Aarti Surfactants Limited (Revised)

August 24, 2022

Ratings

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long Term Bank Facilities	189.50 (Enhanced from 165.00)	CARE BBB+; Stable (Triple B Plus; Outlook: Stable)	Reaffirmed
Total Bank Facilities	**189.50 (₹ One Hundred Eighty-Nine Crore and Fifty Lakhs Only)**		
Long-Term Instruments-Preference Shares-Redeemable	18.50	CARE BBB; Stable (Triple B; Outlook: Stable)	Reaffirmed
Total Long-Term Instruments	**18.50 (₹ Eighteen Crore and Fifty Lakhs Only)**		

Details of instruments/facilities in Annexure-1.

Detailed Rationale & Key Rating Drivers

The ratings continue to derive strength from extensive experience of promoters in chemical industry through Aarti Industries Limited, ASL's continued growth momentum in revenue, reputed client profile comprising leading multinational companies in the FMCG sector and comfortable gearing. However, ratings remain constrained by company's presence in competitive market and susceptibility of operating performance to raw material prices.

Rating sensitivities

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

- 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- Factors that could lead to negative rating action/downgrade:

- Lower than expected revenue growth and profitability.
- Overall gearing of the company exceeding 1.75x level.
- Major debt led capex impacting the liquidity profile of the company.

Detailed description of the key rating drivers

Key rating strengths

Strong background of the promoters in chemical industry vide Aarti Industries Limited: Aarti Surfactants Limited (ASL) continues to benefit from rich experience of their promoters in chemical/pharma sector through the Aarti Group founded by them. Also, ASL is managed under the guidance of Mr. Chandrakant Vallabhaji Gogri, who is the founder and the current Chairman Emeritus of Aarti Industries Limited (AIL). ASL's Managing Director, Mr. Nikhil Parimal Desai, is the son of Mr. Parimal H Desai, Whole Time Director of AIL. Aarti Industries was incorporated in 1984 and is a leading Indian manufacturer of speciality chemicals and pharmaceuticals with a global footprint. Aarti Industries Limited possesses a diverse portfolio of basic chemicals, agrochemicals, speciality chemicals and intermediates, which are extensively used in the manufacture of pharmaceuticals, agri-products, polymers, additives, pigments and dyes.

Consistent improvement in revenue; growth momentum to continue: ASL has shown consistent improvement in revenue at a CAGR of 29.52% over FY19-FY22. ASL has continued achieving double digit revenue growth in FY22 with revenue at Rs. 574.41 crores (FY21: Rs. 464.56 crores) majorly driven by volume. Also, expanding its customer base in domestic as well as export market in past few years, has resulted in increase of revenue. The overall revenue contribution from the domestic segment is more than 70% as per March 31, 2022. The domestic segment grew moderately at 9% in FY22. Significant growth of 82% is observed in exports. The growth momentum has sustained in Q1FY23 with revenues of Rs. 158.13 crores (Q1FY22: Rs 149.15 crores; Q4FY22: Rs. 151.40 crores).

The growing disposable income of the people in both developed and developing countries will lead the growth in home and personal care segment. In addition to this, the global supply chain driven by China plus one policy, will further boost demand for surfactants and other speciality products manufactured by ASL. With completion of capacity enhancement of Pithampur

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

(Madhya Pradesh) plant, the company is in a position to meet this increasing demand. The capacity of Pithampur plant is 82,600 MT per annum, which is higher than that of 50,000 MT of Silvassa plant. ASL has incurred total capital expenditure of around Rs. 100.00 crores over FY19-Q1FY23 to enhance its total capacity to 1,32,600 MT per annum from 92,000MT per annum. The said incremental capacity has been operational from Q1FY23. Given that the capacity of Pithampur plant (Madhya Pradesh) was not operational to its fullest in FY22, the total capacity utilisation (including both plants) was low at 51%; however same has improved in Q1FY23 to above 85%.

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 moderate as contribution of top 3 customers to total sale is around 41% (FY21: 35%; FY20: 55%). Revenue growth has been achieved primarily through expansion in the domestic market with continued strong relationship with large MNCs in the FMCG sector.

Comfortable gearing and coverage metrics: The overall gearing of ASL is comfortable at 1.29x in FY22 (FY21: 1.15x). The marginal deterioration in gearing in FY22 is due to increase in debt level to fund the capital expenditure. Given the improvement in profitability in Q1FY23, the interest coverage has improved above 3.5x (FY22: 2.9x). As per the management of ASL, there is no concrete plan with regards to capital expenditure in upcoming years. Based on this, the overall gearing and coverage is expected to remain comfortable in near to mid-term.

Key rating weaknesses

Susceptibility of operating performance to volatility in raw material prices: ASL's prime raw materials are Lauryl alcohol (LA), fatty acids (HCFA) and Alpha Olefin (AO) which forms major portion of the raw material costs. The pricing of these raw materials is volatile in nature and is linked to palm oil price. Given, the price of the palm oil was in upward trend during FY21-FY22, the palm oil derived products got impacted by price inflation as well. India being largest importer of palm oil, companies such as ASL are susceptible to volatility in supply as well as pricing, which has been observed in past two years. ASL's meets 65%-75% of raw material procurement from imports. Considering all these factors, ASL is highly susceptible to movement in raw material prices. To mitigate the forex risk associated with imports, the company is planning to hedge the forex risk from near term.

Profitability impacted in FY22; recovery seen in Q1FY23: ASL's profitability was impacted in FY22 owing to continued high raw material prices, limited bargaining power vis-à-vis its large MNC clients as well as competitive pressure from other surfactant manufacturers. Due to increase in one of its key raw materials, i.e., lauryl alcohol, ASL's procurement price has increased by almost 51% in FY22 at Rs. 167 per kg. Moreover, high freight cost further contracted the margins in the year. Following three quarters of low profitability, improvement is observed in Q1FY23 at 7.27% (FY22:5.40%). This was possible due to pass through of price increases achieved in the quarter. Raw material cost constitutes 82%-84% of total operating cost and considering the volatility in prices, the margins remain a key monitorable in upcoming quarters.

Fire Incident at Silvassa plant constraining the operating performance: There had been a fire incident at Silvassa plant on March 19, 2022, which completely damaged the Sulphonation capacity, and there has been no production of surfactants till date from this facility. The damage to the plant has been estimated by the company at Rs. 27.32 crores. However, the company was able to shift Sulphonation production to Pithampur, as there was surplus capacity available in the latter, hence there has been no loss of revenue till date. Also, the production of speciality chemicals continues at Silvassa, which contributes 25% towards the top line. As per the management, the Silvassa plant is expected to be operational approximately in a year. The said plant is fully insured, and the insurance claim is under process.

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, Godrej Industries Limited, 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 within the surfactants industry, ASL is also affected by competition faced by its customers, specifically manufacturers of FMCG products which also limits its pricing power.

Liquidity: Adequate

The liquidity of the company is adequate with gross cash accrual of Rs. 21.11 crore in FY22. The gross accruals are expected to improve in near to mid-term backed by likely improvement in top line and profitability. The average maximum working capital utilisation of its fund-based limit of Rs. 100.00 crore remained at around 80% for the last 12 months ended 31 May 2022. ASL's cash flow from operations continued to remain positive for third consecutive year at INR23.36 crores in FY22 (FY21: INR35.83 crores). The company has repayments of INR13.62 crores in FY23 & INR26.00 crores in FY24. The unrestricted cash and bank balance remains modest at INR1.67 crores as on August 08, 2022 (FY21: INR6.73 crore).

Analytical approach: Standalone

Applicable criteria
[Policy on default recognition]
[Financial Ratios – Nonfinancial Sector]
[Liquidity Analysis of Non-financial sector entities]
[Rating Outlook and Credit Watch]
[Manufacturing Companies]

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 Southeast Asian countries with exports accounting for 28% of the sales in FY22. 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 (₹ crore)	31-03-2021 (A)	31-03-2022 (A)	Q1FY23 (UA)
Total operating income	464.56	574.40	158.13
PBILDT	44.30	31.03	11.50
PAT	21.64	5.50	3.71
Overall gearing (times)	1.15	1.19	NA
Interest coverage (times)	4.24	2.91	3.86

A: Audited; UA: Unaudited; NA: Not available

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		-	-	October 2026	89.50	CARE BBB+; Stable
Fund-based - LT-Cash Credit		-	-	-	70.00	CARE BBB+; Stable
Fund-based - LT-Cash Credit		-	-	-	30.00	CARE BBB+; Stable
Preference Shares-Redeemable		August 20, 2019	0.00	August 19, 2026	18.50	CARE BBB; Stable

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	89.50	CARE BBB+; Stable	-	1)CARE BBB+; Stable (11-Aug-21)	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; Stable	1)CARE BBB; Stable (15-Apr-22)	1)CARE BBB (RPS); Stable (11-Aug-21)	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 (11-Aug-21)	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-Cash Credit	LT	30.00	CARE BBB+; Stable	-	1)CARE BBB+; Stable (11-Aug-21)	1)CARE BBB; Stable (02-Nov-20) 2)CARE BBB; Stable (07-Oct-20)	1)CARE BBB-; Stable (02-Jan-20)

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities- Not applicable

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	Preference Shares-Redeemable	Highly Complex

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.

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About CARE Ratings Limited:

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With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

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