SMS Pharmaceuticals Limited
September 03, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Ratings	Rating Action
Long Term Bank Facilities	253.80	CARE A; Stable (Single A; Outlook: Stable)	Revised from CARE A-; Stable (Single A Minus; Outlook: Stable)
Short Term Bank Facilities	50.83	CARE A2+ (A Two Plus)	Revised from CARE A2 (A Two)
Total Bank Facilities	**304.63 (Rs. Three Hundred Four Crore and Sixty-Three Lakhs Only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of SMS Pharmaceuticals Limited (SMS) is on account of significant improvement in total operating income (TOI) and operating profits in FY21 (refers to the period April 01 to March 31), successful completion of capex and commencement of commercial production of Ibuprofen. The ratings continue to remain underpinned by, experienced promoters with established track record of operations, integrated manufacturing facility, presence of major regulatory approvals, comfortable coverage and leverage metrics, healthy profitability margins, satisfactory order book from reputed clientele and favourable industry growth prospects. The rating strengths are however partially offset by, elongated operating cycle, relatively moderate scale of operation albeit improving, high product and client concentration, risk on account of exposure towards associate company, presence in highly regulated pharma industry and susceptible to foreign exchange fluctuation risk.

Key Rating Sensitivities

<u>Positive Sensitivities- Factors that could lead to positive rating action/upgrade:</u>

- ✓ Notable improvement in TOI by more than 30% y-o-y while maintaining PBILDT margins at 20% or above, on a sustained basis.
- ✓ Improvement in TDGCA and total debt to PBILT to below unity.
- ✓ Operating cycle shortening to less than three months without stretching creditors days, on a consistent basis.
- ✓ Diversification in its customer base, wherein no single customer contributes over 25% of total gross sales.

<u>Negative Sensitivities- Factors that could lead to negative rating action/downgrade:</u>

- × Any un-envisaged debt funded capex/additional debt availed by the company resulting in deterioration of solvency ratios
- × Significant decline in total operating income or operating profits by more than 20% y-o-y.

Detailed description of the key rating drivers

Key Rating Strengths

Improved scale of operations and profitability during FY21

The total operating income of the company increased from Rs. 414.46 crore in FY20 to Rs. 564.06 crore in FY21 registering a y-o-y growth of 36.10% on account of increase in export sales from 23% to 56% coupled with increase in revenue from COVID products like Remdesivir. Apart from this, the sales volume of the product Tenofovir (contract manufacturing to Mylan) and Famotidine (Anti-ulcer and an alternative to Ranitidine HCL) also improved steadily. Furthermore, the PBILDT margins strengthened from 19.90% in FY20 to 21.62% in FY21 on account of increase in revenue from better margin products and change in product mix. The company is under process of developing more than ten products catering to therapeutic segment namely Antidiabetic, lowering of cholesterol, Stroke, anti inflammatory, Pulmonary arterial hypertension and Gastrointestinal.

Successful completion of capex

The company has successfully completed the augmentation project at existing facility Unit VII which is situated in Kandivasala, Andhra Pradesh for manufacturing of Ibuprofen. The total project cost was Rs.185 crore which was funded through debt of Rs.140 crore (75% debt funded) and remaining Rs.45 crore through internal accruals. The company has completed the project without any cost or time overrun. The commercial operations commenced from March 2021. Company is expecting incremental revenue from the project during the current financial year and subsequent financial years.

Rich experience of promoters and accredited manufacturing facilities

SMS has been promoted by Mr. P Ramesh Babu (Chairman and Managing Director). The current promoters have over 30 years of experience in the pharmaceutical industry. Under the present management, SMS has two manufacturing facilities (unit II and VII) and 1 R&D centre. The day-to-day affairs of the company are looked after by the promoters. They are assisted by a team of experienced professionals. Further during FY20, the company has completed the EDQM audit during January 2020 and received EUGMP certificate for Tadalafil unit. The company also completed USFDA inspection and received EIR for Unit VII and R&D facility in January 2020 and WHO GMP (CDSCO – Govt. of Andhra Pradesh) in November 2019.

Comfortable leverage and coverage indicators

In view of recently completed capex, the debt levels as on March 31, 2021 increased vis-à-vis previous year. The capital structure however continues to remain satisfactory marked by debt equity and overall gearing ratio at 0.44x and 0.61x respectively as on March 31, 2021 backed by accretion of profits to TNW. The coverage ratio represented by PBILDT interest coverage improved from 6.75x in FY20 to 10.93x in FY21 mainly on account of stronger PBILDT levels. TDGCA also remained satisfactory at 2.61x.

Satisfactory order book position with reputed client base

The company has an outstanding order book of Rs. 307.95 crore as on June 30, 2021 with about 60% orders towards contract manufacturing and remaining 40% through domestic and export sales. The order book is from the reputed customers like Dr. Reddy's Laboratories, Cipla Limited (CARE A1+) Ajanta Pharma Limited (CARE AA; Stable; CARE A1+) , Aurbindo Pharma Limited , Lara Drugs Private Limited and Alkem Laboratories Limited (CARE AA+; Stable/ CARE A1+) among others.

Favourable Industry Outlook

With market size of around USD 45 billion in FY21, Indian pharmaceutical industry globally ranks third in terms of volume and thirteenth in terms of value. The reason for higher rank in terms of volume while lower rank in terms of value is primarily attributed to the predominance of Indian pharma market in the generic segment. The industry has exhibited compound annual growth rate (CAGR) of about 7.2% during FY17-FY21 and registered a growth of about 12% during FY21. However, with the change in dynamics, CARE Ratings expects the industry to grow at about 11% in next two years and reach a size of over USD 60 bn.

The main factors that are expected to drive the growth of industry are (a) ability to leverage the opportunity available for Indian pharma companies due to expiry of the patent drugs across the globe, (b) ebbing of regulatory risks, (c) adoption of various strategies to de-risk from dependency on China for key raw materials, (d) increasing trend in PE investments, and (e) solid fundamentals of the industry. Exploiting these opportunities, CARE Ratings expects the credit risk profiles of its rated entities to remain stable to positive during FY22 and FY23

Key Rating Weaknesses

Client and product concentration risk

SMS is exposed to client and product concentration risk with a single client contributing to more than 35% and top two products contributing nearly 55% of the company's TOI in FY21. However, the product mix normally changes y-o-y depending upon demand. Also, company has been adding new products on regular basis. The revenue concentration from single product has been reduced over the

past. Also, the company's key product ARV is supplied to Mylan, for which SMS has been receiving regular orders.

Extension of support to associate company

SMS has extended Letter of Comfort (LOC) to one of its associate companies VKT Pharma Private Limited (VKT) towards meeting VKT's debt obligations. VKT is engaged in manufacturing of formulations & semi-finished formulations viz. pellets. VKT had been incurring losses until FY20, however during FY21, VKT has started generating sufficient cashflows to meet its own debt obligations and support from SMS is may not be required. Nevertheless, SMS continues to have a moral obligation towards timely servicing debt availed by VTK.

Exposure to regulatory and foreign exchange fluctuation risk

The company is exposed to regulatory risk as 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. Apart from above the ability of the company to continue to observe the regulatory and CGMP standards without receiving any critical observations from regulatory authorities are viewed critically from business and credit risk point of view.

Also, SMS is exposed to foreign exchange fluctuation risk in view of large volume and high value transactions of exports. Though imports are relatively lower as compared to exports, a phenomenon common to the players in the industry, there is natural hedging that SMS enjoys to some extent. The company earned foreign exchange gain of Rs.0.57 crore in FY21 (Rs. 1.80 crore in FY20).

Liquidity: Adequate
The liquidity position of the company is adequate marked by healthy gross cash accruals of Rs. 97.36 crore during FY21 as against term debt obligation of around Rs.31 crore. This apart, the company has free cash and bank balance of Rs.40.42 crore as on March 31, 2021. Furthermore, the company sparingly utilizes its working capital limits and average utilization remained low at 48% during the last 12 month ended June 30, 2021. The future capex requirement is modular and will be funded through internal accruals, no further term debt is envisaged.

Analytical approach: Standalone
Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
Rating Methodology – Pharmaceutical
Criteria for Short term Instruments
Rating Methodology – Manufacturing Companies
Financial ratios – Non-Financial Sector
Liquidity Analysis – Non-Financial Sector
CARE's Policy on Default Recognition

About the Company
SMS Pharmaceuticals Limited (SMS), listed on BSE and NSE, is promoted by Mr. Ramesh Babu Potluri (Chairman and Managing Director). SMS is engaged in manufacturing of Active Pharmaceutical Ingredients (APIs) and its intermediates and undertakes contract manufacturing for API/ bulk drugs. Currently, SMS has two regulated facilities (Unit II and Unit VII) located in Telangana and Andhra Pradesh. The company supplies to pharmaceutical companies across North America, Europe and has presence in over 70 countries across the globe.

Brief Financials (Rs. crore)	FY20 (A)	FY21(A)
Total operating income	414.46	564.06
PBILDT	82.48	122.00
PAT	32.69	60.96
Overall gearing (times)	0.44	0.60
Interest coverage (times)	6.75	10.93

A: Audited
During Q1FY22, the company earned a TOI of Rs.164.28 crore and a PAT of Rs.23.20 crore as against a TOI of Rs.113.71 crore and PAT of Rs. 9.20 crore reported during Q1FY21.
Status of non-cooperation with previous CRA: Not Applicable
Any other information: Not Applicable
Rating History for last three years: Please refer Annexure-2

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-Cash Credit	-	-	-	66.00	CARE A; Stable
Non-fund-based - ST-Letter of credit	-	-	-	30.00	CARE A2+
Fund-based - LT-Term Loan	-	-	March 2027	172.80	CARE A; Stable
Fund-based - ST-Line of Credit	-	-	-	16.00	CARE A2+
Fund-based - LT-Packing Credit in Foregin Currency	-	-	-	15.00	CARE A; Stable
Non-fund-based - ST-Bank Guarantees	-	-	-	2.00	CARE A2+
Non-fund-based - ST-Forward Contract	-	-	-	2.83	CARE A2+

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 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Fund-based - LT-Cash Credit	LT	66.00	CARE A; Stable	-	1)CARE A-; Stable (30-Dec-20)	1)CARE A-; Stable (22-Nov-19)	1)CARE A-; Stable (04-Oct-18)
2.	Non-fund-based - ST-Letter of credit	ST	30.00	CARE A2+	-	1)CARE A2 (30-Dec-20)	1)CARE A2 (22-Nov-19)	1)CARE A2 (04-Oct-18)
3.	Fund-based - LT-Term Loan	LT	172.80	CARE A; Stable	-	1)CARE A-; Stable (30-Dec-20)	1)CARE A-; Stable (22-Nov-19)	1)CARE A-; Stable (04-Oct-18)
4.	Fund-based - ST-Line of Credit	ST	16.00	CARE A2+	-	1)CARE A2 (30-Dec-20)	1)CARE A2 (22-Nov-19)	1)CARE A2 (04-Oct-18)
5.	Fund-based - LT-Packing Credit in Foregin Currency	LT	15.00	CARE A; Stable	-	1)CARE A-; Stable (30-Dec-20)	1)CARE A-; Stable (22-Nov-19)	1)CARE A-; Stable (04-Oct-18)
6.	Non-fund-based - ST-Bank Guarantees	ST	2.00	CARE A2+	-	1)CARE A2 (30-Dec-20)	1)CARE A2 (22-Nov-19)	1)CARE A2 (04-Oct-18)
7.	Non-fund-based - ST-Forward Contract	ST	2.83	CARE A2+	-	1)CARE A2 (30-Dec-20)	1)CARE A2 (22-Nov-19)	1)CARE A2 (04-Oct-18)

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities: Not Applicable

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

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Cash Credit	Simple
2.	Fund-based - LT-Packing Credit in Foregin Currency	Simple
3.	Fund-based - LT-Term Loan	Simple
4.	Fund-based - ST-Line of Credit	Simple
5.	Non-fund-based - ST-Bank Guarantees	Simple
6.	Non-fund-based - ST-Forward Contract	Simple
7.	Non-fund-based - ST-Letter of credit	Simple

Annexure 5: Bank Lender Details

Click here to view Bank Lender Details

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

Contact us

Media Contact
Mradul Mishra
Contact no. – +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact
Group Head Name – Ms. Nivedita Ghayal
Group Head Contact no.: +91-40-67937110
Group Head Email ID: nivedita.ghayal@careratings.com

Relationship Contact
Name: Mr. Ramesh Bob
Contact no.: +91 - 9052000521
Email ID: ramesh.bob@careratings.com

About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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