufficient headroom to fund its capex plans in FY22-23 through raising debt. The company has term loan repayment of Rs.6 crore against expected cash accruals of Rs.41 crore in FY22. Considering above, ASL's liquidity profile remains adequate to meet its incremental working capital requirement over next one year.

Analytical approach: Standalone
For arriving at the ratings, CARE has considered the standalone financial of ASL and the linkages with AIL. Both ASL and AIL share same first name of entity and sizable part of shareholding of ASL is held by promoters of AIL.

Applicable Criteria
CARE's policy on Default recognition
Criteria on assigning 'Outlook' and 'Credit watch' to Credit Ratings
Rating methodology – Manufacturing companies
Rating Methodology: Consolidation and Factoring Linkages in Ratings
Financials Ratio - Non-Financial Sector
Liquidity Analysis of Non-Financial Sector Entities

About the Company
Aarti Surfactants Limited (ASL) was formed as a result of the demerger of the home and personal care division of Aarti Industries Limited. ASL is engaged in the manufacture of ionic and non- ionic surfactants and specialty products serving the home and personal care (HPC) industry. Its product portfolio includes surfactants, mild surfactants, rheology modifiers, pearlising agents, UV filters, soap bases as well as conditioning agents. ASL supplies surfactants, including concentrates for shampoo, hand wash, dish wash and oral care. Apart from India, ASL also exports its products to USA, Europe and South East Asian countries with exports accounting for 28% of the sales in FY21. ASL is a preferred supplier to Hindustan Unilever, Proctor & Gamble, Patanjali and Dabur. Its Manufacturing Units are located at Pithampur in Madhya Pradesh and Silvassa in Dadra Nagar Haveli.

Brief Financials (Rs. Crore)	FY20 (A)	FY21 (A)
Total operating income	326.07	465.83
PBILDT	23.81	45.57
PAT	2.09	21.64
Overall gearing (times)	0.98	1.15
Interest coverage (times)	2.32	4.37

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 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-Term Loan	-	-	July, 2027	70.00	CARE BBB+; Stable
Fund-based - LT-Cash Credit	-	-	-	70.00	CARE BBB+; Stable
Fund-based - LT- Proposed Limits	-	-	-	25.00	CARE BBB+; Stable
Preference Shares-Redeemable	August 20, 2019	0.00	August 19, 2026	18.50	CARE BBB (RPS); Stable

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 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Fund-based - LT-Term Loan	LT	70.00	CARE BBB+; Stable	-	1)CARE BBB; Stable (02-Nov-20) 2)CARE BBB; Stable (07-Oct-20)	1)CARE BBB-; Stable (02-Jan-20)	-
2.	Preference Shares-Redeemable	LT	18.50	CARE BBB (RPS); Stable	-	1)CARE BBB- (RPS); Stable (02-Nov-20) 2)CARE BBB- (RPS); Stable (07-Oct-20)	1)CARE BB+ (RPS); Stable (02-Jan-20)	-
3.	Fund-based - LT-Cash Credit	LT	70.00	CARE BBB+; Stable	-	1)CARE BBB; Stable (02-Nov-20) 2)CARE BBB; Stable (07-Oct-20)	1)CARE BBB-; Stable (02-Jan-20)	-
4.	Fund-based - LT-Proposed Limits	LT	25.00	CARE BBB+; Stable	-	1)CARE BBB; Stable (02-Nov-20) 2)CARE BBB; Stable (07-Oct-20)	1)CARE BBB-; Stable (02-Jan-20)	-

Annexure 3: Complexity level of various instruments rated for this company

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Cash Credit	Simple
2.	Fund-based - LT-Proposed fund-based limits	Simple
3.	Fund-based - LT-Term Loan	Simple
4.	Preference Shares-Redeemable	Highly Complex

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.*

Contact us

Media Contact
Mradul Mishra
Contact no.: 022-68374424
Email ID: mradul.mishra@careratings.com

Analyst Contact
Mr. Soumya Dasgupta
Contact no.: 022-67543456
Email ID: soumya.dasgupta@careratings.com

Relationship Contact
Name: Ankur Sachdeva
Contact no.: 022-67543495
Email ID: ankur.sachdeva@careratings.com

About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**