Twitter Thread by Leading Nowhere

Leading Nowhere
@leading_nowhere

Every annual report tells a story.

In small companies, you can read between the lines to get a feel of the management style and business economics.

I take Fredun Pharmaceuticals Ltd (FPL) to illustrate how to go about this (it's not pretty).

Let's go ■ (1/n)

Please note that the main objective of this review is to get a preliminary understanding without doing a thesis.

It is oriented towards a "quick and dirty" review to decide if you want to dig deeper.

Review financials on a screener website before reading further. (2/n)

Profit & Loss

Figures in Rs. Crores

	Mar 2010	Mar 2011	Mar 2012	Mar 2013	Mar 2014	Mar 2015	Mar 2016	Mar 2017	Mar 2018	Mar 2019	Mar 2020	Mar 2021	TTM
Sales +	5	8	12	15	21	25	42	57	60	97	113	135	167
Expenses +	4	7	11	14	20	24	38	53	54	87	104	125	156
Operating Profit	**0**	**1**	**0**	**1**	**1**	**2**	**4**	**3**	**6**	**10**	**8**	**11**	**11**
OPM %	9%	9%	3%	9%	7%	7%	9%	6%	10%	11%	7%	8%	7%
Other Income	0	0	1	0	0	0	1	2	0	0	1	-1	-1
Interest	0	1	1	1	1	1	2	2	2	3	4	4	4
Depreciation	0	0	0	0	1	1	1	1	1	1	2	2	2
Profit before tax	**0**	**0**	**-0**	**0**	**0**	**1**	**2**	**2**	**3**	**6**	**2**	**3**	**4**
Tax %	6%	67%	0%	80%	47%	52%	42%	36%	34%	28%	24%	37%	
Net Profit	**0**	**0**	**-0**	**0**	**0**	**0**	**1**	**1**	**2**	**4**	**2**	**2**	**3**
EPS in Rs	0.60	0.09	-1.02	0.04	1.02	1.11	4.55	6.08	5.11	11.18	4.76	5.04	8.10

Now, you can already guess Fredun Pharmaceuticals is named after Fredun Medhora. His mother, Dr Daulat Medhora and his father, Nariman Medhora, are the original promoters of the company. Interestingly, Nariman Medhora has stepped down from active involvement in June 2021. (3/n)

BOARD OF DIRECTORS AND KEY MANAGERIAL PERSONNEL

Dr. (Mrs.) Daulat Medhora	Chairperson & Jt. Managing Director
Mr. Fredun Medhora	Managing Director & Chief Financial Officer
Mr. Nariman Medhora	Whole Time Director
Dr. Aspi Raimalwala	Non-Executive Independent Director
Dr. Chandrakant Shah	Non-Executive Independent Director
Dr. Rohinton Kanga	Non-Executive Independent Director
Ms. Ankita Joshi	Company Secretary Cum Compliance Officer

Then we have Dr Daulat Medhora, who seems to have the qualifications and a decent background in the pharma industry. However, she is 76 years old and unlikely to be actively involved for much longer. (4/n)

Name	Dr. (Mrs.) Daulat Medhora
Date of Birth	16/03/1945
Date of Appointment	08/06/1987
Qualification / expertise in specific functional areas	Masters in Chemistry Ph. D in Chemistry
Brief Profile	Dr. (Mrs.) Daulat Medhora is a Promoter Director of the Company and holds a Ph. D in Chemistry from UDCT. She was awarded Lady Tata Scholarship for her R& D work. She started her career as an R&D Manager in a leading Company and was approved as an expert staff in Fine Chemicals by FDA where she developed manufacturing processes of a number of drugs and drug intermediaries. In 1994, she along with her husband Mr. N.B. Medhora set up an Export Oriented Pharmaceutical Unit employing about 150 persons in the backward areas of Palghar in the name of Fredun Pharmaceuticals Ltd. She is a Lifetime member of Indian Pharmaceuticals Association from the year 2001 was awarded with Rashtriya Ratan Award by Global Economic Council, New Delhi. In November 2008 she was also awarded Bharat Nav Nirman Ratan Award by All India Business Development Association, New Delhi.
Directorship held in other Companies	NIL
Membership of committees across Companies	NIL
Shares held as on 31/03//2021	13,40,710 Equity Shares
Relationship Between the Directors	Dr. (Mrs.) Daulat Medhora is wife of Mr. Nariman Medhora and Mother of Mr. Fredun Medhora

That leaves Fredun Medhora, who does not have a technical or scientific background and his primary qualification is an MBA.

The biography provided in the AR describes the CV of an MBA student, nothing on the contribution or role in the company.

(5/n)

(IV) Job profile and their suitablitiy :

Mr. Fredun Medhora

Mr. Fredun Medhora is a graduate with honours of Magma Cum Laude in Business Entrepreneurship from Plattsburgh University New York having completed 127 credits in 2.5 years. He has achieved the highest graduating grade point average for entire major. He was also awarded a standing in the Dean's List for all the semesters. He was the recipient of Direct Marketing Seminar Scholarship whilst working with the Director of Small Business Development Center (SBDC) Plattsburgh New York for helping new entrepreneurs setup their business. He has gained experience in creating organization flow charts for (SBDC) office and working with prospective clients through research and gathering background information for their interests. During his Internship he was also involved in developing the Supply Chain Management Major at the School of Business. He has been a member of the Beta Gamma Sigma Honour Society and also Phi Kappa Phi Honour Society.

The wide experiene gained by him during his graduation in US has helped him in completing his Masters in Business Administration from Cardiff Business School Wales. During his studies in Cardiff he worked in the Finance Department of Student's Union of Cardiff University where he created process flow charts and job description of each individual within the office. He was assigned the topic "Prospects of Neutraceuticals Industry in India"for his thesis during his MBA course.

He was appointed as the Whole Time Director of the Company in the year 2013 and considering his vigour for growth for the Company, he was appointed as the Managing Director of the Company since 2014. He was again re appointed as the Managing Director for the period from 15th October 2020 He has been entrusted with the entire powers of the management of the Company.

The challenging business environment requires review of all the operations, monitoring and decision making on day to day basis which is required to be taken on fast scale and the Company has been immensely benefted by his timely decision making. He is very much dynamic and it is under his ledership the Company is growing on a large scale.

It is clear this company will primarily be run by Mr Fredun Medhora in the future, which is amply evident from the gradual exit of Nariman Medhora, and the advanced age of Dr Daulat Medhora.

Therefore, we know any investment thesis will be primarily betting on new gen. (6/n)

Given this background, let's start with notice of AGM and see what FPL proposed this year.

First is a special resolution for approving a substantial 125% hike in remuneration for Managing Director and CFO Fredun Medhora. (7/n)

"RESOLVED THAT in supersession to the earlier resolution passed in this respect at the 33rd Annual General Meeting held on 28th September 2020 and pursuant to recommendation of Nomination and Remuneration Committee and approval of the Board of Directors and pursuant to the provisions of Sections 196,197,198 and 203 and all other provisions if any, read with Schedule V of The Companies Act, 2013 ('the Act') and pursuant to the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, as amended from time to time and other applicable provisions of the Companies Act, 2013 and Rules made thereunder (including any statutory modification(s) or re-enactment thereof for the time being in force and any subsequent amendment/ modification in the Rules/ Act and/or applicable laws in this regard, the approval of the Members of the Company is hereby accorded to the increase in the remuneration of Mr. Fredun Medhora (DIN:01745348), Managing Director & CFO for the reminder of his tenure i.e. upto 14th October 2023 including the payment of remuneration in the event of loss or inadequacy of profits in any financial year during the reminder of his tenure and on the same terms and conditions already approved on 28th September 2020 with the liberty to the Board of Directors of the Company to alter and vary the terms and conditions, not exceeding the limits specified under the Act or any Statutory modification or re-enactment thereof."

a. **Tenure:** upto 14th October 2023.

b. **Remuneration:** ₹. 4,50,000/- (Rupees Four lakh fifty thousand only) per month with effect from 1st October 2021

a) **Perquisites:**

1. **Medical Expenses:** The Company shall pay and or reimburse all expenses incurred for himself and for his family subject to ₹. 1,00,000/- per Year subject to the taxability as per Income Tax Act, 1961.

2. **Leave Travel Concession:** The Company shall pay and or reimburse Travel Expenses incurred while on leave for himself and for his family once in a year in accordance with any rules specified by the Company but the amount should not exceed ₹. 80,000/- per year subject to the taxability as per the Income Act, 1961

Cut a long story short, the resolution & explanatory statement highlight 3 things:

(a) New remuneration is 54L p.a. (previous 24L p.a.)

(b) Subject to Schedule V of CA (due to inadequate profits)

(c) Previous remuneration was approved for 3 years (Sept 2020-2023) (8/n)

Item No. 5

Mr. Fredun Medhora was re-appointed as the Managing Director of the Company by the Board of Directors at their Board Meeting held on July 29, 2020 for a period of three years w.e.f. October 15, 2020 to October 14, 2023. The same was subsequently approved by the shareholders at the 33rd Annual General Meeting held on September 28, 2020.

Further, considering the contribution of Mr. Fredun Medhora and the progress made by the Company under his dynamic leadership and guidance, the Board has decided to increase the remuneration payable to Mr. Fredun Medhora at ₹. 4,50,000/- per month from October 1, 2021 upto October 14, 2023 i.e. upto the reminder of his tenure. . The total remuneration payable to Mr. Fredun Medhora will be as per the provisions of Schedule V of The Companies Act, 2013 and the same has already been approved by the Nomination and Remuneration Committee.

The proposed remuneration is 27% of profit (Rs 2 Cr), beyond the permissible limits under the Companies Act. This is common in smaller companies, and isn't a strong factor to judge management.

Readers may gauge the merits of the remuneration as we go along. (9/n)

Let's see the other agenda item for AGM - providing for approval to appoint cost auditors for FY21-22.

Interestingly, the remuneration is subject to future "mutual" agreement.

Even in FY19-20, same cost auditor appointed w/o disclosing remuneration. (10/n)

SPECIAL BUSINESS:

Annual Report FY 20-21

4. To appoint Cost Auditor

To consider and if thought fit, to pass with or without modification(s), the following Resolution as an Ordinary Resolution:

"**RESOLVED THAT** pursuant to Section 148 of the Companies Act, 2013 read with Rule 14 of the Companies (Audit and Auditors) Rules, 2014 (including any amendments or re-enactments thereof, M/s Joshi Apte & Associates (Firm Registration No.00240), appointed by the Board of Directors, to conduct audit of cost records of the Company, for the year ending March 31, 2022, remuneration to be finalized mutually, plus applicable taxes and out-of-pocket expenses.

RESOLVED FURTHER THAT the Board of Directors ('the Board', which term shall be deemed to mean and include any Committee constituted by the Board) be and is hereby authorised to take such steps as may be necessary to give effect to this Resolution."

U/ S.148 of CA2013, remuneration of cost auditor is required to be approved by members.

However, FPL has taken approval for appointment but left remuneration to be subject to "mutual agreement".

This is an egregious lapse . Opportunity to make some money @SEBI_India! (11/n)

148. Central Government to Specify Audit of Items of Cost in Respect of Certain Companies

(1) Notwithstanding anything contained in this Chapter, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies:

Provided that the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

(2) If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under sub-section (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

(3) The audit under sub-section (2) shall be conducted by a [1][Cost Accountant] who shall be appointed by the Board **on such remuneration as may be determined by the members** in such manner as may be prescribed:

Provided that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records:
Provided further that the auditor conducting the cost audit shall comply with the cost auditing standards.

A review of past ARs shows a fluctuating trend of audit fees with no fixed remuneration. It w as 3L in 2017, 6.5L in 2018, 2.5L in 2019, 3L in 2020 and 6.5L in 2021. (12/n)

Notes:-		
i) Payment to Auditors		
Audit fees	2,50,000.00	2,50,000.00
Taxation matters	1,50,000.00	1,50,000.00
Other matters	1,50,000.00	1,50,000.00
Certification Charges	2,00,000.00	2,00,000.00
Total	**7,50,000.00**	**7,50,000.00**

For such elaborate arrangements, related party transactions usually follow.

FPL has large purchases (FY21: Rs 39 Crore) primarily from Fredun Healthcare, related company.

New gen also gets annual 1.1 5 Cr rent + loan on interest

Making profit is tough w/ promoter cuts. (13/n)

A. Related parties and nature of relationship where control exist (upto 31 March, 2020)

Key Management Personnel :

i) Mr. Nariman B.Medhora
ii) Dr.(Mrs) Daulat N.Medhora
iii) Mr. Fredun N. Medhora

B. Business Organisation controlled by Key Management Personnel or their relatives :

i) Fredna Enterprise
ii) Fredun Healthcare Pvt. Ltd.
ii) Fredun Healthcare Pvt. Ltd.

Details of transactions entered into with the related parties for the relevant financial year

Transaction	Key Managerial Personnel	Fredna Enterprise	Fredun Healthcare Pvt. Ltd
Director Remuneration for the year	49,20,000.00	-	-
Purchase Made from Fredun Healthcare Pvt Ltd.	-	-	35,49,77,743.00
Rent paid to Mr Nariman B. Medhora for utilizing a godown office proprietory firm	-	1,15,20,000.00	-
Sales Made to Fredna Enterprises	-	73,109.00	-
Purchase Made from Fredna Enterprises	-	3,25,62,363.00	-

However, low PAT isn't a significant observation in microcaps and smallcaps, since you are betting primarily on future growth or change in circumstances.

Operating cash flows > reported PAT is a good sign.

Anything that shows efficient cash use is a bonus. (14/n)

FPL has negligible cash flows, generating only 16 lakh in operating cash. Of special note here is the substantial inventory and high trade receivables. Outstanding dues are significantly aged too, though showing some improvement from last fiscal w/ write offs. (15/n)



Poor cashflows generally translate into high debt. There's short term loans, including from related parties. The secured term loans are at astronomical 18% interest!

Apart from no operating cash flow, FPL has substantial interest outgo, which is further funded with debt. (16/n)

Particulars	Year ended 31 March, 2021	Year ended 31 March, 2020
Gross Debt	1,18,54,82,654.68	1,00,05,67,847.72
Less: Cash and cash equivalents	99,45,476.26	2,74,79,231.55
Net debt	1,17,55,37,178.42	97,30,88,616.17
Total Equity	43,07,02,178.93	41,32,13,197.80
Net debt to equity ratio	2.73	2.35

Here's an interesting thought. If cash flows are zilch and there are high value of related party transactions, why not check the closing balances of related party transactions to see if cash flows to related parties are being prioritized? (17/n)

Financial statements always disclose opening/closing balance for such transactions (check image 1). This disclosure is missing in AR FY20-21 despite the header saying "balances". So you *cannot* ascertain the cash movement between related entities during the fiscal. (18/n)

₹ in Lakh

Name	Transaction	Oustanding	
		As at March 31, 2021	As at March 31, 2020
Mr. Gautam R. Ashra	Refundable Deposit for Leave License	–	30.00
Mrs. Mamta Gautam Ashra	Refundable Deposit for Leave License	–	48.75
Mr.S.N.Kamath	Refundable Deposit for Leave License	78.75	78.75
Bliss GVS International Pte Ltd	Investment in Share Capital	22.58	24.05
	Interest Income Receivable	287.67	129.12
	Loan Given	4,223.80	4,324.49
Kremoint Pharma Pvt. Ltd.	Investment in Share Capital	1,803.00	1,803.00
	Payables	–	1.52
	Receivables	27.37	24.81
	Advance Given	100.00	–
Bliss GVS Clinics Health Care Pte Ltd	Investment In Share Capital	4.12	4.12
	Loan Given	2,241.75	338.63
	Interest Income Receivable	534.31	510.11
Asterisk Lifesciences Limited (UK)	Investment In Share Capital	0.10	0.10
	Loan Given	19.84	18.51
	Receivables	17.35	21.17
	Interest Income Receivable	1.61	0.67
Lozen Pharma Pvt. Ltd.	Payables	–	34.46
Greenlife Bliss Healthcare Ltd.	Receivables	6.32	5.26
Asterisk Lifesciences GH Limited	Receivables	2,296.46	2,955.18
	Advance Received	29.06	–
Plastic Ingenuities (I) Pvt. Ltd.	Payables (Net of Receivable)	–	(152.03)

The above figures do not include provisions for gratuity and premium paid for group health insurance, as separate actuarial valuation /premium paid are not available.

This is from Bliss GVS Pharma Annual Report FY 20-21.

This table is entirely missing in FPL's financial statements.

This isn't the only impact of omission. Note 20 says loans from related entities are at "Market Lending Rate" and redirects to further information in related party disclosures (Note 39).

With omission of balances table in note 39, terms of loan are a complete mystery. (19/n)

Note - 20		
Borrowings: Current		
Loans repayable on demand		
a) from banks	7,56,89,588.42	19,62,88,933.92
b) from other parties	98,49,884.97	1,88,81,789.37
c) from related parties	1,97,55,788.59	1,88,93,269.06
Total	**10,52,95,261.98**	**23,40,63,992.35**

20.1 Loan from related Party has been paid at par to the Market Lending Rate and which shall be repayable on demand. Details are given imote - Related party disclosures

ERROR 404: NOT FOUND

Compliance/regulatory lapses are also relevant for assessing management.

"Other expenses" shows substantial fines/penalties under GST for non-compliance with procedures like timely filing of returns and payment of tax. Res ipsa loquitor - the thing speaks for itself. (20/n)

Interest on Late Payment of GST	13,99,852.00	0.00
Interest on Late Payment of TDS	6,70,276.00	6,07,023.00
Interest on Late Payment of TCS	2,462.00	0.00
Late Fees for Late filing of Employees Professional Tax	10,025.00	12,200.00
Late filing Fees on Service Tax	0.00	15,400.00
Late filing Fees on GST	5,650.00	12,300.00

Recently, FPL did a preferential issue to 23 public investors, with highest allotment to Nikhil Vora. The AR FY20-21 specifies him as already the 3rd largest shareholder with 5.85% holding. Interestingly, even new gen promoter doesn't have that much stake in FPL. (21/n)

Sr. No.	Name of Investor/Proposed Allottee	Category of Investor	Proposed No. of Shares to be issued
1.	Nikhil Vora	Non Promoter	1,06,846
2.	Chaitali Vora	Non Promoter	12,082
3.	Ajay Sarupria	Non Promoter	29,613
4.	Faizal Hawa	Non Promoter	23,691
5.	Systematix Fincorp India Limited	Non Promoter	11,845
6.	Prashant Desai	Non Promoter	5,922
7.	Mansi Praful Ganatra	Non Promoter	5,922
8.	Shethia Narendrakumar Vel Ji HUF	Non Promoter	5,922
9.	Subir Diamonds Private Limited	Non Promoter	5,922
10.	Animesh Maheshwari	Non Promoter	3,553
11.	Ashish Ghatnekar	Non Promoter	3,553
12.	Nehal Vora	Non Promoter	3,553
13.	Nimisha Manish Nagarsekar	Non Promoter	3,553
14.	Madhu Nangalia	Non Promoter	3,553
15.	Sohail Manjiramani	Non Promoter	2,369
16.	Amit Dinesh Shah	Non Promoter	2,369
17.	Amita Divyesh Doshi	Non Promoter	1,658
18.	Ketki Paranjpe	Non Promoter	1,184
19.	Kathan M Shah	Non Promoter	1,184
20.	Rajul Mihir Adani	Non Promoter	1,184
21.	Saloni Ghatnekar	Non Promoter	710
22.	Meenakshi Bhalerao	Non Promoter	710
23.	Hypotenuse Investments	Non Promoter	9,476
	Total		**2,46,374**

Essentially, we have the following observations:

A. New gen pay is sky rocketing
B. Strange arrangement w/ auditors
C. Gaps in financial statements, missing disclosures
D. Poor cash flow with high debt
E. Poor legal compliance
F. Large related party transactions

(22/n)

At the end of this analysis, you have a decently good idea of how FPL is run from a governance perspective.

Next step, if you remain interested, would be to look into the commercial side of things. (23/n)

No smallcap or microcap and sometimes even larger companies are devoid of governance issues.

Having a quick and dirty framework is useful to shortlist companies for further analysis.

Every case has to be evaluated on its own merits. (24/n)

Hope you enjoyed this thread. RT first tweet for greater reach, please.

As always, this is not a recommendation to invest or not to invest into FPL. Just an example to illustrate. (25/n)