SMS Lifesciences India Limited

March 02, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Ratings	Rating Action
Long Term Bank Facilities	19.25 (Reduced from 20.00)	CARE BBB+; Stable (Triple B Plus; Outlook: Stable)	Reaffirmed and removed from Credit watch with Developing Implications; Stable outlook assigned
Long Term / Short Term Bank Facilities	30.00	CARE BBB+; Stable / CARE A2 (Triple B Plus; Outlook: Stable/ A Two)	Reaffirmed and removed from Credit watch with Developing Implications; Stable outlook assigned
Short Term Bank Facilities	0.32	CARE A2 (A Two)	Reaffirmed and removed from Credit watch with Developing Implications
Long Term Bank Facilities@	-	-	Withdrawn
Total Bank Facilities	**49.57 (Rs. Forty-Nine Crore and Fifty-Seven Lakhs Only)**		

Details of instruments/facilities in Annexure-1

@ The rating of long-term bank facility i.e. term loan is being withdrawn as the same has been fully repaid based on confirmation from bank.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SMS Lifesciences India Limited (SMS Life) are reaffirmed with removal of credit watch with developing implications as there is no significant impact of the ban of ranitidine by United States Food and Drug Administration (USFDA) on the revenues of the company as it caters to mainly Rest of the World (RoW) markets and ranitidine still remains one of the top contributor to the revenue. Further, the company has also commenced production of various other new products thereby leading to reduction in revenue concentration from ranitidine. Furthermore, SMS Life continues to derive strength from experienced promoters and directors with a strong established track record in the pharmaceutical industry, well-equipped manufacturing facilities with regulatory approvals to cater to the semi-regulated and domestic market, established presence in anti-ulcer segment, diversified and reputed client base with stable flow of repeat business, improvement in profitability margins, continued comfortable capital structure, comfortable working capital cycle, synergy derived from its group company and stable industry outlook. The rating strengths are, however, tempered by decline in total operating income during FY20 (refers to the period April 1 to March 31), product concentration risk, presence in the highly fragmented and competitive bulk drug industry along with exposure to regulatory and foreign exchange fluctuation risk.

Rating Sensitivities

Positive Factors

- Diversification in its product portfolio, wherein no single product contributes over 20% of total gross sales.
- Improvement in profitability margins up to 12% on a sustained basis.

Negative Factors

- Overall gearing of the company going above 1.00x.
- Elongation of working capital cycle to more than 90 days on a continuous basis.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters and directors with a strong track record in the pharmaceutical industry

SMS Life, originally promoted by Mr. Hari Kishore Potluri, Ms. Potluri Hima Bindu and their family members as private limited company in the name of Potluri Real Estate Private Limited and subsequently changed its name to SMS Lifesciences India Private Limited in August 4, 2014. Post demerger, SMS Life is a separate entity operating independently in semi-regulated markets. The current promoters of SMS Life are Mr. P Ramesh Babu (Chairman and Managing Director of SMS Pharmaceuticals Limited) and Mr. TVVSN Murthy (Managing Director). Mr. P Ramesh Babu has over 30 years of experience in the pharmaceutical industry.

Synergy derived from SMS group

SMS Life is part of SMS group. The company was demerged on May 17, 2017 with effect from April 01, 2016. The semi-regulated units of SMS Pharma were transferred to SMS Life along with its assets and liabilities. SMS Life derives benefit as being part of the SMS group. SMS Pharma promoters have experience of around 3 decades and are involved in day-to-day affairs of the company. SMS Life is able to cater to clients which have long term relation with SMS group resulting strong customer base for SMS Life.

Manufacturing facility with various regulatory certifications for domestic and semi-regulated markets

SMS Life has three manufacturing units namely, Unit I – (Kazipally unit), Unit II – (Jeedimetla unit) and Unit III – (Bollaram unit) in Hyderabad and one R&D facility. During FY17, SMS Life completed Korean Food and Drug Administration (KFDA) audit for Unit-I. Further, the Company has successfully completed USFDA audit during April, 2018 and received EIR report against Kazipally Facility (Unit I). All three units also meet World Health Organization (WHO) cGMP standards. Apart from that, the company's subsidiary i.e. Mahi Drugs Private Limited has one manufacturing facility located in J. N. Pharma City, Parawada, Visakhapatnam. Furthermore, the R&D facility of the company has received recognition from Department of Scientific and Industrial Research (DSIR) in January 2021.

Established presence in Anti–ulcer (GAS) therapeutic segment albeit high product concentration

SMS Life, at standalone level, has a portfolio of more than 12 APIs with an established presence in GAS segment followed by Anti-erectile dysfunction (EDF) therapeutic segment. Ranitidine Hcl (Anti –ulcer (GAS) therapeutic segment) is the main product of the portfolio with 33.57% of contribution to gross sales in FY20 resulting in single product concentration risk. Though, the company faces product concentration risk with respect to Ranitidine Hcl, SMS Life is one of the single largest manufacturers of Ranitidine and therefore enjoys a good market share with respect to the same. Apart from this, the concentration of revenue from Ranitidine is steadily going down on account of new products introduced by the company.

Diversified and reputed client base with stable flow of repeat business

The company, on standalone basis, has diversified revenue with top 5 clients contributing 39% (45.60% in FY19) of the gross sales in FY20 reducing risk of revenue stream from single client. These clients have long standing relation with an average age of 18 years of association with the group. Top five clients of the company during FY20 were, Mylan Laboratories Limited, Orchev Pharma Pvt. Ltd., Unique Pharmaceuticals Laboratories Limited, Ravico Pharmaceuticals, Sun Pharmaceutical Industries Limited and which are globally well renowned innovator in pharma and research.

Continued comfortable capital structure and satisfactory debt coverage albeit weak return ratio

SMS Life (consol.) continues to have comfortable capital structure, although deteriorated, with debt to equity and overall gearing below unity at 0.44x and 0.66x as on March 31, 2020 (0.38x and 0.62x as on March 31, 2019 respectively) owing to increase in term loan and working capital borrowing during the year. Further, the PBILDT interest coverage and Total debt/GCA both deteriorated during the year on account of higher debt level and lower profits. Apart from this, the ROCE of the company also deteriorated during FY20 on account of lower profit generated during the year as a result of decline in revenue from ranitidine which one of the major revenue generating product for the company.

Comfortable working capital cycle of the company

The operating cycle of the company, at consol. level, deteriorated from 25 days in FY19 to 41 days in FY20 mainly due to elongation of average inventory period and creditor period. SMS Life operates in a working capital-intensive industry marked by high inventory level and the company has to maintain stock of raw materials on account of lead time associated with imports and fluctuation in prices of raw material. The company generally extends 30 to 45 days credit period to its customers. The company's average working capital utilization (standalone) remained moderate at around 58.29% for the 12 months period ended December 2020.

Stable industry outlook

The operations of pharma industry being considered necessarily came under the ambit of essential manufacturing during the lockdown induced by Covid-19. This had kept production activities at many pharma companies largely unaffected. Also easing of restrictions in different phases of lockdown is believed to have supported the operations of pharma companies. During this period, while the domestic market for antibiotics, cold and cough gained traction. Inbound logistics constraints restricted the movement in exports to an extent during lockdown.

With relief in various restrictions, the industry is expected to see pent up demand for treatments that were postponed which will support the demand for drugs. Moreover, the demand for medicines will increase during the monsoon season as the distributors and retailers normally stock drugs for the season. These parameters will augur well for pharma industry. In addition to this, the industry will continue to see demand from the domestic as well as international markets for some of the antivirals, anti-malarial and antibiotics given the spread of Covid-19.

Prospects:

The prospect in medium to long term period will depend upon the ability of the company to increase the scale of operations by diversifying the product and client profile along with an improvement in profitability in a highly competitive scenario while managing its raw material prices.

Key Rating Weaknesses

Decline in total operating income albeit improvement in profitability margins during FY20

The total operating income (TOI) of SMS Life, at consolidated level, declined by 31% from Rs.380.03 crore during FY19 to Rs.262.34 crore during FY20. The main reason for decline in revenue is due to regulatory guidance on NDMA impurity in Ranitidine HCL (which is one of the key products of SMS life with revenue concentration of 33% during FY20) and subsequent decrease in off take of Ranitidine HCL. Furthermore, out of the revenue earned at consolidated level during FY20, Mahi Drugs Private Limited (MDPL) constitute to around 1.5%. However, the PBILDT margin (consol.) has improved by 55 bps from 9.74% in FY19 to 10.29% in FY20 on account of better margins earned from new products launched during the year. Conversely, the PAT margin (Consol.), declined by 82 bps from 4.70% during FY19 to 3.88% during FY20 on account of lower absorption of depreciation and interest charges.

During 9MFY21, the company (consol.) has earned a revenue of Rs.183.83 crore and contributes to around 71.23% of the projected revenue. Further, the PBILDT margin of the stood at 12.11% and PAT margin at 4.62%.

Impact of Ranitidine issue on financial performance and the current status

During September 2019, USFDA issued a statement stating that some ranitidine medicines contain a nitrosamine impurity called N-nitrosodimethylamine (NDMA) at low levels. NDMA is classified as a probable human carcinogen (a substance that could cause cancer) based on results from laboratory tests. Post to the press release, the company reduced the production and held back any finished stock of Ranitidine available with them. Subsequently, SMS Life stated that as per the third-party lab test carried out on the API manufactured by them that the NDMA levels are 0.018 ppm, which is well within the permissible limits stipulated by regulatory bodies such as USFDA. However, on April 01, 2020, the USFDA again vide its press release announced that it is requesting manufacturers to withdraw all prescription and over the counter (OTC) ranitidine drugs from the market immediately. Subsequently, major regulatory authorities from various countries have started reviewing the information and have put the procurement on hold whereas few countries in RoW market continued to procure Ranitidine. Further, the company is currently manufacturing Ranitidine and in future, the company is anticipating approval from various MOHs in the world. Going forward it is expected that the gradual reduction in revenue contribution from Ranitidine would be substituted by the revenue from other products.

Highly fragmented and competitive bulk drug industry

Indian pharmaceutical industry is highly fragmented with presence of more than thousands of players in APIs and formulations. It manufactures about 60,000 generic brands across 60 different therapeutic categories, about 1,500 bulk drugs and almost the entire range of formulations. The industry is highly fragmented with around 20,000 players, of which, around 250 in the organized sector primarily in formulations control over 70% of the total domestic market.

Exposure to regulatory and foreign exchange fluctuation risk

The company is exposed to regulatory risk with its operations centered majorly into manufacturing pharmaceutical APIs. The pharmaceutical industry is highly regulated in many other countries and requires various approvals, licenses, registrations and permissions for business activities. The approval process for a new product registration is complex, lengthy and expensive. The time taken to obtain approval varies by country but generally takes from six months to several years from the date of application. Any delay or failure in getting approval for new product launch could adversely affect the business prospect of the company. Non-compliance may result in regulatory ban on products/facilities and may impact a company's future approvals from USFDA. Hence, ongoing regulatory compliance has become critical for Indian pharma companies however, for SMS Life risk pertaining to regulatory compliance of USFDA is limited as the company's major share of revenue is from semi regulated markets.

SMS Life is exposed to foreign exchange fluctuation risk in view of large volume and high value transactions of export and import, a phenomenon common to the players in the industry. However, for SMS Life, the risk gets mitigated to certain extent due to natural hedging through netting off the imports of raw materials majorly from China to the extent of Rs.47 crore and exports to different countries to the extent of Rs.89.33 crore.

Liquidity: Adequate

The liquidity position of the company, at consolidated level, remain adequate marked by the current ratio of 1.16x as on March 31, 2020. The company (consol.) has generated GCA of Rs.18.83 crore during FY20 and Rs.14.39 crore during 9MFY20. Further, the company has projected routine capex of about Rs.3.52 crores to be carried out during FY21 which will be entirely funded through internal accruals. The company, at consol. Level, has term debt obligation of Rs.5.88 crore during FY21 out of which the company has already paid Rs.4.22 crore till December 31, 2020. Considering the generated gross cash accruals and cash balance during 9MFY21, the company is expected to repay the balance term debt obligation of Rs.1.66 crore for FY21 comfortably.

Analytical approach: Consolidated; the consolidated business and financial risk profiles of SMS Life and its subsidiaries namely Mahi Drugs Private Limited has been considered as this company is a subsidiary of SMS Life which operate in the same line of business and have financial and operational linkages. Further SMS Life has extended corporate guarantee to Mahi Drugs Pvt Ltd.

Applicable criteria

Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition

[Criteria for Short term Instruments](#)
[Rating Methodology - Consolidation](#)
[Rating Methodology – Manufacturing Companies](#)
[Rating Methodology – Pharmaceutical](#)
[Financial ratios – Non-Financial Sector](#)
[Liquidity Analysis – Non-Financial Sector](#)

About the company
SMS Lifesciences India Limited (SMS Life) was originally incorporated in May 2006 by Mr Hari Kishore Potluri, Ms Potluri Hima Bindu and their family members as private limited company in the name of Potluri Real Estate Private Limited and subsequently changed its name to Potluri Packaging Industries Private Limited on November 6, 2013. Thereafter, the company has changed its name to SMS Lifesciences India Limited in August 4, 2014. SMS Life was a Wholly-Owned Subsidiary (WOS) of SMS Pharmaceuticals Limited (SMS) till May 17, 2017. Pursuant to the scheme of Arrangement approved by National Company Law Tribunal (NCLT), SMS is the Demerged Company and SMS Life is the Resulting Company vide order dated May 15, 2017. The scheme became effective from May 17, 2017. With view to reduce the impact of semi-regulated units on regulated units, SMS has demerged its semi-regulated units under Food and Drug administration (FDA) (i.e., Unit I-Kazipally unit (erstwhile unit I of SMS) Unit II-Jeedimetla unit (erstwhile unit IV of SMS) and Unit III-Bollaram unit (erstwhile unit V of SMS) and one R&D facility along with other assets, liabilities and investments and transferred to SMS Life. The company primarily caters to semi-regulated markets across India, Europe, Asia and has product base of more than 12 products under various therapeutic segments.

Brief Financials (Consolidated) (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	380.03	262.34
PBILDT	37.02	26.99
PAT	17.85	10.18
Overall gearing (times)	0.62	0.66
Interest coverage (times)	6.72	5.25

A: Audited
Status of non-cooperation with previous CRA: NA
Any other information: NA
Rating History for last three years: Please refer Annexure-2
Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3*
Complexity level of various instruments rated for this company: Annexure 4

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	-	0.00	Withdrawn
Non-fund-based - ST-BG/LC	-	-	-	0.32	CARE A2
Fund-based - LT/ ST-Packing Credit in Foreign Currency	-	-	-	30.00	CARE BBB+; Stable / CARE A2
Fund-based - LT-Term Loan	-	-	May 2026	19.25	CARE BBB+; Stable

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Term Loan	LT	-	-	1)CARE BBB+ (CWD) (20-Apr-20)	1)CARE BBB+; Stable (11-Feb-20) 2)CARE BBB+ (CWD) (07-Oct-19)	1)CARE BBB+; Stable (31-Oct-18) 2)CARE BBB+; Stable (03-Oct-18)	1)CARE BBB+; Stable (18-Sep-17)
2.	Non-fund-based - ST-BG/LC	ST	0.32	CARE A2	1)CARE A2 (CWD) (20-Apr-20)	1)CARE A2 (11-Feb-20) 2)CARE A2 (CWD) (07-Oct-19)	1)CARE A2 (31-Oct-18) 2)CARE A2 (03-Oct-18)	1)CARE A2 (18-Sep-17)
3.	Fund-based - LT/ ST-Packing Credit in Foreign Currency	LT/ST	30.00	CARE BBB+; Stable / CARE A2	1)CARE BBB+ / CARE A2 (CWD) (20-Apr-20)	1)CARE BBB+; Stable / CARE A2 (11-Feb-20) 2)CARE BBB+ / CARE A2 (CWD) (07-Oct-19)	1)CARE BBB+; Stable / CARE A2 (31-Oct-18) 2)CARE BBB+; Stable / CARE A2 (03-Oct-18)	1)CARE BBB+; Stable / CARE A2 (18-Sep-17)
4.	Fund-based - LT-Term Loan	LT	19.25	CARE BBB+; Stable	1)CARE BBB+ (CWD) (20-Apr-20)	1)CARE BBB+; Stable (11-Feb-20) 2)CARE BBB+ (CWD) (07-Oct-19)	1)CARE BBB+; Stable (31-Oct-18) 2)CARE BBB+; Stable (03-Oct-18)	-
5.	Non-fund-based - LT/ ST-Loan Equivalent Risk	LT/ST	-	-	-	1)Withdrawn (11-Feb-20) 2)CARE BBB+ / CARE A2 (CWD) (07-Oct-19)	1)CARE BBB+; Stable / CARE A2 (31-Oct-18) 2)CARE BBB+; Stable / CARE A2 (03-Oct-18)	-

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities – NA

Annexure 4: Complexity level of various instruments rated for this Company

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Term Loan	Simple
2.	Fund-based - LT/ ST-Packing Credit in Foreign Currency	Simple
3.	Non-fund-based - ST-BG/LC	Simple

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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