The Pakistan Credit Rating Agency Limited

Rating Report

Pharmagen Limited| PP Sukuk

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
12-Jul-2019	A-	-	Stable	Preliminary	-

Rating Rationale and Key Rating Drivers

The rating reflect the strength of the security structure of the sukuk. This entails in-built advance cushion against the upcoming repayments. The rating reflect strong positioning of Pharmagen Limited in its respective market. The pharmaceutical industry has witnessed a high rate of sustained growth over the years. Cost-efficiencies as well as demand in-elasticity are benefiting the industry players. 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 its raw material, where currency fluctuation and pricing risk could affect margins, however majority of the cost increase can be passed through to its customers. Pharmagen has improved its working capital position by obtaining additional financing facilities - as a result there has been a marked improvement in profitability and turnover during the March 2019 quarter. Predominant proportion of the business is signed with eminent pharmaceutical corporates - both multinational and local. The company's ongoing supply arrangements with GSK and prospects of enhancing the range of products to be supplied will add-on to the growth levels. Pharmagen is poised to derive benefits from downward integration in Moringa Pharmaceuticals which would help Pharmagen, to diversify in different segments and reduce the concentration risk. The underway capacity enhancement plans are set to further boost Pharmagen's operations and financial results. Long association of experienced management team adds comfort. The proceeds from the sukuk will be utilized in improving the composition of the debt book.

The ratings are dependent on the company's ability to sustain margins. Improvement in business volume and profitability will be viewed positively. 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| PP Sukuk
Type of Relationship	Solicited
Purpose of the Rating	Debt Instrument Rating
Applicable Criteria	Methodology | Debt Instrument(Jun-18)
Related Research	Sector Study | Pharmaceutical(Apr-19)
Rating Analysts	Muhammad Obaid | muhammad.obaid@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 13 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.

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 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 PL is sponsored by a group of highly dedicated professionals and technocrats having 13 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 are three associated companies. Milestones achieved by the PL include acquisition of Pharmagen healthcare Ltd in 2007; Pharmagen pharmaceutical in 2007; Moinga Pharmaceuticals (Pvt.) Ltd in May 2017.

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 The External Auditors of the company, Kreston Hyder Bhumji & Co. Chartered Accountants, expressed an unqualified opinion on the financial statements for the year ended June-18. 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 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 current size of Pakistan’s pharmaceutical industry is PKR 355 bln, 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 80bln, out of which 15% is locally produced and 85% is being imported. There are only 6 active API producers in Pakistan. Hence, being a leading API producer, Pharmagen has competitive edge to achieve high business growth and market share compared with the other API producers.

Revenues During 6MFY19, PL's topline dropped as the company was not able to maintain working capital on account of high exchange rates. PL’s topline for the period amounted to PKR 3,210mln. Going forward, PL has seen a continuous upward trend from MoM - with monthly turnover standing 750mln in Feb19 (Dec18: 600mln, Sep18: PKR 408mln). PL estimates to continue with the same trend and post a turnover of PKR 7,500mln as against annual turnover of PKR 5,674mln in FY18.

Margins PL demonstrated a deterioration in margins; gross (6MFY19: 5.1%, FY18: 8.4%, FY17: 9.5%) and operating (6MFY19: 1.7%, FY18: 4.9%, FY17: 5.6%). This can be attributed to PL’s procurement of APIs (major raw material) from China at a depreciated PKR exchange rate. However, since PL's margin is turnover driven, post Sep18 PL's profitability has also witnessed a turnaround on MoM basis; gross profit (Feb18: PKR 87mln, Dec18: PKR 59mln, Sep18: PKR 1mln) and net profit/(-loss) (Feb18: PKR 26mln, Dec18: PKR 9mln, Sep18: PKR -26mln).

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. Expansion of multi-purpose plant is on the cards to cater the increasing demand.

Financial Risk

Working Capital Pharmagen manages its working capital requirements via a mix of internal generation and short-term borrowing (STB). Utilization of STB has increased (6MFY19: PKR 2,159mln, FY18: PKR 1,879mln). PL obtained short term lines from HabibMetro and Soneri worth PKR 250mln each. Net working capital days has seen an improvement (6MFY19: 56 days FY18: 77days, FY17: 81days) on account of better working capital management.

Coverages Increase in short term borrowings, from PKR 1,879mln in Jun18 to PKR 2,371mln in Mar19, resulted in deteriorated interest coverage (6MFY19: 0.6x, FY18: 1.5x, FY17: 1.8x). During 9MFY19, 37% YoY increase in turnover supported the FCFO of the company (Mar19: PKR 214mln, Jun18 PKR 294mln).

Capitalization The company is issuing a privately placed, listed, rated and secured sukuk of PKR 1 bln. The proceeds will be utilized for re-profiling of the existing fund facilities of the company. The tenor of the instrument is five years, with a grace period of 2 years, payable quarterly thereafter in equal installments. Profit rate is being decided. The instrument will be secured through a debt payment account, which will be funded by 1/3 each month for three months for the quarterly payments. The company will also be maintaining one surplus installment equal to the upcoming installment in the debt payment account. The instrument is having a first charge on plant and machinery and building as well with a 30% margin.

Financials (Summary) in PKR mln

Pharmagen Limited

Unlisted Public Limited

BALANCE SHEET	Mar-19	Jun-18	Jun-17	Jun-16
	9M	12M	12M	12M
a Non-Current Assets	**2,064**	**2,012**	**1,110**	**978**
b Investments (Incl. Associates)	**387**	**303**	**229**	**110**
Equity Instruments	72	72	72	20
Debt Instruments	45	45	45	-
Due from Related Parties	270	186	112	89
c Current Assets	**2,881**	**2,324**	**2,156**	**2,182**
Inventory	902	689	827	828
Trade Receivables	1,545	1,275	898	913
Others	434	359	431	442
d Total Assets	**5,332**	**4,639**	**3,495**	**3,270**
e Debt/Borrowings	**2,796**	**2,324**	**2,169**	**1,806**
Short-Term	2,371	1,879	1,784	1,551
Long-Term (Incl. Current Maturity of Long-Term Debt)	424	446	385	255
Other Short-Term Liabilities	982	753	563	690
Other Long-Term Liabilities	-	15	39	66
f Shareholder's Equity	**1,554**	**1,547**	**725**	**708**
g Total Liabilities & Equity	**5,332**	**4,639**	**3,495**	**3,270**

INCOME STATEMENT				
a Turnover	**5,359**	**5,674**	**4,788**	**5,318**
b Gross Profit	397	477	456	482
c Net Other Income	(1)	(4)	(20)	(30)
d Financial Charges	(220)	(202)	(166)	(160)
e Net Income	**8**	**55**	**62**	**79**

CASH FLOW STATEMENT				
a Free Cash Flow from Operations (FCFO)	214	294	302	263
b Total Cashflows (TCF)	214	294	302	263
c Net Cash changes in Working Capital	(383)	(80)	(208)	(354)
d Net Cash from Operating Activities	(363)	15	(71)	(268)
e Net Cash from InvestingActivities	(81)	(139)	(299)	(118)
f Net Cash from Financing Activities	471	138	318	261
g Net Cash generated during the period	27	13	(52)	(124)

RATIO ANALYSIS				
a Performance				
Turnover Growth	26%	19%	-10%	20%
Gross Margin	7%	8%	10%	9%
Net Margin	0%	1%	1%	1%
ROE	1%	5%	9%	11%
b Coverages				
Debt Service Coverage (X) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.4	0.5	0.7	0.9
Interest Coverage (X) (FCFO/Gross Interest)	1.1	1.7	2.1	2.0
Debt Payback (Years) (Total Debt (excluding Covered Short Term Borrowings) / FCFO)	25.5	6.3	3.6	2.4
c Capital Structure (Total Debt/Total Debt+Equity)				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	78	87	95	45
d **Capital Structure** (Total Debt/Total Debt+Equity)	64%	60%	75%	72%

Regulatory and Supplementary Disclosure

Nature of Instrument	Size of Issue (PKR Bln)	Tenor	Security	Quantum of Security	Nature of Assets	Trustee	Book Value of Assets (PKR mln)
Sukuk	1 Bln	5 years	Instrument will be unsecured and subordinated as to payment of principal and profit to all other indebtedness of the bank, including deposits and will not be redeemable before maturity without prior approval of SBP	600 Mln	Plant & Machinery, Building.	To be appointed	2000 Mln

Pharmagen Ltd | Sukuk | Jul '19	
Name of Issuer	Pharmagen Limited
Issue size	PKR 1.0 Bln
Tenor	5 Years
Maturity	5 years from the date of issuance (unless Call Option is exercised)
Profit Rate	3 MK + 2.5%
Principal Repayment	Proft will be payable semi-annually in arrears on the outstanding principal amount. The first such profit payment will fall due six months from the issue date and subsequently every six months thereafter.

Pharmagen | Sukuk | Redemption Schedule

Due Date Principle	Opening Principal	Principal Repayment	Due Date Markup/ Profit	Markup/Profit Rate	6M Kibor	Markup/Profit Payment	Installment Payable	Principal Outstanding
		PKR in mln						*PKR in mln*
Issuance								1,000.00
3 months from issuance	1,000.00		3 months from issuance	3 Month Kibor + 2.5%				1,000.00
6 months from issuance	1,000.00		6 months from issuance	3 Month Kibor + 2.5%				1,000.00
9 months from issuance	1,000.00		9 months from issuance	3 Month Kibor + 2.5%				1,000.00
12 months from issuance	1,000.00		12 months from issuance	3 Month Kibor + 2.5%				1,000.00
15 months from issuance	1,000.00		15 months from issuance	3 Month Kibor + 2.5%				1,000.00
18 months from issuance	1,000.00		18 months from issuance	3 Month Kibor + 2.5%				1,000.00
21 months from issuance	1,000.00		21 months from issuance	3 Month Kibor + 2.5%				1,000.00
24 months from issuance	1,000.00		24 months from issuance	3 Month Kibor + 2.5%				1,000.00
27 months from issuance	1,000.00	83.33	27 months from issuance	3 Month Kibor + 2.5%				916.67
30 months from issuance	916.67	83.33	30 months from issuance	3 Month Kibor + 2.5%				833.33
33 months from issuance	833.33	83.33	33 months from issuance	3 Month Kibor + 2.5%				750.00
36 months from issuance	750.00	83.33	36 months from issuance	3 Month Kibor + 2.5%				666.66
39 months from issuance	666.66	83.33	39 months from issuance	3 Month Kibor + 2.5%				583.33
42 months from issuance	583.33	83.33	42 months from issuance	3 Month Kibor + 2.5%				500.00
45 months from issuance	500.00	83.33	45 months from issuance	3 Month Kibor + 2.5%				416.66
48 months from issuance	416.66	83.33	48 months from issuance	3 Month Kibor + 2.5%				333.33
51 months from issuance	333.33	83.33	51 months from issuance	3 Month Kibor + 2.5%				249.99
54 months from issuance	249.99	83.33	54 months from issuance	3 Month Kibor + 2.5%				166.66
57 months from issuance	166.66	83.33	57 months from issuance	3 Month Kibor + 2.5%				83.33
60 months from issuance	83.33	83.33	60 months from issuance	3 Month Kibor + 2.5%				(0.0)
		1,000.0				-	-	

Rating Scale | Debt Instrument

2019

Debt Instrument Rating Scale & Definitions

Credit rating reflects forward-looking opinion on credit worthiness of underlying 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

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