CARE Ratings
Professional Risk Opinion

Aarti Surfactants Limited

January 02, 2020

Ratings

Facilities	**Amount (Rs. crore)**	**Rating1**	**Rating Action**
Long term Bank Facilities	100.00	**CARE BBB-; Stable (Triple B Minus; Outlook: Stable)**	**Assigned**
Total	**100.00 (Rs. One hundred crore only)**		
Redeemable Preference Shares	18.50 (Rs. Eighteen crore and fifty lakh only)	**CARE BB+ (RPS); Stable (Double B Plus (Redeemable Preference Shares Outlook: Stable)**	**Assigned**

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities and redeemable preference shares of Aarti Surfactants Limited (ASL), derive strength from its strong track record of the promoter group in chemical manufacturing business via Aarti Industries Limited (AIL). The ratings also favorably factor in the long standing relation with reputed clientele comprising leading multinational and domestic companies in the FMCG sector, albiet there exists significant client concentration risk. ASL (as a division of AIL and as a separate company) has exhibited healthy growth in revenue in the past, although its profit margins have been thin and fluctuating. The overall gearing of ASL remains comfortable as on March 31, 2019 on the back of significant transfer of reserves at the time of demerger although, debt coverage indicators remain weak on the back of low operating profitability.
The ratings are tempered by susceptibility of its profitability to fluctuations in key raw material prices, intense competition from domestic and international players.

Rating sensitivities

Positive factors

- Sustained growth in total operating income of around 15% on a yoy basis PBILDT margin of more than 10% on a sustained basis

Negative factors

- Any predominantly debt funded capex adversely impacting the overall gearing beyond 1.5x on sustained basis

Detailed description of the key rating drivers

Key Rating Strengths

Strong track record of the promoter group in the chemical business via Aarti Industries Limited

ASL was formed as a result of demerger of the home and personal care (HPC) division of Aarti Industries Limited, which has over a decades experience in the manufacture and sale of surfactants and speciality chemicals used as intermediates by the HPC industry. The HPC division comprised ~7% of the overall sales of AIL and had recorded thin operating margins in the past. The management of AIL decided to demerge the HPC division to allow greater focus and to adopt relevant strategies necessary for turning around and promoting growth of the division.
ASL is managed under the guidance of Mr. Chandrakant Vallabhaji Gogri, who is the founder and the current Chairman Emeritus of AIL. Mr. Gogri is a B.E. (Chem) and has successfully expanded and managed AIL to its current position. ASL‘s Managing Director Mr. Nikhil Parimal Desai, is the son of Mr. Parimal H Desai, Whole Time Director of AIL. Mr. Nikhil Parimal Desai is a Master of Science in Telecommunications & Networking and holds a Business Management degree from USA. He has worked as IT technical lead, project manager and technical sales with various companies in USA and has an experience of 10 years with AIL. The other key management personnel of ASL are ex-employees of AIL with considerable experience in the industry.

Reputed client profile comprising leading multinational companies in the FMCG sector, albeit significant client concentration with top 3 clients accounting for 48% of the revenue in FY19

ASL caters to reputed FMCG multinationals and domestic customers and is a preferred suppliers for Hindustan Unilever, Procter & Gamble, Patanjali and Dabur in India. ASL’s revenues are highly concentrated with the top 3 clients accounting for ~40%-48%% revenue in the past two years. Apart from catering to domestic clients, ASL exports to countries such as USA, Europe, South East Asia, Middle East and Africa with export accounting for 10%- 15% of its revenues in the past.

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

Healthy growth in revenue in the past, although operating margins are thin and fluctuating

ASL's revenue has shown a CAGR of 11% in the past 4 years (2015-2019)[2] on account of increase in installed capacity and increase in volume offtake. However, margins remain thin and fluctuating with ASL posting EBIT loss in the past as well. So far, ASL has been engaged in manufacturing basic surfactants or doing tolling work for their clients. Further, the scale of operations was too small for economies of scale to set in. As such, ASL's operating margins were thin and fluctuating. Going forward, with ASL more than doubling its existing production capacity and also introducing new high margin products to its basket, operating profitability is expected to improve to some extent.

Comfortable gearing, debt coverage indicators however remain weak

ASL reported a gearing of 0.71x as on March 31, 2019 primarily on account of transfer of significant reserves from AIL, equivalent to the value of the net assets on the books of the surfactant division as on April 1, 2018 (appointed date for demerger). Low operating profits coupled with low gross cash accruals has led to weak debt coverage indicators for ASL in FY19.

Key Rating Weaknesses

Intense competition from domestic and international players

The surfactants and speciality chemicals industry is highly competitive. The primary competitors of ASL are multi-national companies such as BASF Corporation, 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. Further, some of ASL's customers such as Godrej, also have set up in-house facilities for manufacturing certain of products. 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 in the surfactants industry, ASL is also affected by competition faced by their customers, specifically manufacturers of FMCG products.

Susceptibility of operating performance to volatility in raw material prices

ASL has a high dependence on Lauryl alcohol (LA) which forms more than 40% of the raw material costs. ASL derives majority of its revenue (~ 70%) through cost plus model, while for balance through non-cost plus model whereby it derives its revenue on the basis of the prevailing market price. The profitability margin of ASL remains susceptible to the significant volatility in the prices of key raw materials only to the extent the non-cost plus portion of the business.

Liquidity: Adequate

ASL has low gross cash accruals of Rs.2.82 crore in FY19. Its average utilization of working capital limits was high at 85%. However, absence of debt repayments in the current financial year results in the liquidity position of the company been adequate.

Analytical approach: For arriving at the ratings, CARE has considered the standalone financial of ASL and the linkages with AIL. Both ASL and AIL share same first name of entity and sizable part of shareholding of ASL is held by promoters of AIL.

Applicable Criteria

Rating Methodology for manufacturing companies
CARE's methodology for financial ratios (Non-Financial Sector)
Criteria on assigning Outlook and Credit Watch to Credit Ratings
CARE's Policy on Default Recognition
Consolidation and Factoring Linkages in Ratings

About the Company

Incorporated in June 2018, 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 speciality products serving the home and personal care (HPC) industry. Its product portfolio includes surfactants, mild surfactants, rheology modifiers, pearlising agents, UV filters and 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 South East Asian countries with exports accounting for 11% of the sales in FY19.

ASL is 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.

[2] Revenue for ASL from FY15-FY18 has been taken from the segmental information provided by AIL in its annual report for its HPC division

Brief Financials (Rs. crore)	FY19 (A)
Total operating income	310.61
PBILDT	5.23
PAT	(6.48)
Overall gearing (times)	0.71
Interest coverage (times)	2.16

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	-	-	June 2025	30.00	CARE BBB-; Stable
Fund-based - LT-Cash Credit	-	-	-	45.00	CARE BBB-; Stable
Fund-based - LT-Proposed fund based limits	-	-	-	25.00	CARE BBB-; Stable
Preference Shares-Reedemable	August 20, 2019	0.00	August 19, 2026	18.50	CARE BB+ (RPS); Stable

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.	Fund-based - LT-Term Loan	LT	30.00	CARE BBB-; Stable	-	-	-	-
2.	Preference Shares-Reedemable	LT	18.50	CARE BB+ (RPS); Stable	-	-	-	-
3.	Fund-based - LT-Cash Credit	LT	45.00	CARE BBB-; Stable	-	-	-	-
4.	Fund-based - LT-Proposed fund based limits	LT	25.00	CARE BBB-; Stable	-	-	-	-

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.*

Contact us

Media Contact
Mradul Mishra
Contact no.: 022-68374424
Email ID: mradul.mishra@careratings.com

Analyst Contact
Mr. Pulkit Agrawal
Contact no.: 022-67543505
Email ID: pulkit.agrawal@careratings.com

Relationship Contact
Name: Ankur Sachdeva
Contact no.: 022-67543495
Email ID: ankur.sachdeva@careratings.com

About CARE Ratings:

CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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