Smruthi Organics Limited
August 10, 2017

Rating

Facilities	Amount (Rs. crore)	Ratings[1]	Rating Action
Long-term Bank Facilities (Term Loan)	8.47 (reduced from 12.77 crore)	CARE BB; Stable [Double B; Outlook:Stable]	Reaffirmed
Long-term Bank Facilities (Fund based)	24.00	CARE BB ;Stable [Double B; Outlook:Stable]	Reaffirmed
Short-term Bank Facilities (Non Fund based)	13.00 (enhanced from 10.00 crore)	CARE A4 [A Four]	Reaffirmed
Total Facilities	**45.47 (Rs. Forty five Crore and forty seven lakh Only)**		

Details of instruments/facilities in Annexure-1

Rating Rationale and Key rating drivers

The reaffirmation of the ratings assigned to the bank facilities of Smruthi Organics Ltd (SOL) is constrained by its relatively small scale of operations in the APIs (Active Pharmaceutical Ingredients)/ Bulk Drugs Industry along with limited product offerings, prevailing client concentration risk, working capital intensive nature of operations and exposure to regulatory risk. The ratings also factor in SOL's low profitability margins and its susceptibility to foreign exchange fluctuation/volatile raw material prices, elongated operating cycle, tight liquidity position and prevailing intense competition in the API/Bulk drugs industry.

However, the ratings derive strength from the extensive experience of the promoters and long track record of the company in the pharmaceutical industry, accredited manufacturing facilities, coupled with having a reputed and well-established clientele portfolio, order-based nature of business, growth in revenues and moderate gearing levels.

Going forward, the ability of the company to scale up its operations, improve its profitability margins, liquidity position and capital structure through effective management of operating cycle constitute the key rating sensitivities.

Key Rating Weaknesses

***Small scale of operations in the API//*Bulk drugs industry**

SOL is a relatively small sized player in the pharmaceutical (Active Pharmaceutical Ingredients)/ Bulk Drugs Industry with total operating income (TOI) of Rs. 80.32 crore and tangible net worth of Rs.32.77 crore. The relatively small size makes it susceptible to any adverse business conditions in the contingency to absorb losses or meet financial exigencies (if any).

Product concentration risk exists owing to limited product offerings

SOL's revenue profile continues to be concentrated as the top three products contributed around 79% (in FY17) as compared to around 80% (in FY16) with a single product (Metformin intermediates) constituting the highest revenue share. The company continues to focus largely on the anti-diabetic therapeutic segment contributing maximum revenue of around 48% during FY17. Besides, the company is also present in anti-bacterial segments, diseases related to urinary tract and hypertension. Nevertheless, this would help the company to diversify its product profile to an extent.

Well established clientele base; albeit client concentration risks exists

SOL has a well-established and reputed clientele base comprising of leading global pharma companies such as, Cipla, Abott Healthcare, Sun Pharma, Emcure etc. The company has maintained long term relations with these clients and receives repeat orders.However, SOL is exposed to significant client concentration risk with almost 78% of total revenues in FY17 is derived from its top ten clients. Nevertheless, the company has been attempting to diversify its clientele base by adding newer clients.

Growth in revenues albeit thin profitability margins in FY17

During FY17, the company's total operating income increased by around 10% on a y-o-y basis owing to increase in sales volume of its key product i.e. Metformin and other products from export markets. However, SOL's PBILDT margin has declined from around 15.00% in FY16 to around 13.67% in FY17 mainly due to lower sales realisation from its high margin products. Profitability margins at PAT levels though improved marginally; it continues to remain thin at 1.97% in FY17.

Working capital intensive nature of operations as demonstrated by elongated operating cycle& tight liquidity position

As the company's business is largely order based and involved into manufacturing of APIs wherein the, then the company has to maintain high inventory levels of raw materials and finished products to meet timely bulk requirement. Hence, the company's operations are working capital intensive in nature given substantial work-in-progress products and significant raw material inventory. Besides, the company's liquidity position is considered to be tight as working capital utilisation levels are high at around 87% for the past 12 months ended May 31, 2017.Going forward, achievement of gross cash accruals as envisaged leading to improvement in liquidity position is a key rating monitorable.

Profit margins susceptible to volatile raw material prices and foreign exchange fluctuation risk

SOL purchases the raw material from the open market.SOL largely meets its raw material requirement from domestic market as well as it imports from countries like China, Vietnam etc. The key raw materials are price sensitive and highly volatile. Since the company does not have firm annual contracts and sales prices are determined at the time of order procurement taking into consideration the material costs at that point of time, they cannot pass on the increase in the raw material during the two months to its customers and have to absorb the same leading to pressure on the profitability margins.

The company derives around 35% of its revenues i.e. around Rs.27.61 crore from exports and imports aroundRs.18.65 crore i.e. around 41% of its overall purchases. These exports and imports are undertaken denominated in US Dollar and so serve as a natural hedge to an extent. However, as the company does not undertake any specific hedging activity, SOL is exposed to foreign exchange fluctuations.

Exposure to regulatory risk

As the company is in the pharmaceutical business, it is exposed to various regulations present in many 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.

Key Rating Strengths

Experienced promoters coupled with SOL's long track record of the in the bulk drug manufacturing industry

Smruthi Organics Limited is promoted by Mr.Purushotham Eaga, the company's founder, Chairman and MD, who has been in the API industry since 1981. His son, Mr.Swapnil Eaga, is the Executive Director and Chief Financial Officer of the company. He has been associated with the company since 2005. The management is assisted by a team of professionals having adequate experience in relevant fields. Besides, SOL has an operating track record of more than two and a half decades in the pharmaceutical business with presence in the area of manufacturing of bulk drugs and APIs.

Accredited manufacturing units supported with well-equipped R&D facility

The company has two manufacturing units located at Solapur in Maharashtra. One of the units is Good Manufacturing Practices (GMP) certified. The facilities are spread over an area of 22.5 acres with total annual capacity of around 5,800 MT, thus capable of handling large volumes. The company has a well-equipped R&D facility which is recognized by the Directorate of Scientific and Industrial Research (DSIR), Government of India.

Order driven nature of business

Being an API player, the company's business is mainly order driven with no long-term arrangements with its customers. Nevertheless, over the years, the company has maintained long-term relationships with pharma majors and has been successful in receiving repeat orders.

Moderate gearing levels

The company's borrowings mainly comprise of term loans, bank borrowings and unsecured interest free loans from the promoters. The company's gearing levels has improved from 1.22x as at March 31, 2016 to 1.01x as at March 31, 2017 owing to repayment of debt. Going forward, SOL needs to sustain its moderate capital structure and any substantial change in capital structure impacting the credit risk profile adversely is a key rating sensitivity.

Industry Outlook

The outlook of Indian Pharmaceutical Industry is expected to remain stable going forward with emanating opportunities for Generic segment from regulated and across emerging markets, improving affordability, thrust by government to improve the accessibility of health care, healthy share in ANDA approvals by Indian Pharma companies and the ability of the companies to manufacture the drugs with cost competitiveness act as growth drivers. However, the growth prospects of IPI remains stiffened due to heightening of regulatory risks resulting in product bans and delay in receipt of regulatory approvals for products and or facilities, increase in compliance expenses, stiff competition, increasing capex funded through debt and steady rise in R&D expenses etc,

Analytical approach: Standalone basis
Applicable Criteria:
Rating Methodology-Manufacturing Companies
Criteria for Short Term Instruments
Financials Ratio-Non Financial Sector
Criteria on Assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology -Pharmaceutical Sector

Background
Incorporated in 1989, Smruthi Organics Limited (SOL), promoted by the Eaga family is a public limited company engaged mainly in manufacturing of APIs (Active Pharmaceutical Ingredients)/ Bulk Drugs. The company manufactures APIs/Bulk Drugs with an installed capacity of 5,800 MTPA as on March 31, 2017. SOL caters mainly to the anti-diabetic segment for treatment of Type 2 Diabetes and other segments to treat bacterial and urinary tract infections.

Brief Financials (Rs. crore)	FY16 (A)	FY17 (A)
Total operating income	72.93	80.32
PBILDT	10.94	10.93
PAT	1.22	1.58
Overall gearing (times)	1.22	1.01
Interest coverage (times)	2.14	2.50

Status of non-cooperation with previous CRA: CRISIL has conducted the review on the basis of best available information and has classified Smruthi Organics Limited as “Not cooperating” vide its press release dated September 26, 2016

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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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	-	-	March 2020	8.47	CARE BB; Stable
Fund-based - LT-Cash Credit	-	-	-	24.00	CARE BB; Stable
Non-fund-based - ST-BG/LC	-	-	-	13.00	CARE A4

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-Term Loan	LT	8.47	CARE BB; Stable	-	1)CARE BB (22-Nov-16)	-	-
2.	Fund-based - LT-Cash Credit	LT	24.00	CARE BB; Stable	-	1)CARE BB (22-Nov-16)	-	-
3.	Non-fund-based - ST-BG/LC	ST	13.00	CARE A4	-	1)CARE A4 (22-Nov-16)	-	-

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