

February 29, 2024

Aarti Drugs Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term: Fund-based term loan	265.47	209.09	[ICRA]AA- (stable); reaffirmed
Long-term: Fund-based CC	34.0	65.00	[ICRA]AA- (stable); reaffirmed/ assigned
Short-term: Fund-based/ Non- fund based facilities	1,049.64	1085.00	[ICRA]A1+; reaffirmed/ assigned
Total	1,349.11	1,359.09	

*Instrument details are provided in Annexure-I

Rationale

The ratings continue to consider Aarti Drugs Limited's (ADL or the company) 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 sizeable market share as one of the largest domestic and global manufacturers 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 a revenue growth of 9.1% in FY2023 to Rs. 2,716.1 crore on the back of the API segment, the major revenue contributor (~80-85% of the revenue), which grew by 11.7% mainly supported by price hike of 10.2%. The price hike was on the back of elevated raw material (RM) prices and although RM prices started correcting in Q2FY2023 post correction of crude oil price, correction of API prices started in Q3FY2023, following a general lag of about one to two months post correction of RM prices. The volume growth in FY2023 remained muted on account of the elevated API prices for large part of the year, leading to lower demand from the formulation companies, impact of geopolitical tensions in Europe and higher inventories stocked up by the formulation companies in FY2022. The company's operating margin declined YoY by 200 bps to 11.4% in FY2023, mainly on account of elevated raw material prices for the API segment. Although operating profits in absolute terms remained largely similar in FY2023 compared to FY2022, the operating margin remained impacted, as generally the price mark-up for API selling price over RM cost is fixed in absolute terms.

The company's revenue declined by 3.3% YoY to Rs.1,908.6 crore in 9M FY2024, mainly on account of decline in realisations in the API segment. The revenue from the API segment declined by 3.3% YoY in 9M FY2024 on the back of decline in API prices by 14.4%, which was partially offset by healthy volume growth of 11.1% on the back of robust domestic demand. However, the export revenues during the same period declined by ~17% due to several factors, including a slowdown in demand resulting from dollar shortage in key markets, increased stocks held by the formulation companies from previous fiscal, reduced channel inventories due to elevated interest rates resulting in higher working capital costs and cautious spending by the customers amid geopolitical tensions and expectations of global slowdown, in addition to negative rate variance. During 9M FY2024, the company's operating margin improved YoY by 140 bps to 12.1% on the back of correction in raw material prices. However, the expansion of the operating margin during the same period remained limited due to reduced contribution from export sales which typically entail relatively higher margins in addition to impact high-cost inventory in falling raw material price environment. As the API prices continued to correct throughout 9M FY2024 (which have stabilised in Q4 FY2024), the API segment is expected to continue witnessing decline in realisations in FY2025; however, the same is expected to be offset by healthy volume growth. Stabilisation of raw material prices, coupled with healthy operating leverage and increased cost

efficiency with various backward integration initiatives, is expected to support margin expansion going forward. Additionally, ramp up of commercial operations for margin-accretive products from greenfield capacities and expected revival of demand from the export markets are also expected to support the margins going forward.

The company is expected to incur capex of ~Rs.220-230 crore in the current fiscal and ~Rs. 150 crore in FY2025, funded through mix of debt and internal accruals. This is mainly towards setting up two greenfield facilities (salicylic acid and amine plant), various brownfield expansions, debottlenecking and maintenance capex. The debt-funded capex is expected to moderate the debt metrics to certain extent. Timely ramp-up of operations for the newly added capacities and impact of the same on the company's credit metrics remain monitorable.

The ratings are also constrained by moderately high working capital intensity because of large receivables and inventory holding period, as ADL maintains safety stock 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. ICRA also notes that the company has carried out ~Rs. 60.0 crore (Rs. 73.2 crore including the tax on the buyback) of share buyback in addition to Rs. 9.2 crore of dividend payout during the current fiscal which is in line with past trends. Going forward, any significant deviation in expected shareholder payout impacting the company's liquidity position and credit metrics remains a key monitorable.

The Stable outlook on the long-term rating reflects ICRA's opinion that, although realisations are expected to moderate the revenue growth in FY2025 to a certain extent, the same will be offset by healthy volume growth supported by stable domestic demand, incremental capacities from ongoing brownfield and greenfield expansions and expected demand revival from export markets. Further, although the ongoing debt-funded capex is expected to moderate the debt metrics to a certain extent, the same are expected to remain healthy.

Key rating drivers and their description

Credit strengths

Established bulk drug player with strong presence in therapeutic segments like antibiotic, antidiarrheal and anti-inflammatory along with sizeable market share in key molecules – The company caters to 12 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 contributed ~64% of the company's revenues in FY2023. The company remains one of the leaders in fluoroquinolones under antibiotic therapy on the back of strong backward integration and cost-efficient manufacturing supported by large capacities. ADL has a growing presence in antifungal and cardioprotective therapies as well. Its top-five products, namely Ciprofloxacin, Ofloxacin, Metronidazole, Metformin and Ketoconazole, generated ~53% of its revenues in FY2023. ADL has a sizeable market share as the largest domestic and global manufacturer for most of its key products.

Diversified client mix; export customers across 100 countries – ADL's customer base is diversified with its top-10 customers contributing ~15% to its revenues in FY2023. Its client profile includes reputed domestic as well as export end-customers and distributors. Export sales comprised 38-40% of ADL's consolidated revenues in FY2023 and 9M FY2024. Although limited, its exports are diversified across 100 countries in Latin America, Asia Pacific, Europe and Africa.

Healthy capital structure – The company's debt primarily comprises working capital debt and term loans with the former generally contributing over 50% due to working capital-intensive nature of its operations. Further, the ongoing capex is being funded through mix of debt and internal accruals. Consequently, total debt increased to Rs. 589.1 crore as on September 30, 2023 (Rs.596.5 crore as on December 31, 2023) from Rs. 542.8 crore as on March 31, 2022, leading to moderation of debt metrics to a certain extent. TD/OPBDITA as on September 30, 2023, increased to 1.8 times from 1.6 times as on March 31, 2022. The increase in debt levels combined with reduced profitability led to decline in interest coverage ratio to 9.6 times in H1 FY2024 from 13.9 times in FY2022 and DSCR to 3.4 times in H1 FY2024 from 4.1 times in FY2022. The gearing of the company

remained unchanged at 0.5 times during the same period. While the ongoing and planned debt-funded capex is expected to impact the debt metrics further, the same are expected to remain healthy.

Favourable growth outlook in near to medium term supported by greenfield and brownfield expansion projects – Although the company witnessed a YoY revenue decline of 3.3% during 9M FY2024, the volume growth remained healthy on the back of strong demand from the domestic markets. Going forward, the company is expected to witness decline in realisations during large part of FY2025 for the API segment; however, the same is expected to be offset by healthy volume growth to a certain extent. This volume growth will be supported by continuation of healthy demand from the domestic markets, incremental capacities available from various brownfield expansion for key molecules and expected revival in export demand. Additionally, commencement of operations for ongoing greenfield projects for salicylic acid (commenced operations in January 2024) and amine plant, will support the growth prospects of the company in the medium term. From these greenfield capacities, the company is expected to launch one API, three-to-five intermediates and specialty chemicals.

Credit challenges

Significant near-term debt-funded capex – The company is expected to incur capex of ~Rs. 220-230 crore in the current fiscal and ~Rs. 150 crore in FY2025, funded through mix of debt and internal accruals. This is mainly allocated towards setting up two greenfield facilities (salicylic acid and amine plant) with an average gestation period of 18-24 months, various brownfield expansions for key molecules, debottlenecking and maintenance capex. The debt-funded capex is expected to moderate the debt metrics to certain extent and timely ramp-up of operations for the newly added capacities and impact of the same on the company's profitability along with its credit metrics remain monitorable. However, the company's proven track record of successfully implementing similar projects, leading market position in addressable molecules and flexibility to stagger planned capex, depending on market conditions provide comfort.

Moderately high working capital intensity – The company's working capital intensity remained moderately high at 33.4% in H1 FY2024 and 35.0% in FY2023. The company's operations remain working capital intensive, essential for its growth, as the company generally maintains ~90 days of inventory which includes various raw materials and finished goods to maintain uninterrupted flow of supplies to its customers in addition to debtor days remaining in the range of 90-110 days mainly on account of sizeable portion of export sales. 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. At present, regulators all over the globe are becoming more stringent with allowed levels of nitrosamines in pharmaceutical products, an industry-wide phenomenon, which might entail higher operating costs for pharmaceutical entities going forward. Further, the company's profitability remains vulnerable to packaging and freight costs in addition to volatility in raw material prices as witnessed in FY2023 and the current fiscal and their impact on the margins will remain a key monitorable. However, backward integration for its key molecules, and operational efficiencies from large established capacities mitigate this risk to a certain extent.

Environmental and social risks

Environmental considerations – The company does not face any major physical climate risk. However, it remains exposed to tightening environmental regulations about breach of waste and pollution norms, which can lead to an increase in operating costs or capital investments. To address this, the company is dedicated to minimising its environmental footprint by continuously improving its operations, reducing its energy consumption, and responsibly managing its waste and emissions. The company has also planned for installation of solar power plants at its key facilities during the next fiscal.

Social considerations – The industry faces social risks related to product safety and the associated litigation risks, access to qualified personnel for R&D and process engineering, and maintenance of high manufacturing compliance standards. Further, Government intervention related to price caps/control also remains a social risk faced by entities in the pharmaceutical

industry. The company is committed to promoting the health and safety of its employees by providing a safe work environment, supporting a culture of wellness, and investing in training and development. The company also supports local initiatives, engage in philanthropic activities, and partner with organisations that share its commitment to sustainability and social responsibility.

Liquidity position: Adequate

ADL's liquidity is adequate, with free cash and liquid investments of ~Rs. 13 crore and unutilised working capital limit of ~Rs. 144 crore against its drawing power of Rs. 429.4 crore (sanctioned limit of around Rs. 600 crore) as on September 30, 2023. The company's average working capital utilisation remained at ~69% against its average drawing power of Rs. 482.1 crore between October 2022 and September 2023. The company is expected to incur the capex of Rs.220.0-225.0 crore in FY2024 and ~Rs. 150 crore in FY2025, which is being funded through mix of term debt and internal accruals. The company has annual repayment obligation of Rs. 41.4 crore, Rs. 72.6 crore and Rs.61.8 crore in FY2024, FY2025 and FY2026, respectively, for its term loans. ICRA expects the company to meet its near-term commitments comfortably through its internal accruals.

Rating sensitivities

Positive factors – The ratings could be upgraded with a significant improvement in the company's revenue profile leading to increased profit margins and improved financial profile.

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 DSCR below 2.5 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- Pharmaceuticals
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of ADL.

About the company

ADL, incorporated in 1984, 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 39% of its revenues from exports in FY2023. It has a strong presence in the 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 more than 30 new molecules in the past seven years and is continuously developing new, value-added molecules through its innovative and cost-effective process. At present, 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, which manufactures formulations for the domestic (contract manufacturing) and export markets (own brand). The therapeutic segments it caters to include 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	FY2022	FY2023	H1 FY2024*
Operating income	2488.6	2716.1	1302.6
PAT	205.0	166.4	87.6
OPBDIT/OI	13.4%	11.4%	12.3%
PAT/OI	8.2%	6.1%	6.7%
Total outside liabilities/Tangible net worth (times)	1.1	1.0	0.9
Total debt/OPBDIT (times)	1.6	2.0	1.8
Interest coverage (times)	13.9	8.3	9.6

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amounts in Rs. crore *Provisional

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2024)		Chronology of rating history for the past 3 years					
		Amount rated (Rs. crore)	Amount outstanding as of Dec 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023		Date & rating in FY2022		Date & Rating in FY2021
					Feb 29, 2024	Dec 12, 2022	Jun 30, 2022	Jan 20, 2022	
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	209.09	255.0	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	-
3 Cash credit	Long-term	65.00	-	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	-
4 Fund based/ Non-fund based	Short-term	1085.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
5 Commercial paper	Short-term	-	-	-	-	-	[ICRA]A1+; withdrawn	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instruments

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 I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	FY2017-FY2024	NA	FY2026-FY2032	209.09	[ICRA]AA- (Stable)
NA	Long term-Fund based CC	NA	NA	NA	65.00	[ICRA]AA- (Stable)
NA	Short term- Fund based/Non-fund based	NA	NA	NA	1085.00	[ICRA]A1+

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: 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.

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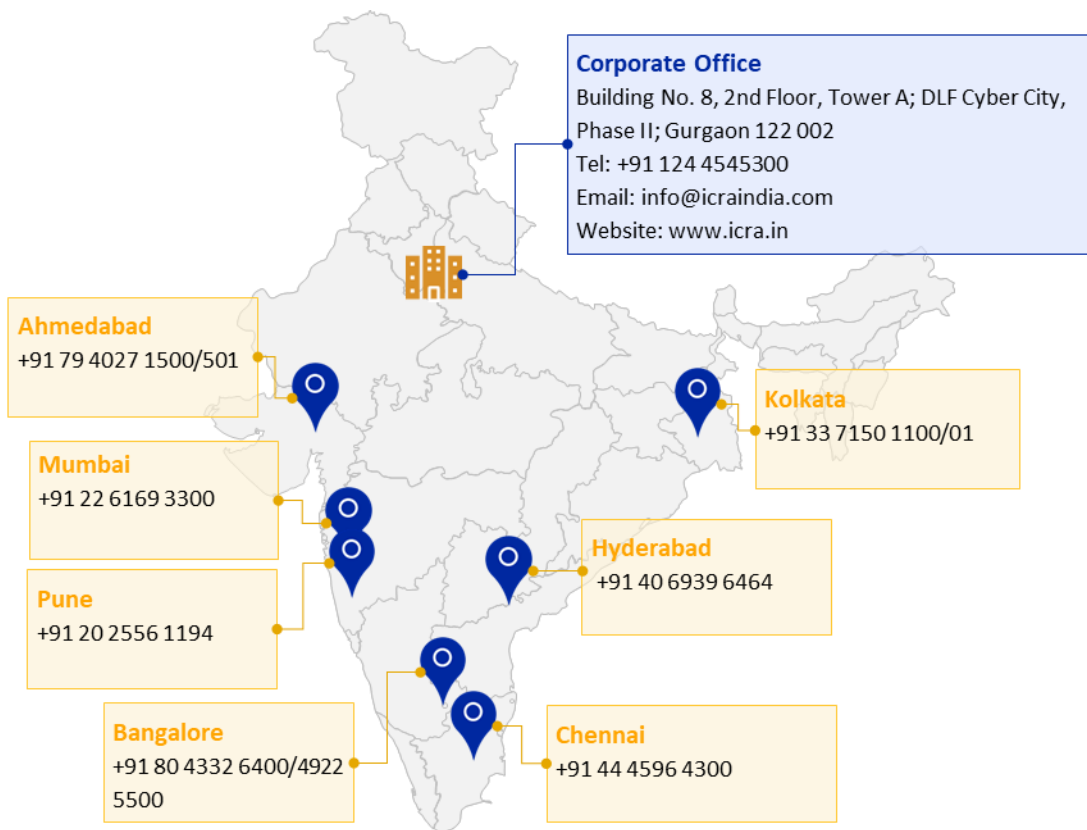
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