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
25-Oct-2023	A-	A2	Stable	Maintain	-
25-Oct-2022	A-	A2	Stable	Maintain	-
25-Oct-2021	A-	A2	Stable	Maintain	-
06-Nov-2020	A-	A2	Stable	Upgrade	-
07-Nov-2019	BBB+	A2	Stable	Maintain	-
08-May-2019	BBB+	A2	Stable	Upgrade	-
31-Dec-2018	BBB	A2	Stable	Maintain	-
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's ("PL or the Company") established market position in a specific segment of the pharmaceutical industry; API (Active Pharmaceuticals Ingredients). Pharmagen Limited holds a prominent domestic position and stands as a market leader among a relatively smaller segment of API manufacturers. APIs are produced mainly in organic and inorganic synthetic drugs from refined chemicals. This is mostly and predominantly fed through imports. Being the essential element of the healthcare sector, it derives strength from the nature of the business. The sector's profitability remained under pressure due to adverse macroeconomic factors such as global & domestic rising inflation, higher policy rates & associated elevated borrowing costs, and massive PKR depreciation. Therefore, resulting in a major cost escalation of imported raw materials as 85% of active pharmaceutical ingredients used in the manufacturing of the drugs are imported. PL's top 5 products include Amoxycillin, Cephradine, Cefixime, Paracetamol and Ciprofloxacin, these contribute ~92% of total revenue. The Company has grown and augmented its position and is seen fortifying its production capabilities and product range. Recently the company has undertaken capacity expansion projects in Paracetamol and Cefixime, aimed at bolstering their revenue-generating potential. The company's customer base comprises renowned multinational and domestic pharmaceutical players. The strategic partnership with SAMI has delivered both operational and financial synergies. According to the management accounts, the FY23 revenue demonstrated a remarkable growth of ~55%, supported by enhanced pricing and slightly improved volumes while the margins also showed improvement at all levels. The Company has strong sponsorship with incredible skills and experience in the sector, which is providing a smooth path to the company in a directive way. The growth prospects are optimistic, as over the years management is focusing on process improvement, cost optimization, and enriching product slates. The financial profile of the Company is considered adequate, with comfortable coverages cashflows, and working capital cycle. Capital structure is modestly leveraged, and borrowings are majorly comprised of short-term to import raw materials and to meet working capital requirements. The management intends to have a reduced appetite for borrowings. The profitability and financial matters will improve gradually.

The ratings are dependent on the successful rollout of the envisaged strategy. The respective market position needs to be maintained and profitability must be aligned with the improving size. Any dilution in business on the financial profile is unwarranted.

Disclosure	
Name of Rated Entity	Pharmagen Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jul-23),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Pharmaceutical(May-23)
Rating Analysts	Kanwal Ejaz | kanwal.ejaz@pacra.com | +92-42-35869504

Profile

Legal Structure Pharmagen Limited (hereinafter referred to as "the company" or "PL") is a public limited company-unquoted pharmaceutical company operating in Pakistan since 1990

Background Company started its commercial operation in 1993. Sponsored by a group of highly dedicated professionals and technocrats having 14 years proven experience of successfully promoting and managing sophisticated pharmaceutical bulk drug projects.

Operations The company is engaged in the manufacturing and sale of pharmaceutical products and over the years it has become the leading producer of APIs (Active Pharmaceutical Ingredients) in Pakistan. The sales and marketing department is responsible to keep close liaison with the pharmaceutical companies. However, there is no distribution/dealer involved in Pharmagen's sales system. PL is pursuing to get EDQM (European Directorate for the Quality of Medicines) certificate which will help PL to access the international market especially the European market.

Ownership

Ownership Structure Pharmagen is majority owned by Pervez Hussain's family (44%), while other strategic partners include Rasheed Khan's family (7%), Rahim Khan Trust / Kashmir Education Foundation (15%), Mr. Shamim Ahmed and his family (30%), and others (4%).

Stability Mr. Usman Hussain, son of Mr. Pervaiz Hussain is currently the Head of marketing of PL and he might be heading the company in future. However, PL needs to have a formal succession planning in order to ensure that future prospects are taken care of in the hour of need.

Business Acumen PL is sponsored by a group of highly dedicated professionals and technocrats having 14 years proven experience of successfully promoting and managing sophisticated pharmaceutical bulk drug projects.

Financial Strength The sponsors have an adequate financial profile with shareholding in multiple companies. Currently, there is one associated company; Moringa Pharmaceuticals (Pvt.) Ltd was acquired in May 2017.

Governance

Board Structure BoD of PL comprises four members from Mr. Pervez Hussain's family, two from Maj. Gen. (Retd.) Muhammad Rahim Khan's family, one from Mr. Rasheed Khan's family, there is an addition of 3 members from family of Mr. Shamim Ahmed.

Members' Profile The board comprises experienced professionals from pharmaceutical and financial services backgrounds. The Chairman, Major Gen (Retd.) Muhammad Rahim Khan, is the brain behind Pharmagen. Having Masters in strategic study, he carries over seven decades of domestic and international professional experience, and has been engaged with the pharmaceutical industry from the past 28 years.

Board Effectiveness The board has formed its Audit Committee comprising of three members to review the accounting and reporting issues and any professional and/or regulatory requirements. There are no other committees in place, which requires sponsors' attention for better corporate governance practices at PL

Financial Transparency The company's External Auditors, Kreston Hyder Bhumji & Co. Chartered Accountants, expressed an unqualified opinion on the financial statements for the year ended June 22. There is an established Internal Audit function, reporting directly to the Audit Committee. The internal audit function is outsourced to EY Ford Rhodes Chartered Accountants (one of the big four CA firms).

Management

Organizational Structure The organizational structure of the company is divided into nine functional departments headed by able professionals (Directors or Controllers): 1) Quality Assurance/Quality Control (QA/QC), 2) Operations, 3) Technical, 4) Marketing & Sales (M&S) – A, 5) Marketing & Sales (M&S) – B, 6) Finance, 7) Information Systems (IS), 8) Human Resources & Administration (HR & Admin), and 9) Internal Audit.

Management Team Mr. Pervez Hussain Sufi, the MD & CEO of PL, since inception. Mr. Parvez Hussain Sufi has 43 years of experience, 27 years' experience of successfully running industrial and other businesses including pharmaceuticals and healthcare. He is a fellow member of ICAEW and ICAP since 1976. He is supported by experienced management team having long association with PL

Effectiveness The company has in place a business development committee constituting directors and HODs. PL needs to incorporate more management committees for efficient and effective execution of operational matters. Within each department, the management hierarchy includes various cadres, which enables the company to carry out smooth operations.

MIS Pharmagen has implemented a state-of-the-art tailor-built web based ERP system called Vintage Pro ERP system deployed at the head office as well as in factory, which is at a remote location. The communication between the servers at head office and factory occurs via WAN tower.

Control Environment PL adheres to strict quality control standards as it is the need of the pharmaceutical industry. The company maintains a comprehensive MIS reporting system for the management to keep track of activities.

Business Risk

Industry Dynamics The global active pharmaceutical ingredients (API) market size reached US$ 209.9bln in 2021. It is expected the market to reach US$ 291.7bln by 2027, exhibiting a CAGR of 5.64% during 2021-2027. During the period under review, the impact of PKR depreciation was the major cost escalation for the pharmaceutical industry where about 85% of the active pharmaceutical ingredients used in the manufacturing of the drug are imported. This significant reliance on imported raw materials increases the inherent risk of supply chain disruption. China is the largest exporter of active pharmaceutical ingredients to Pakistan.

Relative Position Pakistan's Active Pharmaceutical Ingredients (API) is being imported by ~85% while 15% is locally produced. There are only 6 active API producers in Pakistan. Hence, being a leading API producer, Pharmagen has a competitive edge to achieve high business growth and market share compared with the other API producers.

Revenues During FY23, PL's revenue reached at PKR ~14,616mln, as compared to PKR ~9,434mln in FY22, depicting an increase of 55%. The top 5 selling products of the company are Amoxycillin followed by Cephradine, Cefixime, Paracetamol, and Ciprofloxacin, presenting ~89% of concentration. Company has made an expansion in Paracetamol project which will enhance the revenue growth in coming years ahead.

Margins PL demonstrated an increase in gross margin representing at ~8.1% as at FY23 (FY22: 7.0%) and operating margin stands at 6% as of FY23 (FY22: 4.0%). Net margin of the company has remained at ~1.4% in FY23 (FY22: 0.5%).

Sustainability Earnings prospects will improve with the stability of the exchange rate. The capacity of the Penicillin, Cephalosporin and Multi-purpose plant has been increased and also the expansion of Paracetamol has been completed and it will start manufacturing by the end of Oct-23, which will also be able to increase the revenue streams in near future.

Financial Risk

Working Capital Pharmagen Limited manages its working capital requirements via a mix of internal generation and short-term borrowing (STB). Utilization of STB in FY23 is PKR ~491mln (FY22: 804mln). Net working capital days have reached 35 days in FY23 (FY22: 56 days), hence, showing a decreasing trend.

Coverages During FY23, FCFO of the company stood at PKR ~678mln (FY22: PKR 387mln). Interest Coverage of the company clocked in at 3.0x in FY23 (FY22: 2.7x), representing the Company's ability to meet financial obligations.

Capitalization Pharmagen Limited maintains leveraged capital structure. Major portion of debt constitutes short-term borrowing (STB). As of FY23, it remained at ~98% (FY22: 98%). The leverage ratio stood at ~8% in FY23 (FY22: 19%).

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Financial Summary
PKR mln

Pharmagen Limited Pharmaceutical	Jun-23 12M	Jun-22 12M	Jun-21 12M
A BALANCE SHEET			
1 Non-Current Assets	3,699	2,784	2,462
2 Investments	-	-	-
3 Related Party Exposure	769	662	717
4 Current Assets	5,534	4,328	3,136
a Inventories	*1,977*	*1,994*	*1,011*
b Trade Receivables	*1,918*	*1,033*	*1,691*
5 Total Assets	10,002	7,774	6,315
6 Current Liabilities	3,612	3,119	2,086
a Trade Payables	*2,354*	*1,782*	*1,071*
7 Borrowings	502	820	818
8 Related Party Exposure	-	-	-
9 Non-Current Liabilities	-	-	-
10 Net Assets	5,888	3,834	3,411
11 Shareholders' Equity	5,888	3,472	3,411
B INCOME STATEMENT			
1 Sales	14,616	9,434	8,326
a Cost of Good Sold	*(13,426)*	*(8,812)*	*(7,743)*
2 Gross Profit	1,190	621	583
a Operating Expenses	(322)	(245)	(210)
3 Operating Profit	867	376	373
a Non Operating Income or (Expense)	*(319)*	*(134)*	*(12)*
4 Profit or (Loss) before Interest and Tax	549	242	361
a Total Finance Cost	*(238)*	*(145)*	*(173)*
b Taxation	*(102)*	*(46)*	*(125)*
6 Net Income Or (Loss)	209	51	62
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*997*	*387*	*325*
b Net Cash from Operating Activities before Working Capital Changes	*463*	*290*	*138*
c Changes in Working Capital	*(203)*	*(226)*	*488*
1 Net Cash provided by Operating Activities	260	65	626
2 Net Cash (Used in) or Available From Investing Activities	(1,022)	(106)	(51)
3 Net Cash (Used in) or Available From Financing Activities	(317)	(16)	(529)
4 Net Cash generated or (Used) during the period	(1,079)	(57)	46
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	54.9%	13.3%	32.5%
b Gross Profit Margin	8.1%	6.6%	7.0%
c Net Profit Margin	1.4%	0.5%	0.7%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	5.4%	1.7%	9.8%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	4.5%	1.5%	1.9%
2 Working Capital Management			
a Gross Working Capital (Average Days)	86	111	107
b Net Working Capital (Average Days)	35	56	69
c Current Ratio (Current Assets / Current Liabilities)	1.5	1.4	1.5
3 Coverages			
a EBITDA / Finance Cost	4.8	2.9	3.1
b FCFO / Finance Cost+CMLTB+Excess STB	4.5	2.7	2.0
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	0.0	0.1	0.1
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	7.9%	19.1%	19.3%
b Interest or Markup Payable (Days)	44.0	56.0	37.4
c Entity Average Borrowing Rate	30.0%	22.5%	14.2%

Credit Rating

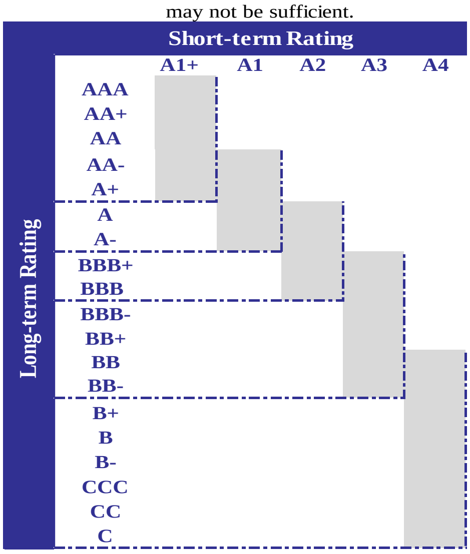
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
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 Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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

Restrictions

(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(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 | Clause 11-(A)(p).
(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)

Proprietary Information