# SMS Lifesciences India Limited

October 07, 2019

**Ratings**

| Facilities | Amount (Rs. crore) | Rating[1] | Rating Action |
|---|---|---|---|
| Long-term Bank Facilities | 32.00 | **CARE BBB+ (Triple B Plus) (Credit watch with Developing implications)** | Placed on credit watch with developing implications |
| Short-term Bank Facilities | 1.00 | **CARE A2 (A Two) (Credit watch with Developing implications)** | Placed on credit watch with developing implications |
| Long-term/Short-term Bank Facilities | 43.00 (enhanced from 41.50) | **CARE BBB+/CARE A2 (Triple B Plus/A Two) (Credit watch with Developing implications)** | Placed on credit watch with developing implications |
| **Total facilities** | **76.00 (Rs. Seventy Six crore only)** | | |

*Details of instruments/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 alert issued by USFDA stating that Ranitidine API may have carcinogenic impurities. Ranitidine contributed 35.75% of the total operating income during FY19, however the contribution of same towards USA and Europe is less than 1%. The company is in the process of evaluating with respect to presence of NMDA impurity (a carcinogenic impurity) in Ranitidine API and the results of the same are awaited. CARE is in the process of evaluating the impact of the above developments 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 enhanced bank facilities of SMS Lifesciences India Limited (SMS Life) continue 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 albeit product concentration risk, diversified and reputed client base with stable flow of repeat business, continued comfortable capital structure and synergy derived from its group company. The ratings also factor in the acquisition of Mahi Drugs Private Limited (Mahi Drugs) enabling SMS Life in quick expansion of capacities. The rating strengths are however, tempered by 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. The ability of company to scale up operations and derive benefits from acquisition, improve profitability and efficient management of working capital cycle are the key rating sensitivities.

**Detailed description of the key rating drivers**

**Key Rating Strengths**

***Experienced promoters and directors:*** The company has experienced promoters Mr. Potluri Ramesh Babu and Mr. TVVSN Murthy (also promoters of SMS Pharmaceuticals Limited) and directors with a strong track record in the pharmaceutical industry. All the directors are also involved in the operations of SMS. The promoters are in the pharmaceutical line of business for the last 29 years.

***Acquisition of Mahi Drugs:*** SMS Lifehas acquired 100% stake in Mahi Drugs Private Limited (Mahi Drugs) as on September 17, 2018. With this Mahi Drugs has become wholly owned subsidiary of SMS Life. The total cost of acquisition was Rs.25.93 crore. The acquisition is targeted to help SMS Life in quick expansion of capacities and also increase sales.

***Improvement in total operating income and profitability margins during FY19:*** The total operating income (TOI) of SMS Life improved significantly by 60.74% from Rs.215.47 crore in FY18 to Rs.346.35 crore. The improvement is on account of new product being launched during the year. PBILDT margin of the company improved significantly by 273 bps from 7.30% in FY18 to 10.03% during FY19 on account of better margins earned from the new products. In line with PBILDT margins, PAT margin also improved significantly by 178 bps from 3.02% during FY18 to 4.80% during FY19.

During Q1FY20, the company has achieved a total operating income of Rs.92.99 crore. The PBILDT% and PAT% of the company also stood at 10.68% and 4.81% for the said period.

[1] *Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

***Presence of regulatory approvals:*** All three units of SMS Life meet World Health Organization (WHO) cGMP standards. The units have the approvals to cater to the domestic and semi-regulated and unregulated markets. Further, the company has successfully completed US Food and Drug Administration (USFDA) audit during April, 2018 at its Kazipally Facility (Unit I) and now the company can export intermediates to the US market.

***Established presence in anti-ulcer segment:*** SMS Life has a portfolio of more than 12 Active Pharmaceuticals Ingredients (API) with an established presence in Anti –ulcer (GAS) segment (77% of gross sales in FY18) followed by Anti-erectile dysfunction (EDF) therapeutic segment. The company enjoys a good market share with respect to Ranitidine Hcl as the group is one of the single largest manufacturers of Ranitidine. Revenue from Ranitidine registered y-o-y growth of 16.91% from Rs.113.44 crore for FY18 to Rs.132.62 crore during FY19 for SMS Life.

***Diversified and reputed client base with stable flow of repeat business:*** The company has diversified revenue with top 6 clients contributing 29% (25% in FY17) of the gross sales in FY18 thereby reducing risk of revenue stream from single client. The clients are globally well renowned innovator in pharma and research. As on September 12, 2018, the company had an order book of Rs.95.43 crore to be executed from unit I-Kazipally and unit II-Jeedimetla.

***Synergy derived from SMS:*** SMS Life derives benefit as being part of the SMS group. SMS life is able to cater to clients which have long term relation with SMS group resulting strong customer base for SMS Life.

***Comfortable capital structure:*** SMS Life continues to have comfortable capital structure however, debt to equity and overall gearing deteriorated marginally to 0.33x and 0.45x as on March 31, 2019 as against 0.24x and 0.31x as on March 31, 2019 owing to increase in term loan and working capital borrowing during the year.

***Satisfactory debt coverage indicators:*** The PBILDT interest coverage improved from 3.76x during FY18 to 6.36x during FY19 on account of improved PBILDT level. Further, Total debt/GCA improved marginally from 2.33x during FY18 to 2.03x during FY19.

***Industry outlook:*** The outlook of the pharma industry is stable in light of healthy prospects for the domestic as well as the export markets. Exports to regulated markets along with semi- markets would drive the growth for Indian Pharmaceutical Industry (IPI) on the back of patent expiries and increasing government emphasis on generics in these markets.

**Key Rating Weaknesses**

***High product contribution for Anti –ulcer segment:*** The expertise of the group led to increased focus in the Anti –ulcer therapeutic segment for Ranitidine Hcl resulting in high product concentration risk contributing around 35.75% of the gross sales in FY19.

***Moderate operating cycl***e: The operating cycle of the company improved from 47 days in FY18 to 30 days in FY19 mainly due to decrease in average inventory period and average collection period. The average inventory period of the company improved to 73 days in FY19 (86 days in FY18). The average collection period of the company also improved from 51 days in FY18 to 31 days in FY19 on account of better realization of debtors.

***Debt funded capex:*** The company is undertaking expansion project at Kazipally to increase the additional capacities as well as renovation of the facility to meet the current regulatory compliances. The total project cost of the proposed unit is estimated at Rs.26.12 crore.

***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.

***Exposure to regulatory and foreign exchange fluctuation risk:*** The Company is exposed to regulatory risk with its operations centered majorly into manufacturing pharmaceutical APIs; however, for SMS Life, risk pertaining to regulatory compliance of USFDA is limited as the company’s major share of revenue is from semi regulated markets. Further, SMS Life is exposed to foreign exchange fluctuation risk in view of large volume and high value transactions of export and import, the risk gets mitigated to certain extent due to natural hedging through netting off the imports and exports to a large extent.

***Prospects:*** The prospect in medium to long term period will depend upon the ability of the company to derive benefits from acquisition, tying debt for capex, increase the scale of operations by diversifying the product and therapeutic segment along with an improvement in profitability in a highly competitive scenario while managing its raw material prices.

**Analytical approach:** Standalone
**Applicable criteria**
[Criteria on assigning Outlook to Credit Ratings]
[CARE's Policy on Default Recognition]
[Criteria for Short term Instruments]
[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 Klishore 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) |
|---|---|---|
| Total operating income | 215.47 | 346.35 |
| PBILDT | 15.72 | 34.75 |
| PAT | 6.50 | 16.63 |
| Overall gearing (times) | 0.31 | 0.45 |
| Interest coverage (times) | 3.76 | 6.36 |

*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 | - | - | September 2020 | 12.00 | CARE BBB+ (Under Credit watch with Developing Implications) |
| Non-fund-based - ST-BG/LC | - | - | - | 1.00 | CARE A2 (Under Credit watch with Developing Implications) |
| Fund-based - LT/ ST-Packing Credit in Foreign Currency | - | - | - | 40.00 | CARE BBB+ / CARE A2 (Under Credit watch with Developing Implications) |
| Term Loan-Long Term | - | - | - | 20.00 | CARE BBB+ (Under Credit watch with Developing Implications) |
| Non-fund-based - LT/ ST-Loan Equivalent Risk | - | - | - | 3.00 | CARE BBB+ / CARE A2 (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 2019-2020 | Date(s) & Rating(s) assigned in 2018-2019 | Date(s) & Rating(s) assigned in 2017-2018 | Date(s) & Rating(s) assigned in 2016-2017 |
| 1. | Fund-based - LT-Term Loan | LT | 12.00 | CARE BBB+ (Under Credit watch with Developing Implications) | - | 1)CARE BBB+; Stable (31-Oct-18)<br>2)CARE BBB+; Stable (03-Oct-18) | 1)CARE BBB+; Stable (18-Sep-17) | - |
| 2. | Non-fund-based - ST-BG/LC | ST | 1.00 | CARE A2 (Under Credit watch with Developing Implications) | - | 1)CARE A2 (31-Oct-18)<br>2)CARE A2 (03-Oct-18) | 1)CARE A2 (18-Sep-17) | - |
| 3. | Fund-based - LT/ ST-Packing Credit in Foreign Currency | LT/ST | 40.00 | CARE BBB+ / CARE A2 (Under Credit watch with Developing Implications) | - | 1)CARE BBB+; Stable / CARE A2 (31-Oct-18)<br>2)CARE BBB+; Stable / CARE A2 (03-Oct-18) | 1)CARE BBB+; Stable / CARE A2 (18-Sep-17) | - |
| 4. | Term Loan-Long Term | LT | 20.00 | CARE BBB+ (Under Credit watch with Developing Implications) | - | 1)CARE BBB+; Stable (31-Oct-18)<br>2)CARE BBB+; Stable (03-Oct-18) | - | - |
| 5. | Non-fund-based - LT/ ST-Loan Equivalent Risk | LT/ST | 3.00 | CARE BBB+ / CARE A2 (Under Credit watch with Developing Implications) | - | 1)CARE BBB+; Stable / CARE A2 (31-Oct-18)<br>2)CARE BBB+; Stable / CARE A2 (03-Oct-18) | - | - |

***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. - +91 88860 97382
Group Head Email ID - dnaveen.kumar@careratings.com

**Relationship Contact**
Name: Ramesh Bob
Contact no. : +91 90520 00521
Email ID: ramesh.bob@careratings.com

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