SMS Pharmaceuticals Limited

October 10, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	352.77 (Enhanced from 312.27)	CARE A; Stable	Reaffirmed; Outlook revised from Negative
Short-term bank facilities	52.83 (Reduced from 57.33)	CARE A2+	Reaffirmed

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

Revision in the long-term rating outlook of SMS Pharmaceuticals Limited (SMS) reflects the recovery in performance in FY24 over FY23, marked by a 35% y-o-y growth in revenue from operations and increased profitability both in terms of absolute levels and margins, and healthy cash flows. In FY24, the company witnessed a recovery in the Anti-Retroviral (ARV) segment, with revenue contribution increasing to 20% from 3% in FY23, and a significant 1.6x growth in revenue from Ibuprofen driving improvement in profitability in FY24 after a sharp decline in profit before interest, lease rentals, depreciation, and taxation (PBILDT) margin company witnessed in FY23. Ratings further continue to derive strength from the experienced management team with a long and proven track record of operations, a diversified and reputed clientele, and the company's presence across several therapeutic segments.

Rating strengths are partially offset by the ongoing capex undertaken by SMS to setup a backward integration unit which is expected to result in lower dependence on imports and further result in better profits. However, completion of this project without cost and time overrun deriving benefit would be critical from credit perspective. Ratings are also constrained by elongated working capital cycle, company's presence in a competitive and regulated industry.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- The total operating income (TOI) increasing to above ₹1,000 crore while maintaining a PBILDT margin of above 20% on a sustained basis.
- Overall gearing falling below 0.25x, going forward.

Negative factors

- Notable decline in TOI and PBILDT margin falling below 15%.
- Total debt to PBILDT above 2.5x, in future.
- Elongating operating cycle beyond 180 days.

Analytical approach: Standalone

Outlook: Stable

CARE Ratings Limited (CARE Ratings) expects that the entity will continue to benefit from its presence in the diversified therapeutic segments.

Detailed description of key rating drivers:

Key strengths

Significant growth in revenue and profitability in FY24

In FY24, the company witnessed a 35% y-o-y growth in revenue, increasing from ₹525.93 crore in FY23 to ₹709.26 crore. This growth was driven by the recovery of business in the ARV therapeutic segment and substantial growth in Ibuprofen revenue. In Q1FY25, the company reported revenue of ₹164.45 crore, with a growth of 21% compared to Q1FY24. Improvement in Ibuprofen's prospects and significant contribution from high-margin products resulted in an increase in the PBILDT margin to 16.47% in FY24 from 11.15% in FY23. The company is currently undertaking a backward integration project for existing products, which is expected to enhance operating profitability in the future.

Comfortable financial risk profile

The company's financial risk profile remains comfortable, marked by an overall gearing of 0.49x as on March 31, 2024. Improved profitability in FY24 has led to better coverage indicators, with the interest coverage ratio at 4.98x (2.68x in FY23) and total debt to gross cash accruals (TD/GCA) at 3.39x (6.74x in FY23). In FY24, the company availed a term loan of ₹100 crore for capacity

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

expansion and backward integration of existing products. Although the overall gearing is expected to moderate slightly due to an increase in working capital borrowings and the drawdown of the term loan, the financial risk profile is anticipated to remain comfortable, supported by improved profitability and adequate cash flows.

Infusion of funds by promoters

In FY24, the company issued 9,000,000 convertible share warrants amounting to ₹114.30 crore on a preferential basis to the promoter and promoter group. The proceeds are intended for expanding production capacities, backward integration of key starting materials (KSM) for existing and new products under pipeline, working capital requirements, and general corporate purposes. As on June 30, 2024, the promoters have infused 25% of the issue proceeds, amounting to ₹28.57 crore.

Moderately diversified customer base and product portfolio

The company has a diversified product portfolio with a presence in over 14 therapeutic segments. Major revenue-contributing therapeutic segments include anti-diabetic, antiretroviral, anti-Inflammatory, anti-migraine, and anti-ulcer, collectively accounting for 85% of the total revenue in FY24. The company also has a reputed and diversified clientele, with the revenue contribution from the top five customers standing at 56% for FY24.

Proven track record and experienced management

SMS has been promoted by P. Ramesh Babu, who serves as the Chairman and Managing Director. The current promoters have over 30 years of experience in the pharmaceutical industry. Under the present management, SMS operates two manufacturing facilities (Unit II and VII) and one R&D centre. The company's day-to-day operations are managed by the promoters, supported by a team of experienced professionals.

Integrated and accredited manufacturing facility

The majority of SMS's export revenues are derived from supply to regulated markets. To operate in regulatory markets such as the US and Europe, pharmaceutical companies must comply with standards set by regulatory bodies such as the USFDA, cGMP, EDQM and Anvisa-Brazil, among others. SMS's Unit II and Unit VII have the necessary regulatory approvals, with Unit II approved by the USFDA, PMDA Japan, European regulatory bodies, Anvisa-Brazil and TGA-Australia, while Unit VII has USFDA, PMDA Japan, European regulatory bodies and Anvisa-Brazil certification.

Stable industry outlook

The Indian pharmaceutical industry has demonstrated consistent growth over recent years, supported by expansion in both domestic and export markets. Regulated markets, which constitute a significant portion of exports, have shown robust performance, while semi-regulated and unregulated markets have also rebounded positively. Going forward, the industry is projected to grow at a compounded annual growth rate (CAGR) of 8% from FY25 to FY27, with exports to regulated markets expected to grow at 9%, while semi-regulated and unregulated markets are likely to expand at 8%, indicating a stable growth outlook for the sector.

Key weaknesses

Ongoing capital expenditure

The company is undertaking a project for capacity expansion of existing products within the existing production block, establishment of two new production blocks for backward integration of key starting materials of existing products and capacity enhancement for solvent recovery system. The total estimated project cost is ₹130 crore, funded by a ₹100 crore term loan and ₹30 crore from internal accruals. Trial run is expected to commence from October 2024 and operations are scheduled to commence from December 2024. The overall physical progress of the project is 85% as on August 31, 2024. However, completion of this project without cost and time overrun would remain a key monitorable.

Elongated operating cycle

The operating cycle improved from 177 days in FY23 to 156 days in FY24, driven by better inventory turnover. However, the collection period deteriorated from 64 days in FY23 to 98 days in FY24 due to higher receivables as on March 31, 2024, resulting from increased sales in Q4 FY24. Despite the increase, the majority of these receivables were not due as of the fiscal year-end. Although there was an overall improvement in FY24, the operating cycle remains elongated.

Exposure to competition and regulatory risk

The company is exposed to the regulatory risk due to the stringent and evolving regulations governing the pharmaceutical industry. Increased sensitivity towards product quality and performance, and rising pricing pressures, are major challenges faced by pharmaceutical companies. Additionally, the scale of operations for SMS remains moderate in a highly competitive industry, which could limit its pricing flexibility. The pharmaceutical sector is subject to strict regulations encompassing drug quality, manufacturing processes, patents, and product pricing. The approval process for new product registration is complex, time-consuming, and costly. Any non-compliance can result in regulatory bans on products or facilities, potentially impacting future growth prospects. Therefore, ongoing regulatory compliance is critical for Indian pharmaceutical companies to ensure sustainable operations and growth.

Liquidity: Adequate

The company maintains an adequate liquidity position, supported by GCA of around ₹83 crore for FY24 and ₹25 crore for Q1FY25, with a free cash and bank balance of ₹36 crore and current ratio at 1.61x as on March 31, 2024. The company's reliance on bank borrowings for working capital is high, marked by an average working capital limit utilisation of 75% for the 12 months ended July 31, 2024.

Assumptions/Covenants - Not applicable

Environment, social, and governance (ESG) risks

Parameters	Risk factors
Environmental	• The company ensures compliance with environmental regulations. By implementing a zero liquid discharge plants, the company aims to eliminate liquid waste discharge, reducing environmental impact. • The company has implemented a multiple effect evaporator (MEE) system to separate solids from liquid effluents, and a reverse osmosis (RO) system and biological treatment, as part of its water conservation efforts. The water recovered through this process is reused after condensation, with approximately 93 KL of water recycled daily.
Social	• The company undertakes CSR initiatives such as building community infrastructure, supporting healthcare for the underprivileged, and improving educational facilities. • Implementing safety protocols, conducting regular risk assessments to prevent hazards, and providing comprehensive safety training to all employees and workers.
Governance	Complies with corporate governance provisions as specified in SEBI (LODR) regulations.

Applicable criteria

Definition of Default
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Rating Watch
Manufacturing Companies
Pharmaceuticals
Financial Ratios – Non financial Sector
Short Term Instruments

About the company and industry

Industry classification

Macroeconomic indicator	Sector	Industry	Basic industry
Healthcare	Healthcare	Pharmaceuticals & biotechnology	Pharmaceuticals

SMS, listed on BSE and NSE, is promoted by Ramesh Babu Potluri (Chairman and Managing Director). It is engaged in manufacturing 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) 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, 2023 (A)	March 31, 2024 (A)	Q1-FY25 (UA)
Total operating income	525.93	709.26	164.45
PBILDT	58.65	116.84	33.46
PAT	4.08	49.42	16.33
Overall gearing (times)	0.51	0.49	NA
Interest coverage (times)	2.68	4.98	7.16

A: Audited, UA: Unaudited, NA: Not available. Note: these are latest available financial results

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years: Annexure-2

Detailed explanation of covenants of rated instrument / facility: Annexure-3

Complexity level of 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 and Rating Outlook
Fund-based - LT-Cash credit		-	-	-	116.00	CARE A; Stable
Fund-based - LT-Packing credit in foreign currency		-	-	-	15.00	CARE A; Stable
Fund-based - LT-Term loan		-	-	March 2028	221.77	CARE A; Stable
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		-	-	-	4.83	CARE A2+
Non-fund-based - ST-Letter of credit		-	-	-	30.00	CARE A2+

Annexure-2: Rating history for 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 2024-2025	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
1	Fund-based - LT-Cash credit	LT	116.00	CARE A; Stable	-	1)CARE A; Negative (07-Dec-23)	1)CARE A; Negative (03-Nov-22) 2)CARE A; Negative (03-Oct-22)	1)CARE A; Stable (03-Sep-21)
2	Non-fund-based - ST-Letter of credit	ST	30.00	CARE A2+	-	1)CARE A2+ (07-Dec-23)	1)CARE A2+ (03-Nov-22) 2)CARE A2+ (03-Oct-22)	1)CARE A2+ (03-Sep-21)
3	Fund-based - LT-Term loan	LT	221.77	CARE A; Stable	-	1)CARE A; Negative (07-Dec-23)	1)CARE A; Negative (03-Nov-22) 2)CARE A; Negative (03-Oct-22)	1)CARE A; Stable (03-Sep-21)
4	Fund-based - ST-Standby line of credit	ST	16.00	CARE A2+	-	1)CARE A2+ (07-Dec-23)	1)CARE A2+ (03-Nov-22) 2)CARE A2+ (03-Oct-22)	1)CARE A2+ (03-Sep-21)
5	Fund-based - LT-Packing credit in foreign currency	LT	15.00	CARE A; Stable	-	1)CARE A; Negative (07-Dec-23)	1)CARE A; Negative (03-Nov-22) 2)CARE A; Negative (03-Oct-22)	1)CARE A; Stable (03-Sep-21)
6	Non-fund-based - ST-Bank guarantee	ST	2.00	CARE A2+	-	1)CARE A2+	1)CARE A2+	1)CARE A2+

						(07-Dec-23)	(03-Nov-22) 2)CARE A2+ (03-Oct-22)	(03-Sep-21)
7	Non-fund-based - ST-Forward contract	ST	4.83	CARE A2+	-	1)CARE A2+ (07-Dec-23)	1)CARE A2+ (03-Nov-22) 2)CARE A2+ (03-Oct-22)	1)CARE A2+ (03-Sep-21)

LT: Long term; ST: Short term; LT/ST: Long term/Short term

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

Annexure-4: Complexity level of 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 lender-wise details of bank facilities please click here

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

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About us:

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