Press Release

Scott Edil Pharmacia Limited (SEPL)

20 July, 2017

Rating Assigned

Total Facilities Rated*	Rs. 85.00 Cr
Long Term Rating	SMERA BBB+/Stable (Assigned)
Short Term Rating	SMERA A2 (Assigned)

**Refer Annexure for details*

Rating Rationale

SMERA has assigned long term rating of **SMERA BBB+ (read as SMERA triple B plus)** and short term rating of **SMERA A2 (read as SMERA A two)** on the Rs.85.00 crore bank facilities of **Scott Edil Pharmacia Limited (SEPL)**. The outlook is **'Stable'**.

Scott Edil Pharmacia Limited (SEPL) was incorporated in 2003 by Mr. B.K. Agarwal, Mr. Sanjeev Agarwal and Mrs. Vaishali Agarwal. The company is engaged in the manufacturing of generic drugs, ointments, ophthalmic drops, syrups, injections and other pharmaceutical products.

Analytical Approach: SMERA has taken a consolidated view of the financial and business risk profiles of SEPL, Scott Edil Advanced Research Laboratories & Education Limited (SEARLE) and Ion Healthcare Private Limited (IHPL). SEARLE was incorporated in 2009 by the promoters of SEPL while IHPL was incorporated in 2004 and was subsequently acquired by the promoters of SEPL in 2014.

The consolidation is on account of the common management of the three companies, similarities in the line of business and presence of significant operational and business synergies. Together these companies have been referred to as the Scott Edil Group (SEG).

SEG was established in 2003 with the incorporation of SEPL by Mr. B.K. Agarwal, Mr. Sanjeev Agarwal and Mrs. Vaishali Agarwal. The group is engaged in the manufacturing of generic drugs, eye drops, syrups, capsules, tablets and medicinal ointments. SEG has its manufacturing facilities at Baddi, Himachal Pradesh and has a consolidated installed capacity of 2 lakh injections per month, 1 lakh bottles of ophthalmic drops per month, 2 lakh tubes of ointments per month, 20 lakh capsules per month, 60 lakh tablets per month, 1.5 lakh viles of oral liquid and 500 litres of syrups per month.

The group markets its products under over 450 brands through a pan-India distribution network of authorised distributors and stockists. SEG also undertakes contract manufacturing for marquee players like Abbot Healthcare Limited, Alembic Pharmaceuticals and Lupin Limited among several others and also supplies pharmaceutical products to several state and central government institutions. SEG caters to the export market by supplying generic drugs and other products to institutional players and pharmaceutical companies in Sri Lanka, Turkey, Jordan, Afghanistan, Iran, Panama among several others.

Strengths:

Experienced management and established track record in the pharmaceutical business: SEG was promoted by Mr. Balaram Krishna Agarwal – who has been in the pharmaceutical business for 25 years. Prior to the incorporation of SEPL, Mr. B.K. Agarwal and his family were engaged in the running of a chain of pharmacies in Punjab.

SEG reported healthy growth in consolidated revenue to Rs. 602.15 crore in FY2017 (Provisional) as against Rs. 550.34 crore in FY2016. The group reported a Compounded Annual Growth Rate (CAGR) of 11 percent in its consolidated revenue in the last four financial years.

SEG is present across 24 states in India via a network of over 75 distributors and eight stockists. The company has 458 generic drug brands in its product portfolio that contributed approximately 40 per cent of the consolidated revenues of the group in FY2017 (Provisional). SEG also caters to a wide range of reputed industrial clients. SEG undertakes contract manufacturing of both generic and patented drugs for players like Lupin, Albemic, Cipla, Abbot and several others. The promoters have developed a strong relationship with the group's institutional clientele over a period of 14 years. In FY2017 (provisional), contract manufacturing accounted for 30 per cent of the consolidated revenue.

Scott Edil Group (SEG) also caters to state government health departments, public dispensaries, government funded hospitals and central government departments. SEG supplies essential drugs and pharmaceutical combinations to these institutions – both to meet their day-to-day demand and under specific health schemes of the central and state governments. Sales to such institutions contributed 16 per cent to the consolidated revenue in FY2017 (Provisional)

SEG has also recently ventured into the overseas pharmaceutical markets. Exports accounted for approximately 14 per cent of the consolidated revenues of the group in FY2017 (Provisional). SEG is currently expanding its installed capacity to increase its footprint in the export market. Going forward, SMERA expects export sales to account for approximately 20 to 22 per cent of the consolidated revenues of the group.

SMERA believes that SEG will continue to benefit from its promoters' experience in the pharmaceutical business, its well-diversified revenue stream and longstanding relationships with several marquee clients. SMERA expects SEG to continue to report significant growth in its consolidated revenues – mainly on account of penetration in the export market coupled with further expansion of the distribution network of the company. SMERA believes that SEG's ability to leverage its market position and sustain growth in its operating income shall be a key credit monitorable.

Prudent financial risk profile: SEG has been undertaking substantial capital expenditure in the recent past. The group's financial risk profile is supported by its healthy accruals and comfortable networth vis-à-vis its overall debt levels. Despite an increase in the consolidated debt levels to Rs. 116.76 crore on 31 March, 2017 (Provisional) from Rs. 94.73 crore on 31 March, 2016, SEG continued to maintain a conservative capital structure. SEG was geared at 0.75 times on 31 March, 2017 (Provisional) as against 0.70 times on 31 March, 2016. The Total Debt-to-EBITDA of the group also remained comfortable at 2.36 times in FY2017 (Provisional) vis-à-vis 2.02 times in FY2016. SEG reported increase in Debt-to-EBITDA levels in FY2017 on account of the debt funded capital expenditure in FY2016 and FY2017. SMERA expects SEG's Debt to EBTIDA to revert to less than 2 times in FY2019 on account of commencement of commercial operations in the new facilities being set up by the group.

SEG also reported healthy internal accruals as against its outstanding debt levels. Net Cash Accruals (NCA) to Total Debt of the group stood at 0.27 times in FY2017 (Provisional) vis-à-vis 0.28 times in FY2016. Despite increase in its overall debt levels, SEG continued to report an increase in its Net Cash

Accruals. The NCA of the company increased by 19 per cent in FY2017 (Provisional) to Rs. 31.35 crore from Rs. 26.35 crore in FY2016.

The conservative capital structure coupled with healthy internal accruals is expected to enable SEG to report comfortable debt protection metrics over the medium term. The group reported an interest coverage ratio of 3.61 times in FY2017 (Provisional) against 2.95 times in FY2016. The Debt Service Coverage Ratio (DSCR) also remained healthy at 2.76 times in FY2017 (provisional) vis-à-vis 1.91 times in FY2016. While some moderation is expected in the DSCR of the group over the near term on account of an increase in debt servicing commitments, SMERA expects the DSCR of the group to continue to remain at comfortable levels over the near to medium term.

Weaknesses:

Exposure to offtake risk with respect to the ongoing capital expenditure: SEG is currently undertaking a substantial capital expenditure in IHPL and SEARLE. IHPL is undertaking a capital expenditure to augment its capacity and set up an ointment manufacturing and packaging unit. SEARLE is also undertaking a capital expenditure to set up a Betalectum plant and to further expand its installed capacity. The planned capital outlay was approximately Rs. 40 crore out of which a total of Rs. 6 crore is expected to be incurred in FY2018.

A substantial portion of the capital budget has been funded with bank borrowings. SEG has consolidated term loan limits to the tune of Rs. 26.95 crore as on 31 March, 2017 (Provisional) – which have mainly been utilised to fund its ongoing capital expenditure.

SEG reported persistent decline in operating profit margins to 8.23 per cent in FY2017 (Provisional) from 9.88 per cent in FY2014 on account of increase in fixed costs and suboptimal capacity utilisation for the newly established units. In case of lower than expected offtake from the new facilities, SEG may experience shortfall in its operating cash flows vis-à-vis its debt servicing and capital expenditure commitments. The risks emanating from the ongoing capital expenditure are partially offset by the presence of healthy orders from institutional clients – both government clients and non-governmental clients. SEG reported a consolidated order book of Rs. 109.66 crore as on 30 May, 2017.

SMERA believes that SEG's ability to maintain adequate capacity utilisation levels over the medium term shall be critical in maintaining its credit risk profile.

Susceptibility of operating performance to movement in Active Pharmaceutical Ingredient Prices (API): SEG imports 90 per cent of its API requirement - the primary raw material, from various suppliers in China – including Farmasino Pharmaceutical Co Ltd. and Skyrun Pharma Co Ltd. SEG has been receiving upto 90 days of clean credit from its suppliers which enables the group to reduce its working capital requirements throughout the year.

SEG is exposed to risks emanating from unprecedented adverse movement in API prices in the international and domestic market. API prices are affected by global demand and supply trends, import duties & levies and the regulatory environment surrounding the pharmaceutical industry. SMERA believes that SEG's ability to pass on any increase in API prices to the end customer shall be critical towards maintaining its credit risk profile. Any adverse movement in API prices on account of global demand-supply mismatches or increase in import duty may result in downward pressures in SEG's profitability margins over the near to medium term.

Applicable Criteria

- Manufacturing Entities: https://www.smera.in/criteria-manufacturing.htm
- Default Recognition: https://www.smera.in/criteria-default.htm
- Application of Financial Ratios and Adjustments: https://www.smera.in/criteria-fin-ratios.htm
- Consolidation of Companies: https://www.smera.in/criteria-consolidation.htm

Outlook: Stable

SMERA believes that SEG will maintain a stable outlook over the medium term on account of its experienced management, marquee clientele and healthy financial risk profile. The outlook may be revised to 'Positive' in case of greater than expected improvement in profitability margins coupled with sustained increase in market share over the medium term. Conversely, the outlook may be revised to 'Negative' in case of continued profitability pressures or in case of challenges being faced by the company in scaling up its operations over the medium term.

About the Group – Key Financials

Scott Edil Group (SEG) reported a Net Profit of Rs. 21.54 crore in FY2017 (Provisional) on operating income of Rs. 601.15 crore compared to Net Profit of Rs. 16.02 crore in FY2016 on operating income of Rs. 550.34 crore. SEG reported networth of Rs. 156.06 crore on 31 March, 2017 (Provisional) as against Rs. 135.45 crore on 31 March, 2016.

About the Rated Entity – Key Financials

SEPL reported net profit of Rs.11.77 crore on operating income of Rs.353.36 crore in FY2017 (Provisional), as compared with net profit of Rs. 10.63 crore on operating income of Rs. 344.11 crore in FY2016. SEPL reported networth of Rs. 95.50 crore on 31 March, 2017 (Provisional) as against Rs. 84.67 crore on 31 March, 2016.

Status of non-cooperation with previous CRA (if applicable): India Ratings & Research Private Limited Suspending the outstanding ratings on the bank facilities of Scott Edil Pharmacia Limited vide Press Release dated 05 Apri, 2016 due to the lack of adequate information.

Any other information: NA

Rating History for the last three years:

Name of Instruments	FY2018 (Current)			FY2017		FY2016		FY2015	
	Scale	Amount (Rs. Crore)	Rating with Outlook	Date	Rating	Date	Rating	Date	Rating
Cash Credit	LT	60.00	SMERA BBB+/Stable (Assigned)	-	-	-	-	-	-
Letter of Credit	ST	25.00	SMERA A2 (Assigned)	-	-	-	-	-	-

***Annexure – Details of instruments rated:**

Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Crore)	Ratings/ Outlook
Cash Credit	N.A	N.A	N.A	60.00	SMERA BBB+/Stable (Assigned)
Letter of Credit	N.A	N.A	N.A	25.00	SMERA A2 (Assigned)

Note on complexity levels of the rated instrument:
https://www.smera.in/criteria-complexity-levels.htm

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ABOUT SMERA

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