



The Pakistan Credit Rating Agency Limited

Rating Report

Pharmagen Limited

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
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 (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 Ratings(Jun-18),Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
Related Research	Sector Study Pharmaceutical(May-18)
Rating Analysts	Muhammad Obaid muhammad.obaid@pacra.com +92-42-35869504

Profile

Legal Structure Pharmagen Limited (PL) is a public limited company-unquoted pharmaceutical company operating in Pakistan since 1990.

Background The sponsors have successfully promoted and managed sophisticated pharmaceutical bulk drug projects, and currently are the leading bulk drug producer in Pakistan manufacturing a broad range of antibiotics, etc.

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.

Ownership

Ownership Structure 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 two trusts, Naghat Rasheed Trust and Kashmir Education Foundation holding (~1.8%) and (~20.9%) respectively.

Stability Since PL is jointly owned by a few families, it 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 Sponsored by a group of highly dedicated professionals and technocrats having 13 years proven experience in the pharmaceutical bulk drug market are poised to fully take advantage of the growing industry.

Financial Strength The sponsors have an adequate financial profile with shareholding in multiple companies.

Governance

Board Structure The seven member BoD of PL comprises four members from Mr. Pervez Hussain's family, two from Maj. Gen. (Retd.) Muhammad Rahim Khan's family and one from Mr. Rasheed Khan's family.

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 27 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 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.

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 41 years of experience, 25 years' experience of successfully running industrial and other businesses including pharmaceuticals and healthcare. He is supported by an experienced core 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.

MIS Pharmagen has implemented a state-of-the-art tailor-built web based ERP system called Vintage Pro ERP system. This user friendly, secure with SSL, scalable, responsive and robust ERP software provides a broad range of capabilities to support all critical back office functions.

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 current size of Pakistan's pharmaceutical industry is PKR 355bln, presently growing at 7% p.a. (previously 10%-12% p.a.). There are total 733 registered pharma companies in Pakistan including 16 MNCs. The top 100 companies contribute 97% of the total industry revenue and the remaining 633 companies account for remainder. Pharmaceutical industry is expected to at ~10% p.a. in foreseeable future on account of high population growth, rising income levels and affordability, accessibility to medicines in rural areas and greater trend and awareness amongst masses for better healthcare and usage of modern medicines.

Relative Position Pakistan's Active Pharmaceutical Ingredients (API) market is ~PKR 89bln, out of which 10% is locally produced and 90% is being imported. Out of the 6 producers of API Pharmagen leads the market and has the competitive edge to achieve even higher business growth and market share compared with the other API producers.

Revenues Besides being the leading API producer, Pharmagen has recently diversified into becoming a producer and marketer of a wide range of quality medicines by acquiring Moringa Pharmaceuticals, and now has 33 registered products.

Margins In FY18, PL's topline amounted to PKR 5,674mln (FY17: PKR 4,788mln, FY16: PKR 5,318mln), up by ~19% YoY. Despite increasing topline, the company demonstrated a slight deterioration in margins; gross (FY18: 8.4%, FY17: 9.5%, FY16: 9.1%) and operating (FY18: 4.9%, FY17: 5.6%, FY16: 5.6%). This can be attributed to PL's procurement of APIs (major raw material) from China and India at a depreciated PKR exchange rate and comparatively higher overheads on the back of increased selling and distribution expenses. During FY18, EBITDA margin dipped to 6.0% (FY17: 6.8%) due to higher finance cost (FY18: 202mln, FY17: 171mln). Consequently, the company posted 11% lower net profit of PKR 55mln in FY18 (FY17: PKR 62mln, FY16: PKR 79mln).

Sustainability Earnings prospects are improving as the raw material cost of API has come down amid considerable PKR depreciation, effect of which has been passed through to the consumers.

Financial Risk

Working Capital Pharmagen manages its working capital requirements via a mix of internal generation and short-term borrowing (STB), though utilization of STB has increased (FY18: PKR 1,879mln, FY17: PKR 1,784mln, FY16: PKR 1,551mln). Net working capital days has seen an improvement (FY18: 77days, FY17: 81days) on account of better working capital management.

Coverages Although sales increased considerably, free cashflows from operations (FCFO) decreased in FY18 due to higher taxes in the current year, amounting to PKR 295mln (FY17: PKR 302mln). Increase in long and short term borrowings resulted in slightly deteriorated interest coverage (FY18: 1.5x, FY17: 1.8x, FY16: 1.6x). Debt coverage ratio stood at 0.9x in FY18 (FY17: 1.1x, FY16: 1.0x) due to a higher quantum of borrowing and respective debt payments falling due during FY18.

Capitalization Pharmagen maintains leveraged capital structure. Major portion of debt constitutes short-term borrowing (STB) (FY18: 81%, FY17: 82%). Despite higher long-term debt (FY18: PKR 446mln, FY17: PKR 385mln), debt-to-debt-plus-equity ratio (net of revaluation surplus) stood static at ~75% in FY18 (FY17: ~75%, FY16: ~72%).



Pharmagen Limited

BALANCE SHEET	30-Jun-18	30-Jun-17	30-Jun-16
	Annual	Annual	Annual
Non-Current Assets	2,012	1,110	978
Investments (incl. Associates)	117	117	20
Equity	72	72	20
Debt Securities (incl. income funds)	45	45	-
Current Assets	2,509	2,268	2,272
Inventory	689	827	828
Trade Receivables	1,275	898	913
Others	545	542	531
Total Assets	4,639	3,495	3,270
Debt	2,324	2,169	1,806
Short-term	1,879	1,784	1,551
Long-term (incl. Current Maturity of Long-Term debt)	446	385	255
Other Short-term Liabilities	753	563	690
Other Long-term Liabilities	15	39	66
Shareholder's Equity	1,547	725	708
Total Liabilities & Equity	4,639	3,495	3,270

INCOME STATEMENT

Turnover	5,674	4,788	5,318
Gross Profit	477	456	482
Other Income	(4)	(20)	(30)
Financial Charges	(202)	(166)	(160)
Net Income	55	62	79

Cashflow Statement

Free Cashflow from Operations (FCFO)	295	302	263
Net Cash changes in Working Capital	(80)	(208)	(354)
Net Cash from Operating Activities	16	(71)	(268)
Net Cash from Investing Activities	(139)	(299)	(118)
Net Cash from Financing Activities	138	301	261
Net Cash generated during the period	14	(69)	(124)

Ratio Analysis

Performance

Turnover Growth	18.5%	-10.0%	19.8%
Gross Margin	8.4%	9.5%	9.1%
Net Margin	1.0%	1.3%	1.5%
ROE	4.0%	8.9%	11.2%

Coverages

Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD)	0.9	1.1	1.0
Interest Coverage (x) (FCFO/Gross Interest)	1.5	1.8	1.6
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	6.1	3.4	2.5

Liquidity

Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	77	81	72
--	----	----	----

Capital Structure (Total Debt/Total Debt+Equity)	60.0%	75.0%	71.8%
---	-------	-------	-------

Pharmagen Limited

December 18

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

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

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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.
- (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

(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's prior written consent