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ICRA upgrades Kudos Chemie Limited long term rating to LBBB-, assigns stable outlook and also upgrades short term rating to A3

ICRA has upgraded rating assigned to the Rs. 78.68 Crore[1] term loans, Rs. 60.0 crore cash credit limits and Rs. 0.55 Crore non-fund based limits of Kudos Chemie Limited (KCL) to LBBB- (pronounced L triple B minus) from LBB+ (pronounced L double B plus) [†]. ICRA has also upgraded the rating assigned to Rs. 86.00 Crore fund-based limits and Rs. 71.45 Crore non-fund based limits of KCL to A3 (pronounced A three) from A4+ (pronounced A four plus). The outlook on the long-term rating is stable.

The rating upgrade is supported by the significant positive developments that have happened on the business front in the last one year including successful new product launch and addition of new clients of global repute besides the significantly better than expected performance of the company in terms of projected turnover as well as the profitability and debt coverage metrics. ICRA also draws comfort from the fact that a significant fresh equity infusion is expected from IFC Washington this year. The ratings also continue to draw support from KCL's existing long term relationships with global beverage majors for caffeine supplies (which ties up large part of the capacity); large volumes resulting in higher operational efficiencies; healthy profitability indicators and comfortable debt coverage metrics supported by sound margins. The assigned ratings also factor in the cost competitive manufacturing operations of KCL and its near monopoly status in domestic market for caffeine. The ratings however, continue to be constrained by the company's s high leverage resulting from high working capital intensity and aggressive debt funded capital expenditure in the past three years. The rating also takes into account the company's exposure to raw material price fluctuation risks; the strong competition from China which is reflected in declining operating margins of the company in the past three years and its single product dependence which makes it vulnerable to any significant adverse development in the industry. ICRA notes that the company is trying to mitigate the product concentration risk by adding some more products of the Xanthine group to the product basket; however, it would take time to develop market for these products and they are not expected to significantly reduce the share of caffeine in overall revenue pie in the medium term. ICRA also notes that KCL's customer concentration is high with over 60% revenues coming from its Top 3 customers. With exports contributing about 60% of the company's revenues, KCL's profitability remains exposed to the fluctuations in currency exchange rates; however, the imports and foreign currency denominated debt do provide significant natural hedge.

As per provisional accounts, KCL's operating income at Rs. 365.6 Crore in 2009-10 registered a growth of over 61% compared to the previous year. The company's topline grown at a CAGR of about 60% during the last five years led by the growth in business from the existing and addition of new clients. However, the operating margins have been declining since 2007-08 as the company is trying to capture higher market share against the stiff competition from China. However, with an OPM of 29.5% and NPM of 12.9%, KCL's profitability is relatively strong. The strong margins are reflected in healthy return indicators despite a cumulative capital expenditure of over Rs. 200 Crore in the last three years. ROCE and RONW for 2009-10 were 23.1% and 47.5% respectively. Despite healthy accruals and equity infusion of over Rs. 17.8 Crore in last two years, the company's gearing remains high at 3.4 times as of March 31, 2010 on account of extremely high working capital intensity and large debt funded capital expenditure. The company has incurred over Rs. 200 Crore capital expenditure in the last three years most of which is still to yield returns (about Rs. 130 Crore of capital investment was locked in capital works in progress and capital advances as of March 31, 2010). Once the returns start accruing from these investments, the capital structure could see some improvement provided the company does not go for aggressive debt funding of future capital expenditure. Besides, about Rs. 90 Crore fresh equity infusion is expected from IFC Washington this year. The debt coverage indicators are supported by sound margins and remain relatively comfortable despite high leverage. However, ICRA also notes that the high working capital intensity coupled with a high pace topline growth could lead to temporary liquidity constraints and would be a key rating sensitivity.

[1] 100 lakh = 1 crore = 10 million

† For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications.

Company Profile:

Incorporated in 1994, Kudos Chemie Limited (KCL), commenced operations the same year with product portfolio of Synthetic Caffeine, Theophylline and its derivatives catering to the domestic pharmaceutical industry. The key uses of synthetic caffeine are in drugs, aerated drinks and confectionary. In order to diversify its customer base, KCL implemented the quality requirements of beverage industry in 1996 and started supplies of caffeine thereafter. Subsequently, KCL was approved under the global systems of beverage majors.

As per the "one clean mill for one product" requirements of its key client, KCL had discontinued with other products and remained focused on 'Synthetic Caffeine" till 2008-09. The Company is now in the process of enhancing its product basket by re-introducing other products from the Xanthine group. Thus, it launched "Theobromine" in Q4; 2009-10 by implementing a separate clean room. It is also planning to re-launch "Theophylline" in the current financial year.

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ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in