Fairchem Organics Limited

August 18, 2022

Ratings

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	123.99 (Enhanced from 58.49)	CARE A+; Stable (Single A Plus; Outlook: Stable)	Reaffirmed
Long Term / Short Term Bank Facilities	2.25 (Reduced from 2.50)	CARE A+; Stable / CARE A1+ (Single A Plus; Outlook: Stable/ A One Plus)	Reaffirmed
Short Term Bank Facilities	5.00	CARE A1+ (A One Plus)	Assigned
Long Term Bank Facilities*	-	-	Withdrawn
Total Bank Facilities	**131.24 (₹ One Hundred Thirty-One Crore and Twenty-Four Lakhs Only)**		

Details of instruments/facilities in Annexure-1; * The said term loans have been fully repaid.

Detailed rationale and key rating drivers

The ratings assigned to the bank facilities of the Fairchem Organics Limited (FOL) continue to derive strength from its experienced and resourceful promoters, long-standing operational track record in the manufacturing of specialty chemicals having diverse industry applications, leadership position in the domestic market for its products and its established relations with the reputed customers. The ratings continue to factor its growing scale of operation, with the company maintaining its healthy profitability, comfortable capital structure, debt coverage indicators and its strong liquidity.

The ratings are, however, constrained on account of FOL's presence in the niche market, risk of import substitutability from low-cost Chinese products and susceptibility of profitability to volatile raw material prices and fluctuations in the forex rate. The ratings are further constrained due to its exposure to technology obsolescence risk and stringent pollution control norms.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Growth in the scale of operations marked by total operating income (TOI) of more than ₹1,000 crore along with earning profit before interest, lease, depreciation and tax (PBILDT) margin of around 18% on a sustained basis.
- Diversification of revenue stream in terms of products as well as reduced dependence on few major customers.

Negative factors – Factors that could lead to negative rating action/downgrade:

- Decline in its scale of operations marked by TOI of less than ₹400 crore on a sustained basis with PBILDT margin of less than 15% on a sustained basis.
- Elongation in its operating cycle beyond 100 days affecting its liquidity.
- Any large-size debt-funded capex leading to moderation in its overall gearing beyond 0.60x.

Detailed description of the key rating drivers

<u>Key rating strengths</u>

Experienced and resourceful management

FOL is led by Nahoosh Jariwala (the Chairman and Managing Director), who has an experience of more than 25 years in chemical manufacturing and trading of various textile products. He looks after the core operations of the company, including process optimisation, product development, production planning, etc. He is well supported by a qualified second-tier management. As on June 30, 2022, Canada-based FIH Mauritius Investment Limited (FMIL) holds 52.83% equity stake (66.65% as on June 30, 2021) in FOL. FMIL is an investment arm of Fairfax India Holdings Corporations (Fairfax India) founded in 2014 by V. Prem Watsa, having diverse investment portfolio with fair value of ₹24,571 crore in India as on June 30, 2022. The investment portfolio of Fairfax India includes IIFL Finance Limited (rated 'CARE AA; Stable'), IIFL Wealth Management Limited (rated 'CARE A1+'), IIFL Securities Limited, CSB Bank Limited, Bangalore International Airport Limited, Seven Islands Shipping Limited, 5paisa Capital Limited, National Commodities Management Services Limited amongst others.

Established track record of operations along with diverse industry application

FOL had been operating in the specialty chemicals segment for more than two decades, wherein it manufactures niche products having diverse industry applications. The company is primarily engaged in the manufacturing of dimer acid and linoleic acid, which find application in industries like paints, printing ink, polyamides and adhesives. The residue generated during the manufacturing processes is sold to the local soap manufacturers and other industries as a fuel. FOL's product portfolio also includes mixed tocopherol concentrate and concentrated sterols under nutraceuticals segment. Over the period, the company has been increasing its processing capacity from 10,000 metric ton per annum (MTPA) as on March 31, 2011, to 72,000 MTPA

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

as on March 31, 2021. During FY21-FY22 (refers to the period April 1 to March 31), it had undertaken the capex to increase its manufacturing capacity to 120,000 MTPA as on June 30, 2022. The total cost of the project was around ₹47 crore, which was entirely funded from the internal accruals.

Reputed clientele with leadership position in domestic market creating entry barriers to other players
FOL has long association with its customers in the domestic as well as export markets. FOL has association with reputed and diversified clientele, which includes companies like Asian Paints Limited, Uniform Synthetics, Resins & Plastics Limited, Resinova Chemie Limited, BASF Corporation (USA), Arkema Chemicals India Private Limited among others. During FY22, top 10 customers contributed around 71% of its net sales (FY21: 64%), with top customer contributing around 40% (FY21: 41%) reflecting moderate customer concentration. However, majority of FOL's clientele enjoy a leading position in their respective industry segments and hence the credit risk is envisaged to be minimal.
FOL enjoys a leadership position in the industry in terms of acid-based products, mainly dimer acid and linoleic acid, in India. FOL manufactures its products through fatty acid (which is 1%-1.50% of waste generated during edible oil refining) providing it the cost advantage as compared to other players, who manufacture these products using raw/soft oil. The total availability of the fatty acid in India is limited. FOL, over a period of time, has developed strong relations with its suppliers and has established procurement network, ensuring a steady supply of raw material. Cost advantage, established procurement network and limited size act as barriers for other players in the industry.

Growing scale of operation with healthy profitability
Overall, FOL has exhibited growing scale of operation, with a growth in its TOI at a compounded annual growth rate (CAGR) of 28% in the last six years ended March 31, 2022, with periodic capacity addition and steady growth in the sales volume. FOL had developed a variant of linoleic acid catering to the requirement of paint industry, which is the key growth driver in the last 2-3 years. The TOI of FOL grew by 62% from ₹396.57 crore during FY21 to ₹643.29 crore during FY22 on the back of 14% growth in the sales volume along with improvement in the average sales realisation. Linoleic acid and dimer acid are the major products of FOL, which form around 75% of the net sales during FY22 (FY21: 77%). Both these products have shown strong growth during FY22 on y-oy basis. The nutraceuticals segment in FOL's total revenue has remained low mainly due to unremunerative prices of the end products. FOL continues to have healthy profitability marked by PBILDT margin of 16.32% (FY21: 17.36%) and profit after tax (PAT) margin of 10.56% (FY21: 10.71%) during FY22. FOL reported strong gross cash accruals (GCA) of ₹76.47 crore during FY22 (FY21: ₹48.94 crore).
During Q1FY23, FOL has reported healthy net sales of ₹224.94 crore (Q1FY22: ₹138.98 crore), primarily on account of strong demand of linoleic acid as well as dimer acid and other newly developed products. The PBILDT margin and PAT margin though moderate on y-o-y basis remained healthy at 17.94% and 12.02% during Q1FY23.

Comfortable capital structure and debt coverage indicators
FOL's overall gearing remained comfortable and improved over the years with steady accretion of the profit to net-worth base and largely stable debt levels. The overall gearing and total outside liability (TOL) to tangible net worth (TNW) improved and remained comfortable at 0.27x and 0.34x, respectively, as on March 31, 2022, as compared with 0.34x and 0.47x, respectively, as on March 31, 2021. PBILDT interest coverage and total debt to GCA (TDGCA) have also improved from 10.08x and 1.16x, respectively, during FY21 to 15.33x and 0.81x, respectively, during FY22. With healthy profitability and low reliance on the external debt, FOL is likely to maintain its comfortable capital structure and debt coverage going forward.

Stable demand prospect from industry
The products manufactured by FOL find application in high growth consumer goods industries like nutraceuticals, paints, printing ink, adhesives, soap manufacturing, etc. All these industries are expected to grow at a steady rate in the medium term due to factors such as rising population, increase in disposable income, increase in penetration of e-commerce, which increases the demand for packaging and printing ink industry and increasing spending on healthcare and nutrition products.

Key rating weaknesses
Presence in niche market with competition from low-cost Chinese products
The industry size for dimer acid and linoleic acid is relatively small as compared with the overall size of speciality chemical industry, which limits the growth of the company. Furthermore, FOL faces competition from the low-cost products from China, especially in dimer acid. However, FOL has been able to gain significant market share in India with its apt pricing strategy and cost advantages.

Susceptibility of the profitability to volatile raw material prices and fluctuations in forex rates
Vegetable oil distillate and acid oil are the main raw materials for FOL. These raw materials are the by-products of soya and sunflower oils generated during their refining process as by-products. The prices of both these oils have remained volatile and witnessed sharp fluctuations in the last two years for various reasons. FOL's exports comprise around 2% of its net sales during FY22 (FY21: 3%), whereas major portion of its raw material requirement is procured domestically with some import. Hence, the profitability of FOL is susceptible to volatile agro-based raw material prices and forex rates, as the company does not have any active hedging policy.

Stringent pollution control norms
There is stringent pollution control regulation laid down for chemical processing units under the Gujarat Pollution Control Board (GPCB) norms. The company during its production process generates polluted water and air that needs to be treated before

their disposal. Compliance with stringent pollution control norms set by the regulatory authorities and any violation in compliance with these norms or any further strengthening of these norms would adversely impact FOL's operations. FOL has zero liquid discharge facility with adequate hazardous and non-hazardous waste disposal mechanism in place. Continuous adherence to the prevailing pollution control norms would remain crucial from the credit perspective.

Product obsolescence and substitution risks
The companies like FOL, which operate in the niche specialty chemical segment, carry risk in terms of challenges emanating from the development of alternative technologies and introduction of newer products, and hence are exposed to the risk of product obsolescence and substitution. However, FOL has expanded its R&D capabilities, which facilitate the launching of new derivatives of its existing products to its product portfolio.

Liquidity: Strong
FOL has strong liquidity marked by healthy cash accruals against nil term debt repayment obligations, moderate liquidity ratios and low utilisation of fund-based limits. FOL paid all of its term loan, which also includes prepayment of certain term loan leading to nil term debt o/s as on June 30, 2022. Average monthly fund-based utilisation remained low at 32.63% for the last 12 months ended June 30, 2022. FOL is expected to earn strong cash accruals during FY23, which are sufficient to cater to its capex requirement, and hence, it is not planning to avail any term debt in the near to medium term. The cash flow from operation stood strong at ₹41.40 crore during FY22 as compared with ₹41.42 crore during FY21. Its current ratio and quick ratio remained comfortable at 1.77x and 0.87x, respectively, as on March 31, 2022, as compared with 1.93x and 1.04x, respectively, as on March 31, 2021. The operating cycle of the company shortened to 63 days during FY22 as compared with 74 days during FY21 on the back of improvement in the average debtors as well as average inventory days during FY22.

Analytical approach: Standalone

Applicable criteria
Policy on default recognition
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Manufacturing Companies
Policy on Withdrawal of Ratings

About the company
Fairchem Organics Limited (CIN: L24200GJ2019PLC129759) was established in 2019, wherein Fairchem Speciality Limited (FSL) transferred the businesses of Oleo chemicals and nutraceuticals (entire business of FSL) as per the scheme of demerger. FOL is engaged in the manufacturing of specialty chemicals like dimer acid, linoleic acid, mixed tocopherol concentrate and sterols concentrate, which find application in various industries like nutraceuticals, paints, printing ink, detergents, adhesives, etc. FOL's manufacturing facility is located at Chekala village near Sanand, Gujarat, with an installed capacity of 120,000 MTPA as on June 30, 2022. FSL (formerly known as Adi Finechem Limited) was promoted by Rajan Harivallabhdas in May 1985. During FY10, Rajan Harivallabhdas sold his stake to three new promoters, namely, Utkarsh Shah, Bimal Parikh and Hemant Shah. Moreover, during FY16, Fairfax India, through its wholly owned subsidiary, FIH Mauritius Investment Limited (FMIL), acquired controlling equity stake in FSL. FMIL holds 52.83% equity stake in FOL as on June 30, 2022.

Brief Financials (₹ crore)	FY21 (A)	FY22 (A)	Q1FY23 (Prov.)
Total operating income	396.57	643.29	224.94
PBILDT	68.83	104.97	40.35
PAT	42.48	67.91	27.03
Overall gearing (times)	0.34	0.27	N.A.
Interest coverage (times)	10.08	15.33	16.74

A: Audited; Prov.: Provisional

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not Applicable

Rating history for the last three years: Please refer Annexure-2

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

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

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	-	-	0.00	Withdrawn
Fund-based - LT-Cash Credit	-	-	-	-	123.99	CARE A+; Stable
Non-fund-based - LT/ ST-Bank Guarantee	-	-	-	-	2.25	CARE A+; Stable / CARE A1+
Non-fund-based - ST-Letter of credit	-	-	-	-	5.00	CARE A1+

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based - LT-Term Loan	LT	-	-	-	1)CARE A+; Stable (20-Aug-21)	1)CARE A; Stable (08-Mar-21) 2)CARE A; Stable (16-Sep-20)	-
2	Fund-based - LT-Cash Credit	LT	123.99	CARE A+; Stable	-	1)CARE A+; Stable (20-Aug-21)	1)CARE A; Stable (08-Mar-21) 2)CARE A; Stable (16-Sep-20)	-
3	Non-fund-based - LT/ ST-Bank Guarantee	LT/ST*	2.25	CARE A+; Stable / CARE A1+	-	1)CARE A+; Stable / CARE A1+ (20-Aug-21)	1)CARE A; Stable / CARE A1 (08-Mar-21) 2)CARE A; Stable / CARE A1 (16-Sep-20)	-
4	Non-fund-based - ST-Letter of credit	ST	5.00	CARE A1+	-	-	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities

Name of the Instrument	Detailed Explanation
A. Financial covenants	
I	Minimum tangible net-worth of ₹240 crore.
B. Non-financial covenants	
	-

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

Sr. No.	Name of Instrument	Complexity Level
1	Fund-based - LT-Cash Credit	Simple
2	Fund-based - LT-Term Loan	Simple
3	Non-fund-based - LT/ ST-Bank Guarantee	Simple
4	Non-fund-based - ST-Letter of credit	Simple

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please click here

Note on complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

Contact us

Media contact
Name: Mradul Mishra
Phone: +91-22-6754 3596
E-mail: mradul.mishra@careedge.in

Analyst contact
Name: Akhil Goyal
Phone: 8511190015
E-mail: akhil.goyal@careedge.in

Relationship contact
Name: Deepak Purshottambhai Prajapati
Phone: +91-79-4026 5656
E-mail: deepak.prajapati@careedge.in

About us:
Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

For the detailed Rationale Report and subscription information, please visit www.careedge.in