The Pakistan Credit Rating Agency Limited

Rating Report

Martin Dow Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
01-Sep-2023	A	A2	Stable	Downgrade	-
02-Sep-2022	A+	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Martin Dow Limited (herein referred to as "MDL" or the "Company"), is an operating and holding company of the Martin Dow group and one of the leading pharmaceutical groups in Pakistan. The Akhai family entered the pharmaceutical industry in 1960. As of now, four companies operate within MDL group (MDG) which include; (i) Martin Dow Limited (ii) Martin Dow Marker Limited (iii) Martin Dow Specialties (Private) Limited & (iv) Seatle (Private) Limited. Martin Dow has a diversified portfolio that includes both chronic and acute therapeutic segments. The business growth is driven through organic portfolio growth and new launches. MDL had also been known for its high-end acquisitions. In the past, Martin Dow achieved the largest acquisition in the Pakistan Pharma industry at that time by acquiring industrial assets and leading brands of ROCHE in 2010 followed by the acquisition of Merck Pakistan in 2016. The group produces and sells well-known brands under its domain, including Rocephin, Synflex, Concor, Evion, Glucophage, Lexotanil & Sangobion. The group is well poised in the industry with a group size of PKR ~30bln as of Dec 22. The rating takes comfort in the company’s association and strategic alliances with renowned multinational groups such as Roche, Merck, Sanofi & Boehringer Ingelheim. From time to time the Company has invested in modernizing and integrating new technologies into its manufacturing facilities. The board of MDL comprises experienced and professional experts. The Board size is considered adequate as the management is mindful of the corporate governance requirements and fulfills the applicable statutory criteria. Currently, the pharmaceutical sector faces industry-specific challenges which hinder its growth and profitability matrix. These challenges include high cost of borrowing triggered by significant increase in KIBOR, massive PKR devaluation resulting in increased cost of imported APIs as well as causing hefty foreign exchange losses during CY22. Being price controlled pharma companies also can not pass on the impact of these price escalations to end consumers. The company’s margins have diluted at all levels on the back of the adverse macroeconomic environment. The financial risk profile of the company has depleted marginally owing to a stretched working capital cycle, modest coverages, and stressed cashflows. The company has a leveraged capital structure with short-term borrowings significantly dominating the debt portfolio in order to meet working capital needs. Also, long-term borrowings are availed to fund brand acquisitions and expansion. Going forward, the financial risk profile of the company is expected to improve as MDL is taking strong initiatives in production and supply chain areas besides pursuing a robust product localization plan, the impacts of which are expected to contribute positively to the company’s margins. Moreover, the positive effect of the special CPI allowance by DRAP in May-2023 shall be visible on the financial performance of MDL starting Q3 of 2023.

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	Martin Dow 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	Sohail Ahmed Qureshi | sohail.ahmed@pacra.com | +92-42-35869504

Profile

Legal Structure Martin Dow Limited (the Holding Company) "MDL" is a public unlisted Company. The registered office of the Holding Company is located at Plot No. 37, Sector 19, Korangi Industrial Area, Karachi - 74900, Pakistan.

Background Akhai family entered the pharmaceutical business in 1960. After that MDL was incorporated in Pakistan on February 6, 1995, as an unlisted public limited company under the repealed Companies Ordinance, 1984 (now the Companies Act, 2017). In 2010, MDL acquired the Roche facility in Pakistan along with the acquisition and brand licensing of the global product lines from Hoffman-La Roche, Switzerland.

Operations MDL commenced its business on November 7, 1995. The first manufacturing facility opened for business in 2000 to manufacture and market its pharmaceutical products. It holds a portfolio of 90+ brands under its name as a group and also markets drugs for sixteen therapeutic areas like diabetes, cardiology, multivitamins, analgesics, antibiotics, Psychostimulants, and Beta Blocking agents for pain, Tranquilizers etc. Its subsidiary Martin Dow Marker Limited is also the sole manufacturer of 'pharma grade soft gel' products such as Evion and Sangobion in the country.

Ownership

Ownership Structure Mr Ali Akhai – son of Mr Jawed Akhai(late) is the ultimate beneficial owner of the Company and holds over 97% ownership stake.

Stability The sponsoring members of Martin Dow Group are reputed names and well entrenched in the pharmaceutical business for decades. Martin Dow Group is positioned in the top 06 largest pharmaceutical groups operating in Pakistan. Martin Dow has strategic alliances to manufacture licensed products from international reputes like: Merck, Sanofi, Roche, and P&G, providing international expertise and exposure to operate efficiently as a leading pharmaceutical group.

Business Acumen Martin Dow had been known for its high-end acquisitions and investments. The legacy now continues with Mr Ali Akhai (the main sponsor). Numerous products of the Martin Dow Group are placed #1 in their respective molecules. In the past, Martin Dow incurred the largest acquisition in the Pakistan Pharma industry by acquiring industrial assets of ROCHE leading brands and licensing rights in 2010 followed by Merck Pakistan acquisition in 2016.

Financial Strength Martin Dow Group (MDG) has 4 companies: Martin Dow Limited, Martin Dow Marker Ltd, Martin Dow Specialities Pvt Ltd and Seatle Pvt Ltd. It is well poised in the industry with a group size of PKR 30bln as of Dec'22. Future prospects of the company are considered strong.

Governance

Board Structure MDL has a four-member board including Mr. Ali Akhai (the chairman), Mr Javed Ghulam Muhammad (the CEO of the company), Mr. Abdul Samad (Group CFO and company secretary) and Mr. Syed Dawood (the independent director). Mr Dawood is associated with MDL since 2018. All members of the board are well-qualified and professionally sound.

Members' Profile Mr Ali Akhai is the present Chairman. He is a foreign qualified double Master's degree holder from UK & France. Mr Ali returned to Pakistan to join their family business with his father Mr Jawed Akhai (late), the man behind Martin Dow. He played his part in the leadership team that successfully acquired the majority shareholding of Merck (Pvt) Ltd in 2016.

Board Effectiveness The company is compliant with its respective statutory requirements. Both Chairman and the CEO conduct meetings when it is required

Financial Transparency The auditors of the company, A.F Ferguson & Co. (Member of PWC International), expressed an unqualified opinion on the financial statements for the year ended Dec-22.

Management

Organizational Structure The company's organizational structure is divided into multilevel functional departments headed by able professionals. All heads of the departments report to the CEO who then reports to Chairman.

Management Team Mr Javed Ghulam Muhammad is the Group MD/CEO, and is a qualified fellow member of the Institute of Cost & Management Accountants of Pakistan. His professional journey spreads over 29 years during which he has worked in diversified functions in several key positions at leading multinational and national companies. He is accompanied by a team of qualified and experienced professionals.

Effectiveness The Company does not have any formal management committees in place. However, business affairs are overseen in an efficient manner.

MIS MDL is equipped with SAP comprising a number of SAP modules. Reporting is held on a monthly basis and reviewed by the head of the departments.

Control Environment There exists an internal audit department which is led by the Group head of internal audit. He then reports directly to the Chairman. Also, controls have been established at each department level.

Business Risk

Industry Dynamics The healthcare industry is considered a relatively low-risk sector considering limited demand cyclicality. The overall size of the industry has grown to PKR 705bln (Dec-22) from PKR 616bln (Dec-21). Although there are numerous companies registered companies, the sector is dominated by few big players. In fact, the top 100 companies enjoy a 97% market share. This year proved challenging for the sector as import restrictions and massive PKR devaluation led to supply chain-related challenges and also resulted in a surge in raw material costs for this import-dependent segment. The pharmaceutical industry imports up to 95% of APIs. Also, an increase in finance costs due to higher KIBOR has posed a challenge as the industry has limited ability to pass on this increase to consumers due to price regulations.

Relative Position MDL as a group is the market leader in many therapeutic areas. It holds a market share of ~4% and is ranked 6th on YTD basis under the IQVIA ranking report of Dec-22. MD Group also represents major global pharmaceuticals players in Pakistan mainly Roche & Merck. MDM the subsidiary of MDL is the only company to have a pharma-grade Soft gel capsule manufacturing facility in the country.

Revenues During CY22, the consolidated sales of MDL clocked at PKR 30,441mln (CY21: 26,186mln) showing a growth of 16.2% YoY basis. On a consolidated basis, the top 5 selling products are Concor, Evion, Rocephin Sangobion, and Neurobion , presenting ~32% of concentration. The sales growth trend has an upward sloping trend from the last three years.

Margins The Gross Margin of the company remained under stress and stood at 33.8% during CY22 (36.6%, CY21) on the back of an increase in COGS due to global inflation and the massive depreciation of PKR which has led to a foreign exchange loss of PKR 655mln during CY22. The increase in finance costs to PKR 1,311mln in CY22 (PKR 772mln, CY21) on the back of increased KIBOR, and high inflation has resulted in squeezed margins at all levels.

Sustainability Martin Dow Limited is well poised in the industry bearing the fruits of its association with the leading pharmaceutical companies. It is continuously focusing on adding new products to strengthen its current portfolio. During CY22, the Company has managed to commercialize 17 new brands. Multiple new products are expected to be launched this year. The company is also pursuing a product localization plan which will help improve the margins for some key products and boost overall profitability.

Financial Risk

Working Capital MDL's net cash cycle has shown improvement over the last three years 3 years CY22: 48 days; (CY21: 63 days, CY20: 76 days). This trend reflects that they have better credit terms with their suppliers and efficient receivables management. The working capital needs are fulfilled through a mix of internal cashflows and short-term borrowings.

Coverages MDL has FCFO of PKR 1,773mln during CY22 (CY21: PKR 3,174mln) driven by sales growth and stress on net profitability. However, the company has a leveraged capital structure with positive cash flows. The company's debt servicing ability has decreased considerably as evidenced by the decrease in FCFO to Finance Costs to 1.4x in CY22 (4.1x, CY21). This decrease came on the back of increase in finance costs to PKR 1,311mln in CY22 (PKR 772mln, CY21).

Capitalization The company has a leveraged capital structure as depicted by the leverage ratio of 49.4% in CY22 (44.%, CY21). MDL's debt portfolio is dominated by short-term debt which comprises 79.6% of total borrowings. STB of MDL stood at PKR 8,603mln in CY22 (PKR 6,429mln, CY21). MDL has also availed long-term debt of PKR 1,313mln as of Dec-22 (PKR 1,894mln, CY21).

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Financial Summary
PKR mln

Martin Dow Limited	Dec-22	Dec-21	Dec-20	Dec-19
Pharmaceutical	12M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	17,044	16,438	11,810	11,975
2 Investments	-	-	-	-
3 Related Party Exposure	-	-	-	-
4 Current Assets	13,361	11,100	11,369	11,829
5 Total Assets	30,404	27,537	23,179	23,803
6 Current Liabilities	7,955	5,704	5,125	7,025
7 Borrowings	10,804	9,341	9,069	8,938
8 Related Party Exposure	-	20	200	414
9 Non-Current Liabilities	601	550	514	486
10 Net Assets	11,045	11,923	8,272	6,940
11 Shareholders' Equity	11,045	11,923	8,272	6,940
B INCOME STATEMENT				
1 Sales	30,441	26,186	22,091	19,207
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*1,773*	*3,174*	*3,012*	*1,047*
b Net Cash from Operating Activities before Working Capital	*736*	*2,500*	*2,092*	*64*
c Changes in Working Capital	*(681)*	*212*	*(1,734)*	*354*
1 Net Cash provided by Operating Activities	55	2,713	358	417
2 Net Cash (Used in) or Available From Investing Activities	(939)	(2,755)	(265)	(1,936)
3 Net Cash (Used in) or Available From Financing Activities	704	(207)	(755)	3,486
4 Net Cash generated or (Used) during the period	(180)	(250)	(662)	1,967
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	16.2%	18.5%	15.0%	13.1%
d Cash Conversion Efficiency (FCFO adjusted for Working C	3.6%	12.9%	5.8%	7.3%
2 Working Capital Management				
a Gross Working Capital (Average Days)	98	107	130	153
b Net Working Capital (Average Days)	48	63	76	86
c Current Ratio (Current Assets / Current Liabilities)	1.7	1.9	2.2	1.7
3 Coverages				
a EBITDA / Finance Cost	2.1	4.6	4.2	2.0
b FCFO / Finance Cost+CMLTB+Excess STB	0.3	1.1	1.1	0.4
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Fi	11.7	1.7	1.9	113.9
4 Capital Structure				
a Total Borrowings / (Total Borrowings+Shareholders' Equit	49.4%	44.0%	52.8%	57.4%
c Entity Average Borrowing Rate	13.0%	8.3%	10.0%	10.7%

Credit Rating

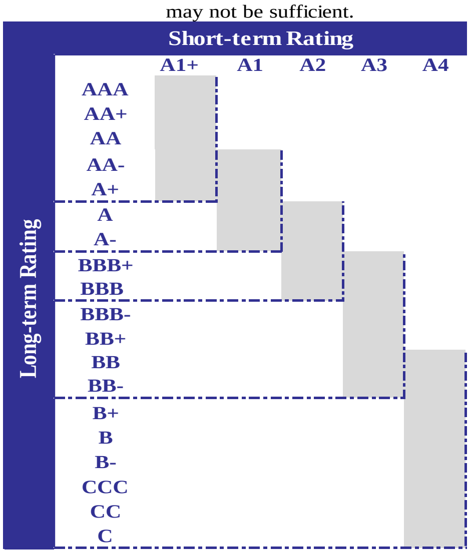
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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

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