Smruthi Organics Limited

January 05, 2022

Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	15.00 (Reduced from 34.00)	CARE BBB; Stable (Triple B; Outlook: Stable)	Rating removed from ISSUER NOT COOPERATING category and Revised from CARE BB+; Stable; (Double B Plus; Outlook: Stable)
Short Term Bank Facilities	13.00 (Reduced from 17.00)	CARE A3+ (A Three Plus)	Rating removed from ISSUER NOT COOPERATING category and Revised from CARE A4+; (A Four Plus)
Total Bank Facilities	**28.00 (Rs. Twenty-eight crore only)**		

Details of instruments/facilities in Annexure-1

In absence of information required for the purpose of rating, CARE Ratings was unable to express an opinion on the ratings of Smruthi Organics Limited and in line with the extant SEBI guidelines, CARE Ratings had revised the ratings of bank facilities of the company to 'CARE BB+; Stable; ISSUER NOT COOPERATING/CARE A4+; ISSUER NOT COOPERATING'. However, the company has now submitted the requisite information and paid surveillance fees to CARE Ratings. CARE Ratings has carried out a full review of the ratings and the ratings stand at CARE BBB; Stable/ CARE A3+.

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the bank facilities of Smruthi Organics Limited (SOL) takes cognizance of significant improvement in overall operational performance during FY21 (refers to the period from April 01 to March 31). The same was backed by healthy profitability margins along with significant improvement in financial risk profile due to paring down of working capital limits and accretion of net profits to net worth. The revision also factors in build-up of healthy liquidity, turning SOL into net debt free company as on March 31, 2021. The ratings continue to remain underpinned by experienced promoters in the pharmaceutical industry, accredited manufacturing facilities, and favourable industry growth prospects. The rating strengths, however, remain tempered by, modest and stagnant scale of operations, product and customer concentration risk, susceptibility of operating margins to volatile raw material prices, order-based and competitive nature of business, and exposure to regulatory and foreign exchange fluctuation risk.

Rating Sensitivities

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

- Increase in TOI to more than Rs.300 crore along with operation margin of 18% and above on sustained basis
- Ability of the company to reduce the therapeutic concentration risk with no segment contributing more than 30% along with diversifying its customer base.
- Ability of the company to diversify its significant level of revenues from regulated markets.

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

- Deterioration in the overall gearing beyond 1x on sustained basis.
- TOI falling below Rs.100 crore and/or PBILDT margin falling below 12% on a sustained basis.

Detailed description of the key rating drivers

Key Rating Strengths

Significant improvement in profitability level albeit stagnant operating income: While the total operating income (TOI) of the company remained stagnant in past three years, the profitability of the company has improved significantly. During FY19, SOL had posted operating margins of 12.63% which eventually improved to 14.51% and 22.90% in FY20 and FY21 respectively. Such improvement in profitability is mainly attributable to various measures adopted by the company such as process realignment to effectuate backward integration with some of key starting materials being produced inhouse. Also, in FY21, owing to high raw material prices for metformin and lower ability to pass on such costs, the company made opportunistic shift towards other products and accordingly revenue contribution from metformin declined from 44% in FY20 to 33% in FY21. This change in product mix also led to decline in raw material cost and improvement in overall profitability. Owing to consistent deleveraging, the finance cost of the company also declined substantially and thus PAT margin of the company improved significantly to 14.19% in FY21 from 6.19% in FY19. In FY22, the profitability margins of the company are likely to be impacted owing to increase in raw material costs, however is expected to remain over FY20 level at close to 15-16%.

Significant improvement in capital structure and debt coverage indicators: The capital structure of the company remains comfortable with debt equity and overall gearing ratio marking consistent improvement over the years. As on March 31, 2019, overall gearing and debt equity ratio of the company was 1x and 0.09x respectively, which improved to 0.38x and 0.06x as on March 31, 2020 respectively. The ratios further improved to 0.17x and 0.03x as on March 31, 2021 respectively.

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

Such improvement was mainly due to significant reduction in the utilization of working capital limits alongside accretion of profits to net worth (which rose from Rs. 36 crore to Rs. 60 crore in corresponding periods). Improved profitability over the years coupled with reduction in overall debt has also resulted in improved debt coverage indicators. Total debt/ PBILDT and total debt/ GCA improved to 0.07x and 0.08x as on March 31, 2021 as against 0.13x and 0.18x as on March 31, 2020 respectively (further improved from TD/PBILDT: 0.18x and TD/GCA: 0.22x, as on March 31, 2019). Furthermore, with improved profitability in FY21, the company could build-up significant liquidity level. SOL's free cash and cash equivalent increased from Rs.0.64 crore as at March 31, 2020 to Rs.14.78 crore as at March 31, 2021, resulting into company turning to net debt free entity.

Experienced promoters in the bulk drug manufacturing Industry: SOL is managed/promoted by Mr. Purushotham Ega and Mr. Ega Swapnil, having more than 30 years and 15 years respectively in pharmaceutical industry. SOL's operating track record is of more than three decades in the pharmaceutical business with presence in the area of manufacturing of bulk drugs and APIs.

Accredited manufacturing units: The company has two manufacturing units located at Solapur in Maharashtra. The facilities are spread over an area of 22.50 acres with total annual capacity of around 5,800 MT, thus capable of handling large volumes. The Unit II plant is Good Manufacturing Practice (GMP) certified. The company's research and development department is recognized by the Directorate of Scientific and Industrial Research (DSIR), Government of India.

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

Modest and stagnant scale of operations with declining sales volume: In FY19, SOL had registered a growth of 42% on a y-o-y basis, to achieve total operating income (TOI) of Rs.138 crore and thereafter, it witnessed degrowth of 2% and 6% in FY20 and FY21 respectively. TOI, thus remained stagnant in past three years mainly due to declining sales volume of the products of the company. In FY20, the company sold similar volume of metformin as in FY19 however, realizations declined. In FY21, however, the company witnessed significant fall in volume for Metformin which was partially offset by better realization and higher sales volume for other products restricting degrowth of TOI to 6% in FY21. With such decline in volumes and overall revenue profile, company continues to operate at a small scale and is expected to remain of similar size in medium term.

Product and customer concentration Risk:

The company derived 96% of the revenue from top 5 products in H1FY22 as against 88% in FY21 and FY20 each. The top two products viz. Metformin and Diloxanide Furoate contributed around 59% of the revenue in FY21 as against 65% in FY20. In H1FY22, though, Telmisartan replaced Diloxanide Furoate as second most revenue contributing product, reflecting diversification to certain extent and accordingly revenue from top 2 products reduced to 56%. This apart, top 10 customers of the company contributed 67% and 68% of total sales in FY21 and H1FY22 and hence, there exists customer concentration risk as well.

Susceptibility of operating margins to volatile raw material prices and foreign exchange rate: The major raw materials required for the company are Dicyandiamide (DCDA) and Dimethylacetamide, prices of which are volatile in nature. Since, raw material (contributed around 66% of cost of sales in FY21) is the major cost driver for the company, any upward movement in raw material prices, with no increase in prices of finished products in an intensely competitive industry may result in adverse performance of the company. Further, SOL imports majority of raw material from China and exports its products to several countries like Pakistan, Thailand, Argentina etc. In the absence of a hedging mechanism, although being a net exporter, the company is exposed to foreign currency fluctuation risk owing to timing differences.

Order based nature of business: Being an API player, the company's business is mainly order driven (spot sales) with no long-term arrangements with its customers, thus, leading to lack of revenue visibility over medium term for the company. Nevertheless, over the years, the company maintained long term relationships with pharmaceutical majors and has been successful in receiving repeat orders. As on Dec 27, 2021, the company's order book was around Rs.20 crore (0.15 times of FY21 gross sales) to be executed in the upcoming quarter.

Exposure to regulatory risk: The pharmaceutical industry is highly regulated and requires various approvals, licenses, registrations and permissions for business activities. Each authority has its own requirement and they could delay or refuse to grant approval, even when a product has already been approved in another country. The approval process for a new product registration is complex, lengthy and expensive. Any delay or failure in getting approval for new product launch could adversely affect the business prospect of the company. This apart, the ability of the company to continue to observe the regulatory and CGMP standards without receiving any adverse observations from regulatory authorities remains critical from business and credit risk perspective. Furthermore, the company has substantial level of imports from China and exports to Pakistan, any geopolitical issues with such countries could materially impact the operations of the company.

Liquidity: Adequate
The company has a comfortable liquidity position characterized by expected cash accruals of around Rs.17 crore against negligible repayment obligations and liquid investments to the tune of Rs.13.44 crore as on September 30, 2021. With a gearing of 0.18 times as of September 30, 2021, the issuer has sufficient gearing headroom, to raise additional debt for its capex. The liquidity of the company is further supported by unutilized bank lines as the average working capital limit utilization remained low at 27% in the last 12 months ended September 2021. Further, the current & quick ratio stood comfortable at 2.37 times and 1.64 times respectively as on March 31, 2021.

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
SOL established in 1989 by Mr. Ega Purushotham (Managing Director) and is headquartered at Solapur, Maharashtra. Mr Eaga Purushotham along with Mr Eaga Swapnil (son of Mr. Eaga Purushotham) manages the overall operations of the company. The company is engaged in the business of manufacturing and marketing active pharmaceutical ingredients (APIs) and intermediates. The product portfolio of the company consists of more than 12 APIs and intermediates including Metformin, Diloxanide Furoate, Norfloxacin, Telmisartan, Amlodipine, Potassium Losartan amongst others.

Brief Financials (Rs. crore)	31-03-2020 (A)	31-03-2021 (A)	30-09-2021 (UA)
Total operating income	135.50	127.06	61.45
PBILDT	19.66	29.09	8.99
PAT	8.39	18.03	5.20
Overall gearing (times)	0.38	0.17	0.18
Interest coverage (times)	6.18	26.61	16.96

A: Audited; UA: Unaudited

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	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit		-	-	-	15.00	CARE BBB; Stable
Non-fund-based - ST-BG/LC		-	-	-	13.00	CARE A3+

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-Term Loan	LT	-	-	-	-	1)Withdrawn (28-Jun-19)	1)CARE BB; Stable (04-Sep-18)
2	Fund-based - LT-Cash Credit	LT	15.00	CARE BBB; Stable	1)CARE BB+; Stable; ISSUER NOT COOPERATING* (13-Aug-21)	1)CARE BB+; Stable; ISSUER NOT COOPERATING* (14-Sep-20)	1)CARE BB+; Positive (28-Jun-19)	1)CARE BB; Stable (04-Sep-18)
3	Non-fund-based - ST-BG/LC	ST	13.00	CARE A3+	1)CARE A4+; ISSUER NOT COOPERATING* (13-Aug-21)	1)CARE A4+; ISSUER NOT COOPERATING* (14-Sep-20)	1)CARE A4+ (28-Jun-19)	1)CARE A4 (04-Sep-18)

* Long Term / Short Term

Annexure-3: Detailed explanation of covenants of the rated facilities: Not applicable

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	Non-fund-based - ST-BG/LC	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 instrument: CARE Ratings Ltd. 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
Contact no.: +91-22-6754 3573
Email ID: mradul.mishra@careedge.in

Analyst Contact
Name: Monika Goenka
Contact no.: +91-020-40009019/8879300881
Email ID: monika.goenka@careedge.in

Relationship Contact
Name: Aakash Jain
Contact no.: +91-20-4000 9090
Email ID: aakash.jain@careedge.in

About CARE Ratings Limited:
Established in 1993, CARE Ratings Ltd. is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India (SEBI), it has also been acknowledged as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). With an equitable position in the Indian capital market, CARE Ratings Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.
With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

****For detailed Rationale Report and subscription information, please contact us at www.careedge.in**