Fermenta Biotech Limited

January 10, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities (fund based limit)	69.00 (enhanced from 35.75)	**CARE A-; Stable (Single A Minus; Outlook: Stable)**	**Revised from CARE BBB+ [Triple B Plus] (under Credit watch with developing implications)**
Long-term Bank Facilities (term loan)	45.52 (enhanced fro 7.00)	**CARE A-; Stable (Single A Minus; Outlook: Stable)**	**Revised from CARE BBB+ [Triple B Plus] (under Credit watch with developing implications)**
Short-term Bank Facilities (non-fund based limit)	6.25 (enhanced from 5.25)	**CARE A2 (A Two)**	**Revised from CARE A3+ [A Three Plus] (under Credit watch with developing implications)**
Total	**120.77 (Rs. One hundred Twenty crore and Seventy Seven lakhs only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of Fermenta Biotech Limited (FBL) takes into account the improved financial and operational performance of the company in FY18 (refers to the period April 1 to March 31) and H1FY19 (unaudited). The improvement is majorly on the back of increase in installed capacities to cater to growing demand for Vitamin D3 active pharmaceutical ingredients (API) segment and significant increase in prices under animal feed grade segments. The removal of 'credit watch with developing implications' is on account of limited impact expected on the credit and financial profile of FBL in case the amalgamation with DIL Limited (parent company) is approved from various statutory and other authorities. The proposed amalgamation of FBL with DIL is expected to result in elevated debt levels, the impact of which has already been considered in the present analysis and hence, the rating watch has been removed.

The ratings continue to derive strength from established track record of FBL in pharmaceutical industry, leadership position in Vitamin D3 API product range albeit high product concentration risk, wide spread presence across various geographies with reputed client base, and comfortable capital structure and debt coverage indicators emanating in to adequate liquidity position being maintained. The core expertise for Vitamin D3 API is developed on the back of strong in-house research and development team.

The rating strengths are tempered by small scale of operations, working capital intensive nature of business, supplier concentration risk for major raw materials for Vitamin D3 API manufacturing, profitability susceptible to volatile movement of commodity prices in feed grade segment, and competition from China in feed grade segment. Furthermore, the company is exposed to project risk including timely completion and cost overrun amongst others for planned capital expenditure until completion and stabilization of the same.

The ability of the company to maintain improved profitability whilst scaling up operations as envisaged, and efficient management of working capital cycle are key rating sensitivities. Furthermore, any major capital expenditure/acquisition/proposed amalgamation, if any undertaken, adversely impacting the existing cash flows/capital structure/credit profile of the company, other than envisaged, is a key rating montiorable.

Detailed description of the key rating drivers

Key Rating Strengths

Established track record in the pharmaceutical industry along with strong research and development

FBL presence in the pharmaceutical industry is well established of over three decades of track record with key focus on Vitamin D3 active pharmaceutical ingredient (API) segment. Over the years, the company developed in-house research and development (R&D) team to improve process and product technologies to have competitive edge in the industry. The research and development division is approved by Department of Scientific Industrial Research (DSIR), Ministry of Science and Technology, Government of India.

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

Leadership position in Vitamin D3 API segment albeit high product concentration risk
The company's business can be classified majorly under four segments which are Vitamin D3 APIs, specialty APIs, biological enzymes and biotech based environmental solutions. The company is one of the few players globally to obtain a Certificate of Suitability from European Directorate for the Quality of Medicines (EDQM) for manufacturing of Vitamin D3 API. However, out of total sales in FY18, 84% is contributed through Vitamin D3 API range leading to significant product concentration risk.

Reputed client base with presence in domestic and export markets
Over the years, the company is increasing presence in export market through sale of feed grade segment and other Vitamin D3 API products. In FY18, around 75% of the total sales are derived from export markets with presence across 50 countries and sales to reputed players in the industry.

Significant Improvement in operating profitability in FY18 and H1FY19
In FY18, the operating performance significantly improved on account of increase in feed grade prices due to disruption of supply from China which in turn increased the selling price and increase in installed capacities to cater to additional demand under vitamin D3 API segment. In addition, the company increased selling prices of products across all segments (in FY18 and H1FY19) which further contributed positively towards the profitability. The same is reflected in improvement in profit before interest, depreciation, and tax (PBILDT) margin in FY18 to 34.80% from 14.56% in FY17. The growth continued in H1FY19 (unaudited) due to sustained demand for vitamin D3 API segment leading to economies of scale on increased capacity utilisation in the plants. The same is reflected in further improvement in PBILDT margin to 40.46% in H1FY19 (unaudited) from 21.11% in H1FY18 (unaudited).

Adequate liquidity position in the company
As on September 30, 2018, the cash and cash equivalents held by the company is around Rs.46 crore. Furthermore, the adequate liquidity is available in form of unutilized portion of fund based working capital limits. The total repayment commitment towards term debts in FY19 is Rs.2.90 crore.

Comfortable capital structure and debt coverage indicators
The company's financial risk profile is comfortable characterized by modest overall gearing (including acceptances) at 0.19 times as on March 31, 2018. Furthermore, the debt coverage indicators also stood comfortable as indicated by interest coverage ratio of 29.60 times and total debt to gross cash accruals (GCA) of 0.41 times in FY18.

Proposed amalgamation not expected to impact the credit profile of FBL
In June 2018, the Board of Directors approved the scheme of amalgamation of FBL with DIL Limited, subject to receipt of necessary approvals. The impact on the credit and financial profile of FBL is expected to be limited except for elevated debt levels, in case of amalgamation with DIL Limited (parent company) is approved and completed. The same is in view of significant improvement in the financial and operational performance of FBL in FY18 and H1FY19 (unaudited) as explained above.

Key Rating Weaknesses
Small scale of operations
The net sales reflected a growth of 81.75% in FY18 to Rs.284.38 crore from Rs.157.31 crore in FY17 and to Rs.188.13 crore in H1FY19 (unaudited) from Rs.102.83 crore in H1FY18 (unaudited), however, the scale of operations continues to be at modest scale. The growth in FY18 and H1FY19 is backed up increase in sales volumes and sales realization of Vitamin D3 API segment. Over the years (FY17-FY18), the company installed additional capacities to meet the growing demand under the same segment especially feed grade segment.

Supplier concentration risk
The major raw material for manufacturing of Vitamin D3 API is cholesterol which isan oligopolistic market, thus, resulting in supplier concentration risk.

Working capital intensive operations
The business is working capital intensive since it carries significant inventory for various products under manufacturing at different stages of production, maintained at two factories. Also, the credit period required to be offered to customers under feed grade segment is higher due to intense competition. Despite the same, the operating cycle improved to 110 days in FY18 from 131 days in FY17 majorly on account of improvement in collection cycle due to established relation with customers.

Susceptible to volatile movement of commodity prices and competition from China under feed grade segment
China is one of the major suppliers under animal feed grade segment and the industry is characterized by intense competition, low entry barriers and volatile commodity prices. Hence, the profitability continues to be vulnerable to movement in commodity prices.

Project risk
In H2FY19-H1FY20, the company is constructing a multi-synthesis plant at existing Dahej plant to meet the growing demand under vitamin D3 API segment and strengthen overall manufacturing processes. The total cost of the plant is around Rs.67.50 crore, which is partly funded through term debt and internal accruals. The timely completion of the project without any time and cost overrun and without any additional stress on the cash flows of the company, and achievement of the stabilisation of the plant without disrupting the existing manufacturing process are crucial from credit perspective and a key rating monitorable.

Analytical approach: Standalone. The company is in the process of obtaining necessary statutory and other approvals for amalgamating FBL with DIL Limited (parent company) which is approved by the Board of Directors. In view of pending approval from National Company Law Tribunal and other requisite authorities, standalone approach is considered for analyzing the credit profile of FBL. However, the impact of the amalgamation of FBL with DIL on the resultant credit profile of FBL has been factored in while revising the ratings.

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
CARE's methodology for Short-term Instruments
Financial ratios – Non-Financial Sector
Rating Methodology – Pharmaceutical Sector

About the Company
FBL, incorporated in 1986 and is a subsidiary of DIL Limited (DIL), holding 91.20% equity stake as on September 30, 2018. The parent company, DIL is a listed entity engaged in leasing/renting out of properties.
FBL's business can be classified majorly under four segments which are Vitamin D3 APIs, specialty APIs, biological enzymes and biotech based environmental solutions with each contributing 84%, 13%, 2% and 1% respectively to the total gross sales in FY18. The company's manufacturing facilities are located at Kullu (Himachal Pradesh) and in Dahej (Gujarat). The facilities are registered with Food Facility Registration Module (FFRM) which operates under the aegis of United States Food and Drug Administration (USFDA). FBL is also certified by World Health Organisation (WHO), Good Manufacturing Practise (GMP), USFDA Establishment Inspection Report (EIR) and received Certificate of Suitability (CEP) accreditation issued by European Directorate for the Quality of Medicines (EDQM) for manufacturing vitamin D3 API. The company's two wholly owned subsidiaries are Fermenta Biotech UK Limited and GI Biotech Private Limited, which are dormant.

Brief Financials (Rs. crore)	FY17 (A)	FY18 (A)
Total operating income	161.55	299.11
PBILDT	23.52	104.10
PAT	10.34	72.06
Overall gearing (times)	0.45	0.19
Interest coverage (times)	5.71	29.60

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 Facilities

Name of the facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	37.00	CARE A-; Stable
Fund-based - LT-Cash Credit	-	-	-	32.00	CARE A-; Stable
Non-fund-based - ST-BG/LC	-	-	-	6.25	CARE A2
Fund-based - LT-Term Loan*	-	-	November 2020	45.52	CARE A-; Stable

*loan of Rs.41.26 crore is pending disbursement

Annexure-2: Rating History of last three years

Sr. No.	Name of the Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Dates & Ratings assigned in 2018-2019	Dates & Ratings assigned in 2017-2018	Dates & Ratings assigned in 2016-2017	Dates & Ratings assigned in 2015-2016
1.	Fund-based - LT-Cash Credit	LT	37.00	CARE A-; Stable	1)CARE BBB+ (Under Credit watch with Developing Implications) (06-Apr-18)	1)CARE BBB+ (Under Credit watch with Developing Implications) (26-Dec-17) 2)CARE BBB+; Stable (19-Apr-17)	-	-
2.	Fund-based - LT-Cash Credit	LT	32.00	CARE A-; Stable	1)CARE BBB+ (Under Credit watch with Developing Implications) (06-Apr-18)	1)CARE BBB+ (Under Credit watch with Developing Implications) (26-Dec-17) 2)CARE BBB+; Stable (19-Apr-17)	-	-
3.	Non-fund-based - ST-BG/LC	ST	6.25	CARE A2	1)CARE A3+ (Under Credit watch with Developing Implications) (06-Apr-18)	1)CARE A3+ (Under Credit watch with Developing Implications) (26-Dec-17) 2)CARE A3+ (19-Apr-17)	-	-
4.	Fund-based - LT-Term Loan	LT	45.52	CARE A-; Stable	1)CARE BBB+ (Under Credit watch with Developing Implications) (06-Apr-18)	1)CARE BBB+ (Under Credit watch with Developing Implications) (26-Dec-17) 2)CARE BBB+; Stable (19-Apr-17)	-	-

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