Aarti Drugs Limited (Revised)

January 8, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities-Term Loan	203.08 (232.14)	**CARE A+;Stable [Single A Plus; Outlook: Stable]**	Reaffirmed
Long-term/Short-term Bank Facilities	939.99	**CARE A+; Stable/ CARE A1+ [Single A Plus; Outlook: Stable/ A One Plus]**	Reaffirmed
Total Facilities	**1143.07 (Rs. One thousand one hundred and forty-three crore and seven lacs)**		
Instrument			
Commercial Paper	50.00 **(Rs. Fifty crore only)**	**CARE A1+ [A One Plus]**	Reaffirmed

Details of instruments/facilities in Annexure-1
^Based on the undertaking from the company that the lower of drawing power or sanctioned fund based working capital bank limits, to remain unutilized to the extent of outstanding commercial paper.

Detailed Rationale & Key Rating Drivers

The rating reaffirmation to Bank facilities and Commercial Paper of Aarti Drugs Limited factors in the leading position of Aarti Drugs Limited (ADL) in Active Pharmaceutical Ingredients (APIs) business with its strong and diverse product portfolio, long standing relationship with geographically diverse & reputed clientele along with extensive experience of management in pharmaceutical / chemical business. The ratings also favorably factors in the healthy operating profit margin translating into comfortable debt coverage indicators with moderate leverage.

The rating strengths are however tempered by the regulatory risk associated with pharmaceutical business, intense competition within the industry and susceptibility of its operating profit margins to fluctuations in crude oil prices.

The ability of the company to add new product into the portfolio thereby further improving its market position and operating profit margin coupled with efficient management of working capital requirement are the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Strengths

Leading manufacturer of API's with strong product portfolio: ADL is among the leading manufacturers of APIs in India having a strong product portfolio of about 121 products of which top 5 products contribute to ~53% of FY18 sales and top 10 products contribute 75% of sales in FY18. Ciprofloxacin HCL (17%), Metronidazole (11%), Metformin (10%), Ketoconazole (8%) and Ofloxacin (8%) are among the top selling products of the company. Also, it is continuously involved in developing new value added molecules and in past six years it has successfully developed around 30 new molecules. Further, 5 more APIs are under development. ADL is having presence across more than 10 therapeutic segments with strong presence in antibiotic, antidiarrheal and anti-inflammatory segments (contributing to around 75% of total sales). The share in lifestyle based drugs like Anti-diabetic and cardio-protective is also increasing since past 3 years (6% in FY15 to 14% in FY18).

Long standing relationship with reputed clientele along with geographic diversification of revenues: ADL generates majority of its gross sales from domestic market which contributes 63% to its total sales, while rest is split between exports sales to regulated markets (21%) and export sales to semi and un-unregulated markets (16%). In domestic market, ADL caters to demand from its reputed clientele which consists of companies like Abbott Healthcare Private Limited, Cipla Limited (CARE A1+), Alkem Laboratories Limited. ADL shares long standing relationship with both domestic and export clientele, as a result, it has been generating repeated order from these clientele.

The revenue profile of ADL is fairly diversified; same can be substantiated from the fact that ADL export its products to more than 90 countries worldwide. Top 10 customers both for export or domestic sales contribute ~10% of ADL's gross sales.

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

Experienced Promoters with a succession plan under execution; albeit limited research and development expenditure: The company has experienced management of which the Chairman and MD has experience in the field of chemical industry of more than 40 years. Also the other 3 promoter directors have vast experience in this field. The second generation of few promoter directors has also started taking active part in the day to day operations of the company from quite some time now (around 6-8 years).

ADL being largely focused on APIs, does not have significant presence in research and development. It spends around 0.30%-1.50% of total sales on R&D expense on annual basis. Such R&D expenditure is mainly directed towards improvement in processes translating into enhanced operating efficiencies. In last few years, about 30 API's (New and Existing) have been developed in lab. Besides, with promoters being closely involved in the R&D activities, the expenditure is fairly controlled.

Comfortable capital structure and debt coverage indicators: Overall gearing of ADL stood comfortable at 1.21x as on March 31, 2018, similar to 1.22x as on March 31, 2017. As on Sept 30, 2018, the overall gearing stood at 1.07x. Company foresees a recurring capital expenditure of Rs. 70 crore-75 crore, every year for the next 2-3 years which would be funded partially through debt and rest through internal accruals. The company expects keeping the overall capital structure at around 1.2x-1.25x. The company does not envisage any additional capital infusion in the near future.

The interest coverage ratio has improved from 4.82x in FY17 to 5.28x in FY18, largely on account of reduction in interest rates and premium cost on the foreign currency loans.

Moderation in healthy operating margin: ADL reported marginal Y-o-Y growth of ~4% in its total operating income during FY18, the growth was attributed to increase in sales volume which grew by 9% over past year. The said growth was lower than previous year mainly on account of impact of GST on the sales for H1FY18. ADL has been reporting healthy operating profit margin (in the range of 15% - 17%) over the years. During H1FY19, the operating margin moderated to around 14% because of higher raw material costs caused by temporary supply disruption from China to comply with tighter pollution norms. More than 50% of raw materials are procured from China. Subsequently, the company has changed the processes to manufacture APIs with less polluted chemicals and the suppliers have either shifted their base or processes to comply with the tighter pollution norms.

However, the total operating income increased by 21% as envisaged in H1FY19 over H1FY18 (that includes excise duty of Rs. 19.20 crore), which was impacted due to implementation of Good and Sales Tax (GST) and closure of 2 units for around 20 days.

The ability of the company to improve its operating margin, whilst increasing its scale of operations remain a key rating sensitivity.

Key Rating Weaknesses

Regulatory risk associated with business coupled with intense competition in industry: The pharmaceutical industry is highly regulated in many other countries and requires various approvals, licenses, registrations and permissions for business activities. The approval process for a new product registration is complex, lengthy and expensive. The time taken to obtain approval varies by country but generally takes from six months to several years from the date of application. Any delay or failure in getting approval for new product launch could adversely affect the business prospect of the company. Given, India's significant share in the USA's generic market, the USFDA has increased its scrutiny of manufacturing facilities and other regulatory compliance of the Indian pharma companies supplying generics drugs to the USA. Non-compliance may result in regulatory ban on products/facilities (as in the recent cases of import alerts issued by the USFDA to top pharma companies) and may impact a company's future approvals from USFDA. Hence, ongoing regulatory compliance has become critical for Indian pharma companies including ADL as it seeks to strengthen its position in the regulated markets like USA, UK, etc.

Limited supplier concentration risk with high country concentration risk: During FY18,~57% of raw materials were imported and the rest were indigenously procured. Of the top 10 importers of the company 8 are Chinese dealers, who contribute ~54% of its imports which is a high country concentration risk.

Susceptibility of its operating profit margin to fluctuations in crude oil prices: ADL imports around 60% of its total raw material requirement and most of the chemicals used for manufacturing are derivatives of Crude Oil. Though, ADL may pass on the fluctuation to its customers through change in prices of its product, however, it may happen with a lag of around 60-90 days depending on the orders book under execution and price revision understanding with the customer.

Analytical approach: Consolidated Approach which includes ADL's subsidiary Pinnacle Life Science Private Limited.

Liquidity Analysis

ADL generate gross cash accruals in the range of Rs. 120 crore – Rs.130 crore per year. In addition, the company generates positive cash flow from operations amounting in the range of Rs. 70 crore – Rs. 100 crore per year. Liquidity is further supplemented by the working capital borrowings. The company continues to have high working capital utilisation (average utilisation for the last 12 months - ~91%). However, the net working capital as percentage of total capital employed has remained around 40% (FY18: 42% v/s FY17: 37%).

The major usage of liquidity has been debt repayments, which has been in the range of Rs. 30 crore – Rs. 40 crore, per year and other discretionary payments include dividend/share repurchases which has been in the range of Rs. 20 crore – Rs. 27 crore, per year.

Applicable Criteria
[Criteria on assigning Outlook to Credit Ratings]
[CARE's Policy on Default Recognition]
[Criteria for Short Term Instruments]
[Rating Methodology- Manufacturing Companies]
[Rating Methodology-Pharmaceutical Sector]
[Financial ratios-Non-Financial Sector]

About the Company
Incorporated in 1984, Aarti Drugs Limited is one of the leading manufacturers of bulk drugs in therapeutic groups and of specialty chemicals. ADL exports to more than 90 countries with a strong presence in antibiotic, antidiarrheal and anti-inflammatory segments. Its share in lifestyle based drugs like Anti-diabetic and cardio-protective is also increasing. The company has its manufacturing facilities located at Tarapur, Maharashtra and at Sarigam, Gujarat. The manufacturing facilities are also approved by WHO-GMP, EUGMP, ACCREDITATION from JAPAN, IDL, ANVISA, ISO, TGA Australia, COFEPRIS and COS.

Consolidated Brief Financials (Rs. Crore)	FY17 (A)	FY18 (A)
Total operating income	1,195.71	1,244.35
PBILDT	192.96	202.59
PAT	81.80	82.31
Overall gearing (times)	1.22	1.21
Interest coverage (times)	4.82	5.28

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

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.*

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facilities/instruments are rated by CARE have paid a credit rating fee, based on the amount and type of bank facilities/instruments.

In case of partnership/proprietary concerns, the rating /outlook assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.

Annexure-1: Details of Instruments/Facilities

Name of the Instrument/ Bank Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	December 2025	203.08	CARE A+; Stable
Fund-based - LT/ ST-Working Capital Limits	-	-	-	939.99	CARE A+; Stable / CARE A1+
Commercial Paper	-	-	7 to 364 days	50.00	CARE A1+

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 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Commercial Paper	ST	50.00	CARE A1+	-	1)CARE A1+ (09-Jan-18)	-	-
2.	Fund-based - LT-Term Loan	LT	203.08	CARE A+; Stable	-	1)CARE A+; Stable (09-Jan-18)	-	-
3.	Fund-based - LT-Cash Credit	-	-	-	-	-	-	-
4.	Fund-based - LT/ ST-Working Capital Limits	LT/ST	939.99	CARE A+; Stable / CARE A1+	-	1)CARE A+; Stable / CARE A1+ (09-Jan-18)	-	-

CARE Ratings
Professional Risk Opinion

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