RATING REPORT

The Searle Company Limited

REPORT DATE:
December 22, 2020

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		**Initial Rating**	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	AA-	A-1	AA-	A-1
Rating Date	*December 22, 2020*		*December 03, 2019*	
Rating Outlook	Stable		Stable	
Rating Action	*Reaffirmed*		*Initial*	

COMPANY INFORMATION	
Incorporated in 1965	**External auditors:** A. F. Ferguson & Co.
Public Limited 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) ~ 19.7%	
- Foreign Companies ~ 6.2%	

APPLICABLE METHODOLOGY(IES)
Industrial Corporates (April 2019) **https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf**

The Searle Company Limited

OVERVIEW OF THE INSTITUTION

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.

RATING RATIONALE

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. Upon completion of acquisition in August 2020, OBS Pakistan (OBS) has 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 Shahrah-e-Faisal 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.

Key Rating Drivers

Established distribution network with extensive coverage

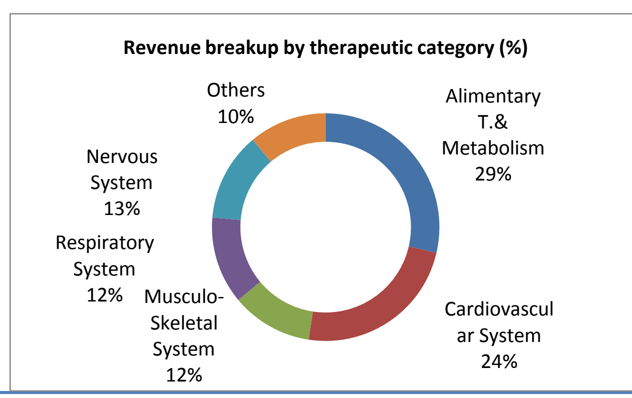
With an effective network of 100 branches across Pakistan, IBL Operations (wholly owned subsidiary of IBL Group) is exclusively managing distribution of SCL's products and its subsidiaries. IBL Operations covers 43,000 pharmacies nationwide and has 200 active sub distributors & a vast range of transport 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

With the completion of acquisition of OBS, SCL's team has increased to 2100+ sales representatives allocated to 18 marketing teams (specialized in different therapeutic areas) covering around 40,000+ doctors. Maximum sales are routed through General Physicians (GPs). Retail sales represent bulk of the Company's sales with institutional sales comprising around 5% of total sales.

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

SCL is one of the leading pharmaceutical companies in the country and is ranked 2nd in terms of volume and 4th in terms of value amongst local pharmaceutical firms. Market position is expected to strengthen further post completion and consolidation of OBS revenues. Full impact of the same will be reflected in financials from 2Q20. Ratings also incorporate high relative market share of top 10 products which enjoy market leadership position. During the period under review, Remdesivir was introduced by SCL with the Company entering into an exclusive licensing & marketing agreement with Beximco Pharmaceuticals, Bangladesh to help treat Covid-19 patients.



Diversified Product Portfolio & Therapeutic Coverage

SCL's product portfolio is well diversified comprising 100+ products catering to over

19 therapeutic segments. 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 FY20. As per management's long term strategic vision, strong focus on treatment of chronic diseases has positively contributed to sustainability of customer base and repeat business. Going forward, key focus area will remain on cardiovascular, nutraceuticals and pain management segments.

Product concentration risk is considered on the lower side with top five brands (Hydrilin, Nuberol, Extor, Tramal, Peditral) accounting for around two-fifth of total revenue. 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. 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 (Sales have increased as is being used for Covid management), 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 growing demand, non-cyclical nature of industry and favorable population demographics

Pharmaceutical sector comprises low business risk given the non-cyclical nature of the industry and relatively stable demand. Revenue of the sector is supported by favorable changes in demographics, increasing life expectancy, rising incidences of new and chronic diseases, and improved affordability. However, key sector risks including regulatory risk (delay in approval of new product, changes in pricing policy), rupee devaluation and significant dependence on Drug Regulatory Authority of Pakistan for approval of hardship cases.

Profitability indicators are expected to remain healthy despite sizeable debt drawdown. Given organic growth from existing product and rise in demand of medical needs along with stable margins and higher other income, management expects the topline to further strengthen in FY21

Over the past five fiscal years (FY15-19), topline has reported double digit CAGR of ~14.8%. Growth momentum was sustained in FY20. In the revenue mix, local sales dominate by contributing around 90% of total revenues. During 1QFY21, net sales were registered higher at Rs. 5.6b (1QFY20: Rs. 5b) with completion of acquisition of OBS being the key growth driver.

Imported raw material (API) coupled with rupee devaluation over the last few years have resulted in escalated cost of production. Similarly, price increases and currency fluctuations have also impacted gross margins. However, volumetric growth, manufacturing efficiencies and price increase allowed by DRAP have helped the company to offset escalated cost of sales. Thus, gross margins have largely been maintained (FY20: 47%; FY19: 48%). Finance cost depicted an increase (FY20: Rs. 685m; FY19: Rs. 439m) due to an uptick in quantum of debt and higher average benchmark rates. Despite decline in interest rates, finance cost is expected to remain elevated on the back of increase in debt levels. Despite increase in finance cost and higher effective tax rate, profitability profile will be supported by higher revenues and slight increase in margins.

Healthy cash flow generation has resulted in strong liquidity profile. While remaining within satisfactory levels, cash flow coverages are expected to decline. Increase in working capital cycle has resulted in higher short-term borrowings. Overall long-term and short-term debt coverages are expected to remain strong

In absolute terms, Funds from Operations (FFO) was reported higher at Rs. 3,234m (FY19: Rs. 2,452m) in FY20 due to higher operating profit. While remaining satisfactory, cash flow coverages have weakened as at end-1Q20 following a sizeable growth in debt levels. Resultantly, FFO to long term debt declined considerably to 0.2x (FY20: 7.13x) at end-1QFY21. On a timeline basis, trade debt to sales ratio has depicted an increasing trend to 42% (FY19: 34%; FY18: 27%) at end-FY20. Aging profile of trade debts is considered satisfactory with minimal amount of receivables being overdue by 1 year. Further reduction in the same as has been witnessed during 1Q20 is considered important. Given the increase in working capital cycle, short-term borrowing have increased and are expected to remain high given increased WC requirements post OBS acquisition. Stock in trade and trade debts to sales ratio was reported at 2.4x (FY19: 2.3x; FY18: 2.8x) while the current ratio is also considered strong and was reported at 2.1x (FY19: 1.9x; FY18: 1.7x) at end-FY20. Going forward, cash flow coverages are expected to improve over the rating horizon due to debt repayments and increase in cash flows.

Completion of right issuance along with healthy internal capital generation to result in improvement in leverage indicators

Equity base (excluding revaluation surplus on assets) of the company increased on account of internal capital generation (FY20: Rs. 14.1b; FY19: Rs. 12.1b). Completion of rights issue is expected to strengthen capitalization levels. Dividend payout ratio for FY20 remained at 20% (FY19: 20%). As at end-1QFY21, gearing and debt leverage ratios depicted a sizeable jump to 1.2x (FY20: 0.38x; FY19: 0.33x) and 1.9x (FY20: 0.65x; FY19: 0.64x) at quarter-end 1QFY21, respectively. Post completion of rights issuance, gearing levels are expected to reduce to below 1x.

The Searle Company Limited **Appendix I**

FINANCIAL SUMMARY *(Rs. in millions)*
Appendix I- *Unconsolidated figures*

BALANCE SHEET	2018	2019	2020	3MFY21
Property, plant and equipment	1,714.1	2,879.4	3,707.4	3706.4
Investment Properties	2,456.6	2,458.0	2,203.9	2,198.4
Long-term Investment - Subsidiaries	1,686.2	1,686.2	1,686.2	17,486.2
Stock-in-Trade	2,294.3	2,194.7	2,632.9	2,560.3
Trade Debts	3,290.0	4,866.1	7,801.8	7,025.8
Loan & Advances	4,327.3	4,516.9	4,712.1	4,986.3
Cash & Bank Balances	137.0	204.5	299.6	265.2
Total Assets	18,093.6	23,301.5	25,341.3	40,640.5
Trade and Other Payables	2,861.7	4,529.5	2,719.8	3,399.6
Short Term Debt	2,737.8	3,954.8	4,974.6	4,602.0
Total Debt	2,737.8	3,954.8	5,423.6	15,428.6
Paid Up Capital	1,847.2	2,124.3	2,124.3	2,124.3
Total Equity (without surplus)	11,740.2	13,467.1	15,424.3	16,029.2
INCOME STATEMENT	2018	2019	2020	3MFY21
Net Sales	12,675.1	14,537.2	16,567.2	4,068.9
Gross Profit	4,437.4	4,920.3	8,272.0	2,011.4
Operating Profit	4.8	(269.7)	2,524.2	593.1
Profit Before Tax	3,233.2	2,830.2	3,304.5	776.7
Profit After Tax	3,049.2	2,641.9	2,455.1	592.1
RATIO ANALYSIS	2018	2019	2020	3MFY21
Gross Margin (%)	35.0%	33.8%	49.9%	49.4%
Net Margin (%)	24.1%	18.2%	14.8%	14.6%
Net Working Capital	6,337.5	7,470.7	9,632.2	8,807.9
Trade Debt/Sales (%)	26.0%	33.5%	47.1%	43.2%
FFO to Total Debt (x)	1.12	0.68	0.60	0.24
Current Ratio	2.11	1.87	2.22	2.07
Gearing (x)	0.23	0.29	0.35	0.96
Debt Leverage (x)	0.49	0.65	0.55	1.45
Debt Servicing Coverage Ratio (x)	31.7	11.2	7.7	2.9
(Stock in trade + trade debts) / Short term borrowings (%)	204.0%	178.5%	209.8%	208.3%
Return on Average Assets (%)	19.5%	12.8%	10.1%	7.2%
Return on Average Equity (%)	28.1%	21.0%	17.0%	15.1%

The Searle Company Limited **Appendix II**

FINANCIAL SUMMARY *(Rs. in millions)*
Appendix II- *Consolidated figures*

BALANCE SHEET	**2018**	**2019**	**2020**	**3MFY21**
Property, plant and equipment	2,692.5	3,786.2	4,415.7	5,712.7
Investment Properties	2,871.8	2,724.1	2,571.7	2,702.2
Stock-in-Trade	2,831.2	2,953.9	3,428.5	5,178.1
Trade Debts	4,359.9	6,209.8	8,633.8	9,167.1
Loan & Advances	883.2	2,944.2	2,950.4	3,193.5
Cash & Bank Balances	204.6	262.1	335.2	540.3
Total Assets	17,249.2	21,277.1	25,102.6	44,978.7
Trade and Other Payables	3,073.7	3,520.2	3,351.3	6,785.3
Short Term Debt	2,537.8	3,922.3	4,953.3	6,192.2
Total Debt	2542.4	3926.9	5,407.0	17,081.2
Paid Up Capital	1,847.2	2,124.3	2,124.3	2,124.3
Total Equity (without surplus)	10,776.6	12,081.3	14,116.4	14,777.6

INCOME STATEMENT	**2018**	**2019**	**2020**	**3MFY21**
Net Sales	16,148.5	18,602.1	20,474.8	5,562.5
Gross Profit	8,331.0	8,599.9	9,705.8	2,560.1
Operating Profit	3,098.0	2,597.8	3,152.9	884.2
Profit Before Tax	3,254.4	2,832.3	3,658.9	927.1
Profit After Tax	2,716.6	2,265.3	2,548.0	648.3

RATIO ANALYSIS	**2018**	**2019**	**2020**	**3MFY21**
Gross Margin (%)	51.6%	47.6%	47.4%	46.0%
Net Margin (%)	16.8%	12.5%	12.4%	11.7%
Net Working Capital	3,897.6	6,711.3	9,055.3	6,861.3
Trade Debt/Sales (%)	27.0%	34.4%	42.2%	41.2%
FFO to Total Debt (x)	1.1	0.60	0.60	0.12
Current Ratio	1.7	1.9	2.1	1.5
Gearing (x)	0.2	0.3	0.4	1.2
Debt Leverage (x)	0.5	0.6	0.7	1.9
Debt Servicing Coverage Ratio (x)	28.8	8.0	6.7	4.19
(Stock in trade + trade debts) / Short term borrowings (%)	283.4%	233.6%	243.5%	231.7%
Return on Average Assets (%)	15.4%	11.8%	11.0%	7.4%
Return on Average Equity (%)	24.1%	19.8%	19.5%	18.0%

RATING SCALE & DEFINITION Appendix I

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.

REGULATORY DISCLOSURES — Appendix II

Name of Rated Entity	The Searle Company 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.
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Due Diligence Meeting	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
12/04/2019	AA-	A-1	Stable	Initial
12/22/2020	AA-	A-1	Stable	Reaffirmed

Due Diligence Meeting

Name	Designation	Date
Mobeen Alam Shahrukh Ahmed	CFO Financial Analyst	14th December 2020