Aarti Drugs Limited (Revised)

December 25, 2019

Ratings

Facilities	**Amount (Rs. crore)**	**Rating1**	**Rating Action**
Long term Bank Facilities	203.12 (enhanced from Rs.203.08 crore)	**CARE A+; Stable (Single A Plus; Outlook: Stable)**	**Reaffirmed**
Long term/Short term Bank Facilities	931.00 (reduced from Rs.939.99 crore)	**CARE A+; Stable/ CARE A1+ (Single A Plus; Outlook: Stable/A One Plus)**	**Reaffirmed**
Total Facilities	**1134.12 (Rs. One thousand one hundred and thirty four crore and twelve lacs only)**		
Instrument			
Commercial Paper (Carved out)^	50.00 (Rs. Fifty Crore Only)	**CARE A1+ (A One Plus)**	**Reaffirmed**

Details of instruments/facilities in Annexure-1

^Earlier the CP rating was 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. However, as per revised criteria same is now being treated as Carved Out of working capital limits

Detailed Rationale & Key Rating Drivers

The rating reaffirmation to Bank facilities and Commercial Paper of Aarti Drugs Limited factors in the established position of Aarti Drugs Limited (ADL) in Active Pharmaceutical Ingredients (APIs) business with its strong and diverse product portfolio, long standing relationship with clients and geographically diversification of revenue along with extensive experience of management in pharmaceutical / chemical business. The ratings also favorably factors in comfortable debt coverage indicators with moderate leverage.

The rating strengths are however tempered by high import concentration from China, regulatory risk associated with pharmaceutical business and intense competition within the industry.

Rating Sensitivities

Positive Factors

- Improvement in PBILDT margins to 15% on sustained basis
- Overall gearing around 1x on sustained basis

Negative factors

- Reduction in PBILDT margins below 12%
- Higher than anticipated capital expenditure leading to deterioration in capital structure above 1.6x

Detailed description of the key rating drivers

Key Rating Strengths

Experienced Promoters: 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 3-4 years).

Established market position in the active pharmaceutical ingredients (APIs) business along with strong product portfolio: ADL is among the leading manufacturers of APIs in India with 11 manufacturing facilities of which nine manufacturing facilities are located at Tarapur, Maharashtra and two manufacturing facilities at Sarigam, Gujarat. It has also got approval from WHO-GMP, EUGMP, accreditation from JAPAN, IDL, ANVISA, ISO, TGA Australia, COFEPRIS and COS. ADL has a strong product portfolio of about 121 products of which top 5 products (API) contribute to 50.80% of FY19 sales and top 10 products contribute 73.08% of sales in FY19. Ciprofloxacin HCL (17.44%), Metronidazole (8.55%), and Metformin (8.32%), Ketoconazole (7.29%) are among the top selling products of the company.

ADL is having presence across 11 therapeutic segments with strong presence in antibiotic, antidiarrheal and anti-inflammatory segments (contributing to around 70% of total sales).

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

For the year 2018-19, 92.44% of the total Standalone Sales of the Company came from APIs and its allied Intermediate Segment and approximately 3.11% from the Specialty Chemicals. Within the API Segment, Antibiotic Therapeutic Category contributes to around 39.98%, Anti-diarrhoeal/Anti-protozoal around 17.19%, Anti-inflammatory around 12.35%, followed by Anti-diabetic, Anti-fungal and Cardioprotectant Therapeutic categories.

***Long standing relationship with reputed clientele along with geographic diversification of revenues*:** ADL has diversified client base, including most of the major pharmaceuticals players in India, European and Gulf countries. Domestic sales account for 48% of total sales followed by exports to regulated market at 43% and around 9% to unregulated markets. Thus, the company exports its products to more than 90 countries worldwide and thus there is a comfortable geographic diversification of revenues. The same is evident from top 10 export customers contributing to only 18% of company's export sales.

Comfortable capital structure with further improvements in FY19: Overall gearing of ADL improved at 1.06x as on March 31, 2019, from 1.21x as on March 31, 2018. The company has done capex of Rs.70.96 crore during FY19 & further capex of Rs.32.93 crore during FY20, which is for the multipurpose facility of vitamins/anti-inflammatory segment to target regulated markets. The overall capital structure as at March 31, 2019 has improved on the back of improved net worth, on the back of increasing profits & consequent transfer to reserves & surplus which has boosted the net worth.

The interest coverage ratio has deteriorated from 5.28x in FY18 to 4.87x in FY19 largely on account of increase in interest. The term debt to GCA has remained steady at 1.73x in FY19. But, the total debt to GCA ratio has declined from 4.15x in FY18 to 3.60x in FY19, on account of repayment of working capital borrowings.

Key Rating Weaknesses

Moderation in profitability margins in FY19: The total operating income has shown an increase of 25.53% from FY18 to FY19, increasing from Rs.1244.35 crore to Rs.1562.10 crore, primarily on the back of increasing revenue from its API segment, which increased from Rs.1052.65 crore to Rs.1326.45 crore, an increase of 26%. PBILDT has increased by 4.68%, as PBILDT increased from Rs.202.59 crore to Rs.212.08 crore, on account of underabsorbtion of overhead costs. However, the PBILDT margins have fallen during FY19, from 16.28% in FY18, to 13.58% in FY19, on account of increasing raw material cost. This was due to temporary disruption in supply of raw materials from China on account of which the company had to change process of certain of its products. However, in FY20, the company has managed to stabilize the disruption caused by change in process of certain products, which is reflected in improved financial performance in H1FY20 as against H1FY19, wherein sales increased by 22.34% to Rs.882.93 crore with PBILDT of Rs.123.26 crore (Rs.100.62 crore in H1FY19) and PAT of Rs.54.74 crore (Rs.41.43 crore in H1FY19)

High geographical concentration risk for import of raw material: During FY19, around 54% of raw materials requirement of the company were met through imports out of which around 70% is from China indicating high concentration risk. However, the company has started sourcing some of the raw material from local market to reduce the dependency on imports.

Regulatory risk and intense competition: 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, on-going 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.

Since March 2015, US FDA has banned exports to the US from one of ADL's manufacturing facilities in Palghar. As per this status, the company still cannot export from the said facility. Such exports amounted to only 1-2% of the total sales of the company and hence there is no major impact on revenues. The plant is registered with WHO GMP, COS Certificate, TGA Australia, FDA Canada and European Directorate of Quality and Management and the Company is exporting to those countries. The exports during 2018-19 from said plant was Rs.33.61 Crores

Liquidity: Adequate - The Company's operating cycle is 92 days. The company has free cash & cash equivalents of Rs.4.64 crore as on March 31, 2019 and its fund based working capital limits are utilized to an extent of 90%. GCA is expected to be around Rs.150 crore and repayment of Rs.36 crore in FY20.The company has a planned capex of around Rs.120 crore over FY20 and FY21. The company has Rs.144.63 crore available for its debt obligations.

Analytical approach: Consolidated including ADL's subsidiary Pinnacle Life Science Private Limited. Pinnacle Life Science Private Limited is into the formulation business. It uses API input from ADL along with other suppliers.

Applicable Criteria
Criteria on assigning 'Outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology-Factoring Linkages in Ratings
Rating Methodology-Pharmaceutical Sector
Rating Methodology- Manufacturing Companies
Financial ratios – Non-Financial Sector

About the Company
Aarti Drugs Limited (ADL) is a manufacturer of bulk drugs in therapeutic groups and of specialty chemicals. ADL was founded in 1984 and later listed on Bombay and National Stock Exchanges. The company was promoted by four chemical engineering graduates from UDCT Mumbai (now Institute of Chemical Technology). ADL exports to 100 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 Company is engaged in the manufacturing of Active Pharmaceutical Ingredients (APIs), Pharma Intermediates and Specialty Chemicals with its wholly-owned subsidiary- Pinnacle Life Science Private Limited. Products under APIs include Ciprofloxacin Hydrochloride, Metronidazole, Metformin HCL, Ketoconazole, Ofloxacin etc. whereas Specialty Chemicals includes Benzene Sulphonyl Chloride, Methyl Nicotinate etc. Company has also got approval from WHO-GMP, EUGMP, ACCREDITATION from JAPAN, IDL, ANVISA, ISO, TGA Australia, COFEPRIS and COS

Consolidated Brief Financials (Rs. Crore)	FY18 (A)	FY19 (A)
Total operating income	1,244.35	1562.10
PBILDT	202.59	212.08
PAT	82.31	89.75
Overall gearing (times)	1.31	1.06
Interest coverage (times)	5.28	4.87

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	-	-	Dec 2025	203.12	CARE A+; Stable
Fund-based - LT/ ST-Working Capital Limits	-	-	-	931.00	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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Commercial Paper	ST	50.00	CARE A1+	-	1)CARE A1+ (08-Jan-19)	1)CARE A1+ (09-Jan-18)	-
2.	Fund-based - LT-	LT	203.12	CARE A+;	-	1)CARE A+;	1)CARE A+;	-

	Term Loan			Stable		Stable (08-Jan-19)	Stable (09-Jan-18)	
3.	Fund-based - LT-Cash Credit	-	-	-	-	-	-	-
4.	Fund-based - LT/ ST-Working Capital Limits	LT/ST	931.00	CARE A+; Stable / CARE A1+	-	1)CARE A+; Stable / CARE A1+ (08-Jan-19)	1)CARE A+; Stable / CARE A1+ (09-Jan-18)	-

Annexure 3- List of companies consolidated

S. No.	Name of Companies
1	Aarti Drugs Limited
2	Pinnacle Life Science Private Limited

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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