RATING REPORT

Highnoon Laboratories Limited

REPORT DATE:
September 20, 2023

RATING ANALYST:
Saeb Muhammad Jafri
saeb.jafri@vis.com.pk

Rating Category	Rating	
	Long-term	Short-term
Entity	A+	A-1
Rating Date	*September 20, 2023*	
Rating Outlook	Positive	
Rating Action	*Initial*	

COMPANY INFORMATION

Incorporated in March 1984	**External auditors:** EY Ford Rhodes, Chartered Accountants
Listed Public Limited Company	**Chairman of the Board:** Mr. Tausif Ahmad Khan
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Dr. Adeel Abbas Haideri
Mr. Tauqir Ahmed Khan – 11.84%	
Mr. Taufiq Ahmed Khan – 9.87%	
Pharmatec Investments Limited – 8.34%	
Mr. Tausif Ahmed Khan – 7.48%	
Mrs. Nosheen Riaz Khan (CDC) – 6.94%	
Jubilee Life Insurance Company Ltd – 6.54%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates (May 2023)
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:
https://docs.vis.com.pk/docs/VISRatingScales.pdf

Highnoon Laboratories Limited (HINOON)

OVERVIEW OF THE INSTITUTION

In 1984, Highnoon Laboratories Limited (HINOON) was incorporated as a private limited company. Subsequently, it was converted into a public limited company in 1995 and its shares were listed on Pakistan Stock Exchange Limited. Registered office of the Company is located in Lahore, Pakistan.

Profile of Chairman

Mr. Tausif Ahmad Khan is a graduate in Economics from the University of Oregon, USA. He actively contributes to the pharmaceutical industry and advises the government on healthcare services. He serves on various boards and engages in national and international pharmaceutical advancements.

Profile of Chief Executive Officer

Dr. Adeel Abbas Haideri, holds a bachelor's degree in medicine and surgery. With extensive experience in the pharmaceutical industry. He joined Highnoon as GM Marketing in 2007. Dr. Adeel has participated in sales, marketing, finance, and general management seminars and served on various boards.

RATING RATIONALE

Company Profile

Highnoon Laboratories Limited ("the Company" or "HINOON" or "Highnoon") is a pharmaceutical manufacturing, importing, and marketing company based in Pakistan. It was incorporated in 1984 as a private limited company and has been listed on the Pakistan Stock Exchange as a public limited company since November 1995. The Company's registered office and manufacturing facility are located at 17.5 KM, Multan Road, Lahore, while its corporate office is situated at Tricon Corporate Center, Jail Road, Lahore.

Highnoon is positioned as the 12th largest pharmaceutical company in Pakistan, demonstrating a 5-Year Compound Annual Growth Rate (CAGR) of 22% with four of its brands exceeding Rs. 1 bln in revenue. HINOON is a generic manufacturing pharmaceutical company, producing and marketing a wide range of products across numerous therapeutic areas. However, it is among the top market leaders in Respiratory, Inhalation, Cardio and Diabetes. It's also a leader in Anti-infective market through its subsidiary Curexa. Major products of the Company include Combivair (Respiratory), Cyrocin (Anti-Infection), Tagipmet (Diabetic), Kestine (Anti-Allergy) and Ulsanic (Anti-Ulcerant).

Curexa Health Private Limited ("the Subsidiary" or "Curexa"), specializing in antibiotics with a primary focus on cephalosporins (*anti-infections*). Curexa's state-of-the-art, cGMP-compliant manufacturing facilities produce sterile powder for injections, powder for oral suspensions, and capsules for both local and export markets. Its broad spectrum cephalosporins cater to various therapeutic and disease segments, including respiratory, gastroenterology, urology, gynecology, and pediatrics.

Furthermore, Highnoon has an associate company named Route2Health ("the Associate" or "R2H"), which primarily manufactures and markets herbal remedies and dietary supplements. R2H has a presence in Pakistan, Canada, and the UAE. The Associate operates a state-of-the-art manufacturing facility in Lahore, recognized as Asia's first USP-accredited dietary supplement plant. R2H has established partnerships with renowned pharmaceutical and herbal companies such as Abbot, Engelhard Arzneimittel GmbH & Co., and Himalaya.

In CY22 the Company reported revenue of Rs.15,816 mln (CY21: Rs.13,001 mln), showing a growth of 22% year over year.

Key Rating Drivers

Business risk is considered medium to low given non-cyclicality of the sector, albeit being strictly regulated.

Vis categorizes the pharmaceutical industry as medium to low risk with low cyclicality, medium competitiveness, medium to low capital intensity and high regulatory risk. Stable demand supported by population growth, high disease incidents, emergence of new diseases and poor hygiene levels results in low cyclicality in the sector.

The pharmaceutical industry is highly regulated. Reliance on the Drug Regulatory Authority of Pakistan (DRAP) for approval of new products and pricing increases, consequently, exposes the company to profitability pressures.

Moreover, high dependence on imported raw materials also results in a significant portion of product costs being denominated in foreign currency, exposing the Company to exchange rate volatility as well as supply constraints on account of foreign exchange limitations in the economy.

Broad based product portfolio

HINOON is present in over 50 therapeutic segments. Its main segments include Respiratory, Inhalation, Anti-infectant, Cardio and Diabetes. Current product portfolio is characterized by low concentration with top 5 brands (Combivair, Cyrocin, Tagipmet, Kestine and Ulsanic) accounting for around 31% of turnover. Further, Highnoon's business is characterized by adequate therapeutic diversity as top five therapeutic segments represent ~45% of sales. Moreover, the Company introduces 7-8 new products per annum, which continues to drive growth. Moreover, the product line includes both acute and long-term treatment products, which provides the company with a good mix of high and low margin products.

Currently, export sales only contribute ~5% to the top line. Management envisages export sales at 7-10% of sales in the next 2-3 years, as it looks to increase its focus on the international market and improve its competitive ability on the global stage.

Consistent sales growth over the years.

Highnoon has consistently achieved revenue growth, with a 5-Year Compound Annual Growth Rate (CAGR) of 22%, resulting in an increase from Rs. 5,971 million in 2017 to Rs. 15,816 million in 2022. Despite facing regulatory pricing constraints and foreign exchange risks, the company has successfully maintained its margins at an average of around 49% over the 5-Year period. However, the 2QCY23 results indicate a significant decline in margins to 45% due to escalating input costs.

Nevertheless, the management expects a recovery in margins due to recent price hike approval by DRAP. Sales growth is projected to remain stable at 20% over the next 3 years with organic growth in existing portfolio and further supported by regular introduction of 7-8 new products by Highnoon annually. The Company anticipates maintaining margins of around 50% going forward.

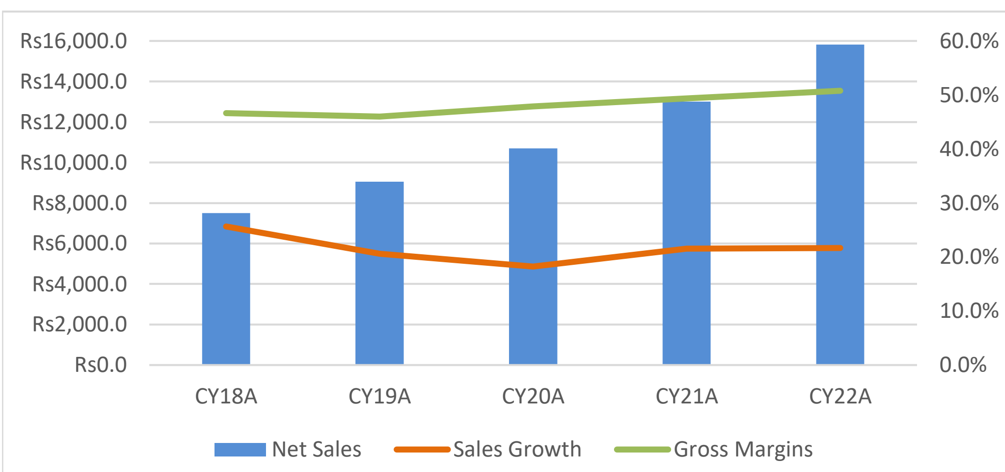

Figure 1 Sales and Margin

Expansion in the long term

In the long term, Company plans to increase capacity and efficiencies for product expansion and export growth. For the same, a new manufacturing facility on a 12-acre acquired land in Quaid-e-Azam Business Park (a special economic zone) has been planned. The project is still in the planning stage thus the total cost and the funding structure is yet to be finalized. However, in the meantime, regular replacement CAPEX to continue. Funding of the expansion project and its impact on capitalization indicators will remain important for ratings going forward.

Sound liquidity profile

The Company has maintained sound liquidity profile over the years, with an average current ratio of 3.7x between CY20 and CY22. Liquidity profile is also supported by ~Rs 1bn portfolio of cash and short-term investments, which however, on a timeline basis depict a declining trend on account of increase in working capital cycle arising from higher stock buffer and extension in collection period. Going forward, Highnoon's ability to manage its increasing Cash Conversion Cycle will remain important for ratings.

Historically, debt servicing coverage has remained strong with Debt-Servicing-Coverage-Ratio (DSCR) reported at 11.3x (CY21: 9.4x, CY20: 57.5x) and FFO to total debt at 348.8% (CY21: 336.2%, CY20: 601.4%) in CY22. Sensitizing margins with potential exchange rate volatility reflects adequate debt servicing cushion till CY24 with pressure building in CY25.

Conservative capital structure.

Conservative capitalization trends have been prominent on Highnoon's financials over the years. The Company's gearing and leverage ratios have consistently remained at comfortable levels, ranging around 0.1x and 0.4x, respectively. While Highnoon historically maintained minimal levels of short-term debt, in recent years, short term borrowings have increased. This rise was driven primarily by the need to address the expanding working capital gap. The gap widened significantly due to increased stock buffers of 6-8 months, compared to the previous 3 months, to mitigate the risk of possible raw material shortages caused by imposed import restrictions in the country during the year. Furthermore, the Company experienced delays in payments from distributors during the year due to the prevailing economic situation in the country, exerting additional pressure on the Company's working capital.

Increase in the Company's long-term debt has been the result of utilization of SBP's Refinance scheme for salaries and wages during COVID-19, and more recently due to financing of its solar power project. Despite rising debt HINOON's gearing and leverage ratios have remained stable, supported by higher profits and a resultant increase in equity base.

Going forward, the Company plans on availing further financing for their new Quaid-e-Azam Business Park project. As represented by management, gearing and leverage indicators will be maintained at existing levels over the rating horizon. Ratings remain sensitive to the same.

Sound corporate governance and management.

Being a listed entity, the Company adheres to Corporate Governance framework. Compliance with the requirements outlined in the Companies Act, 2017, and the Listed Companies (Code of

Corporate Governance) Regulations, 2019 is ensured regarding the composition, procedures, and meetings of the Board and its committees. The Board consists of 7 directors, including the Chief Executive Officer, possessing a diverse mix of knowledge and expertise to enhance effectiveness. The Board includes 1 female director and 6 male directors. In the year 2022, the Board fulfilled its responsibilities through 6 meetings.

Highnoon has established an Audit Committee comprising of an Independent Director and 2 Non-Executive Directors. Additionally, a Human Resource and Remuneration Committee is in place, consisting of 1 Independent Director, 1 Executive Director, and 1 Non-Executive Director. As a public listed company, Highnoon is subject to stricter regulations, ensuring robust corporate governance and management framework.

The Company is led by a professional from the medical field who has extensive experience in the pharmaceutical industry and has been associated with the Company since 2007. Other management also comprises of experienced professionals.

To enable effective enterprise resource planning, an SAP-based system (SAP S/4 HANA) has been implemented by the Company. This system facilitates real-time transaction processing and analysis of business data. However, data backup facilities are in the process of being set up.

Highnoon Laboratories Limited — Appendix I

FINANCIAL SUMMARY							(Rs. Millions)
	Actual				Projections		
BALANCE SHEET	**CY20A**	**CY21A**	**CY22A**	**1QCY23A***	**CY23P**	**CY24P**	**CY25P**
Property, plant and equipment	1,456.8	1,516.2	2,058.6	2,187.7	3,339.5	3,339.6	3,372.1
Stock-in-Trade	2,106.0	2,315.9	3,835.1	3,793.5	4,844.6	5,813.5	6,976.2
Trade Debts	322.6	582.3	1,330.3	2,046.1	1,676.6	2,011.9	2,414.2
Short term Investment	1,093.8	2,059.7	1,193.6	789.5	0.0	0.0	0.0
Cash & Bank Balances	823.2	812.0	432.6	327.2	1,585.3	2,337.5	3,321.7
Total Assets	6,633.9	8,040.1	10,640.1	11,225.6	13,103.7	15,421.0	18,315.2
Trade and Other Payables	679.0	976.8	1,503.7	1,461.8	1,899.6	2,279.5	2,735.4
Long-term Debt (incl. current portion and lease liability)	471.3	314.3	276.0	275.0	1,138.9	942.7	659.1
Short-term Debt	0.0	0.0	464.5	514.9	0.0	0.0	0.0
Total Debt	471.3	314.3	740.5	789.9	1,138.9	942.7	659.1
Paid up Capital	346.1	380.8	418.8	418.8	423.0	465.3	511.9
Equity (excl. Revaluation Surplus)	4,072.3	5,371.3	7,078.5	7,706.5	8,838.4	10,961.5	13,656.9
Total Equity	4,486.2	5,762.6	7,445.2	8,065.9	9,196.0	11,309.9	13,996.2
INCOME STATEMENT	**CY20A**	**CY21A**	**CY22A**	**1QCY23A***	**CY23P**	**CY24P**	**CY25P**
Net Sales	10,697.6	13,000.8	15,815.9	4,872.8	19,932.4	23,918.8	28,702.6
Gross Profit	5,121.2	6,415.6	8,030.1	2,212.6	10,097.1	12,116.6	14,539.9
Administrative Expenses	448.0	530.9	614.6	200.7	692.1	830.6	996.7
Distribution Costs	2,645.5	3,416.3	3,988.5	1,127.4	5,026.3	6,031.5	7,237.8
Profit Before Tax	1,921.7	2,372.1	3,345.5	842.1	4,628.2	4,596.4	5,600.8
Profit After Tax	1,420.7	1,808.0	2,417.2	625.5	3,653.8	3,412.3	4,158.1
RATIO ANALYSIS	**CY20A**	**CY21A**	**CY22A**	**1QCY23A***	**CY23P**	**CY24P**	**CY25P**
Gross Margin (%)	47.9%	49.3%	50.8%	45.4%	50.7%	50.7%	50.7%
Net Margin (%)	13.3%	13.9%	15.3%	12.8%	18.3%	14.3%	14.5%
FFO to Total Debt* (%)	391.9%	601.4%	336.2%	348.8%	287.6%	411.6%	708.5%
FFO to Long Term Debt* (%)	391.9%	601.4%	902.1%	1001.8%	287.6%	411.6%	708.5%
Gearing (x)	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Leverage (x)	0.5	0.4	0.5	0.4	0.4	0.4	0.3
Debt Servicing Coverage Ratio* (x)	57.5	9.4	11.3	34.5	16.5	12.6	13.6
Current Ratio	3.8	3.9	3.4	3.6	4.0	4.2	4.5
(Stock in trade + trade debts) / STD (x)	0.0	0.0	11.1	11.3	0.0	0.0	0.0
Return on Average Assets* (%)	28.4%	24.6%	25.9%	22.9%	30.0%	23.9%	24.7%
Return on Average Equity* (%)	41.2%	35.3%	36.6%	32.3%	42.3%	33.3%	32.9%

**Annualized, if required*

REGULATORY DISCLOSURES	Appendix II
Name of Rated Entity	Highnoon Laboratories Limited
Sector	Pharmaceutical
Type of Relationship	Solicited
Purpose of Rating	Entity Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
20-Sep-23	A+	A-1	Positive	Initial

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.
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Due Diligence Meetings Conducted

S. No	Name	Designation	Date
1.	Mr. Adeel Abbas Haideri	CEO	31st July, 2023
2.	Mr. Ashfaq Alidina	CFO	28th August, 2023
3.	Ms. Annie Mazhar Malik	Head of Finance	18th July, 2023
4.	Mr. Taha Alam	Head of Business Development	