



The Pakistan Credit Rating Agency Limited

Rating Report

Zafa Pharmaceutical Laboratories (Pvt.) Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
13-Sep-2023	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

ZAFA Pharmaceutical (the “Company”) is a domestic player, claiming a prominent position amongst the local players. It specializes in the formulation development, manufacturing, testing and marketing of a wide range of quality, affordable medicines. The Company’s manufacturing facilities, are the few dedicated facilities for the manufacturing of Beta-Lactam and Cephalosporin products. ZAFA’s top 5 products include Folic Acid tablets, Famila Injection, Zodip tablets, Xynosine Nasal Spray & Ciprofloxacin HCL, these contribute ~21% of total revenue. Presently, ZAFA holds a market share of 30-35% in terms of units in the folic acid market. The company is driven by its vision to offer economically and affordably priced high-quality healthcare products to the public, at significantly lower costs compared to its competitors. The Board comprises experienced and professional experts, its size is considered adequate. Global inflation, high logistics cost and massive PKR depreciation have impacted the pharma sector negatively. The Company has grown and augmented its position and is seen fortifying its production capabilities and product range. In the coming years, some new products are also in the pipeline. The financial risk profile of the company is strong with comfortable coverages and cashflows. During 9MFY22, the gross margin of ZAFA remained 36.0% (CY22: 37.2%, CY21: 37.9%). Despite the significant inflationary impact and increased operating expenses, the operating margin remained 20.7% during 9MFY23 (CY22: 8.3%, CY21: 10.6%, CY20: 11.5%). ZAFA has shown an increase in its net margin during 9MFY23 at 20.2% (CY22: 4.2%, CY21: 6.2%) mainly because of decline in finance cost. The debt on the books of ZAFA comprises mainly short-term borrowings of PKR 319mln & long-term borrowings of PKR 85mln during FY22. In CY22, the leverage ratio stood at 19.8% during 9MFY23 (CY22: 17.5%, CY21: 13.6%). The Company has an equity base of PKR 3,797mln during 9MFY23 (CY22 2,974, CY21 2,769).

The ratings are dependent on management’s ability to sustain its growth in revenues, margins and profitability. Prudent management of the working capital, and maintaining sufficient cash flows and coverages are imperative. Further improvement in governance structure remains important for the ratings.

Disclosure

Name of Rated Entity	Zafa Pharmaceutical Laboratories (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Corporate Rating(Jun-22),Methodology Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology Rating Modifiers(Jun-22)
Related Research	Sector Study Pharmaceutical(May-23)
Rating Analysts	Muhammad Zain Ayaz zain.ayaz@pacra.com +92-42-35869504



Profile

Legal Structure Zafa Pharmaceutical Laboratories (Private) Limited (the Company) was incorporated in Karachi, Pakistan as a private company limited by shares on 8 November 1974, previously under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017). The principal activity of the Company is to manufacture pharmaceutical products.

Background Zafa Pharmaceutical laboratories (Private) Limited has become one of the recognized pharmaceutical companies in Pakistan, Mr. Mohammad Amin Khan (late) Exemplified strong dedication and leadership prowess while serving as the Chairman and CEO at Zafa's.

Operations The company specializes in the production of pharmaceuticals under multiple segments and is actively involved in the marketing and sales of licensed products approved by the Drug Regulatory Authority of Pakistan. Zafa boasts a comprehensive product portfolio of over 300 products, with an additional 30 products currently in development. Notably, 13 of their products have attained a leading market position within Pakistan. The company operates 10 manufacturing facilities, majorly situated in the industrial zone of Karachi.

Ownership

Ownership Structure Zafa is majority owned by Mr. Jawad Amin Khan. (~91%); while other partners include Mr. Mohammad Amin Khan (late) (3.7%), Mrs. Zafar Amin (3.7%), Mrs. Maria Jawad Khan (0.11%), Mrs. Saba Ahmed (1.34%), and Mr. Mohammad Shah Mir Amin Khan (0.11%).

Stability Zafa Pharmaceutical is a prominent player in the pharmaceutical industry, conducting its operations in the country through its four affiliated companies. The strategic acquisition of a significant stake in BALSAM Pharmaceutical Company Limited will further strengthen its position in internal markets.

Business Acumen Zafa Group, founded in 1973, is a prominent player in Pakistan's healthcare industry. It is renowned for its expertise in establishing international partnerships and strategic relations with reputable global firms. With a widespread presence across the country, Zafa has a team of skilled medical representatives and healthcare professionals.

Financial Strength Mr. Mohammad Amin Khan (late), the visionary behind Zafa Pharmaceutical and its primary sponsor, embarked on his career in the Pakistani pharmaceutical industry with a modest investment. Zafa Pharmaceutical Laboratories commenced its journey with a mere four products and a single factory, driven by a resolute mission to contribute to the betterment of the society.

Governance

Board Structure The Board of Directors of Zafa Pharmaceutical consists of five members, all of whom are family representatives. Notably, there are currently no independent directors on the board. The composition of the board includes accomplished professionals with extensive backgrounds in the pharmaceutical and financial services sectors.

Members' Profile Mr. Jawad Amin Khan, the Managing Director of the company, holds an MBA degree from Pakistan and possesses more than three decades of diverse professional experience within the country. With a remarkable tenure of 32 years in the pharmaceutical industry, he is deeply entrenched in the field. Additionally, Mr. Khan holds senior positions within other Group companies operating in the pharmaceutical and glass product industries.

Board Effectiveness Zafa Pharmaceutical has no formal board committee in place at present.

Financial Transparency The auditors of the company, EY Ford Rhodes Chartered Accountants, expressed an unqualified opinion on the financial statements for the year ended June-22. There is an established Internal Audit function, that reports directly to the CEO/MD.

Management

Organizational Structure The organizational structure of the company is divided into seven functional departments headed by able professionals (Directors or Controllers): 1) CFO/ Company Secretary, 2) Internal Audit, 3) Production, 4) Human Resource (M&S), 5) Supply Chain, 6) Business Unit, and 7) Engineering.

Management Team Mr. Jawad Amin Khan, currently serving as the MD & CEO of Zafa, assumed the role of managing director within the company in 1991. With a wealth of experience spanning up to three decades, his expertise is predominantly focused on the pharmaceutical industry. Mr. Khan is backed by a seasoned core management team, comprising individuals with extensive tenure at Zafa and diverse professional backgrounds. Leading the financial operations of the company is Mr. Rehan Saleem (M.Com, M.A. Economics, LLB), serving as the Chief Financial Officer (CFO).

Effectiveness Currently, the Company has no formal management committee in place, but is in process of creating management committees in the future.

MIS Zafa has successfully implemented and currently utilizes the complete suite of developed inhouse Oracle modules as part of their enterprise resource planning (ERP) system.

Control Environment A quarterly presentation is sent to the MD by the CFO, detailing the company's financial performance for the quarter.

Business Risk

Industry Dynamics The healthcare services industry is regarded as a low-risk sector due to its limited demand cyclicality. As of December 2022, the industry's size is approximately PKR 704.5 billion, compared to PKR 650.6 billion in May 2022. Import figures indicate that the industry's imports amounted to around USD 3.73 billion during the first nine months of FY22. The industry has experienced an 11.6% increase in prices, primarily influenced by global inflation and devaluation of the rupee. It is important to note that the industry's significant reliance on imported raw materials elevates the inherent risk of potential disruptions in the supply chain.

Relative Position Zafa has a diverse product portfolio that includes both its own range of branded products and licensed products approved by the Drug Regulatory Authority of Pakistan. Presently, Zafa holds a market share of 30-35% in terms of units in the folic acid market. The company is driven by its vision to offer economically and affordably priced high-quality healthcare products to the public, at significantly lower costs compared to its competitors.

Revenues In FY22, the sales of the company are clocked at PKR 4,899mln (CY21: PKR 4,792mln, CY20: PKR 4,074mln) growth of 2.23% YoY basis. The Company has adopted a strategy to mitigate its higher top product concentration risk by launching supporting brands with their existing product line. The top 10 products of the Company contributed 37.04% of total sales.

Margins During 9MFY22, the gross margin of Zafa reached 36.0% (CY22: 37.2%, CY21: 37.9%). Despite the significant inflationary impact and increased operating expenses, the operating margin clocked at 20.7% during 9MFY23 (CY22: 8.3%, CY21: 10.6%, CY20: 11.5%) declining trend can be clearly seen. Zafa has shown a massive increase in its net margin during 9MFY23 at 20.2% (CY22: 4.2%, CY21: 6.2%) mainly because of decline in finance cost.

Sustainability Earning prospect is dependent on stability of the exchange rate, market share of top products, and profitability of the group companies.

Financial Risk

Working Capital Zafa's net cash cycle at 9MFY23 has reached 127 days (CY22: 99 days, CY21: 104 days). The inventory and receivable days during 9MFY23 stood at 115 days and 17 days respectively (CY22: 90, 19 days, CY21: 83, 28 days).

Coverages Zafa has a sizeable FCFO at 9MFY23: PKR 824mln (CY22: PKR 333mln, CY21: PKR 959mln). Interest coverages are sustained at ~24.3x in 9MFY23 (CY22: ~14.1x, CY21: ~21.9x). The Company's debt servicing ability is improved in 9MFY23: 0.2x (CY22: 1.0x, CY21: 0.2x).

Capitalization The debt on the books of Zafa comprises mainly short-term borrowings of PKR 319mln & long-term borrowings of PKR 85mln during FY22. In CY22, the leverage ratio stood at 19.8% during 9MFY23 (CY22: 17.5%, CY21: 13.6%). The Company has an equity base of PKR 3,797mln during 9MFY23 (CY22 2,974, CY21 2,769).



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Financial Summary
PKR mln

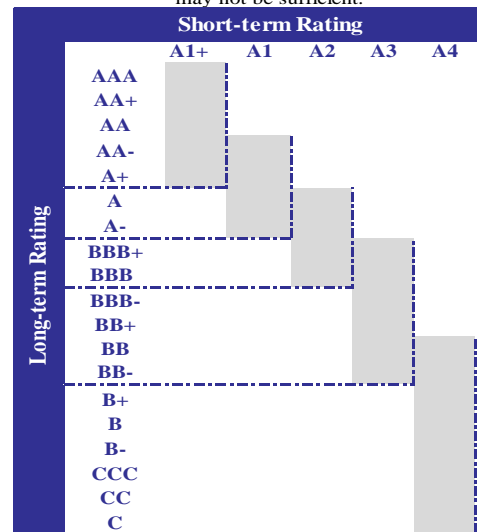
Zafa Pharmaceutical Laboratories (Pvt.) Limited Pharmaceutical	Mar-23 9M	Jun-22 12M	Jun-21 12M	Jun-20 12M
A BALANCE SHEET				
1 Non-Current Assets	1,572	1,002	1,002	1,071
2 Investments	439	439	444	450
3 Related Party Exposure	394	341	401	416
4 Current Assets	2,910	2,289	1,654	1,892
<i>a Inventories</i>	2,133	1,285	1,131	1,055
<i>b Trade Receivables</i>	228	290	212	529
5 Total Assets	5,314	4,070	3,501	3,829
6 Current Liabilities	201	434	261	332
<i>a Trade Payables</i>	4	142	114	89
7 Borrowings	933	485	430	954
8 Related Party Exposure	4	146	5	1
9 Non-Current Liabilities	379	31	36	70
10 Net Assets	3,797	2,974	2,769	2,472
11 Shareholders' Equity	3,797	2,974	2,769	2,472
B INCOME STATEMENT				
1 Sales	4,074	4,899	4,793	4,075
<i>a Cost of Good Sold</i>	(2,606)	(3,077)	(2,975)	(2,619)
2 Gross Profit	1,468	1,822	1,818	1,456
<i>a Operating Expenses</i>	(625)	(1,417)	(1,312)	(824)
3 Operating Profit	843	406	506	632
<i>a Non Operating Income or (Expense)</i>	19	(10)	(70)	(161)
4 Profit or (Loss) before Interest and Tax	862	396	436	470
<i>a Total Finance Cost</i>	(38)	(27)	(50)	(119)
<i>b Taxation</i>	-	(164)	(88)	(183)
6 Net Income Or (Loss)	824	205	298	168
C CASH FLOW STATEMENT				
<i>a Free Cash Flows from Operations (FCFO)</i>	824	333	959	657
<i>b Net Cash from Operating Activities before Working Capital Changes</i>	824	324	903	527
<i>c Changes in Working Capital</i>	-	51	(50)	(330)
1 Net Cash provided by Operating Activities	824	374	854	197
2 Net Cash (Used in) or Available From Investing Activities	-	(184)	(123)	(4)
3 Net Cash (Used in) or Available From Financing Activities	-	22	(571)	(291)
4 Net Cash generated or (Used) during the period	824	212	160	(98)
D RATIO ANALYSIS				
1 Performance				
<i>a Sales Growth (for the period)</i>	10.9%	2.2%	17.6%	12.0%
<i>b Gross Profit Margin</i>	36.0%	37.2%	37.9%	35.7%
<i>c Net Profit Margin</i>	20.2%	4.2%	6.2%	4.1%
<i>d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)</i>	20.2%	7.8%	19.0%	8.0%
<i>e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh</i>	32.4%	7.1%	11.4%	6.8%
2 Working Capital Management				
<i>a Gross Working Capital (Average Days)</i>	132	109	111	142
<i>b Net Working Capital (Average Days)</i>	127	99	104	134
<i>c Current Ratio (Current Assets / Current Liabilities)</i>	14.5	5.3	6.3	5.7
3 Coverages				
<i>a EBITDA / Finance Cost</i>	24.3	22.1	21.8	6.7
<i>b FCFO / Finance Cost+CMLTB+Excess STB</i>	24.3	3.5	5.6	1.9
<i>c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)</i>	0.2	1.0	0.2	0.5
4 Capital Structure				
<i>a Total Borrowings / (Total Borrowings+Shareholders' Equity)</i>	19.8%	17.5%	13.6%	27.9%
<i>b Interest or Markup Payable (Days)</i>	17.2	64.9	18.0	44.0
<i>c Entity Average Borrowing Rate</i>	5.8%	4.4%	6.3%	11.9%

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB-	
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.
B-	
CCC	
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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

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(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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(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)

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(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)

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(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)

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(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)

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(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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