SMS Life sciences India Limited

April 20, 2020

Ratings

Instrument	Amount (Rs. Crore)	Ratings	Rating Action
Long-term Bank Facilities	24.50	**CARE BBB+; (Triple B Plus) [Under credit watch with developing implications]**	Placed on credit watch with developing implications
Short-term Bank Facilities	0.32	**CARE A2 [A Two] [Under credit watch with developing implications]**	Placed on credit watch with developing implications
Long-term Bank Facilities/ Short-term Bank Facilities	30.00	**CARE BBB+; /CARE A2 (Triple B Plus /A Two) [Under credit watch with developing implications]**	Placed on credit watch with developing implications
Total	**54.82 (Rs. Fifty Four crore and Eighty Two lakh only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

CARE has placed the ratings assigned to the bank facilities of SMS Lifesciences India Limited (SMS Life) on 'Credit watch with developing implications' subsequent to the press release issued by USFDA stating manufacturers to withdraw all prescription and over-the-counter (OTC) ranitidine drugs from the market immediately as the agency has determined that the impurity (NDMA) in some ranitidine products increases over time and when stored at higher than room temperatures and may result in consumer exposure to unacceptable levels of this impurity.. Ranitidine along with its intermediates contributed about 48% and 51% of gross sales during FY19 and 9MFY20 in SMS life, however the contribution of same towards USA and Europe is less than 1%. The company vide its press release conveyed that the company is waiting for the guidance of health authorities of Rest of the world (ROW)/domestic market. CARE is in the process of evaluating the impact of the above developments along with the lockdown due to COVID19 on the credit quality of SMS Life and would take a view on the rating when the exact implications of the above are clear.

The ratings assigned to the bank facilities of SMS Lifesciences India Limited (SMS Life) continues to derive strength from experienced promoters and directors with a strong established track record in the pharmaceutical industry, well-equipped manufacturing facilities with regulatory approvals to cater to the semi-regulated and domestic market, improvement in total operating income and profitability margins during FY19 (refers to the period April 1 to March 31), established presence in anti-ulcer segment, diversified and reputed client base with stable flow of repeat business, continued comfortable capital structure, synergy derived from its group company and stable industry outlook. The ratings also factor in the acquisition of Mahi Drugs Private Limited (Mahi Drugs) enabling SMS Life in expansion of capacities. The rating strengths are however, tempered by subdued financial performance during 9MFY20 (refers to period April 01 to December 31), product concentration risk, working capital intensive nature of business with moderate operating cycle, ongoing debt funded capex and presence in the highly fragmented and competitive bulk drug industry along with exposure to regulatory and foreign exchange fluctuation risk.

Rating Sensitivities

Positive Factors

- Diversification in its product portfolio, wherein no single product contributes over 20% of total gross sales.
- Improvement in scale of operations and profitability margins.

Negative Factors

- Overall gearing of the company going above 1.00x.
- Elongation of working capital cycle to more than 90 days on a continuous basis.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters and directors with a strong track record in the pharmaceutical industry

SMS Life, originally promoted by Mr. Hari Kishore Potluri, Ms. Potluri Hima Bindu and their family members as private limited company in the name of Potluri Real Estate Private Limited and subsequently changed its name to Potluri Packaging Industries Private Limited on November 6, 2013 and to SMS Lifesciences India Private Limited in August 4, 2014. Post demerger, SMS Life is a separate entity operating independently in semi-regulated markets. The current promoters of SMS Life are Mr. P Ramesh Babu (Chairman and Managing Director of SMS) and Mr. TVVSN Murthy (Managing Director). Mr. P Ramesh Babu has over 30 years of experience in the pharmaceutical industry. He has worked for various reputed pharmaceutical companies as a Director (Overall Business Development & Supervision and Marketing).

Acquisition of Mahi Drugs Private Limited

The company has acquired 100% stake in Mahi Drugs Private Limited (Mahi Drugs) as on September 17, 2018. With this total stake of the company as on date in Mahi Drugs is 100% and has become wholly owned subsidiary of SMS Life. The total cost of acquisition is of Rs.25.93 crore which has been funded by way of Un-secured loans from promoters to the tune of Rs.4.95 crore and balance by way of internal accruals available with the company. (Rs.4.95 crore was invested in FY18 and balance was invested in FY19). In order to enable growth of SMS Life, instead of putting up a green field project which would take 2-3 years, the management has decided to take the acquisition route. This is expected to help SMS Life in quick expansion of capacities and also increase sales. Mahi Drugs is a new facility (established 5 years back) and has an existing business of around Rs.30 crore with 2 production blocks situated at Visakhapatnam and capacity of 90 KLPA.

Synergy derived from SMS group

SMS Life is part of SMS group. The company was demerged on May 17, 2017 with effect from April 01, 2016. The semi-regulated units of SMS Pharma were transferred to SMS Life along with its assets and liabilities. SMS Life derives benefit as being part of the SMS group. SMS Pharma promoters have experience of around 3 decades and are involved in day-to-day affairs of the company. SMS Life is able to cater to clients which have long term relation with SMS group resulting strong customer base for SMS Life.

Manufacturing facility with various regulatory certifications for domestic and semi-regulated markets

SMS Life has three manufacturing units namely; Unit I – (Kazipally unit), Unit II – (Jeedimetla unit) and Unit III – (Bollaram unit) in Hyderabad and one R&D facility. During FY17, SMS Life completed Korean Food and Drug Administration (KFDA) audit for Unit-I. Further, the Company has successfully completed USFDA audit during April, 2018 and received EIR report against Kazipally Facility (Unit I). All three units also meet World Health Organization (WHO) cGMP standards. Apart from that, the company's subsidiary i.e. Mahi Drugs Private Limited has one manufacturing facility located in J. N. Pharma City, Parawada, Visakhapatnam.

Diversified and reputed client base with stable flow of repeat business

The company (consol.) has diversified revenue with top 6 clients contributing 44% (28% in FY18) of the gross sales in FY19 increasing client concentration risk. These clients have long standing relation with an average age of 17 years of association with the group. Top five clients of the company during FY19 were Uquifa - Union Quimico Farmaceutica, S.A. (Spain based), Orchev Pharma Pvt Ltd (manufacturing Ranitidine Hydrochloride), Helm De Mexico S.A, Sun Pharmaceutical Industries Limited and Mylan Laboratories Limited which are globally well renowned innovator in pharma and research.

Significant improvement in total operating income and profitability margins during FY19

The total operating income (TOI) of SMS Life, at consolidated level, improved significantly by 76.38% from Rs.215.47 crore during FY18 to Rs.380.06 crore during FY19. Out of the revenue earned during FY19, Mahi Drugs Private Limited constitute to around 9%. PBILDT margin (consol.) has improved significantly by 245 bps from 7.30% in FY18 to 9.75% in FY19 on account of better margins earned from new products launched during the year. In line with improved PBILDT level, PAT margin (Consol.) also improved by 168 bps from 3.02% during FY18 to 4.70% during FY19.

Continued comfortable capital structure and satisfactory debt coverage

SMS Life (consol.) continues to have comfortable capital structure, although deteriorated, with debt to equity and overall gearing below unity at 0.38x and 0.53x as on March 31, 2019 (0.24x and 0.31x as on March 31, 2018 respectively) owing to increase in term loan and working capital borrowing during the year. Further, the PBILDT interest coverage and Total debt/GCA both improved during the year on account of better profitability margins. The PBILDT interest coverage and Total debt/GCA improved to 6.73x and 1.87x (3.76x and 2.33x respectively for FY18) during FY19.
During 9MFY20, the PBILDT interest coverage (consol.) deteriorated to 5.44x vis-à-vis 6.73x in FY19 on account of decrease in PBILDT level

Comfortable working capital cycle of the company

The operating cycle of the company, at consol. level, improved from 47 days in FY18 to 25 days in FY19 mainly due to improvement in average inventory period and average collection period. The average inventory period of the company improved to 70 days in FY19 (86 days in FY18). The average collection period of the company also improved to 30 days in FY19 (51 days in FY18). The company generally extends 30 to 45 days credit period to its customers. The company's average working capital utilization (consolidated) remained moderate at around 43.61% for the 12 months period ended November 2019.

Stable pharma industry outlook

Pharma exports are expected to grow by 8%-10% on a y-o-y basis and are likely to reach the level of USD 20.7 billion-USD 21.1 billion during FY20. The increase in exports will be backed by higher exports to USA, pharmemerging nations, developed nations and other nations. A stabilising price erosion environment is likely to aid pharma exports to USA. Moreover, the need for affordable healthcare in pharmemerging and developed nations are likely to support exports of branded generics to these countries. Also, rising per capita incomes in pharmemerging nations will contribute to the rise in branded generics exports from India.

On the domestic front, the industry is expected to grow at around 10%-12% and reach the level of USD 20.4 billion-USD 20.8 billion during FY20. This will be backed by growth in presence of chronic diseases, increasing per capita income, improvement in access to healthcare facilities and penetration of health insurance.

Considering the growth in domestic and export pharma market, we expect Indian pharma industry outlook to remain stable and to grow by about 9%-11% to USD 41.1 billion-USD 41.9 billion by FY20.

Key Rating Weaknesses

Subdued financial performance during 9MFY20.

During 9MFY20, the company (consol.) has earned a revenue of Rs.212.05 crore with PBILDT margin at 10.12% and PAT margin at 3.62%.The growth rate of the company declined by 14.00% during 9MFY20 as against 9MFY19 on account of decline in revenue from Ranitidine HCL which contributed around 36% of total revenue as there was a worldwide issue of NDMA in respect of Rantidine HCL and lack of clarity from regulatory authorities about its permissible level, its impact and about its carcinogenic effect on prolonged usage.

Established presence in Anti–ulcer (GAS) therapeutic segment albeit high product concentration

SMS Life, at standalone level, has a portfolio of more than 12 APIs with an established presence in GAS segment followed by Anti-erectile dysfunction (EDF) therapeutic segment. The top 7 products of the portfolio accounted for 78% in FY19 (83% in FY18). Ranitidine HCL (Anti –ulcer (GAS) therapeutic segment) is the main product of the portfolio with 35.75% of contribution to gross sales in FY19 resulting in single product concentration risk. Though, the company faces product concentration risk with respect to Ranitidine HCL, SMS Life is one of the single largest manufacturers of Ranitidine and therefore enjoys a good market share with respect to the same. Demand for Ranitidine has been increasing over the years and so has its revenue share. Revenue from Ranitidine registered y-o-y growth of 16.91% to Rs.132.62 crore for FY19 (Rs. 113.44 crore in FY18) for SMS Life.

Debt funded capex

The company has undertaken expansion project at Kazipally to increase the additional capacities for various products as well as renovation of the facility to meet the current regulatory compliances. The total project cost is estimated to be Rs.26.12 crore and is being funded with internal accruals of Rs.6.12 crore and term loan of Rs. 20 crore.

During FY18, the company has incurred around Rs.8.30 crore (Out of Rs.26.12 crore) funded by way of internal accruals (part of which was reimbursed by term loan subsequently). Balance Rs.17.82 crore capex has been incurred in FY19 and 7MFY20 and was funded by way term loan. Further, the company has completed the capex in the month of October 2019. However, term loan to the extent of Rs.1 crore is expected to be disbursed by end of February 2020.

Apart from the aforesaid capex, Mahi Drugs is also carrying out capacity expansion at Parawada unit. The total project cost for the same is Rs.26.67 crore which will be funded through term loan to the extent of Rs.20 crore and balance Rs.6.67 crore through internal accruals. Till December 23, 2019, the company has incurred around Rs.10.04 crore which was funded through term loan to the extent of Rs.5.83 crore and balance through internal accruals of Rs.4.21 crore. The expected COD for the said project is by September 2020.

Impact of Ranitidine issue on financial performance and the current status

On September 13, 2019, USFDA issued a statement stating that some ranitidine medicines contain a nitrosamine impurity called N-nitrosodimethylamine (NDMA) at low levels. NDMA is classified as a probable human carcinogen (a substance that could cause cancer) based on results from laboratory tests. NDMA is a known environmental contaminant and found in water and foods, including meats, dairy products, and vegetables. Post to this, the company reduced the production and held back any finished stock of Ranitidine available with them. Further, the company carried out test on the Ranitidine internally as well as through third party labs to validate the presence of NDMA. Thereafter, on November 01, 2019, USFDA vide its press stated that consuming up to 0.096 micrograms or 0.32 parts per million (ppm) of NDMA per day is considered reasonably safe for human ingestion based on lifetime exposure. Through their testing so far, they have found levels of NDMA in Ranitidine HCL that are similar to the levels expected in common foods like grilled or smoked meats. On April 01, 2020, the USFDA vide its press release announced that it is requesting manufacturers withdraw all prescription and over-the-counter (OTC) ranitidine drugs from the market immediately as the agency has determined that the impurity (NDMA) in some ranitidine products increases over time and when stored at higher than room temperatures and may result in consumer exposure to unacceptable levels of this impurity. The director of USFDA has also commented stating that, “We didn’t observe unacceptable levels of

NDMA in many of the samples that we tested. However, since we don't know how or for how long the product might have been stored, we decided that it should not be available to consumers and patients unless its quality can be assured". On April 09, 2020, SMS Life vide its press release stated that the company does not have any Ranitidine API sales to US market either directly or indirectly, however, the company need to wait for the guidance of health authorities of ROW / domestic markets. As the company has been deriving majority of its revenue from sale of Ranitidine, the aforementioned development has led to subdued performance of overall revenue during Q3FY20.

Highly fragmented and competitive bulk drug industry

Indian pharmaceutical industry is highly fragmented with presence of more than thousands of players in APIs and formulations. It manufactures about 60,000 generic brands across 60 different therapeutic categories, about 1,500 bulk drugs and almost the entire range of formulations. The industry is highly fragmented with around 20,000 players, of which, around 250 in the organized sector primarily in formulations control over 70% of the total domestic market.

Exposure to regulatory and foreign exchange fluctuation risk

The company is exposed to regulatory risk with its operations centered majorly into manufacturing pharmaceutical APIs. In India, the government also controls the prices of pharmaceutical products through the drug price control order (DPCO) under price control mechanism. Besides, 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. The time taken to obtain approval varies by country but generally takes from six months to several years from the date of application. Any delay or failure in getting approval for new product launch could adversely affect the business prospect of the company.

SMS Life is exposed to foreign exchange fluctuation risk in view of large volume and high value transactions of export and import, a phenomenon common to the players in the industry. However, for SMS Life, the risk gets mitigated to certain extent due to natural hedging through netting off the imports of raw materials majorly from China to the extent of Rs.100.83 crore and exports to different countries to the extent of Rs.166.68 crore.

Liquidity – Adequate

The liquidity position of the company, at consolidated level, remain adequate marked by the current ratio of 1.13x as on March 31, 2019. SMS Life at consolidated level has undertaken capex for capacity expansion of Kazipally unit (project cost of Rs.26.12 crore) and in Mahi Drugs (Project cost of Rs.26.62 crore). The cost of the entire project amounts to Rs.52.74 crore. Out of the said project cost, around Rs.7.71 crore of internal accruals is committed towards the capex during FY20. Further, the company has already incurred Rs.4.21 crore till December 31, 2019. Further, the company (consol.) has generated GCA of Rs.25.15 crore during FY19 and Rs.13.82 crore during 9MFY20 coupled with cash balance of Rs.0.33 crore as on December 31, 2019. The company has already paid the current maturities of Rs 5.12 crore during FY20 and has opted for moratorium of three months only for principal payment of term loan from EXIM bank of Rs 1.99 crore, however, the company has not opted for moratorium in RBL Bank and is servicing the interest obligations as per schedule.

Analytical approach: Standalone to Consolidated; the consolidated business and financial risk profiles of SMS Life and its subsidiaries namely Mahi Drugs Private Limited has been considered as this company is a subsidiary of SMS Life which operate in the same line of business and have financial and operational linkages. Earlier CARE has considered in its analysis the Standalone approach as SMS Life didn't had any subsidiaries. However with acquisition of entire stake by SMS life in Mahi Drugs Private Limited which would act as backward integration unit for SMS Life, along with considering operational, financial and management being fungible the analytical approach has been changed to Consolidated.

Applicable criteria

Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short term Instruments
Rating Methodology: Consolidation and Factoring Linkages in Ratings
Rating Methodology – Manufacturing Companies
Rating Methodology – Pharmaceutical
Financial ratios – Non-Financial Sector

About the company

SMS Lifesciences India Limited (SMS Life) was originally incorporated in May, 2006 by Mr. Hari Kishore Potluri, Ms. Potluri Hima Bindu and their family members as private limited company in the name of Potluri Real Estate Private Limited and subsequently changed its name to Potluri Packaging Industries Private Limited on November 6, 2013. Thereafter, the company has changed its name to SMS Lifesciences India Limited in August 4, 2014. SMS Life was a Wholly Owned Subsidiary (WOS) of SMS

Pharmaceuticals Limited (SMS) till May 17, 2017. Pursuant to the scheme of Arrangement approved by National Company Law Tribunal (NCLT), SMS is the Demerged Company and SMS Life is the Resulting Company vide order dated May 15, 2017. The scheme became effective from May 17, 2017. With view to reduce the impact of semi regulated units on regulated units, SMS has demerged its semi-regulated units under Food and Drug administration (FDA) (i.e. Unit I-Kazipally unit (erstwhile unit I of SMS) Unit II-Jeedimetla unit (erstwhile unit IV of SMS) and Unit III-Bollaram unit (erstwhile unit V of SMS) and one R&D facility along with other assets, liabilities and investments and transferred to SMS Life. The company primarily caters to semi-regulated markets across India, Europe, Asia and has product base of more than 12 products under various therapeutic segments.

Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3*

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
	Standalone	Consolidated
Total operating income	215.47	380.06
PBILDT	15.72	37.05
PAT	6.50	17.85
Overall gearing (times)	0.31	0.53
PBILDT Interest coverage (times)	3.76	6.73
PBIT Interest Coverage (times)	2.40	5.31

A: Audited

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-Term Loan	-	-	-	4.50	CARE BBB+ (Under Credit watch with Developing Implications)
Non-fund-based - ST-BG/LC	-	-	-	0.32	CARE A2 (Under Credit watch with Developing Implications)
Fund-based - LT/ ST-Packing Credit in Foreign Currency	-	-	-	30.00	CARE BBB+ / CARE A2 (Under Credit watch with Developing Implications)
Fund-based - LT-Term Loan	-	-	-	20.00	CARE BBB+ (Under Credit watch with Developing Implications)

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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Term Loan	LT	4.50	CARE BBB+ (Under Credit watch with Developing Implications)	-	1)CARE BBB+; Stable (11-Feb-20) 2)CARE BBB+ (Under Credit watch with Developing Implications) (07-Oct-19)	1)CARE BBB+; Stable (31-Oct-18) 2)CARE BBB+; Stable (03-Oct-18)	1)CARE BBB+; Stable (18-Sep-17)
2.	Non-fund-based - ST-BG/LC	ST	0.32	CARE A2 (Under Credit watch with Developing Implications)	-	1)CARE A2 (11-Feb-20) 2)CARE A2 (Under Credit watch with Developing Implications) (07-Oct-19)	1)CARE A2 (31-Oct-18) 2)CARE A2 (03-Oct-18)	1)CARE A2 (18-Sep-17)
3.	Fund-based - LT/ ST-Packing Credit in Foreign Currency	LT/ST	30.00	CARE BBB+; Stable / CARE A2 Under Credit watch with Developing Implications)	-	1)CARE BBB+; Stable / CARE A2 (11-Feb-20) 2)CARE BBB+ / CARE A2 (Under Credit watch with Developing Implications) (07-Oct-19)	1)CARE BBB+; Stable / CARE A2 (31-Oct-18) 2)CARE BBB+; Stable / CARE A2 (03-Oct-18)	1)CARE BBB+; Stable / CARE A2 (18-Sep-17)
4.	Fund-based - LT-Term Loan	LT	20.00	CARE BBB+; Stable Under Credit watch with Developing Implications)	-	1)CARE BBB+; Stable (11-Feb-20) 2)CARE BBB+ (Under Credit watch with Developing Implications) (07-Oct-19)	1)CARE BBB+; Stable (31-Oct-18) 2)CARE BBB+; Stable (03-Oct-18)	-
5.	Non-fund-based - LT/ ST-Loan Equivalent Risk	LT/ST	-	-	-	1)Withdrawn (11-Feb-20) 2)CARE BBB+ / CARE A2 (Under Credit watch with Developing Implications) (07-Oct-19)	1)CARE BBB+; Stable / CARE A2 (31-Oct-18) 2)CARE BBB+; Stable / CARE A2 (03-Oct-18)	-

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

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 – D Naveen Kumar
Group Head Contact no. - 040-67937416
Group Head Email ID - dnaveen.kumar@careratings.com

Relationship Contact
Name: Ramesh Bob
Contact no. : +91 90520 00521
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.