August 24, 2023

Everest Organics Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based – Cash Credit	16.00	16.00	[ICRA] B+ (Stable); reaffirmed
Long-term – Fund-based – Term Loans	18.00	17.10	[ICRA] B+ (Stable); reaffirmed
Short-term – Non-fund based	6.00	6.00	[ICRA] A4; reaffirmed
Long-term/Short-term – Fund-based	7.00	7.00	[ICRA] B+ (Stable)/[ICRA]A4; reaffirmed
Long-term – Unallocated	-	0.90	[ICRA] B+ (Stable); reaffirmed
Total	**47.00**	**47.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating factors in Everest Organics Limited's (EOL) modest scale of operations with revenues of Rs. 189.3 crore in FY2023 and Rs. 42.7 crore in Q1 FY2024 in the competitive Active Pharmaceutical Ingredients (API) and intermediaries segments. The company's revenues declined in FY2023 as it curtailed its production due to unfavourable raw material costs. In Q1 FY2024, EOL's revenues declined by ~1% on YoY basis owing to subdued demand. However, realisations of two of its key products improved in Q2 FY2024, which coupled with expected ramp-up in sales volumes of eight new products is expected to result in low single digit growth in FY2024. The operating margin (OPM) declined to 1.2% in FY2023 from 4.0% in FY2022 owing to unfavourable raw material costs, which could not be passed on to its customers owing to high competition. However, the OPM improved to ~6% in the last two quarters with softening raw material costs. Increased realisations and better product mix is expected to support improvement in the company's margins in FY2024. ICRA also notes the statutory auditor's qualifications in the recently published quarterly results concerning EOL's non-compliance with accounting standards and below par corporate governance practices. ICRA will continue to monitor the same.

The ratings also consider EOL's high revenue dependence on the mature anti-ulcerative therapeutic segment. The company's liquidity also remains stretched with a significant build-up of inventory and high receivables, and its working capital requirements are partly funded by stretching its creditors. Moreover, the company is expected to incur a debt-funded capex of Rs. 15.0 crore in FY2024, which would impact its liquidity position and debt metrics. The ratings are also constrained by the vulnerability of its profits to fluctuating raw material and finished goods prices owing to stiff competition in the API industry.

The ratings, however, draw comfort from the company's established track record and customer relationships in the pharmaceutical industry, resulting in repeat orders and healthy capacity utilisation levels.

The Stable outlook on the rating reflects ICRA's opinion that EOL's earnings would improve with the launch of new products and improved realisations, continuing to benefit from its long association with its customers.

Key rating drivers and their description

Credit strengths

Extensive experience in pharmaceutical industry – The promoters have an established track record in the pharmaceutical industry, which enabled the company to have established relationships with various reputed formulation companies, resulting in repeat orders over the years.

Favourable demand prospects for API manufacturing – The plant capacity utilisation remains high at more than 90%, especially for the top two products—Omeprazole and Esomeprazole. Given the high utilisation levels, the company plans to expand the capacity of Esomeprazole, Pantoprazole and Benzimidazole, as well as newly added products in FY2024.

Credit challenges

Moderate scale of operations – The company's scale of operations is moderate with revenues declining to Rs. 184.3 crore in FY2023 against Rs. 201.7 crore in FY2022 owing to decreased production due to unfavorable margins, while raw material costs remained high, growth in realisations remained muted. In Q1 FY2024, the company's revenues declined by ~1% YoY, owing to subdued demand. However, realisations of two of its key products improved in Q2 FY2024, which coupled with expected ramp-up in sales volumes of eight new products is expected to result in low, single-digit growth for EOL in FY2024.

Significant moderation in margins impacting debt protection metrics – The company's operating margin declined to 1.2% in FY2023 from 12.9% in FY2021 owing to unfavourable raw material costs that could not be passed on to its customers due to high competition. However, its margin improved to ~6% in Q1 FY2024 with correction in raw material costs. Increase in realisations of key products in Q2 FY2024 and expected ramp-up in sales volumes of its new products resulting in better product mix, are expected to support the company's margins to ~6-7% in FY2024 from 1.2% in FY2023.

Non-adherence to accounting policies and pollution control guidelines – The company's auditor has provided qualified opinion in the quarterly results published for Q1 FY2024 and the audited results for FY2023. This included production exceeding approved thresholds that could impact the going concern, overstatement of accruals and profit because of the revenue recognition policy, which is not in line with IND-AS 115, and the absence of actuarial assessment for gratuity liability. ICRA notes that the company has addressed a few qualifications highlighted by the auditor in the past; however, continued non-adherence to accounting policies and/or production beyond approved limits could impact EOL's business operations.

High exposure to mature anti-ulcerative segment – The company is focused on the matured anti-ulcerative segment with the entire revenue over the years being generated by APIs and intermediates. Sales are mainly driven by Omeprazole and Esomeprazole, accounting for ~60% of EOL's revenues in FY2023. However, the proposed launch of new products and ramp-up in sales volumes of recently launched products could reduce this risk to an extent.

Stretched liquidity position and high dependence on creditors for working capital requirements – The company's liquidity position stood stretched owing to high debtors and inventory as it offers a credit period of 2-3 months to its customers and also maintains an average inventory of 60-90 days. Also, the creditors remained high in Q1 FY2024 while the working capital requirements are mainly funded by creditors, resulting in high TOL/TNW of 3.2 times as on June 30, 2023. The company receives high credit period from domestic suppliers, who account for ~70-80% of its raw material procurement, on the back of its established relationships.

Exposed to intense competition in API industry - The pharmaceutical industry is intensely competitive with various established manufacturers in the field, resulting in limited pricing power and profitability.

Environmental and social risks

Environmental considerations – The company remains exposed to tightening environmental regulations with regard to breach of the waste and pollution norms, which can lead to an increase in operating costs and new capacity instalment costs. This can also require capital investments to upgrade its effluent treatment infrastructure to reduce the carbon footprint and waste generation. The company has been exceeding its production levels without necessary approvals from the Telangana State Pollution Control Board (TSPCB), as highlighted by the auditors. Such non-compliance would disrupt the company's operations and lead to the closure of its plant as witnessed in the past. While the company has stated that it is in the process of receiving approvals to operate at enhanced production levels, timely compliance with the TSPCB guidelines remains critical.

Social considerations – The company faces high industry-wide 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.

Liquidity position: Stretched

The company's liquidity position is stretched with zero buffer in the working capital limits and low cash and bank balances of Rs. 0.3 crore as on June 30, 2023. The company is expected to generate retained cash flows of Rs. 6-10 crore against repayment obligations of Rs. 5.0–7.0 crore in FY2024. Moreover, the company has sizeable debt-funded capex plans, a part of which needs to be funded from internal accruals.

Rating sensitivities

Positive factors – ICRA could upgrade the ratings if the company demonstrates recovery in the operating margins and improvement in liquidity position while recording healthy growth in its scale of operations, leading to improved debt metrics.

Negative factors – Negative pressure on EOL's rating could arise if there is a significant decline in revenues, or if there is no material improvement in earnings, or if the working capital cycle deteriorates, impacting its liquidity position further. Also, the company's inability to comply with regulatory norms or accounting policies will be a key monitorable.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology - Pharmaceuticals
Parent/Group support	Not Applicable
Consolidation/Standalone	The rating is based on the company's standalone financial profile.

About the company

Everest Organics Limited was established in 1993 by Dr. Srihari Raju. It is currently managed by his daughter, Dr. Sirisha Kakarlapudi, who is the new CEO of EOL. Initially incorporated as a private limited company, it went public and was listed on the BSE in 1995. The company manufactures APIs and intermediates such as Omeprazole, Esomeprazole, Pantoprazole, Chloro compound and Benzimadizole. Its manufacturing facility is at Aroor village, in the Medak district of Telangana, with an installed production capacity of 820 MTPA. The company is ISO 9001-2008 certified, while the plant is WHO-GMP certified. The manufacturing facility also received US FDA approval in June 2017.

Key financial indicators (audited)

	FY2022	FY2023
Operating income	201.7	184.3
PAT	1.1	-0.2
OPBDIT/OI	4.0%	1.2%
PAT/OI	0.6%	-0.1%
Total outside liabilities/Tangible net worth (times)	2.8	3.4
Total debt/OPBDIT (times)	5.1	23.5
Interest coverage (times)	2.6	0.7

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 (FY2024)				Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount O/s as on Jun 30, 2023 (Rs. crore)	Date & Rating in FY2024	Date & rating in FY2023		Date & rating in FY2022	Date & rating in FY2021		
					Aug 24, 2023	Aug 22, 2022	Jun 08, 2022	Dec 15, 2021	Feb 19, 2021	Sep 09, 2020	Aug 31, 2020
1	Cash Credit	Long Term	16.00	-	[ICRA]B+(Stable)	[ICRA]B+(Stable)	[ICRA]BB(Negative)	[ICRA]BB+(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)
2	Term Loans	Long Term	17.10	15.51	[ICRA]B+(Stable)	[ICRA]B+(Stable)	[ICRA]BB(Negative)	[ICRA]BB+(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)
3	Non -fund Based	Short Term	6.00		[ICRA]A4	[ICRA]A4	[ICRA]A4	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A3
4	Fund-Based	Long/ Short Term	7.00	-	[ICRA]B+(Stable)/ [ICRA]A4	[ICRA]B+(Stable)/ [ICRA]A4	[ICRA]BB(Negative)/ [ICRA]A4	[ICRA]BB+(Stable)/ [ICRA]A4+	[ICRA]BBB-(Stable)/ [ICRA]A3	[ICRA]BBB-(Stable)/ [ICRA]A3	[ICRA]BBB-(Stable)/ [ICRA]A3
5	Unallocated	Long Term	0.90	-	[ICRA]B+(Stable)	-	-	-	[ICRA]BBB-(Stable)/ [ICRA]A3	[ICRA]BBB-(Stable)/ [ICRA]A3	[ICRA]BBB-(Stable)/ [ICRA]A3

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term – Fund based – Term Loan	Simple
Long Term – Fund based – Cash Credit	Simple
Short Term – Non Fund based	Very Simple
Long Term/Short Term – Fund based - Bill Discounting/ Export Packaging Credit	Simple
Long Term – Unallocated	Not Applicable

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 No	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Cash Credit	-	-	-	16.00	[ICRA]B+ (Stable)
NA	Term Loan	FY2021	-	FY2028	17.10	[ICRA]B+ (Stable)
NA	Letter of Credit	-	-	-	5.50	[ICRA]A4
NA	Bank Guarantee	-	-	-	0.50	[ICRA]A4
NA	Bill discounting/Export Packaging Credit	-	-	-	7.00	[ICRA]B+ (Stable)/[ICRA]A4
NA	Unallocated	-	-	-	0.90	[ICRA]B+ (Stable)

Source: Company

Annexure II: List of entities considered for consolidated analysis – Not Applicable

ANALYST CONTACTS

Shamsher Dewan

+91 12 44545300

shamsherd@icraindia.com

Srikumar K

+91 44 45964318

ksrikumar@icraindia.com

Nithya Debbadi

+91 40 45474829

nithya.debbadi@icraindia.com

Raviteja Etikala

+91 40 45474829

etikala.teja@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6169 3300
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

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