



5 MINUTE STOCK IDEA

BY SMART SYNC INVESTMENT ADVISORY SERVICES

SMRUTHI ORGANICS

WHAT WE LIKE

PRODUCT EXPANSION & BACKWARD INTEGRATION IN PLAY

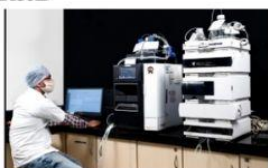
- Incorporated in 1989, Smruthi Organics manufactures API products in the anti-diabetic, anti-hypertension, and anti-infectives therapeutic categories.
- Developed 4 APIs as targeted in FY 2021 – 22. These are in the diabetic and platelet therapeutic category.
- Reduction of import dependency and cost optimization are key reasons behind adopting a backward integration strategy.

FAVORABLE LONG-TERM OUTLOOK FOR THE API INDUSTRY

- Ability to leverage the opportunity available for Indian pharma companies due to the expiry of the patent drugs across the globe,
- Ebbing of regulatory risks,
- Adoption of various strategies to de-risk from dependency on China for key raw materials,
- Increasing trend in PE investments, and
- Solid fundamentals of the industry.

CONSTANT INVESTMENT IN R&D

Their R&D has developed 6 key starting materials and undertaken several cost optimization projects to implement their backward integration strategy.



Particulars	FY17	FY18	FY19	FY20	FY21	FY22
Revenue (INR Cr)	79.35	97.34	137.41	131.07	126.50	133.37
R&D (INR Cr)	0.48	0.33	0.53	3.64	3.54	3.42
R&D as a % of Rev	0.60	0.39	0.39	2.77	2.80	2.56

MARKET EXPANSION & REGULATED MARKET APPROVALS

The product portfolio expansion is being made with the objective of adding new clients and markets to drive growth in the future. Planning to re-enter the European market by securing the necessary regulatory approvals for its manufacturing site. They have filed Drug Master Files in several countries for market access. We are expecting a regulatory audit from a Pharmaceutical Inspection Co-operation Scheme (PIC/S) signatory country in FY 2022 – 23, which will enable them to access markets in 52 PIC/S signatory countries of Asia, EU, Latin America, and Africa.

STRONG BALANCE SHEET & NEW CAPACITY FUNDED THROUGH INTERNAL ACCRUALS

- Due to a strong Balance Sheet, they have been able to upgrade & debottleneck their existing facilities by investing 6.56 Cr from their own funds.
- Despite investing in new products and new markets and adopting backward integration, they have been consistently reducing debt.

Particulars	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Debt (INR Cr)	45	37	33	31	28	16	10	3

WHAT WE DON'T LIKE

MODEST SCALE OF OPERATIONS

API business is all about scale as there is hardly any differentiation or branding power. And in a small scale of operation there are limited opportunities to be competitive and efficient. Unless they achieve scale, there is little scope of creating value. From FY19 to FY23, the scale of operation has largely been stagnant at ~ INR 130 Cr of annual sales.

PRODUCT & CUSTOMER CONCENTRATION RISK

Particulars	% of Sales	
Top 5 Products	90%	
Top 10 Customers	70%	

VOLATILITY OF MARGINS

Due to the commodity nature of the business, they are price takers and not price setters. And this gets reflected in the huge variation in their operating margin due to fluctuating raw material prices and foreign exchange rate.

FY	19	20	21	22	TTM
OP	12%	12%	23%	14%	8%

HIGHLY COMPETITIVE SPACE + NO LONG-TERM CONTRACTS

The API business is highly fragmented and competitive. It is of order-based nature. Hence, there are no long-term contracts or assurance from the customers. Therefore depending on market demand and supply dynamics, the volumes and realizations fluctuate wildly. This makes it difficult to gauge the near-term performance of the business given the uncertain times we are in.

INDUSTRY CURRENTLY GOING THROUGH A HEADWIND

When Divi's Lab, the big daddy of API, is talking about pricing pressures in the industry, one can imagine how difficult it would be for a business like Smruthi Organics to survive and thrive in these times.

The pricing pressures, I think it's not only with us, it is across the industry and across products. Now yes, you are right that the pre-COVID, during COVID, post-COVID, there is a difference in the consumption of the therapeutic segment and now slowly therapeutic segments are coming back. So we don't know the real stocks at each of the either API manufacturers or dosage manufacturers, but we felt the pricing pressures. I'm sure everybody is feeling across industry. And we see the raw material prices getting better right now what contracts we are entering. So we expect that in the coming quarters, not only we have the volume growth, I think we should be having a profitability growth as well.

Source: Divi's Lab Q3FY23 Concall

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