Aarti Surfactants Limited

November 02, 2020

Ratings[1]

Facilities	**Amount (Rs. crore)**	**Rating**[1]	**Rating Action**
Long term bank facility – Term Loan	70.00 (Enhanced from Rs. 30.00 crore)	**CARE BBB; Stable** [Triple B; Outlook: Stable]	**Rating reaffirmed**
Long term bank facility – Cash Credit	95.00 (Enhanced from Rs. 70.00 crore)		
Total	**165.00 (Rs. One Hundred and Sixty Five Crore Only)**		
Redeemable Preference Shares	**18.50**	**CARE BBB- (RPS); Stable** [Triple B Minus (Redeemable Preference Share); Outlook: Stable]	**Rating reaffirmed**

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to bank facilities and instruments of Aarti Surfactants Limited (ASL) factors in the significant improvement in operational performance for FY20 (turnover growth of 22% over FY19 and operating margins at 7.30% in FY20 (PY: 1.98%) and Q1FY21 (turnover growth of 48% YoY). Further, the revision in the ratings of ASL also factors in favourable demand outlook in surfactant market due to increase in awareness of home and personal care and government campaigns promoting sanitisation and hygiene. Consequently, turnover and profitability of the company is likely to improve going forward.

The ratings also derives strength from extensive experience of promoters in chemical industry through Aarti Industries Limited, healthy growth in revenue and operating margins, reputed client profile comprising leading multinational companies in the FMCG sector, comfortable capital structure, improvement in debt coverage indicators and favourable impact of COVID-19 pandemic on ASL's business and financial risk profile. The ratings also factors in the open offer made by promoter group of ASL to acquire and consolidate shareholding in the company. However, the ratings are constrained by company's presence in competitive market, susceptibility of operating performance to raw material prices and brownfield expansion project in FY21-22.

Rating Sensitivity:

Positive Factors:

- Sustainable improvement in operating performance with the company registering sales of Rs 600 Cr on a continuous basis
- Consistent improvement in PBILDT margin from existing level of 9.34 % to 12.50% on a continuous basis
- Diversified customer base with no customer contributing to more than 15% of total revenue.

Negative Factors:

- Lower than expected revenue growth and profitability.
- Overall gearing of the company exceeding 2.00x level.
- Delay or cost overrun in upcoming capacity expansion project leading to stretched liquidity profile.

Detailed description of the key rating drivers

Key Rating Strengths

Strong background of the promoters in chemical industry via Aarti Industries Limited

Aarti Surfactants Limited (ASL) was formed in 2018 as a result of demerger of the home and personal care (HPC) division of Aarti Industries Limited (AIL), which has over a decade of 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. Managing Director Mr. Nikhil Parimal Desai, is the son of Mr. Parimal H Desai, Whole Time Director of AIL. Mr. Nikhil

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

Parimal Desai is associated with AIL for more than 10 years. The other key management personnel of ASL are ex-employees of AIL with rich experience in the industry.

Reputed client profile comprising leading multinational companies in the FMCG sector

ASL caters to reputed FMCG multinationals and domestic customers and is a preferred suppliers for Hindustan Unilever, Procter & Gamble Home Products Pvt. Ltd., Patanjali Ayurved and Dabur as well as other reputed global brands in India. ASL's revenue is highly concentrated among top 3 customers with contribution of 55% in total sales in FY20. However, customer concentration risk is partially mitigated as the company has long standing relationship with its customer base, status of preferred supplier and healthy credibility of the top customers. For customers like HUL and P&G, ASL has long term contracts with cost plus delta model to pass on any fluctuations in raw material prices.
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.

Healthy growth in revenue with improvement in margins over last 4 years.

In past, ASL being a division of AIL, revenue growth was muted and profitability margins were thin. From demerger, ASL was able unlock growth potential and registered healthy CAGR of 21% for the period FY18-FY20. The value growth was supported by volume growth as well as launch of new product categories over last 3 years. Going forward, with ASL undertaking capacity expansion and also introducing new high margin products to its basket, operating profitability is expected to improve. ASL currently has installed capacity of 33,600 MTA for Sulfonation (AOS & SLS), which is utilized around 85% in FY20 and Q1FY21.

Favourable impact of COVID-19 on ASL's business profile

COVID-19 outbreak offered opportunity to ASL's health and hygiene division to expand into addressable market. ASL being a preferred supplier for home and personal care products of leading FMCG brands, the company was able to carry out normal plant operations during COVID-19 lockdown period. ASL has more than 50% of its products labelled as essential product, it could continue its manufacturing operations with regulatory approvals even during the lockdown phase. ASL has registered revenue of Rs. 112 crore for Q1FY21 (Rs. 76 crore in Q1FY20) with PBILDT margin of 9.34%. For July-August, 2020, ASL has reported sales of Rs. 75 crore.

Comfortable gearing with improvement in debt coverage indicators

ASL's capital structure remains comfortable with overall gearing at 0.98x as on March 31, 2020 (PY: 0.71x). It is to be noted that the TNW of ASL reduced to Rs 110.95 crore as on 31st March 2020 compared to Rs 135.97 crore as on 31st March 2019. ASL has disposed its equity investment in Aarti Drugs Limited in FY20. These shares of Aarti Drugs Limited were transferred to ASL in pursuant of the Scheme of Arrangement with AIL. Earlier, being a division of AIL, ASL had thin profitability margins. Following the demerger, ASL was able to gain benefit of the operating as a standalone entity and improved financial and business profile. With improvement in profitability margins, ASL's debt coverage indicators improved significantly. ASL's total debt to gross cash accrual improved to 8.07x for FY20 (FY19: 34.33x) while total debt of cash flow from operations improved to 6.18x for FY20 (FY19: 18.49x). However, interest coverage remained stable at 2.32x for FY20 (FY19: 2.16x).

Change in capital structure in pursuant of Scheme of Arrangement and listing of shares on BSE and NSE.

As per the Scheme of Arrangement approved by NCLT Ahmedabad, ASL has issued 75,84,477 equity shares of face value of Rs. 10 each and 10,82,387 redeemable preference share of face value of Rs. 10 each. Shareholders of AIL was given an option to subscribe shares of ASL in following manner:
"*1 fully paid up Equity Share of ASL shall be issued and allotted for every 10 fully paid up Equity Shares held in AIL*" OR "*1 fully paid up Redeemable Preference Share of ASL shall be issued and allotted for every 10 fully paid up Equity Shares held in AIL*".
Further, as per NCLT order, shares of ASL was listed on BSE and NSE on July 14, 2020.

Open offer by the Promoters to consolidate shareholding in the company

Mrs. Jaya Chandrakant Gogri (w/o Mr. Chandrakant Vallabhji Gogri, Director of ASL) and M/s Nikhil Holdings Pvt. Ltd. (Managed by Mr. Nikhil Desai, who is also Managing Director of ASL) has made open offer to acquire 19,16,606 shares (26% of total voting rights) of ASL using Share Purchase Agreement and open market purchase. Open offer was announced by the company on August 10, 2020. Objective of this open offer is to consolidate shareholding in promoter group by the acquirers. Post-acquisition, promoters and promoter group will hold 59.23% of ASL (as against pre-acquisition holding of 48.44%). Share price for acquisition is set at Rs. 284 per share (closing price as on August 09, 2020). Sellers are majorly family members, Trust and associates of promoters, except for share purchase order placed through brokers. The offer is expected to complete by November 02, 2020, post which, new shareholding pattern will take effect.

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 (for customers such as HUL, P&G, Patanjali etc.) 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.

Brownfield expansion project in FY21

ASL has undertaken capacity expansion project in year 2018 and increased the capacity from 22,000 MTA to 43,000 MTA. ASL has successfully completed this project and achieved benefit in improvement in scale of operations in FY20 with revenue growth of 22%. Looking at the current market trends and impact of COVID-19 on behaviour of the individuals (increased demand for personal care items), ASL is further expanding capacity by 40% in current year at Pithampur plant (MP). The company has already negotiated specifications equipment/machinery. The project is expected to be completed by March, 2021. The project cost is approx. Rs 60 crore which will be funded through internal accruals and promoter contribution of Rs. 35 crore and remaining through term loan Rs. 25 crore for this project.

Liquidity: Adequate

ASL's liquidity profile is marked by modest cash and bank balance of Rs. 0.09 crore and below unity (0.95x) current ratio as on March 31, 2020. This has marginally improved to 1.06x as on 30th June 2020. Average working capital utilization remained high at 89% for 11-month period ending in July, 2020. For upcoming years, ASL is undertaking capacity expansion projects for current plants, which will be financed through term loan from the lender and also thorough internal accrual & promoter contribution. The company mentioned that the promoters have infused Rs 10 Crs for the initial expenditure of the project and are willing to invest more if required. ASL has repayments of Rs. 3.00 crore in FY21 as against expected cash accruals of Rs. 31 crore.

Analytical approach: Standalone

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 – Manufacturing Companies
Factoring Linkages in Ratings
Financial ratios – Non-Financial Sector
Criteria on assigning Outlook and Credit Watch to Credit Ratings
CARE's Policy on Default Recognition

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 (AIL). 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 16% of the sales in FY20. 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. Shares of ASL were listed on BSE and NSE w.e.f. July 14, 2020.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	264.39	326.07
PBILDT	5.23	23.81
PAT	-6.48	2.09
Overall gearing (times)	0.71	0.98
Interest coverage (times)	2.16	2.32

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	-	-	March, 2025	30.00	CARE BBB; Stable
Fund-based - LT – Proposed Term Loan	-	-	-	40.00	CARE BBB; Stable
Fund-based - LT-Cash Credit	-	-	-	70.00	CARE BBB; Stable
Fund-based - LT-Proposed fund based limits	-	-	-	25.00	CARE BBB; Stable
Preference Shares-Redeemable	August 20, 2019	0.00	August 19, 2026	18.50	CARE BBB- (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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Term Loan	LT	70.00	CARE BBB; Stable	1)CARE BBB; Stable (07-Oct-20)	1)CARE BBB-; Stable (02-Jan-20)	-	-
2.	Preference Shares-Redeemable	LT	18.50	CARE BBB- (RPS); Stable	1)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 (07-Oct-20)	1)CARE BBB-; Stable (02-Jan-20)	-	-
4.	Fund-based - LT-Proposed fund based limits	LT	25.00	CARE BBB; Stable	1)CARE BBB; Stable (07-Oct-20)	1)CARE BBB-; Stable (02-Jan-20)	-	-

Annexure 3: Complexity level of various instruments rated for this Company

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Cash Credit	Simple
2.	Fund-based - LT-Proposed fund based limits	Simple
3.	Fund-based - LT-Term Loan	Simple
4.	Preference Shares-Redeemable	Highly Complex

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
Mr. Mradul Mishra
Contact no. – +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact
Mr. Soumya Dasgupta
Contact no. - 022-67543456
Email ID- soumya.dasgupta@careratings.com

Relationship Contact
Mr. Ankur Sachdeva
Contact no. – +91-22-6754 3495
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.

****For detailed Rationale Report and subscription information, please contact us at www.careratings.com**