June 30, 2022

Aarti Drugs Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term: Term loan ($ million)*	$15.0 million	$15.0 million	[ICRA] AA- (stable); reaffirmed
Long-term: Fund-based term loan	167.71	167.71	[ICRA] AA- (stable); reaffirmed
Long-term: Fund-based CC	34.0	34.0	[ICRA] AA- (stable); reaffirmed
Short-term: Fund-based/ Non-fund based facilities	816.0	816.0	[ICRA] A1+; reaffirmed
Total	**1,017.71 $15.0 million**	**1,017.71 $15.0 million**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmed ratings favorably factor in Aarti Drugs Limited's (ADL's or the company's) experienced management and established operations spanning over 30 years in active pharmaceutical ingredients (APIs), intermediates, specialty chemicals and formulations space. The ratings continue to consider ADL's sizable market share as the largest domestic and global manufacturer for most of its key products. It has an established track record of supplying these molecules and derives significant operational efficiencies from large installed capacities and backward integration of intermediates and related chemicals that support the company's profitability to an extent. The ratings also take comfort from ADL's diversified and reputed client base, including major pharmaceuticals players with top ten customers contributing to only 15% of its revenues in FY2022.

ADL witnessed healthy YoY revenue growth of 15% in FY2022 led by increasing volumes and realizations (in APIs) across key therapeutic areas of antibiotic, anti-diarrheal, anti-inflammatory, antidiabetic and antifungals. The increase in volumes was supported by ongoing brownfield capacity expansions for APIs and intermediates while increase in realisations was on account of price increases across the API industry. ICRA expects the revenue to grow favorably in the near to medium term led by new product line introductions, increasing geographic penetration, and sizable capex over the next 2-3 years to enhance capacities. ADL's OPMs declined from 20.4% in FY2021 to 13.2% in FY2022 majorly on account of steep increase in raw material prices which could not immediately be passed on to the customers. The margins were also impacted by higher freight expenses. Going forward, during FY2023, margins of the company are expected to improve on the back of price increases taken by the company, brownfield expansions for some products which increases operating leverage and in turn supports margins, continued R&D efforts to reduce consumption and increase efficiencies and increasing levels of backward integration. Despite the sizeable debt funded capex in FY2023-FY2024, the leverage profile is expected to remain comfortable supported by consistent profitability and accruals. Further, pharmaceutical companies are increasingly establishing secondary sources of procurement in India to diversify their supply chain, which bodes well for ADL and other domestic API players

The company is expected to undertake sizeable capex of Rs. 220.0 crore in FY2023. This is mainly towards setting up two greenfield facilities in addition to maintenance capex of Rs. 40-50 crore. The capex is directed towards scaling its capacities for APIs, related intermediates and formulations though achieving the desired levels of profitability and accruals remains a key sensitivity.

The rating is also constrained by moderately high working capital intensity because of large receivables and inventory holding period as it is bound to maintain a minimum inventory for various raw materials and finished goods to maintain uninterrupted flow of supplies. ADL's profitability is also exposed to regulatory risks, fluctuations in raw material prices and limited pricing flexibility because of large share of mature molecule portfolio. The risk is mitigated to an extent by its leading market position and backward integration in related intermediates that protect the profitability to an extent.

Key rating drivers and their description

Credit strengths

Established bulk drug player with strong presence in certain therapeutic segments like anti-biotic, anti-diarrheal and anti-inflammatory and sizeable market share in key molecules - The company caters to 11 therapeutic groups, including antibiotic, antidiarrheal, anti-fungal, anti-diabetic, anti-inflammatory, cardioprotective, vitamins and anti-arthritis, among others. The top three therapeutic segments—viz., antibiotic, antidiarrheal and anti-diabetic—drove ~61% of the company's consolidated revenues in FY2022. ADL has a growing presence in anti-fungal, anti-diabetic and cardioprotective therapies as well. Its top five products, namely Ciprofloxacin, Ofloxacin, Metronidazole, Metformin and Ketoconazole, generated 54.6% of its revenues in FY2022. ADL has a sizable market share as the largest domestic and global manufacturer for most of its key products.

Diversified client mix; geographical diversification in export customers- ADL's customer base is diversified with its top ten customers contributing only ~14-16% of its revenues in FY2022. Its client profile includes reputed domestic as well as export end-customers and distributors. Export sales comprised 37% of ADL's consolidated revenues in FY2022. Although limited, its exports are diversified across 100 countries in Latin America, Asia Pacific, Europe and Africa.

Healthy financial profile - The capitalization and coverage ratios remained healthy with a gearing of 0.4 times and 0.5 times in as on end of FY2021 and FY2022 respectively. The TD/OPBITDA, interest coverage, TOL/TNW and DSCR stood at 1.6 times, 15.9 times, 1.1 times and 4.3 times respectively in FY2022. Despite the sizable debt-funded capex in FY2023-FY2024, the leverage profile is expected to remain comfortable supported by consistently healthy profitability and accruals.

Favourable growth outlook in the near to medium term supported by greenfield and brownfield expansion projects – ADL's operating income (OI) witnessed a healthy YoY growth of 15% in FY2022, led by increasing volumes and realisations (in APIs) across key therapeutic areas. The increase in volumes was supported by ongoing brownfield capacity expansions for APIs and related intermediates, while increase in realisations was led by changes in product mix and price increases across the API industry. ICRA expects ADL's revenues to grow favourably in the near to medium term, led by new product introductions, increasing geographic penetration, and sizable capex over the next 2-3 years. Further, ongoing capex is also expected to support revenue growth in the medium term.

Credit challenges

Significant near-term debt-funded capex; achieving desired level of profitability remains to be seen – ADL is undertaking a sizable capex plan of ~Rs. 400-450 crore crore in FY2023 and FY2024 towards brownfield and greenfield project to enhance and expand its API capacities. The capex is towards scaling its capacities for APIs, related intermediates and formulations; with an average gestation period of 18-24 months for greenfield capex, achieving desired levels of profitability and accruals remains a key sensitivity. The greenfield capex will be funded by accruals and long-term debt. The risk is mitigated to an extent by the proven track record of successful implementation of similar projects, leading market position in addressable molecules and flexibility to stagger planned capex, depending on market conditions.

Moderately high working capital intensity - The working capital intensity increased to 33.5% in FY2022 from 30.2% in FY2021. This was led by increased debtors and creditors days offset by decline in inventory days to a certain extent. The company is bound to maintain a minimum inventory for various raw materials and finished goods to maintain uninterrupted flow of supplies. Going forward, the working capital intensity is expected to remain in line with past trends.

Profitability remains exposed to regulatory risks and fluctuations in raw material prices – The company is exposed to regulatory risks like manufacturing facility approvals and local manufacturing requirement by various Government authorities, as part of a regulated industry amid an evolving landscape. It is also exposed to raw material price fluctuations since it imports nearly 50-55% of its total raw materials. The operating margins in FY2022 were impacted on account of sharp increases in raw material prices which could not immediately be passed on to the customers. The company continues to benefit from backward integration for its key molecules, and operational efficiencies from large established capacities.

Liquidity position: Adequate

ADL's liquidity is adequate, supported by fund flow from operations of Rs. 238.9 crore in FY2022. The liquidity is further supported by healthy accruals, unutilized working capital limits of ~Rs. 95 crore and unencumbered cash and cash equivalents of ~Rs. 22 crore, as on March 31, 2022. The annual repayment obligations for existing term loans remains moderate at ~Rs. 43.0 crore for FY2023 and Rs. 41.4 crore for FY2024. ADL has a capex commitment of ~Rs. 220.0 crore in FY2023, funded by internal accruals and financed partly by long term debt, of which the company has already availed a sanction for term loan of Rs. 150 crore.

Rating sensitivities

Positive factors - The ratings could be upgraded with a sustained improvement in the company's revenue profile leading to increased profit margins and improved financial profile. Specific credit metric which can lead to a rating upgrade include improvement in TD/OPBDITA to below 1.0 times on a sustained basis.

Negative factors – The ratings could be downgraded in case of a significant and sustained deterioration in the company's profitability. Negative pressure on ADL's rating could arise with a weakening in the company's TD/OPBITDA beyond 1.5 times on a sustained basis. The rating could also be downgraded if its liquidity position worsens on account of higher-than-expected working capital intensity or capex funding requirements.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Pharmaceutical Industry
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of ADL.

About the company

Incorporated in 1984, ADL is manufacturing APIs, intermediates and specialty chemicals. The company was promoted by four chemical engineering graduates from UDCT Mumbai (now Institute of Chemical Technology). ADL derived nearly 37% of its revenues from exports in FY2022. It has a strong presence in antibiotic, antidiarrheal and anti-inflammatory segments with a growing product portfolio in anti-fungal, anti-diabetic, cardio-protectant, vitamins and anti-arthritis therapeutic groups. ADL's key products include Ciprofloxacin, Metronidazole, Metformin HCL, Ketoconazole and Ofloxacin. It successfully developed around 30 new molecules in the past six years and is continuously developing new value-added molecules through its innovative and cost-effective process. The company has nine manufacturing plants in Tarapur (Maharashtra) and two plants in Sarigam (Gujarat). The manufacturing units have approval from WHO-GMP, EDQM (Europe), accreditation from Japan, ANVISA, ISO 9001: 2000, TGA Australia, COFEPRIS, Canadian Authorities, China, Russia, Taiwan, Ukraine, Vietnam, and Korea.

PLSPL is a wholly owned subsidiary of ADL involved in manufacturing formulations for domestic (contract manufacturing) and export markets (own brand). The therapeutic segments it caters to ranges includes CNS, Cardiovascular, Dermatology

Ointments, Gastrointestinal, Oncology, Pain Management and Respiratory. Its facility at Baddi is ISO 9001: 2008 certified and WHO – GMP approved. PLS is also approved by various regulatory bodies like FMHACA (Ethiopia), NDA (Uganda), PPP (Kenya), and Ministry of Health (Ivory Coast). Most of its requirement of APIs are met by its parent.

Key financial indicators (audited)

ADL Consolidated	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)
Operating Income (Rs. crore)	1806.1	2154.8	2488.7
PAT (Rs. crore)	141.4	280.4	205.0
OPBDIT/OI (%)	14.7%	20.4%	13.2%
PAT/OI (%)	7.8%	13.0%	8.2%
Total Outside Liabilities/Tangible Net Worth (times)	1.4	0.9	1.1
Total Debt/OPBDIT (times)	1.5	0.8	1.6
Interest Coverage (times)	7.1	16.8	15.9

Source: *Company and ICRA research; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
					June 30, 2022	January 20, 2022	April 15, 2021	Mar 25, 2021	-
1	Term loan USD million	Long-term	15.0	1.5*	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	-
2	Term Loan (Rs. crore)	Long-term	167.71	141.6*	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	-	-
3	Cash Credit	Long-term	34.0	-	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	-	-
4	Fund based/ Non-fund based	Short term	816.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
5	Commercial Paper	Short Term	90.0	-	-	[ICRA]A1+; withdrawn	[ICRA]A1+	[ICRA]A1+	-

**Amount O/s as on March 31, 2022*

Source: *Company and ICRA research*

Complexity level of the rated instrument

Instrument	Complexity Indicator
Fund Based - Working Capital/ Cash Credit	Simple
Term Loan	Simple
Non fund based - LC/BG	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Term Loan (USD million)	25-Aug-2020	NA	14-Mar-2027	15.0	[ICRA]AA- (Stable)
NA	Term Loan 1 (Rs. crore)	17-Jun-2016	NA	30-Jun-2025	65.26	[ICRA]AA- (Stable)
NA	Term Loan 2 (Rs. crore)	27-Aug-2020	NA	11-Aug-2023	54.0	[ICRA]AA- (Stable)
NA	Term Loan 3 (Rs. crore)	11-Sep-2020	NA	30-Sep-2025	48.45	[ICRA]AA- (Stable)
NA	Long term-Fund based CC	NA	NA	NA	34.0	[ICRA]AA- (Stable)
NA	Short term- Fund based/Non-fund based	NA	NA	NA	816.0	[ICRA]A1+

Source: *Company*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Pinnacle Life Science Private Limited	100.0%	Full Consolidation
Aarti Speciality Chemicals Limited	100.0%	Full Consolidation
Pinnacle Chile SPA	95.0%	Full Consolidation

Source: *ADL Q4FY2022 Results;* ***Note:*** *ICRA has taken a consolidated view of the parent (ADL), its subsidiaries while assigning the ratings.*

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