India Ratings Affirms Aarti Industries' Bank Loans at 'IND AA'/Stable; CP at 'IND A1+'

Feb 07, 2024 | Specialty Chemicals

India Ratings and Research (Ind-Ra) has affirmed Aarti Industries Limited's (AIL) debt instruments as follows:

Instrument Type	Date of issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating	Rating Action
Term loan	-	-	FY26	INR6,315 (reduced from INR7,000)	IND AA/Stable	Affirmed
Working capital facilities	-	-	-	INR6,000	IND AA/Stable	Affirmed
Working capital facilities	-	-	-	INR370	IND AA/Stable	Assigned
Commercial paper (CP)	-	-	Six to nine months	INR4,000	IND A1+	Affirmed

Analytical Approach: Ind-Ra continues to take a consolidated view of AIL and its subsidiaries to arrive at the ratings, as all the companies operate in the chemicals and related space, and have strong operational and strategic linkages among them.

Key Rating Drivers

Strong Business Profile with Leading Market Position and Diversification: AIL holds a leading market position globally in the benzene derivatives space and is ranked among the top three companies globally in chlorination, nitration, ammonolysis and hydrogenation in the benzene value chain chemistry. AIL's business model is fully backward-integrated, with adequate domestic availability of the key raw material, benzene, which obviates any dependence on imports. The company has over 100 end-products and it is among the top four players in 75% of its portfolio with a 25%-40% of market share, according to the management. The products are used in diversified sectors such as agrochemicals (25%-30%); automobiles, paints, pigment and printing inks (15%-20%), pharmaceuticals (15%-30%); polymers and additives (15%-25%); along with FMCG and other discretionary products (10%-20%). AIL also has a diversified geographical mix, with exports accounting for around 50% of the consolidated revenue over FY18-FY23. AIL's major export markets are North America (13% of the FY23 revenue), Europe (11%), China (5%), Japan (3%) and the rest of the world (15%). Moreover, according to the management, no single product/customer contributes more than 10% to its overall revenue, indicating a de-risked management strategy.

Long-term Revenue Visibility Remains Intact despite Near-term Headwinds: AIL has strong customer retention due to multi-year and multi-product tie-ups with various global customers, aided by its large value-added portfolio which comprised 80% of its revenue in FY23. Revenue generation from the third long-term contract started in FY24, in addition to two contracts entered into during FY24 with a potential to generate annual revenue of around INR18 billion for the contract durations, provides adequate near-to-medium term growth visibility.

Post demerger of the pharma business in FY22, AIL's consolidated revenue grew 21% yoy to INR66.2 billion in FY23. However, AIL's revenue declined 13%yoy to INR33 billion in 1HFY24 due to a slowdown in demand in key exports markets, cut-down on discretionary spends and inventory de-stocking leading to a decline in both volumes and realisations. Notwithstanding a sequential recovery in 2H, Ind-Ra believes AIL's revenue is likely to witness a 10%-12% yoy decline in FY24. While the recovery in some of the segments namely agrochemicals could be slower, the agency believes that gradual normalisation of channel inventory and a recovery in underlying demand would propel growth FY25 onwards, given AIL's healthy end-user diversification with segments such as polymers, additives, and FMCG likely to fare better.

Pass-through Pricing Reduces EBITDA Volatility, Capacity Ramp-up to Aid Profitability over FY25-FY26: Given the proportion of value-added products, AIL is able to largely pass-on the volatility in input prices to its customers with a lag, reducing the volatility in its profitability amid the sharp fluctuations in chemical prices in the past one year. The consolidated margins have ranged between 14%-17% over the past 10 quarters. Besides, according to the management, the EBITDA/kg of its products reflects high stability. AIL's normalised EBITDA (excluding contract termination and shortfall fees) had increased to INR10.9 billion in FY23 (FY22: INR9.5 billion). However, it fell 21%yoy to INR4.4 billion in 1HFY24, owing to a weak demand and pricing environment. While EBITDA grew sequentially in 2QFY24 and a continued recovery is expected over 2H, Ind-Ra believes AIL's EBITDA would witness a yoy decline in FY24. However, Ind-Ra expects a significant growth in EBITDA over FY25-FY26 with a gradual demand recovery, revenue growth driven by the scale and product expansion coupled fixed cost optimisation with higher capacity utilisation.

Long-term Industry Outlook Remains Robust despite Near-term Headwinds: While the high channel inventory has led to headwinds for the sector in FY24, Ind-Ra believes that the demand environment would recover in FY25 as the inventory levels normalise and the underlying demand grows. Furthermore, the agency believes the demand environment would become robust for the sector in the medium term, on account of domestic demand from end-user industries and push for self-sufficiency, which is aimed at import substitution. Moreover, global participants are diversifying their supply chains away from China, which is likely to boost the exports of Indian players. To capitalise on this opportunity, the company plans to incur capex of INR30 billion-35 billion over FY24-FY26.

Continued Large Capex to Increase Near-term Leverage, Deleveraging Likely FY26 Onwards: AIL has been consistently incurring capex for the past six to seven years to improve its product profile, increase the scale of operations, enhance the profitability and cater to a wider range of customers. After incurring around INR25 billion capex over FY22-FY23, AIL plans to spend INR35 billion-40 billion over FY24-FY26 in the downstream chemistries of benzene, chlorotoluene value chain, expansion of acid unit, ethylation and nitrotoluene capacities. AIL shall also develop new chemical value-chains and introduce high potential products that will broaden its addressable market size, to respond to increased demand from key customers. The projects shall be commercialised in a phase-wise starting from 2HFY25, with a gradual ramp-up from FY27.

AIL's continued large capex led to the consolidated net leverage (net debt/EBIDTA) increasing to 2.5x in FY23 (FY22: 2.2x) and further to 2.8x in 1HFY24. Ind-Ra believes that the planned capex would lead to a further increase in the net leverage over FY24-FY25, before improving to below 3x by FY26 supported by EBITDA generation from the new projects, which will remain a key rating monitorable. Ind-Ra believes that the improvement in business profile and visibility of cash flows over the near-to-medium term provide comfort against the near-term higher leverage. The interest coverage remained robust, although fell to 6.56x in FY23 and 4.38x in 1HFY24 (FY22: 9.40x) as the borrowing costs surged with additional debt. The coverage ratio is likely to remain healthy over the near-to-medium term.

Liquidity Indicator – Adequate: The company had consolidated unencumbered cash and equivalents of INR4.3 billion at end-September 2023 (FYE23: INR1.67 billion). The consolidated cash flow from operations rose to INR11.4 billion in FY23 (FY22: INR4.2 billion) with a reduction in working capital requirements. AIL's average monthly utilisation of its consortium working capital limits was 75%-80% for the 12 months ended November 2023, up from 65%-70% in the preceding 12 months, given the lower internal accruals. Furthermore, AIL has access to unsecured sanctioned working capital limits in addition to CPs. AIL is also in discussion with its lenders for an enhancement of its working capital limits. Ind-Ra believes that despite the capex lined up, the company's cash flows and liquidity are sufficient to meet its scheduled debt repayments of INR3.4 billion and INR3.6 billion in FY24 and FY25, respectively. Ind-Ra also draws comfort from management's stance and history of maintaining adequate free cash balance of INR1.5 billion-2 billion. AIL has also periodic equity infusions through the qualified institutional placements undertaken by the company (FY22: INR12 billion; FY19: INR7.5 billion).

Free Cash Flow to Remain Negative amid Large Capex Planned: AIL's continuous capex has resulted in negative free cash flows over the past five years (FY23: negative INR2.7 billion; FY22: negative INR8.8 billion); and the trend is likely to continue in the near-term, given the large capex plans. The capex, however, will be funded using a mix of debt and internal accruals, and the company has been raising debt for the purpose. Ind-Ra draws comfort from AIL's diversified funding sources including Indian and foreign banks and capital markets.

Limited Forex Risks: The company follows a structured hedging policy, which covers a major portion of the open positions (net of natural hedge) through forwards/derivative contracts. AIL reported a net forex gain of INR0.49 billion in FY23 (FY22: INR0.12 billion).

Standalone Performance: On a standalone basis, AIL generated revenue of INR65.7 billion in FY23 (FY22: INR54.09 billion excluding termination income) with EBITDA margins of 16.5% (20%), net debt/EBITDA of 2.46x (2.26x) and interest coverage of 6.47x (10.64x), which is in line with the consolidated profile.

Rating Sensitivities

Positives: A substantial improvement in the revenue and EBITDA led by a successful ramp-up of the enhanced production capacity and positive free cash flow generation, all on a sustained and consolidated basis, could lead to a positive rating action.

Negative: Lower-than-expected EBITDA generation and/or a higher-than-expected debt levels due to a higher capex/working capital/investment, leading to an increased likelihood of the consolidated net leverage exceeding 3x beyond FY25 would be negative for the ratings.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on AIL, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

Company Profile

AIL was incorporated in 1984 and was converted into a public limited company in 1992. After the demerger of pharma business, AIL operates only in the speciality chemicals segment.

FINANCIAL SUMMARY – CONSOLIDATED

Particulars	FY23	FY22
Revenue (INR billion)	65.65	54.08
EBITDA (INR billion)	10.88	9.55
Interest expenses (INR billion)	1.66	1.02
Interest coverage (x)	6.56	9.40
Net leverage (x)	2.48	2.20
Source: AIL, Ind-Ra Note: The audited financials of FY22 have been restated post demerger of pharma division		

Non-Cooperation with previous rating agency

Not applicable

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

APPLICABLE CRITERIA

Parent and Subsidiary Rating Linkage

Evaluating Corporate Governance

Short-Term Ratings Criteria for Non-Financial Corporates

Corporate Rating Methodology

The Rating Process

Rating History

Instrument Type	Rating Type	Rated Limits (million)	Current Ratings	Historical Rating/Outlook				
				22 September 2023	9 February 2023	10 February 2022	12February 2021	31 July 2020
Issuer Rating	Long-Term	-	-	WD	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable

Term loan	Long-term	INR6,315	IND AA/Stable	-	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable
Working capital facilities	Long-term	INR6,370	IND AA/Stable	-	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable
CP	Short-term	INR4,000	IND A1+	-	IND A1+	IND A1+	IND A1+	IND A1+

Bank wise Facilities Details

Click here to see the details

Complexity Level of Instruments

Instrument Type	Complexity Indicator
Term loan	Low
Fund-based working capital limits	Low
Non-fund-based working capital limits	Low
CP	Low

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

Contact

Primary Analyst
Harish Kalidas
Senior Analyst
India Ratings and Research Pvt Ltd
Wockhardt Towers, 4th Floor, West Wing, Bandra Kurla Complex, Bandra East,Mumbai - 400051
+91 22 40356124
For queries, please contact: infogrp@indiaratings.co.in

Secondary Analyst
Siddharth Rego
Senior Analyst
+91 22 40356115

Media Relation
Ameya Bodkhe
Marketing Manager
+91 22 40356121

About India Ratings and Research: India Ratings and Research (Ind-Ra) is committed to providing India's credit markets accurate, timely and prospective credit opinions. Built on a foundation of independent thinking, rigorous analytics, and an open and balanced approach towards credit research, Ind-Ra has grown rapidly during the past decade, gaining significant market presence in India's fixed income market.

Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

India Ratings is a 100% owned subsidiary of the Fitch Group.

For more information, visit www.indiaratings.co.in.

DISCLAIMER

All credit ratings assigned by india ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.indiaratings.co.in/rating-definitions. In addition, rating definitions and the terms of use of such ratings are available on the agency's public website www.indiaratings.co.in. Published ratings, criteria, and methodologies are available from this site at all times. India ratings' code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the code of conduct section of this site.