December 12, 2022 (Revised)

Aarti Drugs Limited: Ratings reaffirmed for existing limits and assigned to enhanced limits

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term: Fund-based term loan	167.71	265.47	[ICRA] AA- (stable); reaffirmed on existing limits and assigned to enhanced limits
Long-term: Fund-based CC	34.0	34.0	[ICRA] AA- (stable); reaffirmed
Short-term: Fund-based/ Non-fund based facilities	816.0	1,049.64	[ICRA]A1+; reaffirmed on existing limits and assigned to enhanced limits
Long-term: Term loan (USD million)*	USD 15.0 million	-	-
Total	**1,017.71 USD 15.0 million**	**1,349.11**	

Instrument details are provided in Annexure-1

Rationale

The ratings continue to consider Aarti Drugs Limited's (ADL's or the company's) experienced management and established operations spanning over 30 years in the active pharmaceutical ingredients (APIs), intermediates, speciality chemicals and formulations space. The ratings also factor 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 supporting its market position. The ratings also take comfort from ADL's diversified and reputed client base, including major pharmaceutical players.

ADL witnessed healthy YoY revenue growth of ~13% in H1 FY2023 primarily supported by increasing volumes and realisations across key therapeutic areas. ADL's OPMs declined to 10.8% in H1 FY2023 from 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 and power and fuel expenses. The inflationary pressure on input price along with the higher operating expenditure and finance cost, continued to affect the net margins. Going forward, in H2 FY2023, margins of the company are expected to improve to a certain extent on the back of stabilisation in raw material prices and other input costs and price increases taken by the company. ADL is expected to incur 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; although achieving the desired levels of profitability and accruals remains a key rating sensitivity.

The rating is also constrained by moderately high working capital intensity because of large receivables and inventory holding period as ADL is bound to maintain a minimum inventory for various raw materials and finished goods for uninterrupted flow of supplies. ADL's profitability is also exposed to regulatory risks, fluctuations in raw material prices and limited pricing flexibility because of a 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.

While debt metrics are expected to deteriorate to a certain extent given the relatively lower margins and sizeable capex in FY2023, the same is expected to revive from FY2024 onwards with expected improvement in operating margins. ICRA expects the revenue 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 to enhance capacities. 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.

Key rating drivers and their description

Credit strengths

Established bulk drug player with strong presence in therapeutic segments like antibiotic, antidiarrheal and anti-inflammatory; and sizeable market share in key molecules – The company caters to 11 therapeutic groups, including antibiotic, antidiarrheal, antifungal, antidiabetic, anti-inflammatory, cardioprotective, vitamins and anti-arthritis, among others. The top three therapeutic segments—viz., antibiotic, antidiarrheal and antidiabetic—drove ~61% of the company's consolidated revenues in FY2022. ADL has a growing presence in antifungal, antidiabetic 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 10 customers contributing only ~14-16% to 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 and H1 FY2023. Although limited, its exports are diversified across 100 countries in Latin America, Asia Pacific, Europe and Africa.

Healthy financial profile – The capitalisation and coverage ratios remained healthy with a gearing of 0.5 time as on September 30, 2022. The TD/OPBITDA, interest coverage and TOL/TNW stood at 2.1 times, 9.2 times and 1.0 times respectively, in H1 FY2023. While debt metrics are expected to deteriorate to a certain extent given the relatively lower margins and sizeable capex in FY2023, the same is expected to revive from FY2024, with expected improvement in operating margins.

Favourable growth outlook in near to medium term supported by greenfield and brownfield expansion projects – ADL's operating income witnessed a healthy YoY growth of ~13% in H1 FY2023, led by increasing realisations across key therapeutic areas. 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 in FY2023 and FY2024 towards brownfield and greenfield projects 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, especially with decline in margins in the recent quarters. 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 34.3% in H1 FY2023 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, given the volatility in raw material prices and supply chain issues in the recent past. 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 and H1 FY2023 were impacted by sharp increases in raw material prices, which could not immediately be passed on to 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 positive fund flow from operations in H1 FY2023. The liquidity is further supported by healthy accruals, unutilised working capital limits of ~Rs. 70 crore and unencumbered cash and cash equivalents of ~Rs. 14.6 crore as on September 30, 2022. The annual repayment obligations for existing term loans remains moderate at ~Rs. 25.5 crore for FY2023 and Rs. 38.78 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 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 leading to a rating upgrade could include improvement in TD/OPBDITA to below 1.0 time 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 manufactures APIs, intermediates and speciality 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 antifungal, antidiabetic, cardioprotectant, 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 approvals from WHO-GMP, EDQM (Europe), accreditation from Japan, ANVISA, ISO 9001: 2000, TGA Australia, COFEPRIS, Canadian Authorities, China, Russia, Taiwan, Ukraine, Vietnam, and South Korea.

Pinnacle Life Science Private Limited 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 includes CNS, Cardiovascular, Dermatology Ointments, Gastrointestinal, Oncology, Pain Management and Respiratory. Its facility at Baddi (Himachal Pradesh) 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	FY2021	FY2022	H1 FY2023
Operating income	2154.8	2488.6	1309.7
PAT	280.4	205.0	73.5
OPBDIT/OI	20.3%	13.2%	10.8%
PAT/OI	13.0%	8.2%	5.6%
Total outside liabilities/Tangible net worth (times)	0.9	1.1	1.0
Total debt/OPBDIT (times)	0.8	1.6	2.1
Interest coverage (times)	19.0	15.9	9.2

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

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 as of September 30, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
					12-Dec-22	30-Jun-22	20-Jan-22	15-Apr-21	25-Mar-21	-
1	**Term loan USD million**	Long-term	-	-	-	**[ICRA] AA- (Stable)**	**[ICRA] AA- (Stable)**	**[ICRA] AA- (Stable)**	**[ICRA] AA- (Stable)**	-
2	**Term Loan (Rs. crore)**	Long-term	265.47	138.27	**[ICRA] AA- (Stable)**	**[ICRA] AA- (Stable)**	**[ICRA] AA- (Stable)**	**[ICRA] AA- (Stable)**	-	-
3	**Cash Credit**	Long-term	34.00	34.00	**[ICRA] AA- (Stable)**	**[ICRA] AA- (Stable)**	**[ICRA] AA- (Stable)**	**[ICRA] AA- (Stable)**	-	-
4	**Fund based/ Non-fund based**	Short term	1049.64	658.54	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	-	-
5	**Commercial Paper**	Short term	-	-	-	-	**[ICRA]A1+; withdrawn**	**[ICRA]A1+**	**[ICRA]A1+**	-

Source: *Company and ICRA research*

Complexity level of the rated instrument

Instrument	Complexity Indicator
Fund Based - Working Capital/ Cash Credit	Simple
Term Loan	Simple
Short term Fund based /Non-Fund based	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: [Click Here]

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 1 (Rs. crore)**	17-Jun-2016	NA	30-Jun-2025	48.30	[ICRA]AA- (Stable)
NA	**Term Loan 2 (Rs. crore)**	27-Aug-2020	NA	11-Aug-2023	177.0	[ICRA]AA- (Stable)
NA	**Term Loan 3 (Rs. crore)**	11-Sep-2020	NA	30-Sep-2025	40.17	[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	1049.64	[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 annual report;* ***Note:*** *ICRA has taken a consolidated view of the parent (ADL), its subsidiaries while assigning the ratings.*

Corrigendum

Document dated December 12, 2022, has been corrected with revisions as detailed below:

Interest coverage ratio for FY2021 in Key financials indicators table has been revised.

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