Smruthi Organics Limited

June 28, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities (Fund Based)	34.00 (enhanced from 29.00)	**CARE BB+; Positive [Double B Plus; Outlook: Positive]**	Revised from CARE BB; Stable
Long Term Bank Facilities (Term Loan)	-	-	Withdrawn*
Short-term Bank Facilities (Non-Fund based)	17.00 (enhanced from 13.00)	**CARE A4+ [A Four Plus]**	Revised from CARE A4
Total Facilities	**51.00 (Rs. Fifty One crore only)**		

Details of instruments/facilities in Annexure-1
** as the entire term loan is repaid*

Detailed Rationale & Key Rating Drivers

The revision in the rating of the bank facilities of Smruthi Organics Limited (SOL) factors continuous growth in scale of operations along with improvement in profit margins, capital structure and debt coverage indicators.
Moreover, the ratings continue to derive strength from extensive experience of the promoters and long track record of the company in the pharmaceutical industry, as well as accredited manufacturing facilities.
However, the ratings continue to remain constrained owing to moderate capacity utilization of its plants and small scale of operations (although improved) and working capital intensive nature of operations. The ratings also factor product and client concentration risks as well as susceptibility to foreign exchange fluctuation risk/raw material prices thereby limiting profitability. Furthermore, the rating factors inherent risk associated with API/bulk drug industry including dependence on imports from China for major raw material, intense competition and regulatory risk.
Going forward, the ability of the company to scale up the operations by further improving its capacity utilisation, to register stable profitability margins along with efficient working capital management constitute the key rating sensitivities.

Outlook:

CARE has revised the outlook for long term bank facilities of SOL from Stable to Positive. The revision is on account of expected improvement in operational performance of the company amidst introduction of new product and improved demand for existing products. The liquidity and working capital utilization are also expected to improve with improved cash accruals.

Detailed description of the key rating drivers

Key Rating Strength

Improvement in scale of operations owing to growth in volumes: In FY19, the net sales increased to Rs.138 crore from Rs.98 crore registering a growth of 42% on a y-o-y basis. The increase in sales is majorly contributed due to improved demand on account of increased market penetration. In FY19, sale volumes increased by 38% majorly attributed by increased demand for Metformin. Moreover, sales realization of Metformin (accounting for 44% of sales in FY19) improved by 16%.

Improvement in profitability level: In FY19, the company's EBIDTA margin increased to 12.63% from 11.73% in previous year. This is mainly due to growth in sales volumes leading to better utilisation of fixed costs and improvement in sales realisation owing to improved demand for Metformin. PAT margin also improved significantly in FY19.

Experienced promoters in the bulk drug manufacturing industry: SOL is managed/promoted by Mr. Purushotham Ega and Mr. Ega Swapnil, having more than 30 years and 15 years respectively in pharmaceutical industry. SOL's operating track record is 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: The company has two manufacturing units located at Solapur in Maharashtra. The facilities are spread over an area of 22.50 acres with total annual capacity of around 4,548 MT, thus capable of handling large volumes. The Unit II plant is Good Manufacturing Practice (GMP) certified. The company's research and development department is recognized by the Directorate of Scientific and Industrial Research (DSIR), Government of India.

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

Moderate gearing levels and debt coverage indicators: The company's borrowings mainly comprise of working capital borrowings and unsecured loans from the promoters. The company's overall gearing levels (including LC acceptances) have improved to 1.01 times as on March 31, 2019 from 1.29 times as on March 31, 2018. The company's interest servicing ability remains comfortable as indicated by interest coverage ratio of 4.88 times in FY19 in comparison of 2.80 times in FY18. The company does not envisage to borrow any term loan in the medium term.

Key Rating Weakness

Product concentration risk: The company's major products are Metformin followed by Diloxanide Furoate, Amlodipine, Telmisartan amongst others. In FY19 (refers to the period April 1 to March 31), the top five drugs contributed around 88% of total sales resulting in product concentration risk.

Customer concentration risk: Although the customer concentration risk reduced in FY19 as reflected in top 10 customers contributing 59% of total sales in FY19 as against 71% in FY18, the same continues to be relatively higher.

Order based nature of business: Being an API player, the company's business is mainly order driven (spot sales) with no long term arrangements with its customers, thus, leading to lack of revenue visibility over medium term for the company.

Inherent risks for pharmaceutical industry along with forex fluctuation risk: The dependence on China for supply of major raw materials by API/bulk drug manufacturers, and highly regulated nature of pharmaceutical industry are inherent risks for SOL. In the absence of a hedging mechanism, although being a net exporter, the company is exposed to foreign currency fluctuation risk owing to timing differences.

Working capital intensive nature of operations: The operations of the company are working capital intensive owing to the nature of the business. However, the adjusted operating cycle (excluding receivable/payable from/to irrecoverable customer being written off in FY18) improved to 71 days in FY19 from 91 days in FY18. The improvement is majorly on the back of improved inventory management. However, the average working capital utilization for the past 12 months ending April 2019 remained high at around 80%.

Moderate liquidity position: The company does not have any term loan as on March 31, 2019. Although the overall gearing level (including LC acceptances) as on March 31, 2019 was moderate at 1.01 times, the liquidity is marked by highly utilized working capital limits and just above unity current ratio.

Analytical approach: Standalone

Applicable Criteria

Criteria on assigning Outlook and credit watch to Credit Ratings
CARE's Policy on Default Recognition
CARE's methodology for Short-term Instruments
CARE's methodology for – Manufacturing companies
Pharmaceuticals

About the Company

SOL established in 1989 by Mr. Ega Purushotham (Managing Director) and is headquartered at Solapur, Maharashtra. As on May 31, 2019, the promoter group held 63.83% equity stake in the company. Mr. Ega Purushotham along with Mr. Ega Swapnil (son of Mr. Ega Purushotham) manages the overall operations of the company.

The company is engaged in the business of manufacturing and marketing active pharmaceutical ingredients (APIs) and intermediates. The product portfolio of the company consists of more than 12 APIs and intermediates including Metformin, Diloxanide Furoate, Norfloxacin, Telmisartan, Amlodipine, Potassium Losartan amongst others. The total installed capacity is 4,548 metric tonnes (MT) per annum for manufacturing of bulk drugs and intermediates with dedicated capacity for Metformin of 3,900 MT per annum. However, the same can be swapped with other products in case of requirement. The company's two manufacturing units are located at Solapur covering total area of 22.50 acres. The unit II is Good Manufacturing Practice (GMP) certified. In FY19, 37% of total sales are through exports and balance 63% are contributed by domestic sales.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	97.55	138.29
PBILDT	11.44	17.47
PAT	-3.21	7.32
Overall gearing including LC acceptances (times)	1.29	1.01
Interest coverage (times)	2.80	4.88

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 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	-	-	-	0.00	Withdrawn
Fund-based - LT-Cash Credit	-	-	-	34.00	CARE BB+; Positive
Non-fund-based - ST-BG/LC	-	-	-	17.00	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 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	-	-	-	1)CARE BB; Stable (04-Sep-18)	1)CARE BB; Stable (10-Aug-17)	1)CARE BB (22-Nov-16)
2.	Fund-based - LT-Cash Credit	LT	34.00	CARE BB+; Positive	-	1)CARE BB; Stable (04-Sep-18)	1)CARE BB; Stable (10-Aug-17)	1)CARE BB (22-Nov-16)
3.	Non-fund-based - ST-BG/LC	ST	17.00	CARE A4+	-	1)CARE A4 (04-Sep-18)	1)CARE A4 (10-Aug-17)	1)CARE A4 (22-Nov-16)

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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