The Pakistan Credit Rating Agency Limited

ENTITY RATINGS REPORT

PHARMAGEN LIMITED

ENTITY	RATING	OUTLOOK	ACTION	DATE
Pharmagen Limited	Long Term: BBB Short Term: A2	Stable	Initial	29-Dec-2017

RATING RATIONALE

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 are low, 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

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DECEMBER 2017

PHARMAGEN LIMITED PROFILE	
Incorporated	1990
Major business lines	▪ Manufacturing and sale of APIs (Active Pharmaceutical Ingredients). ▪ Pharmagen's total number of registered/licensed products or APIs are 44 of which 19 are being regularly produced.
Legal status	Un-Listed

INDUSTRY SNAPSHOT
▪ The current size of Pakistan's pharmaceutical industry is PKR 355bln, presently growing at 7% p.a. ▪ Pakistan's Active Pharmaceutical Ingredients (API) market is ~PKR 89bln, out of which 10% is locally produced and 90% is being imported ▪ Pharmaceutical sector is a highly regulated segment in Pakistan

OWNERSHIP — ADEQUATE

- Pharmagen Limited (PL) is a public limited company-unquoted pharmaceutical company operating in Pakistan since 1990.
- 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 company's manufacturing facilities comprises three plants located at Kot Nabi Bukshwala, Ferozepur Road, Lahore. Manufacturing facilities includes Semi-Systhetic Penicillins plant, Semi-Systhetic Cephallosporins plant and multipurpose plant.
- 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.

GOVERNANCE — ADEQUATE

- The seven member BoD of Pharmagen Limited comprises four members from Mr. Pervez Hussain's family representatives, two from Maj. Gen. (Retd.) Muhammad Rahim Khan's family and one from Mr. Rasheed Khan's family.
- The Chairman, Major General (Retired) Muhammad Rahim Khan, is the brain behind Pharmagen.
- The board comprises experienced professionals from pharmaceutical and financial services backgrounds.
- Independent oversight is lacking, indicating room for improvement in the company's governance framework as there is no independent non-executive director on the board.

MANAGEMENT — ADEQUATE

- Mr. Pervez Hussain Sufi heads the management team of the company as Chief Executive Officer, since inception.
- Mr. Sufi is a fellow member of ICAEW and ICAP since 1976 and oversees the overall operations of PL on a daily basis by meeting with relevant head of departments.
- Mr. Azmatullah is a group CFO, having done ACMA, associated with the group since 1997.
- Key management personnel are qualified having extensive experience in the Pharmaceutical industry.

SYSTEM & CONTROLS — ADEQUATE

- Pharmagen has implemented a state-of-the-art tailor-built web based Enterprise Resource Planning (ERP) system. Vintage Pro ERP system deployed at the head office as well as in factory, which is at a remote location.
- The company maintains a comprehensive MIS reporting system for the management to keep track of activities. Reports including cash position, receivable position, payable position, production, inventory status reports, and segment wise profit & loss statement.
- In addition, licensed software is installed on all machines (client or server) at head office and factor. CIO and CTO ensures the complete implementation of IT policies and SOPs throughout the organization.
- PL is having well-equipped labs ensures the quality control for each batch and state-of-the-art machines, qualified and trained production staff helps the company ensure it produces best quality products.

BUSINESS RISK — ADEQUATE

- In FY17, PL's topline amounted to PKR 4,788mln (FY16: PKR 5,318mln, PKR 4,441mln), reduced by ~10% YoY.
- Despite declining topline, the company demonstrated a slight improvement in margins; gross (FY17: 9.5%, FY16: 9.1%, FY15: 9.2%) and operating (FY17: 5.6%, FY16: 5.6%, FY15: 5.8%).
- This can be attributed to PL's strategy of manufacturing products requiring procurement of APIs (major raw material) from China and India at comparatively low cost in bulk quantities and comparatively lower factory overheads on the back of operational efficiencies.
- However, net profit margin continues to decline (FY17: 1.3%, FY16: 1.5%, FY15: 1.6%), lower net profits, as (i) High taxes, (ii) increased overheads. Net profit thus amounted to PKR 62mln in FY17 (FY16: PKR 79mln, FY15: PKR 69mln).

FINANCIAL RISK — NEEDS IMPROVEMENT

- The company manages its working capital requirements via a mix of internal generation and short-term borrowing (STB), though utilization of STB increased (FY17: PKR 1,784mln, FY16: PKR 1,551mln, FY15: PKR 1,335mln).
- Despite increased short-term borrowings, increased cash flows, coupled with increased long-term borrowings resulted in slightly improved interest coverage (FY17: 1.8x, FY16: 1.6x, FY15: 1.7x). However, debt coverage barely kept to 1.1x in FY17 (FY16: 1.0x, FY15: 1.1x) due to a relatively greater amount of debt payments falling due in FY17.
- Despite lower long-term debt (FY17: PKR 385mln, FY16: PKR 255mln, FY15: 177mln), debt-to-debt-plus-equity ratio slightly increased to ~75% at FY17 (FY16: ~72%, FY15: ~70%), owing to increasing short-term borrowings (STB).

Pharmagen Limited

BALANCE SHEET	30-Jun-17	30-Jun-16	30-Jun-15
	FY17	FY16	FY15
Non-Current Assets	**1,110**	**978**	**909**
Investments (incl. Associates)	**117**	**20**	**35**
Equity	72	20	35
Debt Securities (incl. income funds)	45	-	-
Current Assets	**2,268**	**2,272**	**2,022**
Inventory	827	828	735
Trade Receivables	898	913	773
Others	542	531	514
Total Assets	**3,495**	**3,270**	**2,966**
Debt	**2,169**	**1,806**	**1,513**
Short-term	1,784	1,551	1,335
Long-term (incl. Current Maturity of Long-Term debt)	385	255	177
Other Short-term Liabilities	563	690	707
Other Long-term Liabilities	39	66	86
Shareholder's Equity	**725**	**708**	**660**
Total Liabilities & Equity	**3,495**	**3,270**	**2,966**
INCOME STATEMENT			
Turnover	**4,788**	**5,318**	**4,441**
Gross Profit	456	482	410
Other Income	(20)	(30)	(35)
Financial Charges	(166)	(160)	(164)
Net Income	**62**	**79**	**69**
Cashflow Statement			
Free Cashflow from Operations (FCFO)	302	263	283
Net Cash changes in Working Capital	(208)	(354)	(73)
Net Cash from Operating Activities	(71)	(268)	43
Net Cash from InvestingActivities	(299)	(118)	(87)
Net Cash from Financing Activities	301	261	160
Net Cash generated during the period	(69)	(124)	116
Ratio Analysis			
Performance			
Turnover Growth	-10.0%	19.8%	15.5%
Gross Margin	9.5%	9.1%	9.2%
Net Margin	1.3%	1.5%	1.6%
ROE	3.2%	11.2%	10.5%
Coverages			
Debt Service Coverage (x) (FCFO/Gross Interest+CMLTD+Uncovered STB)	0.9	1.0	1.1
Interest Coverage (x) (FCFO/Gross Interest)	1.8	1.6	1.7
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest	3.4	2.5	1.7
Liquidity			
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	81	72	72
Capital Structure (Total Debt/Total Debt+Equity)	75.0%	71.8%	69.6%

The Pakistan Credit Rating Agency Limited

STANDARD RATING SCALES & 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

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 or 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**. "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.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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'.

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, a suspended 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, or e) the entity/issuer defaults.

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Regulatory and Supplementary Disclosure

Name of Entity	Pharmagen Limited
Sector	Pharmaceuticals
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment

Rating History

Dissemination Date	LT Rating	ST Rating	Outlook	Action
29-Dec-17	BBB	A2	Stable	Initial

Related Criteria and Research Pharmaceutical | Jan-2017

Rating Methodology Corporate Rating Methodology

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Rating Team Statement

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