

SMS Pharmaceuticals Limited

November 03, 2022

Ratings

Facilities/Instruments	Amount (₹ crore)	Rating ¹	Rating Action
Long Term Bank Facilities	312.27 (Enhanced from 253.80)	CARE A; Negative (Single A; Outlook: Negative)	Reaffirmed
Short Term Bank Facilities	57.33 (Enhanced from 50.83)	CARE A2+ (A Two Plus)	Reaffirmed
Total Bank Facilities	369.60 (₹ Three Hundred Sixty-Nine Crore and Sixty Lakhs Only)		

Details of instruments/facilities in Annexure-1.

Detailed Rationale & Key Rating Drivers

The rating assigned to the enhanced bank facilities of SMS Pharmaceutical Limited (SMS) continues to derive strength from proven track record and experienced management, satisfactory financial risk profile, integrated and accredited manufacturing facility, satisfactory order book from reputed clientele and stable industry outlook. The rating strengths are however partially offset by elongation in inventory holding period, therapeutic and product concentration risk, exposure to competition and regulatory risk. The ratings also take cognizance of successful commissioning of ibuprofen production and sales and healthy revenue generation expected from the same.

Rating Sensitivities

Positive Factors - Factors that could lead to positive rating action/upgrade:

- ✓ TOI increasing to above Rs 800 crore while maintaining a PBILDT margin of above 20% and ROCE of around 18% on a sustained basis.
- ✓ Overall gearing falling below 0.5x, going forward.

Negative Factors- Factors that could lead to negative rating action/downgrade:

- ✗ Overall gearing level going beyond 1x, in future.
- ✗ Elongation of the operating cycle beyond 180 days
- ✗ Notable decline in TOI and PBILDT margin falling below 15%

Outlook: Negative

Negative outlook on the rating is on account of moderation in financial performance of the company during Q4FY22 and Q1FY23 due to no major revenue from contract manufacturing in view of delay in bidding process at global level. The outlook may be revised to stable if there is an improvement in overall performance of the company in the upcoming quarters.

Detailed description of the key rating drivers

Key Rating Strengths

Stable financial performance in FY22 albeit moderated in Q1FY23

The total operating income (TOI) of the company remained stable at Rs. 522 crore in FY22 (PY: Rs 563 crore). TOI remained muted on account of reduction in offtake of Anti-Retroviral drugs during Q4FY22 due to delay in bidding process across the Globe. Apart from the Anti-retroviral products, the volumes in certain other APIs were low due to excess channel inventories at customer end. The revenues in Q1FY23 also remained moderate because of the aforementioned and due to lower absorption of overheads company incurred losses at net level. The impact of discontinuation of CMO from Mylan was reflected mainly in Q4FY22 and Q1FY23. The revenue was significantly lower in these quarters as compared to previous quarters. The company however has replaced the CMO revenue with other products like Ibuprofen, Sitagliptin among others.

¹Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

FY21 was relatively high because of revenue from Famotidine which was a replacement of Ranitidine. During FY22, some of the countries lifted the import alter after taking the necessary information from the manufacturers which resultantly impacted the sale of Famotidine, and it slowed down.

Nevertheless, the profitability margins of the company remained satisfactory in FY22 with marginal improvement marked by PBILDT and PAT margin of 22.41% and 13.02% (PY:21.58% and 10.81%) on account of increase in direct sales contribution and improvement in process development.

Proven track record and Experienced Management

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.

The company has received approvals for Ranitidine Hydrochloride – Health Canada (MF 2019-138), Ibuprofen CEP – EDQM (CEP 2020-414 & CEP 2021-056) and Lamotrigine CEP-EDQM among others.

Integrated and accredited manufacturing facility

SMS has presence in over 70 countries across the globe. The company is focusing on strengthening its presence in the regulatory markets. Export sales include deemed exports and export incentives which constituted around 72% of gross sales revenue during FY22 as against 70% of gross sales revenue during FY21. Majority of the company's revenues are derived from exports to regulatory markets. For a pharmaceutical company, to enter the regulatory markets of US and Europe, its manufacturing unit must meet certain regulatory standards like USFDA, cGMP, EDQM etc. The last audit was conducted for Unit VII and II was 2020 and 2017 respectively and there were no observations. SMS's Unit II has USFDA, Korean and European regulatory approvals; and Unit VII has USFDA certification. During FY22, the company has completed remote regulatory assessment by USFDA for the testing facility. SMS (Central Laboratory Analytical Services) received Remote Assessment Report. As a result of this remote assessment, USFDA does not plan to take or recommend regulatory or enforcement action at this time.

Satisfactory financial risk profile

The capital structure of the company continues to remain satisfactory marked by overall gearing ratio below unity at 0.55x as on March 31, 2022. The coverage indicators remained comfortable marked by total debt/GCA at 3.17x in FY22 (2.69x in FY21). In FY22 company availed GECL loans of Rs. 45 crore. Due to aforementioned reason, interest cost increased and the PBILDT interest coverage ratio moderated to 6.20x in FY22(PY:10.90x).

Stable industry outlook

With a market size of around USD 47-49 billion in FY22 (April 1 to March 31), the Indian pharmaceutical industry globally ranks third in terms of volume and thirteenth in terms of value. The industry has exhibited compounded annual growth rate (CAGR) of 8-9% during last five years i.e. FY17-FY22 while registering a y-o-y growth of 5-7% in FY22, largely driven by higher domestic consumption, even as the exports value was stable at USD 24.60 billion in FY22. The United States of America (US) continued to be the prime export destination for the industry, constituting nearly 34% of total exports during FY22, which registered a growth of 2% in USD terms while export to the Rest of the World (ROW) witnessed a decline of 7%. Based on industry aggregates that represent over 85% of the overall pharma market, the operating profitability has remained stable at about 23% during the last 4 years (FY21 being the exception). However, with various factors affecting the Indian pharma entities, CareEdge expects operating profitability to taper by 200-250 bps in FY23.

Key Rating Weakness

Elongated operating cycle

The operating cycle of the company stretched to 164 days in FY22 as against 111 days in FY21. The inventory holding period increased from 110 days in FY21 to 175 days in FY22 as company had invested on some of the COVID related drugs like

Molnupiravir and HCQ and company had received license from Merck and Pfizer for manufacturing of the same. Anticipating launch of these products, significant inventory levels were built up during FY22. Out of the total inventory outstanding as on Mar 31, 2022 around 20% pertains to COVID related stock .

Furthermore, Sitagliptin product was off patented in Europe during the first week of July 22 which is SMS JV Product, its JV Partner viz. M/s, Chemo has indicated volumes and the company had to build the inventory in various stages to capture the product volumes once patent expires. Apart from the above SMS has commercialised Ibuprofen and penetrated the product in domestic market for which the company has built inventory in various stages.

Moderately concentrated customer base and product portfolio

The company has diversified its customer base over the period where top five customers contribute 53% in FY22 whereas 79% in FY19. The company generates 36% of revenue from Mylan followed by Cipla Limited and among others. Despite company's efforts to diversify its customer base, the single largest customer contributes more than 35% of its revenue in FY22. SMS derives 63% of revenue from top five products with single product contributing more than 35% revenue in FY22. Nevertheless, the company able to diversify its revenue concentration by adding new products and depending on the off take from customers as per demand in the market and the same is evident over the period i.e, revenue from top two products is 44% in FY22 as against 55% in FY21

Exposure to competition and regulatory risk

The company is exposed to the regulatory risk, as the increasing regulation, increased sensitivity towards product performance, and pricing pressure are the key challenges faced by the pharmaceutical industry. Furthermore, the scale of operations of SMS remains moderate in a competitive industry, which may restrict its pricing flexibility to a certain extent. Also, the pharmaceutical industry is highly regulated, with regulations in place for drug quality, manufacturing process, patents and prices of products. The approval process for new product registration is complex, lengthy, and expensive. Non-compliance may result in a regulatory ban on products or facilities and may impact a company's further growth. Hence, the ongoing regulatory compliance has become critical for Indian pharmaceutical companies.

Extended support to group entity

SMS has extended Letter of Comfort (LOC) to one of its associate companies VKT Pharma Private Limited (VKT) towards monitoring VKT's debt obligation. VKT is engaged in manufacturing of formulations & semi-finished formulations viz. pellets. VKT has incurred losses during FY22 although the losses were supported by the promoters. Going forward, VKT is expected to generate sufficient accruals to meet its own debt obligations and support from SMS is might not be required. Nevertheless, SMS continues to have a moral obligation towards timely servicing debt availed by VTK.

Liquidity: Adequate

SMS has been generating adequate cash accruals to meet its debt obligations. The company has sufficient liquidity in terms of un-utilised working capital lines and moderate cash and bank balance of Rs.46.58 crore in FY22. Average utilisation of working capital limits remained around 51% for the last 12 months ended July 2022. The company has recently completed capex related to Ibuprofen unit and does not have any major capex plans in near-medium future. Liquidity is further supported by above unity current ratio and positive cash flows from operating activities.

Analytical Approach: Standalone

Applicable Criteria

Policy on default recognition
 Financial Ratios – Non financial Sector
 Liquidity Analysis of Non-financial sector entities
 Rating Outlook and Credit Watch
 Short Term Instruments
 Manufacturing Companies
 Pharmaceutical

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 (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	Q1FY23(UA)
Total operating income	563.75	522.45	65.19
PBILDT	121.69	117.07	0.38
PAT	60.96	68.04	(9.81)
Overall gearing (times)	0.61	0.55	NA
Interest coverage (times)	10.90	6.20	0.08

*A-Audited; UA-Unaudited; NA-Not available

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Cash Credit		-	-	-	93.00	CARE A; Negative
Fund-based - LT-Packing Credit in Foreign Currency		-	-	-	15.00	CARE A; Negative
Fund-based - LT-Term Loan		-	-	March 2028	204.27	CARE A; Negative
Fund-based - ST-Standby Line of Credit		-	-	-	16.00	CARE A2+
Non-fund-based - ST-Bank Guarantee		-	-	-	2.00	CARE A2+
Non-fund-based - ST-Forward Contract		-	-	-	2.83	CARE A2+
Non-fund-based - ST-Letter of credit		-	-	-	36.50	CARE A2+

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding	Rating	Date(s) and	Date(s) and	Date(s) and	Date(s) and

			(₹ crore)		Rating(s) assigned in 2022-2023	Rating(s) assigned in 2021-2022	Rating(s) assigned in 2020-2021	Rating(s) assigned in 2019-2020
1	Fund-based - LT-Cash Credit	LT	93.00	CARE A; Negative	1)CARE A; Negative (03-Oct-22)	1)CARE A; Stable (03-Sep-21)	1)CARE A-; Stable (30-Dec-20)	1)CARE A-; Stable (22-Nov-19)
2	Non-fund-based - ST-Letter of credit	ST	36.50	CARE A2+	1)CARE A2+ (03-Oct-22)	1)CARE A2+ (03-Sep-21)	1)CARE A2 (30-Dec-20)	1)CARE A2 (22-Nov-19)
3	Fund-based - LT-Term Loan	LT	204.27	CARE A; Negative	1)CARE A; Negative (03-Oct-22)	1)CARE A; Stable (03-Sep-21)	1)CARE A-; Stable (30-Dec-20)	1)CARE A-; Stable (22-Nov-19)
4	Fund-based - ST-Standby Line of Credit	ST	16.00	CARE A2+	1)CARE A2+ (03-Oct-22)	1)CARE A2+ (03-Sep-21)	1)CARE A2 (30-Dec-20)	1)CARE A2 (22-Nov-19)
5	Fund-based - LT-Packing Credit in Foreign Currency	LT	15.00	CARE A; Negative	1)CARE A; Negative (03-Oct-22)	1)CARE A; Stable (03-Sep-21)	1)CARE A-; Stable (30-Dec-20)	1)CARE A-; Stable (22-Nov-19)
6	Non-fund-based - ST-Bank Guarantee	ST	2.00	CARE A2+	1)CARE A2+ (03-Oct-22)	1)CARE A2+ (03-Sep-21)	1)CARE A2 (30-Dec-20)	1)CARE A2 (22-Nov-19)
7	Non-fund-based - ST-Forward Contract	ST	2.83	CARE A2+	1)CARE A2+ (03-Oct-22)	1)CARE A2+ (03-Sep-21)	1)CARE A2 (30-Dec-20)	1)CARE A2 (22-Nov-19)

*Long term/Short term.

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

Annexure-4: Complexity level of various instruments rated for this company

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

Annexure-5: Bank lender details for this company

To view the lender wise details of bank facilities please [click here](#)

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

Contact us

Media contact

Name: Mradul Mishra

Phone: +91-22-6754 3596

E-mail: mradul.mishra@careedge.in

Analyst contact

Name: Nivedita Anirudh Ghayal

Phone: 9908090944

E-mail: nivedita.ghayal@careedge.in

Relationship contact

Name: Ramesh Bob Asineparthi

Phone: +91 90520 00521

E-mail: ramesh.bob@careedge.in

About us:

Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

Disclaimer:

The ratings issued by CARE Ratings are opinions on the likelihood of timely payment of the obligations under the rated instrument and are not recommendations to sanction, renew, disburse, or recall the concerned bank facilities or to buy, sell, or hold any security. These ratings do not convey suitability or price for the investor. The agency does not constitute an audit on the rated entity. CARE Ratings has based its ratings/outlook based on information obtained from reliable and credible sources. CARE Ratings does not, however, guarantee the accuracy, adequacy, or completeness of any information and is not responsible for any errors or omissions and the results obtained from the use of such information. Most entities whose bank facilities/instruments are rated by CARE Ratings have paid a credit rating fee, based on the amount and type of bank facilities/instruments. CARE Ratings or its subsidiaries/associates may also be involved with other commercial transactions with the entity. In case of partnership/proprietary concerns, the rating/outlook assigned by CARE Ratings is, inter-alia, based on the capital deployed by the partners/proprietors and the current financial strength of the firm. The ratings/outlook may change in case of withdrawal of capital, or the unsecured loans brought in by the partners/proprietors in addition to the financial performance and other relevant factors. CARE Ratings is not responsible for any errors and states that it has no financial liability whatsoever to the users of the ratings of CARE Ratings. The ratings of CARE Ratings do not factor in any rating-related trigger clauses as per the terms of the facilities/instruments, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and triggered, the ratings may see volatility and sharp downgrades.

**For the detailed Rationale Report and subscription information,
please visit www.careedge.in**