Smruthi Organics Limited

September 04, 2018

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term bank facilities - fund based	29.00 (enhanced from Rs.24 crore)	**CARE BB; Stable (Double B; Outlook: Stable)**	**Reaffirmed**
Long-term bank facilities - term loan	4.24	**CARE BB; Stable (Double B; Outlook: Stable)**	**Reaffirmed**
Short-term bank facilities - non-fund Based	13.00	**CARE A4 (A Four)**	**Reaffirmed**
Total Facilities	**46.24 (Rs. Forty Six crore and Twenty Four lakhs only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings assigned to the bank facilities of Smruthi Organics Limited (SOL) is constrained by relatively small scale of operations in the active pharmaceutical ingredients (APIs)/bulk drugs industry along with limited product offerings, prevailing client concentration risk, and working capital intensive nature of operations. The ratings also factor in SOL's low profitability margins along with susceptibility to foreign exchange fluctuation risk/raw material prices. 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.

However, the ratings continue to derive strength from extensive experience of the promoters and long track record of the company in the pharmaceutical industry, accredited manufacturing facilities coupled with growth in revenues, order based nature of business and moderate gearing levels.

Going forward, the ability of the company to scale up the operations, and improve profitability margins along with liquidity position as envisaged and efficient management of operating cycle constitute the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weakness

Product concentration risk: The company's major products are Metformin followed by Diloxanide Furoate, Norfloxacin amongst others. In FY18 (refers to the period April 1 to March 31), the top five drugs contributed around 90% of total sales resulting in product concentration risk.

Customer concentration risk: The company's customer base includes both domestic as well as international clients. The top 10 customers contributed 71% of total sales in FY18 leading to significant customer concentration risk.

Small scale of operations: SOL is a relatively small sized player in the pharmaceutical (Active Pharmaceutical Ingredients)/ Bulk Drugs Industry with gross sales of Rs.96 crore in FY18 and tangible net worth of Rs.29 crore as on March 31, 2018. The relatively small size makes it susceptible to any adverse business conditions in the contingency to absorb losses or meet financial exigencies, if any.

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.

Thin profitability margin: In FY18, despite operational profit of Rs.3.08 crore, the company wrote off irrecoverable (net) receivable of Rs.7.94 crore from a customer, resulting in net loss of Rs.3.21 crore. The adjusted profit after tax (not factoring non cash expense of Rs.7.94 crore) margin though improved to 2.36% in FY18 from 1.97% in FY17 albeit the same continues to remain thin.

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 improved to 91 days in FY18 from 104 days in FY17 (excluding receivable/payable from/to irrecoverable customer being written off in FY18). The improvement is majorly on the back of improved inventory management.

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

Key Rating Strengths

Growth in sales despite decline in volumes: In FY18, the net sales increased to Rs.96 crore from Rs.78 crore registering a growth of 23% on a y-o-y basis. The increase in sales is majorly contributed due to improved demand on account increased market penetration. In FY18, sale volumes of Metformin declined due to subdued demand in export market, however, the sales realization for Metformin increased due to higher raw material prices, consequentially leading to an improvement in scale of operations as compared to previous year. Thus, the company's gross cash accruals improved on a y-o-y basis during the period under review.

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 13 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 5,800 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

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-long term for the company.

Moderate gearing levels: The company's borrowings mainly comprise of term loans, bank borrowings and unsecured loans from the promoters. The company's gearing levels is moderate at 1.29 times as on March 31, 2018. The company's interest servicing ability remains satisfactory as indicated by interest coverage ratio of 2.80 times in FY18 in comparison of 2.50 times in FY17.

Analytical approach: Standalone

Applicable Criteria

[Criteria on assigning Outlook to Credit Ratings]
[CARE's Policy on Default Recognition]
[CARE's methodology for Short-term Instruments]
[Financial ratios – Non-Financial Sector]
[Rating Methodology -Pharmaceutical Sector]

About the Company

SOL established in 1989 by Mr. Ega Purushotham (Managing Director) and is headquartered at Solapur, Maharashtra. As on June 30, 2018, 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 amongst others. The total installed capacity is 5,800 metric tonnes (MT) per annum for manufacturing of bulk drugs and intermediates with dedicated capacity for Metformin of 4,800 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 FY18, 44% of total sales is through exports and balance 56% are contributed by domestic sales.

Brief Financials (Rs. crore)	FY17 (A)	FY18 (A)
Total operating income	80.33	97.55
PBILDT	10.93	11.44
PAT	1.58	-3.21
Overall gearing (times)	1.13	1.29
Interest coverage (times)	2.50	2.80

A: Audited

Status of non-cooperation with previous CRA: CRISIL conducted the review on the basis of best available information and classified Smruthi Organics Limited as "Not cooperating" vide its press release dated February 22, 2018.

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 facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	May 2020	4.24	CARE BB; Stable
Fund-based - LT-Cash Credit	-	-	-	29.00	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 Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date & Rating assigned in 2018-2019	Dates & Ratings assigned in 2017-2018	Dates & Ratings assigned in 2016-2017	Dates & Ratings assigned in 2015-2016
1.	Fund-based - LT-Term Loan	LT	4.24	CARE BB; Stable	-	1)CARE BB; Stable (10-Aug-17)	1)CARE BB (22-Nov-16)	-
2.	Fund-based - LT-Cash Credit	LT	29.00	CARE BB; Stable	-	1)CARE BB; Stable (10-Aug-17)	1)CARE BB (22-Nov-16)	-
3.	Non-fund-based - ST-BG/LC	ST	13.00	CARE A4	-	1)CARE A4 (10-Aug-17)	1)CARE A4 (22-Nov-16)	-

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CIN - L67190MH1993PLC071691