SMS Pharmaceuticals Limited

December 30, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	277.75 (Reduced from 286.75)	**CARE A-; Stable (Single A Minus; Outlook – Stable)**	Reaffirmed
Short Term Bank facilities	50.83	**CARE A2 (A Two)**	Reaffirmed
Total Facilities	**328.58 (Rs.Three Hundred Twenty Eight crore and Fifty Eight Lakh only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of SMS Pharmaceuticals Limited (SMS Pharma) continue to derive strength from experienced promoters with established track record of the company in pharmaceutical industry, well-equipped manufacturing facilities with presence of regulatory approvals from the United States Food & Drug Administration (USFDA) and current Good Manufacturing practices (cGMP) certified production units, stable order book position with reputed customers, reduced revenue concentration risk towards clients, therapeutic segment and products along with stable industry outlook. The ratings also take into account stable profitability margins during FY20 (refers to the period April 01 to March 31) and H1FY20, improved capital structure as on March 31, 2020 and debt coverage indicators. The ratings are, however, tempered by decline in total operating income during FY20, time overrun in the envisaged debt funded capex due to Covid-19, stretched inventory period leading to elongated working capital cycle, risk on account of exposure towards associate company, foreign exchange fluctuation risk and regulatory risk associated with the pharmaceutical industry.

Rating Sensitivities

Positive factors

- Diversification in its customer base, wherein no single customer contributes over 30% of total gross sales.
- PBILDT margin of the company sustained at 20% over the years.

Negative factors

- Overall gearing of company deteriorating above 1.00x going forward.
- Working capital cycle of the company stretching beyond 180 days.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters

SMS Pharma is being promoted by Mr. P Ramesh Babu (Chairman and Managing Director) and Mr. TVVSN Murthy (Director) who acquired the company in the year 1990. The current promoters have over 30 years of experience in the pharmaceutical industry. Under the present management, SMS Pharma 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. Further during FY20, the company has completed the EDQM/ANSM, France authorities audit during January 2020 and received EUGMP certificate for Tadalafil unit. The company also completed USFDA inspection and received EIR for Unit VII in January 2020 and WHO GMP (CDSCO – Govt. of Andhra Pradesh) in November 2019.

Established track record with presence in various global markets with regulatory approvals in place

SMS Pharma has an established track record of over two decades in the pharmaceutical business with presence across various global markets. SMS Pharma has presence in over 70 countries across the globe. The company is focusing on strengthening its presence in the regulatory markets. Majority of the company's revenues are derived from exports to regulatory markets. For a pharmaceutical company, to enter the regulatory markets of US and Europe, its manufacturing unit must meet certain regulatory standards like USFDA, cGMP, EDQM etc. SMS Pharma's Unit II has USFDA, Korean and European regulatory approvals; and Unit VII has USFDA certification. Going forward, the company will be working on towards increasing revenue from its own product pipeline.

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

Reduced product and customer concentration with presence in several therapeutic segments
Although, SMS Pharma caters to various therapeutic segments namely; Antiretroviral (ARV), Anti-Ulcer, Anti-Fungal, Anti-Hypertensive, Anti Migraine, etc., the Antiretroviral (ARV) segment although remained to be the major contributor to the total revenue during the last three years, the % contribution has declined considerably to 48.22% in FY20 as against 67.65% during FY19 resulting in reduction in therapeutic concentration risk. Further, the top five products of the company contributes to around 60% of gross sales during FY20 as against around 80% during FY19. This indicates reduction in the product concentrations risk. Also, Efavirenz (ARV) is one of the highest selling product for SMS Pharma in FY20 contributing 21.80% of total gross sales as against 49.91% in FY19. Earlier, for treating HIV patients the regimen of drugs used was TLE (Tenofovir, Lamivudine, Efavirenz), however, as per WHO guideline, the new regimen of drugs to be used for treating HIV patients is TLD (Tenofovir, Lamivudine, Dolutagravir). The company enjoys dependable relationships with major global pharma companies. The company has been generating revenue from these customers with long standing relation of over a decade with most of them.

Satisfactory order book position with reputed clientele customer base
SMS Pharma primarily undertakes contract manufacturing for various reputed companies across the globe. The company has long-standing relationships with companies like Mylan Laboratories, Sun Pharmaceutical Industries Limited, Chemo, Sceigen Pharmaceuticals Inc, Welding Gmbh, Astellas Ireland Co. Ltd., Lupin Limited, Cipla Limited, Dr. Reddy's Laboratories, etc. As on September 30, 2020, SMS Pharma had total order book of around Rs.241.51 crore to be executed from its Unit II and unit VII.

Comfortable capital structure of the company
The capital structure of the company mainly comprises of term loans, working capital borrowing and LC backed creditors. The overall gearing (including LC backed creditors) of the company remained stable at 0.44x as on March 31, 2020 as against 0.43x as on March 31, 2019. This is due to loan disbursed during FY20 for the expansion project coupled with accretion of profit to the net worth. On account of the aforementioned reason, the total debt to GCA of the company also deteriorated from 2.14x during FY19 to 2.51x during FY20 on account of decline in GCA level coupled with increase in total debt as on March 31, 2020. The coverage indicator to the company represented by PBILDT/interest also declined from 7.72x during FY19 to 6.75x during FY20 on account of reduction in PBILDT level during the year.

Stable industry outlook
The operations of pharma industry being considered necessary came under the ambit of essential manufacturing during the lockdown induced by Covid-19. This had kept production activities at many pharma companies largely unaffected. Also easing of restrictions in different phases of lockdown is believed to have supported the operations of pharma companies. During this period, while the domestic market for antibiotics, cold and cough gained traction. Inbound logistics constraints restricted the movement in exports to an extent during lockdown.
With relief in various restrictions, the industry is expected to see pent up demand for treatments that were postponed which will support the demand for drugs. Moreover, the demand for medicines will increase during the monsoon season as the distributors and retailers normally stock drugs for the season. These parameters will augur well for pharma industry. In addition to this, the industry will continue to see demand from the domestic as well as international markets for some of the antivirals, anti-malarials and antibiotics given the spread of Covid-19.

Prospects:
The prospect in medium to long term period will depend upon the ability of the company to increase the scale of operations by diversifying the product and client profile while ramping up the production activity at newly constructed production block along with an improvement in profitability in a highly competitive scenario while managing its raw material prices.

Key rating weaknesses
Decline in total operating income albeit stable profitability margins during FY20
The total operating income of SMS Pharma has declined by 11.15% to Rs.414.46 crore in FY20 vis-à-vis Rs.466.48 crore in FY19. The main reason for decline in revenue is due to decrease in off-take from Anti-retroviral drugs which is mainly on account of delay in bidding process by the customer under contract manufacturing. However, the company has been focusing to manufacture and sell off other new molecules developed by its own R&D and to penetrate into overseas markets to increase the revenues as well as profitability margins. The PBILDT margin of the company has improved marginally by 25 bps from 19.65% during FY19 to 19.90% during FY20. However, the PAT margin declined by 100 bps from 8.89% in FY19 to 7.89% in FY20 on account of increase in interest expenses.
During H1FY21, the total operating income of the company stood at Rs.244.33 crores as against Rs.236.26 crore during H1FY20. Further, PBILDT and PAT margin of the company stood at 19.17% and 8.36% in H1FY21 vis-à-vis 19.83% and 8.05% in H1FY20 respectively.

Ongoing debt funded capex

The company has started capex for the expansion of capacity at existing facility Unit VII which is situated in Kandivasala, Andhra Pradesh for new products. The total project cost around Rs.185 crore which will be funded by debt to the extent of Rs.140 crore and remaining Rs.45 crore through internal accruals. Currently, the company has debt tied up for Rs.115 crore and remaining Rs.25 crore is in process and is expected to be sanctioned by end of December 2020. Till October 30, 2020, as per the CA certificate provided, the company has incurred Rs.171.22 crore which was funded through internal accruals (Rs.67.14 crore), term loans (Rs.82.97 crore) and capital creditors (Rs.21.11 crore). Further, the additional internal accruals used for project will be reimbursed once sanction of term loan for Rs.25 crore is in place. The repayment for the term loans will commence from December 2020 onwards. The scheduled commercial operation date for this project was June 30, 2020, however, on account of lockdown due to Covid-19, the project got delayed by around 9 months. The new commercial operations date in March 31, 2021.

Elongation in working capital cycle during FY20

The operating cycle of SMS Pharma deteriorated from 94 days in FY19 to 126 days in FY20. The deterioration is mainly on account of increase in inventory period. The average inventory period of the company increased from 118 days in FY19 to 146 days during FY20. Even though the inventory level as on March 31, 2020 declined by 5.28% vis-à-vis as on March 31, 2019, the cost of sales declined by around 11.43% during FY20 as against FY19. This resulted in increase in the inventory days during FY20. The collection period of the company also increased from 18 days in FY19 to 30 days in FY20. The creditor period also increased to 50 days during FY20 (42 days during FY19). The company's average working capital utilization was at satisfactory level of 45.90% for the 12 months ended September 30, 2020.

Risk on account of support extended to associate company

VKT Pharma Private Limited is an associate company of SMS Pharma engaged in manufacture of formulations & semi-finished formulations viz. pellets. SMS Pharma has given Letter of Comfort (LOC) without any financial obligation or guarantee to the banker (Yes Bank Ltd – term loan of Rs. 90 crore) of VKT Pharma Private Limited. As on March 31, 2020, the company is holding 42.62% of the total paid up capital of the said Associate Company. Going forward, the ability of VKT to generate sufficient cash flows from operations so as to not be dependent on financial support from SMS Pharma will be crucial from credit risk perspective.

Forex risk on account of exports

SMS Pharma continues to remain exposed to foreign exchange fluctuation risk in view of huge volume and high value transactions of export and import, a phenomenon common to the players in the industry. However, for SMS Pharma, the risk gets mitigated to certain extent as the contracts have clause embedded for the exchange rate fluctuation and there is natural hedging through netting off of earning and expenses in foreign currency to extent of 18.47%. The un-hedged foreign currency exposure as on March 31, 2020 was Rs.42.83 crore as against Rs.26.68 crore as on March 31, 2019. The company recorded a total forex gain of Rs.1.80 crore during FY20 as against Rs.0.93 crore during FY19.

Regulatory risk

The company is exposed to regulatory risk with its operations centered majorly into manufacturing pharmaceutical APIs. 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. Given, India's significant share in the USA's generic market, the USFDA has increased its scrutiny of manufacturing facilities and other regulatory compliance of the Indian pharma companies supplying generics drugs to the USA. Non-compliance may result in regulatory ban on products/ facilities (as in the recent cases of import alerts issued by the USFDA to top pharma companies) and may impact a company's future approvals from USFDA. Hence, ongoing regulatory compliance has become critical for Indian pharma companies including SMS Pharma as it seeks to strengthen its position in the regulated markets like USA, UK, etc.

Liquidity: Adequate

The liquidity position of the company remained adequate characterized by free cash balance of Rs.14.80 crore as on March 31, 2020 and GCA of Rs.63.88 crore during FY20. The current ratio of the company remained comfortable and above unity at 1.40x as on March 31, 2020 as against 1.36x as on March 31, 2019. Moreover, the company has adequate unutilized working capital borrowing along with free cash balance of Rs.6.58 crore as on September 30, 2020 and GCA of Rs.35.68 crore during H1FY21. The repayment obligations of the company for FY21 amounts to Rs.31.48 crore out of which the company has repaid Rs.13.67 crore till November 30, 2020. Considering the past performance of the company along with sufficient funds available, it is expected that the company will be able to meet its remaining debt obligations for FY21 comfortably. Further, the company has opted for moratorium only with IDBI bank for March 2020 and June 2020 for principal payment of the term loan.

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
Liquidity Analysis – Non-Financial Sector

About the Company
SMS Pharmaceuticals Limited (SMS Pharma), a public limited company is listed on National Stock Exchange and Bombay Stock Exchange. The 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 that were being manufactured. The current promoters' Mr. P Ramesh Babu (Chairman and Managing Director) and Mr. TVVSN Murthy (Director) acquired the company in the year 1990. SMS Pharma is engaged in manufacturing of Active Pharmaceutical Ingredients (APIs) and its intermediates and also undertakes contract manufacturing for API/ bulk drugs. SMS Pharma has over the years set up manufacturing facilities to suit its operations and to meet various regulatory requirements. Currently, SMS Pharma has two regulated facilities (Unit II and Unit VII) with both the units having US Food and Drug Administration (USFDA) approval and 1 R&D facilities. Apart from USFDA approval, Unit II also has European regulatory approvals while Unit VII has Korean Food and Drug Administration (KFDA) and Japan Pharmaceuticals and Medical Devices Agency (PMDA) approval and all units also meet World Health Organization (WHO) cGMP standards.

Brief Financials (Rs. crore)	FY19 (A)	FY20 (A)
Total operating income	466.48	414.46
PBILDT	91.67	82.48
PAT	41.45	32.69
Overall gearing (times)	0.43	0.44
Interest coverage (times)	7.72	6.75

A: Audited

Status of non-cooperation with previous CRA: NA

Any other information: NA

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 for this company: Annexure 4

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-Cash Credit	-	-	-	66.00	CARE A-; Stable
Non-fund-based - ST-Letter of credit	-	-	-	30.00	CARE A2
Fund-based - LT-Term Loan	-	-	October 2026	196.75	CARE A-; Stable
Fund-based - ST-Line of Credit	-	-	-	16.00	CARE A2
Fund-based - LT-Packing Credit in Foregin 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 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-Cash Credit	LT	66.00	CARE A-; Stable	-	1)CARE A-; Stable (22-Nov-19)	1)CARE A-; Stable (04-Oct-18)	1)CARE A-; Stable (12-Sep-17)
2.	Non-fund-based - ST-Letter of credit	ST	30.00	CARE A2	-	1)CARE A2 (22-Nov-19)	1)CARE A2 (04-Oct-18)	1)CARE A2 (12-Sep-17)
3.	Fund-based - LT-Term Loan	LT	196.75	CARE A-; Stable	-	1)CARE A-; Stable (22-Nov-19)	1)CARE A-; Stable (04-Oct-18)	1)CARE A-; Stable (12-Sep-17)
4.	Fund-based - ST-Line of Credit	ST	16.00	CARE A2	-	1)CARE A2 (22-Nov-19)	1)CARE A2 (04-Oct-18)	1)CARE A2 (12-Sep-17)
5.	Fund-based - LT-Packing Credit in Foregin Currency	LT	15.00	CARE A-; Stable	-	1)CARE A-; Stable (22-Nov-19)	1)CARE A-; Stable (04-Oct-18)	1)CARE A-; Stable (12-Sep-17)
6.	Non-fund-based - ST-Bank Guarantees	ST	2.00	CARE A2	-	1)CARE A2 (22-Nov-19)	1)CARE A2 (04-Oct-18)	1)CARE A2 (12-Sep-17)
7.	Non-fund-based - ST-Forward Contract	ST	2.83	CARE A2	-	1)CARE A2 (22-Nov-19)	1)CARE A2 (04-Oct-18)	1)CARE A2 (12-Sep-17)

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

Annexure 4: Complexity level of various instruments rated for this Company

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based - LT-Cash Credit	Simple
2.	Fund-based - LT-Packing Credit in Foregin Currency	Simple
3.	Fund-based - LT-Term Loan	Simple
4.	Fund-based - ST-Line of Credit	Simple
5.	Non-fund-based - ST-Bank Guarantees	Simple
6.	Non-fund-based - ST-Forward Contract	Simple
7.	Non-fund-based - ST-Letter of credit	Simple

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

Contact us

Media Contact
Name – Mradul Mishra
Contact no. – +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact:
Name – Mr D Naveen Kumar
Tel – 040-40102030
Mobile – +91-8886097382
Email – dnaveen.kumar@careratings.com

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

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