The Pakistan Credit Rating Agency Limited

Rating Report

Pharmagen Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
14-Jun-2018	BBB	A2	Stable	Maintain	-
29-Dec-2017	BBB	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect Pharmagen Limited (PL) strong business fundamentals. The pharmaceutical industry has witnessed a high rate of sustained growth over the years. Cost-efficiencies as well as demand inelasticity are benefiting the industry players. While product pricing has been a challenge, the new CPI-linked pricing criteria has allowed an increase in prices with respect to inflation, indicating a positive sign. The company imports majority of their raw material, thus increased currency fluctuation and pricing risk. However, PL is poised to derive benefits from group synergies in the form downward integration at front end. This could help PL, to diversify in different segments and reduces the concentration risk. Nevertheless, overall financial profile is considered adequate. Although coverages have been deteriorated, the company's designed financial strategy keeps sizeable cushion in short-term borrowing lines to meet shortfalls in operational cash flows in servicing debt obligations; this provides flexibility in management of financial affairs. Long association of experienced management team adds comfort.

The ratings are dependent on the company's ability to sustain margins. Meanwhile, management of debt (current and planned), thereby impacting coverages, is considered important. Furthermore, external factors such as any adverse changes in the regulatory framework and weakening of financial profile owing to delays in cash flow receipts, may impact the ratings

Disclosure

Name of Rated Entity	Pharmagen Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating Methodology(Jul-17),Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17)
Related Research	Sector Study | Pharmaceutical(May-18)
Rating Analysts	Faizan Arif | faizan.sufi@pacra.com | +92-42-35869504

PHARMAGEN LIMITED	
Incorporated	1990
Major business lines	▪ Manufacturing and sale of APIs (Active Pharmaceutical Ingredients). ▪ Pharmagen's total number of registered/licensed products or APIs are 44 of which 19 are being regularly produced.
Legal status	Un-Listed

INDUSTRY SNAPSHOT

- The current size of Pakistan's pharmaceutical industry is PKR 355bln, presently growing at 7% p.a.
- Pakistan's Active Pharmaceutical Ingredients (API) market is ~PKR 89bln, out of which 10% is locally produced and 90% is being imported
- Pharmaceutical sector is a highly regulated segment in Pakistan

OWNERSHIP

- Pharmagen is majority owned by Pervez Hussain's family (60%), while other strategic partners include Rasheed Khan's family (~15.2%), and Maj. Gen. (Retd.) Rahim Khan's family (~2.1), along with trusts, Naghat Rasheed Trust and Kashmir Education foundation holding (~1.8%) and (~20.9%) respectively.

GOVERNANCE

- The seven member BoD of Pharmagen Limited comprises four members from Mr. Pervez Hussain's family representatives, two from Maj. Gen. (Retd.) Muhammad Rahim Khan's family and one from Mr. Rasheed Khan's family.
- The Chairman, Major General (Retired) Muhammad Rahim Khan, is the brain behind Pharmagen.
- The board comprises experienced professionals from pharmaceutical and financial services backgrounds.
- Independent oversight is lacking, indicating room for improvement in the company's governance framework as there is no independent non-executive director on the board.

MANAGEMENT

- Mr. Pervez Hussain Sufi heads the management team of the company as Chief Executive Officer, since inception.
- Mr. Sufi is a fellow member of ICAEW and ICAP since 1976 and oversees the overall operations of Pharmagen on a daily basis by meeting with relevant head of departments.
- Key management personnel are qualified having extensive experience in the Pharmaceutical industry.
- Pharmagen has implemented a state-of-the-art tailor-built web based Enterprise Resource Planning (ERP) system. Vintage Pro ERP system deployed at the head office as well as in factory, which is at a remote location.
- The company maintains a comprehensive MIS reporting system for the management to keep track of activities. Reports including cash position, receivable position, payable position, production, inventory status reports, and segment wise profit & loss statement.
- In addition, licensed software is installed on all machines (client or server) at head office and factor. CIO and CTO ensure the complete implementation of IT policies and SOPs throughout the organization.
- Pharmagen is having well-equipped labs ensures the quality control for each batch and state-of-the-art machines, qualified and trained production staff helps the company ensure it produces best quality products.

BUSINESS RISK

- The company is engaged in the manufacturing and sale of pharmaceutical products and over the years it has become the leading producer of APIs in Pakistan. The company's manufacturing facilities comprises three manufacturing plants.
- In 9MFY18, Pharmagen's topline amounted to PKR 3,904mln (9MFY17: PKR 3,338mln, FY17: PKR 4788mln, FY16: PKR 5,318mln). Increased revenues owing to higher volumes produced by multipurpose plant.
- Despite increased revenues by 17% from the same period last year, company demonstrated a slight reduction in margins; gross (9MFY18: 8.7%, 9MFY17: 10.3%, FY17: 9.5%, FY16: 9.1%) and operating (9MFY18: 5.4%, 9MFY17: 6.7, FY17: 5.6%, FY16: 5.6%).
- The sales are highly concentrated in South region at 80% as compared to North (~6%), Central (~14%).
- Pharmagen is poised to derive benefits from group synergies in the form of (i) bulk discounts from suppliers of raw material – APIs and excipients, (ii) better bank-relationships (iii) strength-wise parking of products, (iv) group-trainings for HR and career growth opportunities within the group.
- However, net profit margin continues to decline at end-Mar18: 0.7% (end-Mar17: 2.2%, FY17: 1.3%, FY16: 1.5%, FY15: 1.6%), lower net profits, as (i) High taxes, (ii) increased overheads. Net profit thus amounted to PKR 62mln at end-Mar18 (end-Mar17: PKR 73mln, FY17: PKR 62mln, FY16: PKR 79mln).

FINANCIAL RISK

- The company manages its working capital requirements via a mix of internal generation and short-term borrowing (STB), though utilization of STB increased (9MFY18: PKR 1,909mln, FY17: PKR 1,784mln, FY16: PKR 1,551mln, FY15: PKR 1,335mln).
- Higher interest on account of increased borrowings, resulted in slightly declined interest coverage (9MFY18: 1.2x, FY17: 1.8x, FY16: 1.6x, FY15: 1.7x). However, debt coverage witnessed a slight improvement at end-Mar18 to 1.2x (FY17: 1.1x, FY16: 1.0x, FY15: 1.1x) due to a relatively greater cashflows.
- Pharmagen's liquidity position has shown a continuous deterioration in absolute terms. The company has a continued feature of deficit in net current assets (9MFY18: PKR -210mln, FY17: PKR -79mln, FY16: PKR 31mln) when compared against STBs
- Despite higher long-term debt (9MFY18: 324mln, FY17: PKR 385mln, FY16: PKR 255mln), debt-to-debt-plus-equity ratio reduced to ~60% at 9MFY18 (FY17: 75%, FY16: ~72%, FY15: ~70%), on account of lower debt repayments falling due in current year and revaluation surplus.

Pharmagen Limited

BALANCE SHEET	31-Mar-18	30-Jun-17	30-Jun-16	30-Jun-15
	9M	FY17	FY16	FY15
Non-Current Assets	**1,916**	**1,110**	**978**	**909**
Investments (incl. Associates)	**117**	**117**	**20**	**35**
Equity	72	72	20	35
Debt Securities (incl. income funds)	45	45	-	-
Current Assets	**2,374**	**2,268**	**2,272**	**2,022**
Inventory	809	827	828	735
Trade Receivables	1,036	898	913	773
Others	529	542	531	514
Total Assets	**4,407**	**3,495**	**3,270**	**2,966**
Debt	**2,232**	**2,169**	**1,806**	**1,513**
Short-term	1,909	1,784	1,551	1,335
Long-term (incl. Current Maturity of Long-Term debt)	324	385	255	177
Other Short-term Liabilities	675	563	690	707
Other Long-term Liabilities	26	39	66	86
Shareholder's Equity	**1,473**	**725**	**708**	**660**
Total Liabilities & Equity	**4,407**	**3,495**	**3,270**	**2,966**

INCOME STATEMENT				
Turnover	**3,904**	**4,788**	**5,318**	**4,441**
Gross Profit	338	456	482	410
Other Income	-	(20)	(30)	(35)
Financial Charges	(171)	(166)	(160)	(164)
Net Income	**29**	**62**	**79**	**69**

Cashflow Statement				
Free Cashflow from Operations (FCFO)	209	302	263	283
Net Cash changes in Working Capital	3	(208)	(354)	(73)
Net Cash from Operating Activities	52	(71)	(268)	43
Net Cash from InvestingActivities	(106)	(299)	(118)	(87)
Net Cash from Financing Activities	46	301	261	160
Net Cash generated during the period	(8)	(69)	(124)	116

Ratio Analysis				
Performance				
Turnover Growth	17.0%	-10.0%	19.8%	15.5%
Gross Margin	8.7%	9.5%	9.1%	9.2%
Net Margin	0.7%	1.3%	1.5%	1.6%
ROE	2.2%	8.9%	11.2%	10.5%
Coverages				
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD)	1.2	1.1	1.0	1.1
Interest Coverage (x) (FCFO/Gross Interest)	1.2	1.8	1.6	1.7
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	10.6	3.4	2.5	1.7
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	67	81	72	72
Capital Structure (Total Debt/Total Debt+Equity)	60.2%	75.0%	71.8%	69.6%

Rating Scale

Credit Rating Scale & Definitions

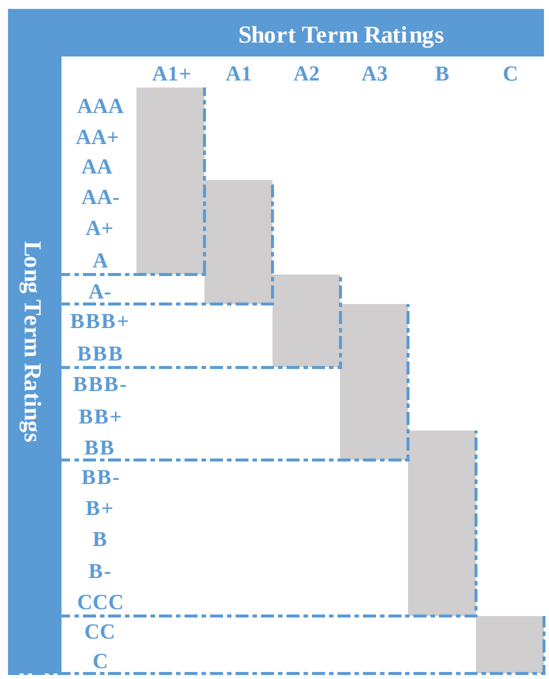
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk “CCC” Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. “CC” Rating indicates that default of some kind appears probable. “C” Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
C	An inadequate capacity to ensure timely repayment.



Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

Rating Watch Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

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(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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