Aarti Drugs Limited

January 09, 2018

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities	232.14	**CARE A+; Stable [Single A Plus; Outlook: Stable]**	Assigned
Long-term/Short-term Bank Facilities	939.99	**CARE A+; Stable /CARE A1+ [Singe A Plus; Outlook: Stable/ A One Plus]**	Assigned
Total Facilities	**1172.13 (Rupees One Thousand One hundred Seventy Two crore and Thirteen lakhs only)**		
Instruments			
Commercial Paper	50.00 (Rs. Fifty crore only)	**CARE A1+ [A One Plus]**	Assigned

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 assignment 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 strong strong product portfolio of about 74 products of which top 5 products contribute to ~50% of FY17 sales and top 10 products contribute ~70-75% of sales in FY17. Ciprofloxacin HCL (19%), Metronidazole (11%) and Ofloxacin (9%) 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 70% 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 13% in FY17).

Long standing relationship with reputed clientele along with geographic diversification of revenues: ADL generates majority of its gross sales from domestic market which contributes 61% to its total sales, while rest is split between exports sales to regulated markets (23%) and export sales to 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

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

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 only 10% of ADL's gross sales.

Healthy operating profit margin translating into comfortable debt coverage with moderate leverage: ADL reported marginal Y-o-Y growth of 5% in its TOI during FY17, the growth was attributed to increase in sales volume which grew by 15 over past year. ADL has been reporting healthy operating profit margin (in the range of 15% - 17%) over the years. Some moderation in income and operating profit margin was witnessed during H1FY18 mainly due to implementation of Good and Sales Tax which led to relatively lower quantum of inventory held by pharmaceutical distributors negatively impacting formulators and consequently translating into lower demand for API's . The impact is expected to be streamlined by end of Q3FY18.
As a consequent to healthy operating profit margin, coupled with lower cost of borrowing led to lower interest cost outgo for FY17 which translating into comfortable healthy debt coverage indicators. The interest coverage has improved from 3.10x in FY16 to 4.12x in FY17 while total debt to GCA of the company has also improved from 4.13x in FY16 to 3.54x in FY17.
Overall gearing of ADL stood comfortable at 1.17x as on March 31, 2017 improving from 1.35x as on March 31, 2016 mainly on account of lower utilization of working capital limits. Further, even factoring in the recurring maintenance capital expenditure, the overall gearing is expected to remain in range of 1.2-1.25x in medium term.

Extensive experience of promoters; albeit limited research and development expenditure: Promoters of ADL have extensive experience of over four decade in operating chemical business. Key promoters are actively involved in day to day management and strategic business decisions. Management has also inducted second generation into business since last three to four years.
ADL is largely focused on APIs so it does not have significant presence in research and development. Besides, with promoters being closely involved in the R&D activities, the expenditure is fairly controlled. It spends around 0.50% to 1.50% p.a. of total sales on annual basis. Such R&D expenditure is mainly directed towards improvement in processes translating into enhanced operating efficiencies.

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.
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.

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)	FY16 (A)	FY17 (A)
Total operating income	1,139.05	1,197.84
PBILDT	185.32	203.25
PAT	75.02	89.96
Overall gearing (times)	1.35	1.17
Interest coverage (times)	3.86	5.08

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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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	-	-	-	232.14	CARE A+; Stable
Fund-based - LT/ ST-Working Capital Limits	-	-	-	939.99	CARE A+; Stable / CARE A1+
Commercial Paper	-	-	-	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 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	Commercial Paper	ST	50.00	CARE A1+	-	-	-	-
2.	Fund-based - LT-Term Loan	LT	232.14	CARE A+; Stable	-	-	-	-
3.	Fund-based - LT-Cash Credit	-	-	-	-	-	-	-
4.	Fund-based - LT/ ST-Working Capital Limits	LT/ST	939.99	CARE A+; Stable / CARE A1+	-	-	-	-

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