RATING REPORT

Macter International Limited (Macter)

REPORT DATE:

September 20, 2019

RATING ANALYST:

Narendar Shankar Lal
narendar.shankar@vis.com.pk

RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A	A-2	A	A-1
Rating Date	*September 17' 19*		*June 1' 18*	
Rating Outlook	Stable		Stable	
Rating Action	*Downgrade*		*Initial*	

COMPANY INFORMATION	
Incorporated in 1992	**External auditors:** Ernst & Young Ford Rhodes Sidat Hyder & Co. Chartered Accountants
Listed Public Limited Company	**Chairman of the Board:** Dr. Amanullah
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Asif Misbah
Misbah Family – 73.3%	
SAAS Enterprises (Private) Limited– 16.4%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: Industrial Corporates (May, 2016)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201605.pdf

OVERVIEW OF THE INSTITUTION

In 1992, Macter International Limited (Macter) was incorporated as a private limited company. Subsequently, it was converted into a public limited company in 2011. In 2017, Macter was listed on Pakistan Stock Exchange Limited. Registered office is located in Karachi, Pakistan.

Profile of Chairman

Dr. Amanullah holds M.B.B.S degree from Sindh Medical College Karachi and possesses extensive experience in management of a private business group. He is also engaged with social charities and serves as the President of Kiran Patient Welfare Society & Zubaida Machiyara Trust.

Profile of Chief Executive Officer

Mr. Asif Misbah has been associated with Macter for over two decades. He holds MBA degree from Institute of Business Administration, Karachi.

RATING RATIONALE

Macter International Limited (Macter) is a publicly listed Pakistani pharmaceutical company engaged in manufacturing and marketing of medicines for more than 25 years. The business activities of the company can be classified into two separate segments - branded generics and contract manufacturing. Majority ownership of the company is held by Misbah Family, while the remaining shareholding is vested with a financial services group, other institutions and general public. During the outgoing year, Pharmalux Holding Limited sold its stake in the company to SAAS Enterprises (Pvt.) Limited. Senior management of the company comprises experienced individuals having significant experience in the pharmaceutical sector.

The company has total annual capacity of ~89m units for drug production in the form of tablets, capsules, syrups, suspensions, dry powder, injections, ointments, creams, drops and inhalers. The company has two production facilities located in SITE at Karachi. Macter is also involved in in toll manufacturing for renowned multinational companies, which comprised 2.0% of the company's net sales in FY18. Management also caters to the export market as export sales constituted 3.1% of net sales in FY18.

Business Risk: Business risk of the pharmaceutical industry is considered to be low in the long term given the relatively non-cyclical nature of the sector with stable demand and demographic profile of the country. However, delays in regulatory approvals for increase in product prices and introduction of new products, rupee depreciation and significant dependence on Drug Regulatory Authority of Pakistan (DRAP) for approval of hardship cases continue to remain key risks affecting the industry in the short term.

Market Share: The assigned ratings reflect existing market share of the company which stood at ~1% (in HY19) in the overall pharmaceutical industry. However, with focus on introduction of new products, the company is classified as one of the fastest growing companies in terms of new products launched (and revenues generated from the same) in the pharmaceutical sector by IMS during the last three years. Continued growth in market share is considered important from ratings perspective.

Product Portfolio & Therapeutic Coverage: Macter is present across 48 therapeutic segments through its 80 products. Current portfolio composition indicates significant product wise diversification with top 5 products (including Cobolmin, Titan, Maclusa, Salmicort and Venticort) accounting for approximately one-third of the company's revenues. In view of the management's plan to introduce new products, product-wise concentration may witness further reduction going forward. Ability of the firm to compete in its existing product segments and achievement of budgeted growth continue to remain important rating drivers.

Marketing, Sales and Distribution Network: The company maintains a comprehensive sales network covering ~ 25,000 physicians and more than 40,000 pharmacies. A separate team of 616 field force (FF) officers caters to specialist doctors to enhance the quantum of prescription business. Moreover, business intelligence tools to facilitate timely decision making are also used to enhance sales. Sales avenues include street sales (over the counter and prescription medicines), institutional business (tender), exports and toll and contract sales; majority of the sales of the company emanate from the street sales segment.

Profitability: During FY18, street sales barring the Hepatitis C portfolio, institutional sales and export sales registered growth of 20%, 13% and 28%, respectively vis-à-vis the preceding year. Hepatitis C portfolio decreased on year-over-year basis due to introduction of several cheaper brands for oral treatment, thereby negatively affecting company's sales and gross profits. Moreover, higher proportion of institutional sales which have lower margins in overall sales mix, rupee depreciation and increase in salary expense translated to lower gross profit margins of 45.0% (FY17: 46.1%) in FY18. Other operating expenses (net of other income) registered sizeable growth to Rs. 1,434.1m (FY17: 1,260.1m) on account of increase in selling and distribution costs, higher promotional spending on new products and higher headcount of employees. Resultantly, net profit and net margin were reported lower at 246.3m (FY17: Rs. 274.2m) and 6.1% (FY17: 7.6%) in FY18.

Profitability of the company also depicted sizeable decrease in 9M''FY19 vis-à-vis the corresponding period in the preceding year. Lower profitability was a function of a decline witnessed in topline and growth experienced in expense base primarily on account of rupee depreciation. Uncertainty associated with exchange rates resulted in lower participation in the tender business; hence overall net sales of the company decreased to Rs. 2,879.2m (9M'FY18: Rs. 3,166.2m) in 9M''FY19. Increase in raw material prices due to rupee deprecation translated to lower gross margins (9M'FY19: 42.8%; 9M'FY18: 44.9%). Operating expenses (net of other income) were reported higher on account of planned new product launches and growth in prescription sales. Higher KIBOR also culminated to rising finance costs. In view of these factors, net profit was significantly lower at Rs. 5.4m (9M'FY18: 227.9m). Going forward, one time price increase in the range of 9%-15% allowed by DRAP in addition to allowed CPI increase is expected to limit downside risk of gross margins of the company during the ongoing calendar year. Over the medium term, rupee depreciation is expected to remain on the lower side vis-à-vis the preceding 18 months, hence profitability of the company is expected to remain stable.

Liquidity and Capitalization: In line with increasing capex requirements which included renovation and installation of new machines, the management utilized higher quantum of diminishing musharakah and ijarah borrowings in FY18 and 9M'FY19. Growth was also witnessed in short term borrowings in 9M'FY19 on account of higher working capital requirements. Resultantly, leverage ratios trended upwards with adjusted debt leverage and adjusted gearing reported at 2.28x (FY18: 1.90x; FY17: 1.65x) and 1.44x (FY18: 1.13x; FY17: 0.97x) at end-9M'FY19. Equity base of the company decreased to Rs. 1.10b (FY18: Rs. 1.17b; FY17: Rs. 1.14b) due to payment of dividend pertaining to FY18. Dividend payout ratio of the company was reported at 51.7% (FY17: 60.6%) in FY18. With decrease in profitability, FFO in relation to long term debt and debt service coverage ratio has also declined on timeline basis. Going forward, ratings will continue to be dependent on maintenance of leveraging profile and cash flow coverage within benchmarks for the assigned ratings.

Macter International Limited — Appendix I

FINANCIAL SUMMARY			*(in Rs. millions)*	
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**9M'FY19**
Property, plant and equipment	740.7	845.2	1,182.3	1,250.2
Stock-in-Trade	625.3	905.1	878.7	930.0
Trade Debts	415.7	535.6	561.4	569.8
Cash & Bank Balances	273.7	102.1	47.0	27.4
Total Assets	2,392.2	2,739.9	3,044.1	3,319.8
Adjusted Trade and Other Payables*	484.7	596.0	712.1	716.0
Adjusted Long Term Debt**	305.3	426.4	692.0	699.7
Adjusted Short Term Debt*	594.1	682.4	622.9	881.8
Total Equity	984.0	1,143.2	1,167.5	1,100.5
INCOME STATEMENT	**FY16(A)**	**FY17(A)**	**FY18**	**9M'FY19**
Net Sales	3,064.4	3,630.0	4,053.2	2,879.2
Gross Profit	1,257.2	1,673.4	1,822.4	1,232.4
Administrative Expenses	187.2	201.5	198.8	161.9
Distribution Costs	806.6	1,061.3	1,235.4	977.3
Profit After Tax	147.1	274.2	246.3	5.4
RATIO ANALYSIS	**FY16(A)**	**FY17(A)**	**FY18**	**9M'FY19**
Gross Margin (%)	41.0%	46.1%	45.0%	42.8%
Net Working Capital	431.1	463.8	340.7	168.0
FFO to Adjusted Total Debt (x)	0.26	0.32	0.25	0.02
FFO to Adjusted Long Term Debt (x)	0.76	0.84	0.47	0.05
Adjusted Gearing (x)	0.91	0.97	1.13	1.44
Adjusted Debt Leverage (x)	1.56	1.65	1.90	2.28
Adjusted Debt Servicing Coverage Ratio (x)	N/A	2.61	1.95	0.47
(Stock in trade + trade debts) / Adjusted Short Term borrowings (x)	1.75	2.11	2.31	1.70
Return on Average Assets (%)	N/A	10.7%	8.5%	0.2%
Return on Average Equity (%)	N/A	25.8%	21.3%	0.6%

* adjusted for Murabaha payables
**adjusted for commitments for Ijarah rentals in respect of plant & machinery, motor vehicles and equipment

RATING SCALE & DEFINITION Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Macter International Limited
Sector	Pharmaceutical
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	n/a
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2019 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.

Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
17-Sep-19	A	A-2	Stable	Downgrade
1-June-18	A	A-1	Stable	Initial