SMS Pharmaceuticals Limited

November 22, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long term Bank Facilities	286.75 (Enhanced from 174.25)	**CARE A-; Stable (Single A Minus; Outlook: Stable)**	Reaffirmed
Short term Bank Facilities	50.83	**CARE A2 (A Two)**	Reaffirmed
Total Facilities	**337.58 (Rs. Three hundred Thirty Seven crore and Fifty Eight lakhs 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, 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, stable order book position with reputed customers, satisfactory working capital cycle and stable industry outlook. The ratings also takes into account stable total operating income and profitability margins during FY19 (refers to the period April 01 to March 31) and H1FY20 (H1 refers to April 1 to September 30), improved capital structure as on March 31, 2019 and debt coverage indicators. The ratings are, however, tempered by continued sales concentration risk in terms of client as well as therapeutic segment and product, risk on account of exposure towards associate company, foreign exchange fluctuation risk and regulatory risk with respect to the pharmaceutical industry.

Rating Sensitivities

Positive Factors

- Diversification in its customer base, wherein no single customer contributes over 30% of total gross sales.
- Improvement in scale of operations and maintaining of PBILDT margins above 20% on sustained basis.

Negative Factors

- Overall gearing of company rising above 1.00x going forward
- Delay in completion and commercialization of the ongoing capex
- Stretch in working capital cycle of the company

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 FY19, there has been no inspections carried out from outside regulatory authority, however, CDSCO inspected Unit VII for WHO GMP, EU-WC certification and Unit II for WHO GMP certification during November 2018.

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. Since, SMS Pharma is focusing on strengthening its presence in regulatory markets for which the company has further filed 22 DMFs till October 21, 2019 and during FY19 (9 DMF from Unit VII and 13 DMF from Unit II). Going forward, the company will be working on towards increasing revenue from its own product pipeline.

Stable total operating income and profitability margins during FY19

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

The total operating income of SMS Pharma has remained stable registering marginal growth of about 0.58% to Rs.466.48 crore in FY19 vis-à-vis Rs.463.78 crore in FY18. The PBILDT margin of the company has declined marginally by 72 bps from 20.37% during FY18 to 19.65% during FY19. However, the PAT margin improved marginally by 17 bps from 8.72% in FY18 to 8.89% in FY19 on account of reduced interest expenses. Further, GCA increased by 1.18% to Rs.68.29 crore during FY19 from Rs.67.49 crore in FY18.

During H1FY20, the total operating income of the company stood at Rs.236.26 crores as against Rs.261.79 crore during H1FY19. Further, PBILDT and PAT margin of the company stood at 19.83% and 8.05% in H1FY20 vis-à-vis 19.43% and 8.67% in H1FY19 respectively.

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, Ohm Laboratories Inc., Chemo India Formulation Pvt. Ltd etc. As on August 31, 2019, SMS Pharma had total order book of around Rs.323.37 crore to be executed from its Unit II and unit VII. Further, SMS Pharma continues to process Tenofovir for Mylan. Further, the company is undertaking R&D process in order to meet the certain speciation required by Japanese market. The Company has successfully completed PMDA, Japan audit during August 2017 at its Bachupally Facility i.e. Unit II.

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 improved from 0.50x as on March 31, 2018 to 0.43x as on March 31, 2019. The total debt to GCA of the company also improved from 2.22x during FY18 to 2.14x during FY19. The coverage indicator to the company represented by PBILDT/interest improved significantly from 6.10x during FY18 to 7.72x during FY19 on account of reduced interest expenses during the year.

Satisfactory working capital cycle during FY19

The operating cycle of SMS Pharma deteriorated from 63 days in FY18 to 94 days in FY19. The deterioration is mainly on account of increase in inventory period. The average inventory period of the company increased from 98 days in FY18 to 118 days during FY19. The collection period of the company increased from 16 days in FY18 to 18 days in FY19. The creditor period also decreased to 42 days during FY19 (51 days during FY18). The company’s average working capital utilization was at satisfactory level of about 48% for the 12 months ended August 2019.

Stable 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. 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. These factors are expected to increase the volumes of Indian pharma industry and the volumes are likely to grow faster compared to total domestic market growth rate. Considering the growth in domestic and export pharma market, it is expected that 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

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.175 crore which will be funded by debt to the extent of Rs.140 crore and remaining Rs.35 crore through internal accruals. The company has already tied up with EXIM bank and Yes bank for the funding of Rs.140 crore. Till September 30, 2019, the company has incurred Rs.57.91 crore which was funded through term loans to the extent of Rs.20.00 crore and balance through internal accruals. Further, the company has incurred more than the estimated level of internal accruals till September 30, 2019 and the same will be adjusted at later stage through term loans. The scheduled commercial operation date for this project is June 30, 2020. During FY20, the company proposes to incur Rs.100.21 crore funded through term loans. Remaining Rs.44.29 crore is proposed to be incurred in FY21 and will be funded through term loan.

Continued high product and customer concentration despite presence in several therapeutic segments

Although, SMS Pharma caters to various therapeutic segments namely; Antiretroviral (ARV), Anti-Ulcer, Anti-Fungal, Anti - Hypertensive, Anti Migraine, Oncology etc., the Antiretroviral (ARV) segment remained to be the major contributor to the total revenue during the last three years. Efavirenz (ARV) continued to remain the highest selling product for SMS Pharma in FY19 at the back of high demand. The company sells Efavirenz to Mylan primarily for the South African markets. Further, the revenue contribution from Efavirenz has come down during FY19 on account of sale of new products introduced by the company during the year benefitting the company through reduced sales concentration from one product. 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.

Risk on account of expected support to be 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 also given Letter of Comfort (LOC) towards the term loan of Rs.90 crore without

any financial obligation or guarantee to the banker (Yes Bank) of VKT Pharma Private Limited. SMS Pharma holds 42.62% of the total paid up capital of the said Associate Company as on March 31, 2019.
However, during FY19, in VKT Pharma Pvt. Ltd., the promoters and related parties have infused equity capital amounting to Rs.12.34 crore and unsecured loans of Rs.18 crore which is sufficient to meet both its debt obligation and working capital requirements.

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 the imports and exports to extent of 5%.

Regularity 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. 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 Position: Adequate

The liquidity position of the company remained adequate characterized by free cash balance of Rs.14.80 crore as on March 31, 2019 and GCA of Rs.69.29 crore during FY19. The current ratio of the company remained comfortable and above unity at 1.36x as on March 31, 2019 as against 1.35x as on March 31, 2018. Further, the company has undertaken a capex of Rs.175 crore which is being funded by term loan to the extent of Rs.140 crore and remaining Rs.35 crore through internal accruals. Till September 30, 2019 the company has incurred Rs.57.91 crore which was funded through term loan to the extent of Rs.20.00 crore and balance through internal accruals. Further, the company has incurred more than the estimated level of internal accruals till September 30, 2019 and the same will be adjusted at later stage through term loans. Moreover, the company has adequate unutilized working capital borrowing along with free cash balance of Rs.8.90 crore as on September 30, 2019 and GCA of Rs.29.71 crore during H1FY20. The repayment obligations of the company for FY20 amounts to Rs.16.68 crore for FY20 out of which the company has repaid Rs.6.25 crore till September 30, 2019. 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 FY20 comfortably.

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 Pharmaceuticals Limited (SMS Pharma), 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 (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.

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	463.78	466.48

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
PBILDT	94.48	91.67
PAT	40.45	41.45
Overall gearing (times)	0.50	0.43
PBILDT Interest coverage (times)	6.10	7.72
PBIT Interest Coverage (times)	4.82	6.10

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-Cash Credit	-	-	-	66.00	CARE A-; Stable
Non-fund-based - ST-Letter of credit	-	-	-	30.00	CARE A2
Fund-based - LT-Term Loan	-	-	July 2026	205.75	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 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-Cash Credit	LT	66.00	CARE A-; Stable	-	1)CARE A-; Stable (04-Oct-18)	1)CARE A-; Stable (12-Sep-17)	1)CARE A- (Under Credit Watch) (12-Oct-16)
2.	Non-fund-based - ST-Letter of credit	ST	30.00	CARE A2	-	1)CARE A2 (04-Oct-18)	1)CARE A2 (12-Sep-17)	1)CARE A2 (Under Credit Watch) (12-Oct-16)
3.	Fund-based - LT-Term Loan	LT	205.75	CARE A-; Stable	-	1)CARE A-; Stable (04-Oct-18)	1)CARE A-; Stable (12-Sep-17)	1)CARE A- (Under Credit Watch) (12-Oct-16)
4.	Fund-based - ST-Line of Credit	ST	16.00	CARE A2	-	1)CARE A2 (04-Oct-18)	1)CARE A2 (12-Sep-17)	1)CARE A2 (Under Credit Watch) (12-Oct-16)
5.	Fund-based - LT-Packing Credit in Foreign Currency	LT	15.00	CARE A-; Stable	-	1)CARE A-; Stable (04-Oct-18)	1)CARE A-; Stable (12-Sep-17)	1)CARE A- (Under Credit Watch) (12-Oct-16)
6.	Non-fund-based - ST-Bank Guarantees	ST	2.00	CARE A2	-	1)CARE A2 (04-Oct-18)	1)CARE A2 (12-Sep-17)	1)CARE A2 (Under Credit Watch) (12-Oct-16)
7.	Non-fund-based - ST-	ST	2.83	CARE A2	-	1)CARE A2	1)CARE A2	1)CARE A2

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
	Forward Contract					(04-Oct-18)	(12-Sep-17)	(Under Credit Watch) (12-Oct-16)

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.*

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