

RATING REPORT

The Searle Company Limited

REPORT DATE:

May 19, 2023

RATING ANALYSTS:

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| Rating Category | RATING DETAILS | | | |
|-----------------------|----------------|------------|-------------------|------------|
| | Current Rating | | Previous Rating | |
| | Long-term | Short-term | Long-term | Short-term |
| Entity | AA- | A-1 | AA- | A-1 |
| Rating Date | May 19, 2023 | | February 15, 2022 | |
| Rating Outlook | Negative | | Stable | |
| Rating Action | Maintained | | Reaffirmed | |

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 Private Limited ~ 56.32% | |
| - General Public (Local & Foreign) ~ 19.7% | |
| - Foreign Companies ~ 5.34% | |

APPLICABLE METHODOLOGY(IES)

Industrial Corporates (August 2021)

<https://docs.vis.com.pk/docs/CorporateMethodology202108.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 FY22 were audited by A. F. Ferguson & Co.

Corporate Profile: Incorporated in 1965 as a private limited company with subsequent conversion to a public limited company in 1993, The Searle Company Limited (the Company) is primarily engaged in the manufacture of pharmaceutical and other consumer products. Product portfolio encapsulates therapeutic areas such as Cardiovascular, Respiratory Care, Gastroenterology, Pain Management, CNS, Orthocare, Neuropsychiatry, Probiotics, Antibiotics, and Nutritional Care. Gross revenue breakup constituted ~92% local sales in FY22 out of which 79% was through related party - IBL Operations (Private) Limited which exclusively manages distribution of Searle and its subsidiaries. Remaining gross sales constituted exports which were majorly focused in Sri Lanka (~36% of gross export sales). Other major destinations included Myanmar (~24% of gross export sales), Cambodia (~15% of gross export sales) and Vietnam (~10% of gross export sales). Registered office of the Company is situated in Shahrah-e-Faisal, Karachi and manufacturing plants, warehouses, and storage facilities are situated in Karachi and Lahore.

The Company forms part of International Brands Private Limited (IBL) Group with IBL holding 56.32% stake in the Company, while the remaining is held by the general public.

The investment portfolio of the Company comprises a substantial portion of its total asset base, representing 39.3% of the assets in FY22. The Searle Company Limited has embarked on the initiative to list Searle Pakistan Limited on the Pakistan Stock Exchange (PSX). However, the company is currently awaiting the final approval from the Securities and Exchange Commission of Pakistan (SECP), which is anticipated to be granted by the conclusion of CY23. Upon the successful completion of the initial public offering, the Company expects to raise an estimated amount of PKR 5 billion from the issuance of 349 million shares. The proceeds are planned to be utilized for expansion in the Intravenous segment.

During the previous year (FY21), the company sold its 100% shares in IBL Identity (Private) Limited to Universal Ventures (Private) Limited – related party (UVPL) for a total consideration at a price equal to PKR 3.53 billion. The Company has received Rs 200m of this, while the remaining PKR 3.3b has been decided to be settled against 100% shareholding acquisition of Stellar Ventures (Private) Limited (SVPL) from UVPL.

| Subsidiaries of the Company | Percentage Shareholding | |
|--|-------------------------|---------------|
| | June 30, 2022 | June 30, 2021 |
| Listed Company | | |
| -IBL HealthCare Limited | 74.19% | 74.19% |
| Unlisted Company | | |
| -Searle Pharmaceuticals (Private) Limited | 100.00% | 100.00% |
| -Searle Pakistan Limited (formerly OBS Pakistan (Private) Limited) | 100.00% | 100.00% |
| -Searle Laboratories (Private) Limited | 100.00% | 100.00% |
| -Searle Biosciences (Private) Limited | 100.00% | 100.00% |
| -IBL Identity (Private) Limited | - | - |

| | | |
|---|---------|---------|
| -IBL Future Technologies (Private) Limited | 100.00% | 100.00% |
| -Nextar Pharma (Private) Limited (Subsidiary of Searle Biosciences) | 87.20% | 87.20% |

Rating Drivers

Low business risk supported by industry dynamics and strong market position.

The rating for Searle draws comfort from the company's low business risk stemming from its strong market position (ranked 5th in terms of value and 2nd in terms of volumes in the industry), as well as the non-cyclical nature of the pharmaceutical industry. Despite the challenging economic climate, demand for Searle's products remained strong during the period under review. Searle intends to capitalize on its market position by expanding its product portfolio into the IVY market, which presents significant growth opportunities for the company. However, to finance this expansion, Searle requires PKR 5.0 billion, the success of which hinges on the outcome of its IPO of Searle Pakistan Limited, which has received approval from the PSX but still awaits approval from the SECP.

Additionally, as an essential business, Searle was granted access to LC facilities without significant constraints, ensuring the business had stable volumes and thus avoided raw material shortages. This helped the company achieve sales growth of 16% in FY22; 7-10% was contributed by approved CPI adjustments while volumes contributed the remaining percentage.

Gross margin compression amid surging input costs and currency devaluation.

The company's gross margins have deteriorated due to a weakened PKR, resulting in higher input costs for imported raw materials. The gross margin in HY23 decreased to 45.54%, down from 48.76% in FY22 and 51.59% in FY21. Given regulated pricing environment, Management continues to face challenges in passing on the increased costs to customers. Other than the 7-10% CPI adjustment in prices generally allowable each year. The Management envisaged a one-time price increase of ~40%, being sought to absorb the extraordinary exchange losses; however, according to recent news report the government has only allowed an increase of 20% to the pharmaceutical companies.

Profitability significantly impacted due to high quantum of debt compounded by increasing interest rates.

Net margins have been adversely impacted due to higher quantum of debt and increasing interest rates, posing significant challenge to profitability. Although, strong equity base gearing ratio remains adequate at 0.71x at end HY23 (FY22: 0.75x, FY21: 0.72x, FY20: 0.35x). The net margin has declined to 5% in HY23, down from 11.79% in FY22 and 12.81% in FY21, highlighting the impact of rising interest expenses. We consider that profitability will remain subdued over the rating horizon as price adjustments will take effect with a lag.

Debt servicing under stress

The company is facing increasing pressure on its ability to meet debt obligations due to contracting margins amid rising interest rates. The FFO has been on a continuous decline over the past few years, with FY23 expected to be around PKR 1,193 million, down from PKR 2,114 million in FY22, PKR 2,526 million in FY21, and PKR 3,253 million in FY20. Consequently, the DSCR in FY23 is expected to close at 0.85x, down from 2.20x in FY22, 3.04x in FY21, and 7.80x in FY20, with HY23 reported at 1.08x. We consider that despite the price hike levels agreed by the Government of approx. 20%, higher financing costs will continue to be a drag on profitability consequently keeping debt servicing under stress. Improvement in debt service coverages will remain a key rating sensitivity.

The Searle Company Limited
Appendix I

| <u>FINANCIAL SUMMARY</u> (Rs. in millions) | <u>Appendix I- Unconsolidated figures</u> | | | | |
|--|---|------------------|------------------|------------------|------------------|
| <u>BALANCE SHEET</u> | FY21 | FY22 | HY23 | FY23 (P) | FY24 (P) |
| Property, plant and equipment | 5,657.39 | 6,729.99 | 6,223.74 | 6,259.13 | 6,042.64 |
| Investment Properties | 2,490.05 | 2,753.90 | 2,820.00 | 2,699.78 | 2,649.74 |
| Long-term Investment - Subsidiaries | 17,436.31 | 18,816.30 | 18,816.31 | 22,816.31 | 22,816.31 |
| Stock-in-Trade | 2,206.90 | 2,086.58 | 2,183.20 | 2,148.01 | 2,627.56 |
| Trade Debts | 8,754.97 | 9,318.23 | 11,913.10 | 8,083.49 | 8,674.02 |
| Loan & Advances | 1,335.83 | 860.10 | 1,024.10 | 860.10 | 860.10 |
| Cash & Bank Balances | 103.68 | 82.875 | 46.97 | 50 | 50.00 |
| Total Assets | 43,925.52 | 47,831.00 | 50,069.65 | 46,144.11 | 46,936.50 |
| Trade and Other Payables | 3,213.87 | 2,594.16 | 4,505.27 | 3,682.31 | 5,255.11 |
| Short Term Debt | 5,988.61 | 8,488.10 | 8,185.80 | 6,825.78 | 6,241.51 |
| Long Term Debt | 9,747.99 | 9,141.68 | 8,956.82 | 7,225.60 | 5,041.68 |
| Total Debt | 15,736.60 | 17,629.78 | 17,142.62 | 14,051.39 | 11,283.19 |
| Paid Up Capital | 2,400.41 | 3,120.53 | 3,900.65 | 3,120.53 | 3,120.53 |
| Total Equity (without surplus) | 21,736.44 | 23,444.85 | 24,110.57 | 24,399.11 | 26,386.89 |
| <u>INCOME STATEMENT</u> | FY21 | FY22 | HY23 | FY23 (P) | FY24 (P) |
| Net Sales | 16,569.60 | 17,737.28 | 10,852.58 | 21,074.82 | 26,383.49 |
| Gross Profit | 8,548.71 | 8,648.03 | 4,942.59 | 9,874.47 | 12,682.66 |
| Operating Profit | 1,729.39 | 464.30 | -84.09 | 441.17 | 1,956.75 |
| Profit Before Tax | 2,734.67 | 2,329.48 | 614.97 | 1,504.51 | 3,130.45 |
| Profit After Tax | 2,122.92 | 2,090.73 | 542.40 | 1,192.90 | 2,484.73 |
| <u>RATIO ANALYSIS</u> | FY21 | FY22 | HY23 | FY23 (P) | FY24 (P) |
| Gross Margin (%) | 51.59% | 48.76% | 45.54% | 46.85% | 48.07% |
| Operating Margin ((%)) | 19.67% | 14.31% | 13.33% | 15.76% | 18.23% |
| Net Margin (%) | 12.81% | 11.79% | 5.00% | 5.66% | 9.42% |
| Net Working Capital | 8,822.87 | 8,153.61 | 6,970.91 | 1,342.79 | 1,424.34 |
| Trade Debt/Sales (%) | 52.84% | 52.53% | 27.44% | 38.36% | 32.88% |
| Funds from Operations (FFO) | 2,526.00 | 2,113.69 | 786.48 | 1,192.90 | 2,484.73 |
| FFO to Total Debt (x) | 0.16 | 0.12 | 0.09 | 0.08 | 0.22 |
| FFO to Long Term Debt (x) | 0.26 | 0.23 | 0.18 | 0.17 | 0.49 |
| Current Ratio | 1.94 | 1.72 | 1.46 | 1.10 | 1.10 |
| Gearing (x) | 0.72 | 0.75 | 0.71 | 0.58 | 0.43 |
| Debt Leverage (x) | 0.89 | 0.89 | 0.93 | 0.75 | 0.65 |
| Debt Servicing Coverage Ratio (x) | 3.04 | 2.20 | 1.08 | 0.85 | 1.06 |
| (Stock in trade + trade debts) / Short term borrowings (%) | 183.05% | 1.34 | 1.72 | 1.50 | 1.81 |
| Return on Average Assets (%) | 6.13% | 4.73% | 4.62% | 2.65% | 5.34% |
| Return on Average Equity (%) | 11.43% | 10.59% | 9.46% | 5.17% | 9.79% |

The Searle Company Limited
Appendix II

| FINANCIAL SUMMARY (Rs. in millions) | | Appendix II- Consolidated figures | | | | |
|--|------------------|--|------------------|------------------|------------------|--|
| BALANCE SHEET | FY19 | FY20 | FY21 | FY22 | 1HFY23 | |
| Property, plant and equipment | 3,786.20 | 4,537.18 | 8,820.91 | 10,095.89 | 9,633.39 | |
| Investment Properties | 2,724.10 | 2,571.70 | 2,970.28 | 3,237.63 | 3,298.68 | |
| Stock-in-Trade | 2,953.90 | 3,428.50 | 4,886.02 | 5,773.88 | 6,110.68 | |
| Trade Debts | 6,209.80 | 8,633.80 | 10,038.86 | 11,978.76 | 15,397.90 | |
| Loan & Advances | 2,944.20 | 2,950.40 | 1,035.53 | 1,043.74 | 1,413.71 | |
| Cash & Bank Balances | 262.1 | 335.2 | 222.996 | 230.212 | 12.241 | |
| Total Assets | 21,277.10 | 25,102.60 | 49,145.54 | 55,731.73 | 59,483.93 | |
| Trade and Other Payables | 3,520.20 | 3,385.62 | 5,088.19 | 5,097.71 | 7,317.70 | |
| Short Term Debt | 3,922.30 | 4,953.30 | 7,794.04 | 9,969.73 | 12,876.67 | |
| Long Term Debt | 4.66 | 453.63 | 9,790.68 | 9,141.68 | 7,042.48 | |
| Total Debt | 3926.9 | 5,406.96 | 17,584.73 | 19,111.41 | 19,919.15 | |
| Paid Up Capital | 2,124.30 | 2,124.30 | 2,400.41 | 3,120.53 | 3,900.66 | |
| Total Equity (without surplus) | 12,081.30 | 14,116.40 | 22,019.28 | 25,518.13 | 26,352.88 | |
| INCOME STATEMENT | | | | | | |
| | FY19 | FY20 | FY21 | FY22 | 1HFY23 | |
| Net Sales | 18,602.10 | 20,474.80 | 26,219.66 | 29,909.66 | 16,855.91 | |
| Gross Profit | 8,599.90 | 9,705.80 | 12,191.17 | 13,119.24 | 7,101.21 | |
| Operating Profit | 2,597.80 | 3,152.90 | 3,682.11 | 3,231.49 | 1031.766 | |
| Profit Before Tax | 2,832.30 | 3,658.90 | 5,035.30 | 3,661.35 | 1157.51 | |
| Profit After Tax | 2,265.30 | 2,548.00 | 3,746.85 | 2,415.85 | 706.152 | |
| RATIO ANALYSIS | | | | | | |
| | FY19 | FY20 | FY21 | FY22 | 1HFY23 | |
| Gross Margin (%) | 47.60% | 47.40% | 46.50% | 43.86% | 42.13% | |
| Net Margin (%) | 12.50% | 12.40% | 14.29% | 8.08% | 4.19% | |
| Net Working Capital | 6,711.30 | 9,021.01 | 8,579.39 | 10,876.07 | 9,882.88 | |
| Trade Debt/Sales (%) | 34.40% | 42.20% | 38.29% | 40.05% | 22.84% | |
| Funds from Operations (FFO) | 2,451.68 | 3,220.38 | 3,403.90 | 3,092.31 | 530.44 | |
| FFO to Total Debt (x) | 0.6 | 0.6 | 0.19 | 0.16 | 0.11 | |
| Current Ratio | 1.9 | 2.1 | 1.7 | 1.7 | 1.5 | |
| Gearing (x) | 0.33 | 0.4 | 0.8 | 0.7 | 0.76 | |
| Debt Leverage (x) | 0.64 | 0.65 | 1.05 | 0.98 | 1.07 | |
| Debt Servicing Coverage Ratio (x) | 8 | 6.85 | 2.92 | 2.58 | 1.34 | |
| (Stock in trade + trade debts) / Short term borrowings (%) | 233.60% | 243.50% | 191.49% | 178.07% | 167.04% | |
| Return on Average Assets (%) | 11.80% | 11.00% | 10.09% | 4.61% | 5.10% | |
| Return on Average Equity (%) | 19.80% | 19.50% | 17.82% | 8.51% | 9.67% | |

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 | Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
| | RATING TYPE: ENTITY | | | | |
| | 05/19/2023 | AA- | A-1 | Negative | Maintained |
| | 02/15/2022 | AA- | A-1 | Stable | Reaffirmed |
| | 12/22/2020 | AA- | A-1 | Stable | Reaffirmed |
| 12/04/2019 | AA- | A-1 | Stable | Initial | |
| 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 | Name | Designation | Date | | |
| | Mobeen Alam Umail Siddiqui | CFO Financial Analyst | 15th November 2021 | | |