SMS Pharmaceuticals Limited
September 12, 2017

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	174.76	**CARE A-; Stable (Single A Minus; Outlook: Stable)**	Reaffirmed Removed from credit Watch
Short term Bank Facilities	50.83	**CARE A2 (A Two)**	Reaffirmed Removed from credit Watch
Total	**225.59 (Rs. Two hundred and twenty five crore and fifty nine lakh only)**		

Detailed Rationale & Key Rating Drivers
The above ratings were placed under 'credit watch' with developing implications, following approval of Draft Scheme of Arrangement for Demerger (DSAD) of Semi-regulated units (Unit I, IV and V) along with other assets to transfer the same to SMS Lifesciences India Limited (Resulting Company) by the company's board. Since the impact and implications of the above developments on the credit quality of SMS Pharmaceuticals Limited (SMS) was unclear at the time of last review, the rating was placed on credit watch.
As per order dated May 15, 2017, the scheme of Arrangement has been approved by National Company Law Tribunal (NCLT) between SMS (Demerged Company) and SMS Lifesciences India Limited (SMS Life) (Resulting Company). The scheme has become effective from May 17, 2017 with appointed date as April 01, 2016. Pursuant to this, ratings have been removed from credit watch.
The ratings assigned to the bank facilities of SMS Pharmaceuticals Limited (SMS) continue to derive strength from experienced promoters with established track record of the company in pharmaceutical industry, presence of regulatory approvals with well-equipped manufacturing facilities with the United States Food & Drug Administration (USFDA) and current Good Manufacturing practices (cGMP) certified production units, improved order book position with reputed customers, satisfactory working capital cycle albeit increased inventory holding period and favorable industry outlook. The ratings also take into account successful completion of demerger, improved profitability margins during FY17 (refers to the period April 01 to March 31), improved capital structure as on March 31, 2017 and satisfactory debt coverage indicators. The ratings are, however, tempered by decline in total operating income (TOI) on account of demerger during FY17, continued sales concentration risk in terms of client as well as therapeutic segment, risk on account of expected additional support to be extended to associate company, foreign exchange fluctuation risk and regulatory risk with respect to the pharmaceutical industry.
The ability of the company to enhance the scale of operation by diversifying the product base along with increased presence in therapeutic segments and manage forex exchange fluctuation risk are the key rating sensitivities.

Detailed description of the key rating drivers
Key Rating Strengths
Successful completion of demerger: With transfer of its semi-regulated units (unit I, IV and V) to SMS Life has enabled the SMS to focus on regulated markets where margins are significantly higher coupled with reduction in cost.
Improved profitability margins during FY17: Profitability margins improved during FY17 vis-à-vis FY16 due to improvement in yields, addition of new products along with reduction in production cost during FY17. Lower interest expense led to improved PAT margin during FY17.
Improved capital structure as on March 31, 2017: The overall gearing level of SMS remained comfortable and improved to 0.57x as on March 31, 2017 as against 0.74x as on March 31, 2016 on account of reduced debt level on account of demerger, repayment of long term debt and reduced working capital utilization. Total debt/GCA improved to 2.46x during FY17 (3.11x for FY16) on account of lower debt levels.
Experienced promoters with established track record of operations: The promoters have over 28 years of experience in the pharmaceutical industry. Under the present management, SMS has remaining two regulated facilities (Unit I and Unit VII) and the one R&D facility post demerger.

[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 meet World Health Organization (WHO) cGMP standards and also have various certifications. Unit II and Unit VIII has US FDA approval along with other approvals.
Improved order book position with reputed customers: SMS had total order book of around Rs.407.29 crore to be executed for clients such as Mylan Laboratories Limited, Lupin Ltd, Sun Pharma Laboratories Limited etc.
Satisfactory working capital cycle; albeit increased inventory holding period: The operating cycle of SMS was satisfactory at 60 days during FY17 (56 days during FY16) on account stretched inventory days to 102 days in FY17 (from 71 days in FY16), the same is offset by increased credit period to 75 days in FY17 (51 days in FY16) from suppliers. The inventory period witnessed significant increase on account of process change with Mylan in February 2017 which affected stocks.
Favorable industry outlook: The outlook of the pharma industry is favorable in light of healthy prospects for the domestic as well as the export markets. Exports to regulated markets along with emerging 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
Decline in TOI during FY17: The TOI of SMS declined by 28% to Rs.438.55 crore in FY17 vis-à-vis Rs.605.82 crore in FY16 primarily on account of demerger which has led to transfer of 3 of its erstwhile manufacturing units and 1 R&D center to the resulting company.
Continued sales concentration: The revenue of the company remains concentrated wherein the top 5 clients contributing around 83.70% to the revenue in FY17 with 70.88% revenue contribution from Mylan Laboratories Limited. Further, major revenue share is constitutes from Efavirenz which accounts for 69% of total gross sales.
Risk on account of expected support to be extended to associate company: SMS has demonstrated support to wards VKT in the form of regular equity infusion in order to support the operation and debt servicing in the past. Going forward, expected support from SMS towards its associated company envisaged will be critical from credit perspective.
Foreign exchange fluctuation risk and regulatory risk: SMS is exposed to forex risk as major revenue of the company comes from exports. The forex risk is partly mitigated by natural hedge through the imports. During the year, SMS has earned net gain on foreign currency transaction and translations. Further the pharmaceutical industry is highly regulated in many other countries and requires various approvals, licenses, registrations and permissions for business activities.

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
Financial ratios – Non-Financial Sector
Rating Methodology- Pharmaceutical Sector
Rating Methodology: Factoring Linkages in Ratings

About the Company
SMS Pharmaceuticals Limited (SMS), a listed company, was originally started by Mr. K G Suggula in the year 1987 as a private limited company and soon turned sick due to the lack of demand for the products being manufactured. The current promoters' Mr. P Ramesh Babu (Chairman and Managing Director) and Mr. TVVSN Murthy (Joint Managing Director) acquired the company in the year 1990. SMS is engaged in manufacturing of Active Pharmaceutical Ingredients (APIs) and its intermediates and also undertakes contract manufacturing. SMS has over the years set up manufacturing facilities to suit its operations and to meet various regulatory requirements. Previously SMS was operating 5 units and 2 R&D facilities. Out of which three units namely Unit I (Kazipally), Unit IV (Jeedimetla) and Unit V (Bollaram unit) along with one R&D facility transferred to SMS Lifesciences India Limited and rest of the two units which are regulated and one R&D facility is with SMS.
The Scheme of arrangement between M/s SMS Lifesciences India Limited & SMS Pharmaceuticals Limited has been approved by the Honorable National Company Law Tribunal vide order dated May 15, 2017. With view to reduce the impact of semi regulated units on regulated units, achieving operational efficiency, site synergies, streamlining its current structure, SMS has demerged its semi-regulated unit (I, IV and V) and transferred to resulting company SMS Lifesciences India Limited (SMS Life).

Brief Financials (Rs. Crore)	FY16 (A)	FY17 (A)
Total operating income	605.82	438.55
PBILDT	91.87	75.41
PAT	41.64	35.52
Overall gearing (times)	0.74	0.58

Brief Financials (Rs. Crore)	FY16 (A)	FY17 (A)
Interest coverage (times)	5.37	4.90

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

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.*

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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.

Annexure-1: Details of Instruments/Facilities

(Rs. crore)

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	75.00	CARE A-; Stable
Non-fund-based - ST-Letter of credit	-	-	-	30.00	CARE A2
Fund-based - LT-Term Loan	-	-	September 2022	84.76	CARE A-; Stable
Fund-based - ST-Line of Credit	-	-	-	16.00	CARE A2
Fund-based - LT-Packing Credit in Foreign Currency	-	-	-	15.00	CARE A-; Stable
Non-fund-based - ST-Bank Guarantees	-	-	-	2.00	CARE A2
Non-fund-based - ST-Forward Contract	-	-	-	2.83	CARE A2

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 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	Fund-based - LT-Cash Credit	LT	75.00	CARE A-; Stable	-	1)CARE A- (Under Credit Watch) (12-Oct-16)	1)CARE A- (18-Sep-15)	1)CARE BBB+ (08-Aug-14)
2.	Non-fund-based - ST-Letter of credit	ST	30.00	CARE A2	-	1)CARE A2 (Under Credit Watch) (12-Oct-16)	1)CARE A2 (18-Sep-15)	1)CARE A3+ (08-Aug-14)

3.	Fund-based - LT-Term Loan	LT	84.76	CARE A-; Stable	-	1)CARE A- (Under Credit Watch) (12-Oct-16)	1)CARE A- (18-Sep-15)	1)CARE BBB+ (08-Aug-14)
4.	Fund-based - ST-Line of Credit	ST	16.00	CARE A2	-	1)CARE A2 (Under Credit Watch) (12-Oct-16)	1)CARE A2 (18-Sep-15)	1)CARE A3+ (08-Aug-14)
5.	Fund-based - LT-Packing Credit in Foregin Currency	LT	15.00	CARE A-; Stable	-	1)CARE A- (Under Credit Watch) (12-Oct-16)	1)CARE A- (18-Sep-15)	1)CARE BBB+ (08-Aug-14)
6.	Non-fund-based - ST-Bank Guarantees	ST	2.00	CARE A2	-	1)CARE A2 (Under Credit Watch) (12-Oct-16)	1)CARE A2 (18-Sep-15)	1)CARE A3+ (08-Aug-14)
7.	Non-fund-based - ST-Forward Contract	ST	2.83	CARE A2	-	1)CARE A2 (Under Credit Watch) (12-Oct-16)	1)CARE A2 (18-Sep-15)	1)CARE A3+ (08-Aug-14)

CARE Ratings
Professional Risk Opinion

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