SMS Pharmaceuticals Limited

December 07, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	312.27	CARE A; Negative	Reaffirmed
Short-term bank facilities	57.33	CARE A2+	Reaffirmed

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

The ratings assigned to the bank facilities of SMS Pharmaceuticals Limited (SMS) remain underpinned by experienced management team with long proven track record of operations, diversified clientele along with presence across several therapeutic segments, and reputed clientele. During FY23, the revenue from the operations witnessed a muted growth on account of loss of revenue share from Anti-Retroviral (ARV) segment products from 40% in FY22 to 3% in FY23. However, the company was able to maintain its revenue levels due to contribution from recently commercialised Ibuprofen and significant increase in anti-diabetic segment's revenue share from 3% in FY22 to 38% in FY23. This shift in the product composition coupled with resurgence of ARV segment in the half year ended September 30, 2023, is expected to contribute to the growth in revenue and profitability, going forward. However, the rating strengths are partially offset by the moderate scale of operations relative to the total debt, elongated working capital cycle and presence in competitive and regulated industry.

Rating sensitivities: Factors likely to lead to rating actions

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

- The total operating income (TOI) increasing to above ₹800 crore while maintaining a profit before interest, lease rentals, depreciation and taxation (PBILDT) margin of above 20% and return on capital employed (ROCE) of around 15% 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 deteriorating beyond 1x, in future.
- Elongation of the operating cycle beyond 180 days.
- Notable decline in TOI and PBILDT margin falling below 15%.

Analytical approach: Standalone

Outlook: Negative

Negative outlook is on account of relatively higher debt levels vis-à-vis the size of the company, and elevated debt levels if continued may impact the credit risk metrics of the company, going forward. The outlook may be revised to Stable if the company is able to demonstrate sustained improvement in its cash flows along with de-leveraging its books, in coming quarters.

Detailed description of the key rating drivers:

Key strengths

Moderate financial performance in FY23 albeit improved in H1-FY24

During FY23, the revenue from operations witnessed a muted growth on account of loss of revenue share from ARV segment products from 40% in FY22 to 3% in FY23. However, the company was able to maintain its revenue levels due to significant increase in anti-diabetic segment's revenue share from 3% in FY22 to 38% in FY23. During H1-FY24, the company reported revenue from operations amounting to ₹301.98 crore on account of improvement in Ibuprofen, ARV and anti-diabetic segment products. Taking into account the improvement in the operational performance and healthy order book, the company is expected to grow by around 12-15% Y-o-Y. The profitability margins for FY23 witnessed decline on account of the company's strategy to facilitate market penetration of recently commercialised Ibuprofen by selling it at negative margins. This combined with the escalation of input prices, resulted in a decline in overall profitability margins. However, on account of stabilisation of input prices and improved performance of Ibuprofen and anti-diabetic segment as well as uptick in ARV demand, the profitability witnessed improvement with PBILDT margin of 18.48% in H1FY24 (6.53%). CARE Ratings expects this to continue going forward.

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

Proven track record and experienced management
SMS has been promoted by 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.

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. The export sales include deemed exports and export incentives which constituted around 67% of gross sales revenue during FY23 (72% of gross sales revenue during FY22). Majority of the company's revenues are derived from exports to regulatory markets. In order to enter the regulatory markets of US and Europe, a pharmaceutical company's manufacturing unit must meet certain regulatory standards like USFDA, cGMP, EDQM, etc. The last audit conducted for Unit VII and II was 2020 and 2017, respectively, and there were no observations. SMS's Unit II has USFDA, PMDA Japan and European regulatory approvals, and Unit VII has USFDA certification. During FY22, the company completed remote regulatory assessment by USFDA for the testing facility. SMS (Central Laboratory Analytical Services) received Remote Assessment Report, as a result of which, USFDA and PMDA does not plan to take or recommend regulatory or enforcement action at this time.

Moderately diversified customer base and product portfolio
The company has diversified its customer base over the period where top five customers contributed around 45% in FY23 having improved from 58% in FY21 and 53% in FY22. The current product portfolio primarily comprises Ibuprofen, Sitagliptin, Sumatriptan, Tenofovir Disoproxil Fumarate, among other products. The revenue contribution from top two products during FY23 remains a tad concentrated accounting for around 50% of the total sales. However, with improvement in the revenue from anti-diabetic segment, resurgence of anti-retroviral segment and increase in the market share of Ibuprofen, CARE Ratings expects the company to reduce the product concentration, in the coming years.

Key weaknesses

Satisfactory financial risk profile
The total debt relative to the scale of operations deems high. However, the financial risk profile of the company stood satisfactory marked by overall gearing of 0.51x as on March 31, 2023. The total debt to PBILDT has increased to 4.26x as on March 31, 2023 from 2.33x as on March 31, 2022, on account of declined profitability for FY23. Nevertheless, there is an optimistic outlook for improvement in these metrics. Based on the observed enhancement in the operational performance, CARE Ratings anticipates improved profitability and cash flows, as reflected in the results for the half-year ended September 30, 2023.

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 further growth of the company. Hence, the ongoing regulatory compliance has become critical for Indian pharmaceutical companies.

Liquidity: Adequate

SMS has been generating adequate cash flows to meet its debt obligations. Average working capital utilisation for the 12 months ending July 31, 2023, stood high at 82%. However, liquidity is supported by the adequate cash flow from operations, current ratio of more than 1.5x and an unencumbered cash and bank balance of ₹32.92 crore as on September 30, 2023.

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
Policy on Withdrawal of Ratings

About the company and industry
Industry classification

Macro-economic Indicator	Sector	Industry	Basic Industry
Healthcare	Healthcare	Pharmaceuticals and biotechnology	Pharmaceuticals

SMS, listed on BSE and NSE, is promoted by Ramesh Babu Potluri (Chairman and Managing Director). It is engaged in the 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, 2022 (A)	March 31, 2023 (A)	H1-FY24 (UA)
Total operating income	522.45	526.94	301.98
PBILDT	117.07	59.59	55.80
PAT	68.04	4.08	21.33
Overall gearing (times)	0.55	0.51	0.54
Interest coverage (times)	6.20	2.72	4.69

A: Audited UA: Unaudited; Note: 'the above results are latest financial results 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: Annexure-4

Lender details: Annexure-5

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 (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2023-2024	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021
1	Fund-based - LT-Cash credit	LT	93.00	CARE A; Negative	-	1)CARE A; Negative (03-Nov-22) 2)CARE A; Negative (03-Oct-22)	1)CARE A; Stable (03-Sep-21)	1)CARE A-; Stable (30-Dec-20)
2	Non-fund-based - ST-Letter of credit	ST	36.50	CARE A2+	-	1)CARE A2+ (03-Nov-22)	1)CARE A2+ (03-Sep-21)	1)CARE A2 (30-Dec-20)

						2)CARE A2+ (03-Oct-22)		
3	Fund-based - LT-Term loan	LT	204.27	CARE A; Negative	-	1)CARE A; Negative (03-Nov-22) 2)CARE A; Negative (03-Oct-22)	1)CARE A; Stable (03-Sep-21)	1)CARE A-; Stable (30-Dec-20)
4	Fund-based - ST-Standby line of credit	ST	16.00	CARE A2+	-	1)CARE A2+ (03-Nov-22) 2)CARE A2+ (03-Oct-22)	1)CARE A2+ (03-Sep-21)	1)CARE A2 (30-Dec-20)
5	Fund-based - LT-Packing credit in foreign currency	LT	15.00	CARE A; Negative	-	1)CARE A; Negative (03-Nov-22) 2)CARE A; Negative (03-Oct-22)	1)CARE A; Stable (03-Sep-21)	1)CARE A-; Stable (30-Dec-20)
6	Non-fund-based - ST-Bank guarantee	ST	2.00	CARE A2+	-	1)CARE A2+ (03-Nov-22) 2)CARE A2+ (03-Oct-22)	1)CARE A2+ (03-Sep-21)	1)CARE A2 (30-Dec-20)
7	Non-fund-based - ST-Forward contract	ST	2.83	CARE A2+	-	1)CARE A2+ (03-Nov-22) 2)CARE A2+ (03-Oct-22)	1)CARE A2+ (03-Sep-21)	1)CARE A2 (30-Dec-20)

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

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the 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: Lender details

To view the lender wise details of bank facilities please click here

Note on the 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	Analytical Contacts
Mradul Mishra Director **CARE Ratings Limited** Phone: +91-22-6754 3596 E-mail: mradul.mishra@careedge.in	Karthik Raj K Director **CARE Ratings Limited** Phone: +91 80-46625555 E-mail: karthik.raj@careedge.in
Relationship Contact Saikat Roy Senior Director **CARE Ratings Limited** Phone: 91 22 6754 3404 E-mail: saikat.roy@careedge.in	Nivedita Anirudh Ghayal Associate Director **CARE Ratings Limited** Phone: +91-040 40102030 E-mail: nivedita.ghayal@careedge.in Sainandan S Pavansri Analyst **CARE Ratings Limited** E-mail: Sainandan.Pavansri@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.

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