RATING REPORT

The Searle Company Limited

REPORT DATE:
December 12, 2019

RATING ANALYST:

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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	AA-	A-1
Rating Outlook	Stable	
Rating Date	December 09, 2019	

COMPANY INFORMATION	
Incorporated in 1965	**External auditors:** A. F. Ferguson & Co.
Public Listed Company	**Chairman of the Board:** Mr. Adnan Asdar Ali
Key Shareholders (with stake 5% or more):	**Chief Executive Officer (CEO):** Mr. S. Nadeem Ahmed
- International Brands Limited ~ 56.6%	
- General Public (Local & Foreign) ~ 18.8%	
- Foreign Companies ~ 6.6%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Industrial Corporates (May 2019) https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf

The Searle Company Limited

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

In 1965, The Searle Company Limited (Searle) was incorporated as a Private Limited Company. Subsequently, it was converted into a public limited company in 1993. The company is listed on Pakistan Stock Exchange.

Financial Statements of the company for FY19 were audited by A. F. Ferguson & Co.

Financial Snapshot

Net Equity: June 2019: Rs. 13.5b, June 2018: Rs. 11.7b

Net Revenue: FY19: Rs. 14.5b, FY18: Rs. 12.7b

The Searle Company Limited (SCL) is a public listed local pharmaceutical company engaged in manufacturing and sale of medicines and consumer products for over five decades. The company is a part of 'International Brand Limited' (IBL) Group which currently holds 56.5% shareholding in SCL. IBL group is a diversified business house with subsidiaries engaged in different businesses including distribution, technology, retail food and beverage, apparel and home furnishing; however, its core strength lies in pharmaceutical business. Remaining shareholding is vested with financial institutions, mutual funds, foreign corporates and general public. Recently, board of directors of SCL gave approval for acquisition of 100% shareholding in Luna Pakistan (Private) Limited which indirectly owns 100% of the issued share capital of OBS Pakistan (Private) Limited (OBS Pakistan) from Universal Ventures (Private) Limited (UVPL). Once the acquisition is complete, OBS Pakistan will become a wholly owned subsidiary of SCL. This acquisition is projected to translate into higher profitability through various synergies. SCL has its own manufacturing units located in Karachi and Lahore. Registered office of the company is situated at Abbasi Shaheed Road, Karachi. The company has a number of wholly owned subsidiaries within its investment structure. IBL Healthcare (marketing of infant nutrition products) and Nextar Pharma are the only two entities not 100% owned where SCL has 74% and 87% shareholding respectively.

<u>Key Rating Drivers</u>

Established distribution network with extensive coverage

With an effective network of 87 branches across Pakistan alongside 400k sq. feet of warehousing space, IBL Operations (wholly owned subsidiary of IBL Group) is exclusively managing distribution of SCL's products and its subsidiaries. IBL Operations covers 43,000 pharmacies nationwide and has 200 active sub distributors & a vast range of transport from mobile vans to mini commercial trucks ensure the continuous supply to super markets, retail, institutional, electronic retail and small local shops. Moreover, indirect government tender business is also managed by IBL Operations whereas direct government tenders and export business is catered by in-house sales team.

Sizeable sales & marketing team with wide spread doctor coverage

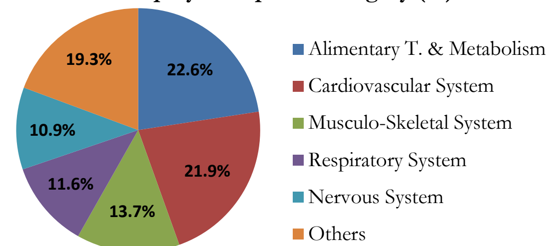
SCL has a sizeable team of 2000+ sales representatives allocated to 18 marketing teams (specialized in different therapeutic areas) covering around 40,000 doctors. Average field force per team stands at 100 employees while maximum sales are routed through General Physicians (GPs).

Strong market position and high relative market share of top 10 products is a key rating driver

As per IMS (MAT – June 2019), SCL is relatively ranked at number third in terms of volume and fourth in terms of value amongst local pharmaceutical firms. Over last five years market share (in value terms) grew from 2.7% in 2013 to 5.3% in 2019. Market position is expected to strengthen further post completion and consolidation of OBS revenues. Ratings also incorporate high relative market share of top 10 products which enjoy market leadership (relative market share is over 100% for top 10 products) position as compared to competing brands.

Diversified Product Portfolio & Therapeutic Coverage

Exhibit 1
Revenue breakup by therapeutic category (%)



SCL's product portfolio is well diversified comprising 100+ products catering to over 19 therapeutic segments with overall 93% therapeutic area-wise coverage. Top five leading revenue generating therapeutic areas are alimentary tract & metabolism, cardiovascular, respiratory, nervous and musculo-skeletal system which represented four-fifth of topline during FY19. As per management's long term strategic vision, strong focus on treatment of chronic diseases has positively contributed to sustainability of customer base and repeated business. Going forward, key focus area will remain on cardiovascular, nutraceutical and pain management segments.

Product concentration risk is considered on the lower side with top five brands (Nuberol, Hydrilin, Extor, Tramal, Metrozine) accounting for around two-fifth of total revenue while relative market share of each top ten brand is above 100%. Limited dependence on fewer products along with diversified product mix is the result of management's strategy of continually expanding the product range by launching new products. In line with same, 3 new products were launched during 2019 while new product launches are continued to be planned over the rating horizon. Overall therapeutic area coverage and product portfolio will broaden further with acquisition of OBS Pakistan portfolio. Top five products of OBS are Venofer (Iron Sucrose Injection), Decadron, Sinemet (Neuroscience), Aldomet (Cardiovascular) and Ferinject. Therapeutic area coverage of OBS Pakistan includes cardiology, neuropsychiatry, gynecology, ophthalmology, endocrinology, vaccines and bone disorders.

Business risk profile is supported by non-cyclical nature of the industry and steady projected demand growth.

Given the non-cyclical nature of the sector with relatively stable (inelastic) demand, revenues of pharmaceutical industry are likely to remain unaffected by the economic downturns. Sales of the sector are supported by growing population and increasing life expectancy (implying increase in elderly population) and continuous emergence of diseases. Thus the business risk of the sector is considered to be low. However, impact on margins on margins due to rupee devaluation and significant dependence on Drug Regulatory Authority of Pakistan (DRAP) for hardship cases and new product launches continue to remain the key rating sensitivities.

Given organic growth from existing product and strong new product pipeline along with stable margins and higher other income, profitability indicators are expected to remain healthy despite sizeable debt drawdown.

Over the past ten fiscal years (FY08-18), topline has registered a double digit CAGR growth of ~22.1% outpacing the industry growth of ~12%. Significant new molecule introductions, expanding doctors' coverage, higher sales volume and efficiencies brought in the sales process have been the major drivers of this growth. The same trend is expected to continue. During 1QFY20, net sales were reported higher at Rs. 4.1b (1QFY19: Rs. 3.5b) as compared to corresponding period of last year. On exports front, sales are presently contributing around one-tenth of revenue while management remains proactive on exploring potentially viable export opportunities in international market.

Higher reliance on imported raw material (API) and rupee devaluation over the last 2 years have resulted in escalated cost of production. Nonetheless, price increase allowed by DRAP along with declining international

prices of API and enhanced focus on manufacturing efficiencies has facilitated the Company in sustaining margins. In absolute terms, overheads increased by 12.6% during FY19. However, overheads to sales ratio remained around prior year level. Given the same, other income is projected to grow in form of dividends from subsidiaries primarily due to higher dividend income from OBS where cost synergies along with healthy sales growth is expected to result in turnaround in profitability. Finance cost is expected to increase considerably given the planned mobilization of long term loan for acquisition. Moreover, due to change in taxation regime, effective tax rate is expected to increase on a timeline basis which will be partly offset by tax shield provided by debt draw down for expansion.

Given strong profitability, cash flows from operations are expected to remain healthy. While remaining within comfortable levels, cash flow coverages and debt serving cushion are expected to weaken vis-à-vis current levels but are expected to gradually improve over the rating horizon.
In absolute terms, Funds from Operations (FFO) was reported lower at Rs. 2,719.0m (FY18: Rs. 3,074.3; FY17: Rs. 2,621.4) in FY19 due to higher finance cost and income tax charges paid. While remaining strong, debt service coverage ratio (DSCR) and FFO to total debt slightly declined to 9.5x (FY19: 11.2x, FY18: 31.7x) and 0.68x (FY19: 1.12x, FY18: 1.60x) during 1QFY20, respectively. However, liquidity profile is considered sound in view of healthy cash flow generation, sufficient coverage of short term borrowings by way of inventory and receivables and adequate debt servicing ability. Even after accounting for incremental finance cost and annual principal payments, cash flows cushion for debt servicing is expected to remain comfortable. Trade debts in relation to sales have increased on a timeline basis and stood at 33.5% (FY18: 26.0%; FY17: 27.7%) at end-FY19. Ageing profile of trade debts is considered manageable with a very limited proportion of receivables being overdue for over three months.

Leverage indicators are expected to increase with planned acquisition of long term debt. Healthy internal capital generation over the rating horizon is projected to result in gradual reduction of the same
Stable net profitability and higher profit retention continue to reinforce capital buffers (Net Equity: 1QFY20: Rs. 14.1b; FY19: Rs. 13.5b; FY18: Rs. 11.7b). Dividend payout ratio was reported at 20.1% (FY18: 34.8%) in FY19. At present, debt profile is only short term in nature; management has planned to obtain long term financing facility of Rs. 12b to fund acquisition of OBS Pakistan. Long-term debt is planned to be mobilized in the ongoing year and will have a tenor of 6 years (including grace period of 1 year). Gearing and debt leverage was reported at 0.26x (FY19: 0.29x; FY18: 0.23x) and 0.58x (FY19: 0.65x; FY18: 0.49x) at end-FY19, respectively. The same is expected to increase with planned acquisition of long term debt. Nonetheless, healthy internal capital generation over the rating horizon is projected to result in gradual reduction in leverage indicators.

FINANCIAL SUMMARY *(Rs. in millions)*			Appendix I
BALANCE SHEET	**2017**	**2018**	**2019**
Property, plant and equipment	1,235.6	1,714.1	2,879.4
Investment Properties	2,460.6	2,456.6	2,458.0
Long-term Investment - Subsidiaries	1,486.2	1,686.2	1,686.2
Stock-in-Trade	1,054.6	2,294.3	2,194.7
Trade Debts	2,977.6	3,290.0	4,866.1
Loan & Advances	2,458.7	4,327.3	4,516.9
Cash & Bank Balances	92.2	137.0	204.5
Total Assets	13,245.1	18,093.6	23,301.5
Trade and Other Payables	1,739.6	2,861.7	4,529.5
Short Term Debt	1,423.1	2,737.8	3,954.8
Total Debt	1,637.4	2,737.8	3,954.8
Paid Up Capital	1,539.3	1,847.2	2,124.3
Total Equity (without surplus)	9,924.8	11,740.2	13,467.1
INCOME STATEMENT	**2017**	**2018**	**2019**
Net Sales	10,753.8	12,675.1	14,537.2
Gross Profit	4,179.4	4,437.4	4,920.3
Operating Profit	546.1	4.8	(269.7)
Profit Before Tax	2,874.9	3,233.2	2,830.2
Profit After Tax	2,638.8	3,049.2	2,641.9
RATIO ANALYSIS	**2017**	**2018**	**2019**
Gross Margin (%)	38.9%	35.0%	33.8%
Net Margin (%)	24.5%	24.1%	18.2%
Net Working Capital	4,637.0	6,337.5	7,470.7
Trade Debt/Sales (%)	27.7%	26.0%	33.5%
FFO to Total Debt (x)	1.60	1.12	0.68
Current Ratio	2.44	2.11	1.87
Gearing (x)	0.16	0.23	0.29
Debt Leverage (x)	0.35	0.49	0.65
Debt Servicing Coverage Ratio (x)	25.7	31.7	11.2
(Stock in trade + trade debts) / Short term borrowings (%)	283.2%	204.0%	178.5%
Return on Average Assets (%)	19.9%	19.5%	12.8%
Return on Average Equity (%)	26.6%	28.1%	21.0%

ISSUE/ISSUER RATING SCALE &DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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.

<table>
<tr><th colspan="2">REGULATORY DISCLOSURES</th><th colspan="4">Appendix III</th></tr>
<tr><td>Name of Rated Entity</td><td colspan="5">The Searle Company Limited</td></tr>
<tr><td>Sector</td><td colspan="5">Pharmaceutical</td></tr>
<tr><td>Type of Relationship</td><td colspan="5">Solicited</td></tr>
<tr><td>Purpose of Rating</td><td colspan="5">Entity Rating</td></tr>
<tr><td rowspan="3">Rating History</td><th>Rating Date</th><th>Medium to Long Term</th><th>Short Term</th><th>Rating Outlook</th><th>Rating Action</th></tr>
<tr><td colspan="5"><u>RATING TYPE: ENTITY</u></td></tr>
<tr><td>09/12/2019</td><td>AA-</td><td>A-1</td><td>Stable</td><td>Initial</td></tr>
<tr><td>Instrument Structure</td><td colspan="5">N/A</td></tr>
<tr><td>Statement by the Rating Team</td><td colspan="5">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.</td></tr>
<tr><td>Probability of Default</td><td colspan="5">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.</td></tr>
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