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Rating Rationale

March 06, 2018 | Mumbai

Fermenta Biotech Limited

Ratings revised to 'Watch with Developing Implications'

Rating Action

Total Bank Loan Facilities Rated	Rs.48 Crore
Long Term Rating	CRISIL BBB (Revised to 'Rating Watch with Developing Implications' from 'Rating Watch with Negative Implications')
Short Term Rating	CRISIL A3+ (Revised to 'Rating Watch with Developing Implications' from 'Rating Watch with Negative Implications')

1 crore = 10 million

Refer to annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL ratings on the bank facilities of Fermenta Biotech Limited (FBL) revised its rating watch to **'Rating Watch with Developing Implications'**, against the earlier 'Rating Watch with Negative Implications'.

The rating action factors in the significant improvement in the company's performance, particularly in the third quarter of fiscal 2018, which it is likely to sustain over the medium term. The rating action also factors in contracting of debt at favourable terms by FBL's parent, DIL Ltd (DIL), to acquire stake in FBL from an outgoing private equity (PE) investor, thereby improving debt-servicing ability and easing pressure on FBL to support parent's debt servicing. Any deterioration in FBL's credit risk profile upon merger with DIL will be modest, against earlier expectation.

Earlier, CRISIL had placed its rating on FBL on 'Watch with Negative Implications' based on the announcement by DIL that it is considering amalgamation of FBL with itself and has authorised a committee of its directors to come out with a recommendation on the same. This was, however, subject to successful execution of a share purchase agreement (SPA) with Evolve India Life Sciences Fund LLC, a PE investor, to acquire its 21.05% stake in FBL; DIL had planned to contract fresh debt of Rs 82.8 crore to fund the aforesaid acquisition. The negative watch reflected CRISIL's belief that the combined entity's credit risk profile was likely to be considerably weaker than FBL's existing credit risk profile, given the material increase in debt vis-à-vis FBL's borrowing and cash accrual expected over the medium term, at that point.

For the nine months ended December 2017, DIL's consolidated operating income (over 95% of this comes from FBL) grew by 69% year-on-year to Rs 206 crore. Operating margin also improved significantly to 28.7% from 7.6%. Furthermore, the SPA was executed at the end of December 2017 with the newly contracted debt structured in such a way that DIL's repayment obligation is minimal over the medium term. This enhances DIL's ability to service debt by itself and eventually that of the amalgamated entity in case the amalgamation takes place.

CRISIL will continue to engage with the management to understand further details in relation to the authorised committee's recommendation on the amalgamation proposal and improvement in operating performance. CRISIL will remove the ratings from watch and take a final rating action once it has clarity on these aspects.

The ratings continue to reflect FBL's leadership position in the small, but growing, vitamin D3 market, moderate operating efficiency, and adequate financial risk profile. These strengths are partially offset by exposure to intense competition in the active pharmaceutical ingredients (APIs) segment, and fluctuation in global vitamin D3 prices.

Analytical Approach

For arriving at the ratings, CRISIL has not combined the financials of FBL with its parent, DIL, as the two companies are engaged in different businesses. The companies also hitherto did not have any financial linkages. CRISIL will revisit its analytical approach as more clarity emerges on the proposed amalgamation of the two entities.

Key Rating Drivers & Detailed Description

Strengths

* **Leadership position in the niche and growing vitamin D3 market:** FBL is the only vitamin D3 manufacturer in India and one of the three globally - to obtain a Certificate of Suitability from EDQM (European Directorate for Quality of Medicines). It has long-term vitamin D3 supply agreements with domestic and international clients (mainly in Europe and the US).

* **Moderate operating efficiency:** Operating margin is healthy and return on capital employed moderate.

* **Adequate financial risk profile:** Networth was large at Rs 101 crore as on March 31, 2017, and has grown steadily over the years. Gearing was healthy at 0.39 time, while debt protection metrics were comfortable for fiscal 2017.

Weaknesses

* **High product concentration in revenue:** Around 88% of revenue is derived from vitamin D3 and Phenylamidol, which exposes the company to product obsolescence and erosion in prices of APIs.

* **Vulnerability to fluctuations in global vitamin D3 feed grade prices:** Vitamin D3 feed grade prices remain volatile due to intense competition from other global manufacturers. This segment is largely dominated by Chinese players who resort to price undercutting.

* **Exposure to intense competition:** Small capital requirement and low technical intensity, and easy access to process chemistry skills have led to the entry of several entrants. Cheaper imports of intermediates from China also exert pressure on pricing.

About the Company

Set up in 1986 as Fermenta Pharma Biodil Ltd as a subsidiary of DIL (holds 70.15% stake), FBL is a listed company and is promoted by Mr Krishna Datla. DIL derives income from investments and real estate. FBL has two manufacturing facilities, one each at Mandi (Himachal Pradesh; set up in 1987) and Dahej special economic zone (June 2011). The Mandi unit commenced commercial operations in 1988 and manufactures chemicals, bulk drugs, and enzymes. The company has two wholly owned subsidiaries, Fermenta Biotech (UK) Ltd and GI Biotech Ltd, which are currently non-operational.

Key Financial Indicators

Particulars	Unit	2017*	2016
Revenue	Rs. cr.	161	143
Profit After Tax (PAT)	Rs. cr.	10	12
PAT Margins	%	6.2	8.4
Adjusted debt/Adjusted networkth	Times	0.39	0.42
Adjusted interest coverage	Times	5.45	5.58

*Estimated

Any other information: Not applicable

Note on complexity levels of the rated instrument:

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Annexure - Details of Instrument(s)

ISIN	Name of Instrument	Date of Allotment	Coupon Rate (%)	Maturity Date	Issue Size (Rs cr.)	Rating Assigned with Outlook
NA	Cash Credit#	NA	NA	NA	17.0	CRISIL BBB/Watch Developing
NA	Cash Credit*	NA	NA	NA	5.0	CRISIL BBB/Watch Developing
NA	Letter of Guarantee	NA	NA	NA	0.25	CRISIL A3+/Watch Developing
NA	Letter of Credit	NA	NA	NA	5.0	CRISIL A3+/Watch Developing
NA	Long Term loan	NA	NA	31-Mar-2018	8.75	CRISIL BBB/Watch Developing
NA	Packing Credit in Foreign Currency@	NA	NA	NA	12.0	CRISIL A3+/Watch Developing

#Interchangeable with buyer's credit to the extent of Rs 15 crore

*Fully interchangeable with buyer's credit

@Fully interchangeable with post-shipment credit

Annexure - Rating History for last 3 Years

Instrument	Current			2018 (History)		2017		2016		2015		Start of 2015
	Type	Quantum	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Fund-based Bank Facilities	LT/ST	42.75	CRISIL BBB/Watch Developing/ CRISIL A3+/Watch Developing		No Rating Change	12-12-17	CRISIL BBB/Watch Negative/ CRISIL A3+/Watch Negative	01-12-16	CRISIL BBB/Positive/ CRISIL A3+		No Rating Change	CRISIL BBB/Stable/ CRISIL A3+
Non Fund-based Bank Facilities	LT/ST	5.25	CRISIL A3+/Watch Developing		No Rating Change	12-12-17	CRISIL A3+/Watch Negative		No Rating Change		No Rating Change	CRISIL A3+

Table reflects instances where rating is changed or freshly assigned. 'No Rating Change' implies that there was no rating change under the release.

Annexure - Details of various bank facilities

Current facilities			Previous facilities		
Facility	Amount (Rs.Crore)	Rating	Facility	Amount (Rs.Crore)	Rating
Cash Credit#	17	CRISIL BBB/Watch Developing	Cash Credit#	17	CRISIL BBB/Watch Negative
Letter Of Guarantee	.25	CRISIL A3+/Watch Developing	Letter Of Guarantee	.25	CRISIL A3+/Watch Negative
Letter of Credit	5	CRISIL A3+/Watch Developing	Letter of Credit	5	CRISIL A3+/Watch Negative
Long Term Loan	8.75	CRISIL BBB/Watch Developing	Long Term Loan	8.75	CRISIL BBB/Watch Negative
Packing Credit in Foreign Currency@	12	CRISIL A3+/Watch Developing	Packing Credit in Foreign Currency@	12	CRISIL A3+/Watch Negative
Cash Credit*	5	CRISIL BBB/Watch Developing	Cash Credit*	5	CRISIL BBB/Watch Negative
Total	48	--	Total	48	--

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Links to related criteria
CRISILs Approach to Financial Ratios
CRISILs Bank Loan Ratings - process, scale and default recognition
Rating criteria for manufacturing and service sector companies
Rating Criteria for the Pharmaceutical Industry
CRISILs Bank Loan Ratings

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