Fairchem Speciality Limited

May 30, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities	83.43	**CARE A (Single A); Under credit watch with developing implications**	Placed under Credit Watch with Developing Implications
Long-term/ Short-term Bank Facilities	2.50	**CARE A/ CARE A1 (Single A/ A One); Under credit watch with developing implications**	Placed under Credit Watch with Developing Implications
Total Facilities	**85.93 (Rupees Eighty Five crore and Ninety Three Lakh Only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Fairchem Speciality Ltd (FSL) have been placed under 'Credit watch with developing implications' in view of the impending possible impact on its credit profile arising from the proposed scheme of de-merger of FSL's oleochemicals and nutraceuticals business in to Fairchem Organics Limited (FOL) and amalgamation of the aroma chemicals business of its wholly owned subsidiary viz. Privi Organics India Ltd. (POIL) with FSL. CARE will take a view on the ratings once the exact implications of the above on the credit risk profile of FSL become clear.

The ratings continue to derive strength from its resourceful and experienced promoters, its long standing operational track record in manufacturing of specialty chemicals which have diverse industry applications and its established relations with reputed customers. The ratings also take in to account its comfortable profitability & debt coverage indicators and moderate capital structure.

The ratings, however, continue to be constrained on account of FSL's modest scale of operations with susceptibility of profitability margins to volatile raw material prices and foreign exchange rates. The ratings are further constrained due to its exposure to technology obsolescence risk, risk of import substitutability from low cost products from China and stringent pollution control norms.

FSL's ability to significantly grow its scale of operations while maintaining its profitability, improvement in capital structure, widening of its product range and continuation of steady relationship with key customers would be key rating sensitivities.

Detailed description of the key rating drivers

Composite scheme of arrangement and amalgamation

On May 22, 2019, The Board of Directors of Fairchem Speciality Limited (FSL) and Privi Organics India Limited (POIL; presently a wholly owned subsidiary of FSL) have, subject to various approvals, considered and approved a composite scheme of arrangement and amalgamation to separate the businesses of both FSL & POIL.

Under this scheme, the speciality oleochemicals and nutraceuticals business of FSL (which comprises ~99% of FY19 TOI of FSL) would be demerged into Fairchem Organics Ltd (FOL; presently a wholly owned subsidiary of FSL which is recently incorporated on March 27, 2019) whereas POIL which manufactures aroma chemicals would be amalgamated with FSL. In this arrangement, FOL will issue 1 fully paid-up equity share to the shareholders of FSL for every 3 equity shares held by them in FSL; and there would be no cross holdings between the two companies post this arrangement. As per company management, National Company Law Tribunal (NCLT) order to give effect to the extant scheme is expected to be received before end of FY20 with appointed date of the scheme being kept as April 01, 2019.

Key Rating Strengths

Experienced and resourceful management

Mr Nahoosh Jariawala, Managing Director, is a commerce graduate and has experience of more than 25 years in chemical manufacturing and trading of various textile products. He looks after the core operations of the company including process optimization, product development, production planning, etc. The promoters are well supported by a qualified second tier management.

FIH Mauritius Investment Limited, an investment arm of Fairfax India Holdings Corporations (Fairfax India) held 48.75% equity stake in FSL as on March 31, 2019. Headquartered in Toronto, Canada, Fairfax India was founded in 2014 by Mr V. Prem Watsa (CEO of Fairfax group). The investment portfolio of Fairfax India includes India Infoline Finance Limited (rated:

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

CARE AA; Stable), Thomas Cook (India) Limited, Quess Corp Limited, National Collateral Management Services Limited (rated: CARE A+; Stable/ CARE A1+), Bangalore International Airport Limited amongst others.

Established track record of operations along with diversified revenue stream
FSL operates in the specialty chemicals segment where it manufactures niche products with diverse industry applications for the last two decades. FSL's product portfolio includes Mixed Tocopherol Concentrate, Dimer Acid and Linoleic Acid which have diversified industry applications. Diverse application of its products across various industry segments tends to bring greater stability to its revenue. Moreover, company also exports its products to USA. However, during FY18, the export contribution to net sales declined and remained around 10% on account of change in product mix.

Reputed Clientele
FSL has long association with its customers in domestic as well as export markets. Moreover, majority of its clientele enjoy leading position in their respective industry segments and hence their credit risk appears to be minimal. Furthermore, FSL has a diversified client base with top 10 customers contributing nearly 48% of total income during FY18.

Stable scale of operation and healthy profitability during FY19
FSL's scale of operations remained stable in FY19 with ~6% growth in its total operating income to Rs.254.22 crore during FY19 compared with Rs.239.02 crore in FY18. Further, FSL's PBILDT margin remained healthy at 15.89% during FY19 due to optimum utilization of manufacturing capacity coupled with benefit of economies of scale. PAT margin also improved marginally to 8.47% during FY19 in line with marginal improvement in its PBILDT margin.

Moderate capital structure and comfortable debt coverage indicators
Total debt of FSL had increased during the two years-ended FY18 on account of capex undertaken by the company and increase in working capital borrowing to support growing scale of operations. However, the overall gearing of the company improved marginally to 0.55 times as on March 31, 2019 compared to 0.75 times March 31, 2018. Debt coverage indicators during FY19 continued to remain comfortable marked by PBILDT interest coverage of 7.05 times and Total debt/GCA of 1.97 times.

Liquidity Analysis
The liquidity of FSL remained moderate with average working capital utilization of around 76% over the past 12 months ended April 2019. Its working capital cycle increased from 78 days in FY18 to 86 days in FY19 with increase in inventory period; however the same remained range bound. FSL's current ratio remained stable at 1.09x as on March 31, 2019.

Good industry prospects with fortunes directly linked to end user industry
The products manufactured by FSL find application in high growth consumer goods industries like Nutraceuticals, Paints, Printing Ink, Adhesives, Soap manufacturing, etc. As per various industry reports, all these end-user industries are expected to grow steadily due to factors such as rising population, increase in disposable income and increasing spending on healthcare and nutrition products.

Key Rating Weaknesses
Susceptibility of FSL's profitability to volatile raw material prices and fluctuations in forex rates
Vegetable oil distillate and acid oil are the main raw materials for FSL. These raw materials are by-products of soya and sunflower oils generated during the refining process. The prices of both these oils have remained volatile due to seasonality and its close linkages with international prices and forex rates. Further, FSL's exports comprise nearly 10-20% of its net sales over past two years. Hence, the profitability of FSL is susceptible to volatile agro based raw material prices and forex rates. However, FSL avails foreign currency borrowings for working capital purpose which provides a natural hedge and mitigates the forex risk to a certain extent.

Competition from low cost Chinese products
The industry size for Dimer acid and Linoleic acid is relatively small compared to the overall size of chemical industry which limits the growth of the company. Further, FSL faces stiff competition from the low cost products from China especially in Dimer acid.

Product obsolescence and substitution risks
Companies like FSL which operate in the niche specialty chemical segment carry a risk in terms of challenges emanating from the development of alternative technologies and introduction of newer products and hence is exposed to the risk of product obsolescence and substitution. However, FSL has expanded its R&D capabilities during last two years, which helps it to launch new derivatives of its existing products to its product portfolio.

Risk of compliance with stricter pollution control norms
There is stringent pollution control regulation laid down for chemical processing units under the Gujarat Pollution Control Board (GPCB) norms. The company has been complying with the required pollution control norms. Hence, continuous adherence to the prevailing pollution control norms would remain crucial from the credit perspective.

Analytical approach: Standalone
FSL's management has articulated that FSL would continue to operate independently without any financial linkages with its subsidiary (POIL).

Applicable Criteria
Criteria for placing rating on credit watch
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology-Manufacturing Companies
Financial ratios – Non-Financial Sector

About the Company
Promoted by Mr Rajan Harivallabhdas in May 1985, FSL was formerly known as Adi Finechem Limited. FSL was jointly managed by Mr Harivallabhdas and his cousin, Mr Nahoosh Jariwala. During FY10, Mr Harivallabhdas sold his stake to three new promoters namely Mr Utkarsh Shah, Mr Bimal Parikh and Mr Hemant Shah. Moreover, during FY16, Fairfax India through its wholly owned subsidiary acquired 44.90% equity stake in FSL from existing promoters. As on March 31, 2019, Fairfax India holds 48.75% equity stake in the company.
FSL is engaged in the manufacturing of specialty chemicals like Mixed Tocopherol Concentrate, Sterols Concentrate, Dimer Acid and Linoleic Acid which find application in various industries like nutraceuticals, paints, printing ink, detergents, adhesives, etc. FSL's manufacturing facility is located at Chekala village near Sanand, Gujarat with an installed capacity of 45,000 MTPA as on March 31, 2018.

Brief Financials (Rs. crore) [Standalone]	FY18 (A)	FY19 (published results)
Total operating income	239.02	254.22
PBILDT	36.58	40.40
PAT	19.40	21.52
Overall gearing (times)	0.75	0.55
Interest coverage (times)	6.35	7.05

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 2023	24.94	CARE A (Under Credit watch with Developing Implications)
Fund-based - LT-Working Capital Limits	-	-	-	58.49	CARE A (Under Credit watch with Developing Implications)
Non-fund-based - LT/ ST-BG/LC	-	-	-	2.50	CARE A / CARE A1 (Under Credit watch with Developing Implications)

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	24.94	CARE A (Under Credit watch with Developing Implications)	-	1)CARE A; Stable (28-Jun-18)	1)CARE A-; Positive (28-Jul-17)	1)CARE A- (Under Credit Watch) (10-Aug-16)
2.	Fund-based - LT-Working Capital Limits	LT	58.49	CARE A (Under Credit watch with Developing Implications)	-	1)CARE A; Stable (28-Jun-18)	1)CARE A-; Positive (28-Jul-17)	1)CARE A- (Under Credit Watch) (10-Aug-16)
3.	Non-fund-based - LT/ ST-BG/LC	LT/ST	2.50	CARE A / CARE A1 (Under Credit watch with Developing Implications)	-	1)CARE A; Stable / CARE A1 (28-Jun-18)	1)CARE A1 (28-Jul-17)	1)CARE A1 (Under Credit Watch) (10-Aug-16)

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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