

## RATING REPORT

### The Searle Company Limited

**REPORT DATE:**

July 10, 2024

**RATING ANALYST:**

Zainab Imran

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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	July 10, 2024		May 19, 2023	
Rating Outlook/ Rating Watch	Stable		Negative	
Rating Action	Maintained		Maintained	

#### 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 ~ 50.2%	
- General Public (Local & Foreign) ~ 30.12%	
- Joint Stock Companies ~ 6.74%	

#### APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Corporates

<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>

**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.

Registered office of the Company is situated in Shabrah-e-Faisal, Karachi and manufacturing plants, warehouses, and storage facilities are situated in Karachi and Lahore

Financial Statements of the Company for FY23 were audited by A. F. Ferguson & Co.

**Key Audit Matters:**

- 1) Revenue from contracts with customers
- 2) Litigation relation to product pricing matters
- 3) Tax Contingencies

**Key Highlights**

- Essential and non-essential drug prices are being raised by DRAP
- Deregulation of non-essential drugs
- Profits are being impacted by high finance costs.
- The Searle Pakistan disposal
- Targeting GCC markets

**RATING RATIONALE**
**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. The product portfolio of Searle categorized into Pharmaceutical, Biopharmaceutical, Nutraceutical, Nutrition, Consumer and Medical devices and disposables. The Company is particularly attentive to expanding in sectors like Cardiovascular, Cold & Cough, Diabetes, Infant Formula, Probiotics, and Antibiotics. In the long term, the Company aims to delve into emerging sectors such as bio-similars, medical devices, nutraceuticals and genomic sciences. In addition, in an effort to expand the existing portfolio, the Company acquired Searle IV manufacturing facility for production of intravenous.

The Company forms part of International Brands Private Limited (IBL) Group with IBL holding 50.2% stake in the Company, while the remaining is held by the general public.

A substantial part of the asset base of the Company remains vested in investment portfolio, representing 49% of the assets at the end of 9MFY24. During FY24, the Company invested ~Rs. 7b in acquisition of new subsidiaries namely Stellar ventures and Searle IV Solutions (Pvt) Ltd. Stellar was acquired against settlement with related party receivables, while remaining investments were funded through injection of new equity of Rs. 4.2b. Stellar ventures include 1) Mycart IBL Pvt Ltd, a company operating in the retail sector, 2) Prime Health Pvt Ltd, which specializes in the inspection of pharmaceutical products, and 3) IBL Frontier Markets Pvt Ltd, that currently owns a land holding. Searle IV Solutions (Pvt) Ltd, was acquired to set up intravenous manufacturing facilities, for the purposes of the product line extension.

Subsidiaries of the Company	Percentage Shareholding		
	March 31, 2024	June 30, 2023	June 30, 2022
<b>Listed Company</b>			
-IBL HealthCare Limited	74.19%	74.19%	74.19%
<b>Unlisted Company</b>			
-Searle Pharmaceuticals (Private) Limited	100.00%	100.00%	100.00%
-Searle Pakistan Limited	90.61%	90.61%	100.00%
-Searle Laboratories (Private) Limited	100.00%	100.00%	100.00%
-Searle Biosciences (Private) Limited	100.00%	100.00%	100.00%
-IBL Future Technologies (Private) Limited	100.00%	100.00%	100.00%
-Nextar Pharma (Private) Limited *	87.20%	87.20%	87.20%
-Searle IV Solutions (Private) Limited	100.00%	0%	0%
-Stellar Ventures (Private) Limited	100.00%	0%	0%
-MyCart (Private) Limited *	50.0%	0%	0%
-IBL Frontier Markets (Private) Limited *	100.00%	0%	0%
-Prime Health (Private) Limited *	100.00%	0%	0%
*Nextar Pharma (Private) Limited is the subsidiary of Searle Biosciences (Private) Limited being the indirect subsidiary of the Company			
*Mycart (Private) Limited, IBL Frontier Markets (Private) Limited, and Prime Health (Private) Limited are the subsidiaries of Stellar Ventures (Private) Limited being the indirect subsidiaries of the Company			

### Industry Overview & Update:

The Pakistani pharmaceutical market comprises around 650 companies, with less than 26% being multinational. The industry contributes approximately 1% to the country's GDP and grew by 15% in the past year, reaching an estimated \$3.04 billion. Local companies dominate the market with a 74% share, while multinationals hold 26%. The top 25 companies account for 74% of the market, and the top 50 make up 90%.

Around 11,000 drugs are actively marketed in Pakistan, sold through licensed pharmacies based on prescriptions. The Drug Regulatory Authority of Pakistan (DRAP) regulates the sector, handling medicine registration, manufacturing site approval, and setting Maximum Retail Prices (MRP).

The industry relies heavily on imports, with over 90% of raw materials imported and only 12% of Active Pharmaceutical Ingredients (API) produced locally. This reliance makes the sector vulnerable to currency devaluation, inflation, and rising utility costs. Price controls further squeeze profit margins, leading to the exit of some multinational companies. Although CPI-indexed pricing was introduced to mitigate this, it has limitations.

In February 2024, the government deregulated drug prices for medicines not on the National Essential Medicines List (NEML). Previously, price increases were capped based on the Consumer Price Index (CPI). Now, non-essential medicines can be priced without regulatory caps, potentially benefiting companies with a significant proportion of non-essential drugs.

### Key Rating Drivers

#### **Low business risk supported by industry dynamics.**

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 continuous emergence of diseases. Thus, the business risk of the sector is considered to be low.

#### **Ratings incorporate strong market position of the Company**

The ratings draw comfort from Company's strong market position ranked 5<sup>th</sup> in terms of value and 2<sup>nd</sup> in terms of volumes in the pharmaceutical industry. The product concentration risk is considered on the lower side accounting for around two-fifth of total revenue. Despite the challenging economic climate, demand for Searle's products remained strong, as a significant portion of its portfolio comprises chronic disease drugs, for which demand remains inelastic. The Company also intends to capitalize on its market position by expanding on its product portfolio, with multiple new products currently in the pipeline. The products launched in FY23 majorly operated in the respiratory, nutritional supplement, psychiatry, cardiovascular, and antibacterial sectors and going forward the focus will be on IVY market. The Company also expanding their portfolio in GCC markets and registered their Pakistan's manufacturing facility in UAE.

**Price deregulation of the non-essential medicines is a strong positive for the Company**

With the deregulation of non-essential drug prices in February 2024, whereby pharmaceutical companies are allowed to adjust prices at their discretion, pharmaceutical companies stand to benefit, especially those with a large non-essential drug portfolio. The Searle Pakistan's major portfolio ~80% consists of non-essential drugs. This milestone change in regulatory regime is expected to bode well for the Company. Not only does this impact margins positively, it also makes several products more competitive to market than previously.

**Topline growth supported by price increase**

Due to significant currency devaluation last year, the drug authority had allowed a larger price increase, 14% and 20% for essential and non-essential drugs respectively. As a result, sales revenues of the Company increased to Rs. 21.6b (FY22: Rs. 17.7b). Sales were primarily to domestic consumers while 7% of revenues were generated from exports. Majority of the local sales are generated through related party - IBL Operations (Private) Limited which exclusively manages distribution of Searle and its subsidiaries. Exports are majorly focused in Sri Lanka (~27% of net export sales). Other major destinations included Myanmar (~22% of net export sales), Cambodia (~17% of net export sales) and Vietnam (~12% of net export sales).

**Margins remained under pressure**

Gross and operating margins remained constrained in FY23 on account of inflationary pressures and devaluation impact, however there is some respite in the same in the current year primarily due to the price adjustment. Nevertheless, net margins continue to remain under pressure due to higher financial charges. The debt secured for acquisition of Searle Pakistan coincided with the rise in policy rate, which has been a drain on profitability. Consequently, net profit of the Company reduced to Rs 302m from Rs. 2,090m last year. In addition, last year profitability was supported by sizeable dividend income from Searle Pakistan of Rs 1.1b, which was lower in FY23 (Rs. 409m). Net margins were recorded at 1.4% in FY23 vis a vis 11.8% in FY22.

**Deleveraging of balance sheet remains a key rating driver**

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 consistently declining over the past few years (FY21: Rs. 2,526 million, FY22: Rs. 2,114 million,) and remain negative in FY23 with Rs 535.3 million due to high financial charges and low profitability. The DSCR was squeezed in FY23, reported at 0.7x (FY22: 2x), on account of low operating profit however supported by dividends from Searle Pakistan Limited that was declared in FY22. In FY24, the Company has been optimizing its working capital cycle to maximize operating cash flows to meet debt-servicing requirements.

However, recently in May 2024, the Company has approved the disposal of 100% shareholding and control of its subsidiary Searle Pakistan Limited. This strategic decision is aimed at deleveraging balance sheet, in order to reduce debt servicing burden and improving net margins.

Ratings draw comfort from this and realization of the same will remain important for ratings.

Capitalization metrics remain sound on account of large equity base. In FY23, gearing and leverage indicators recorded nominal changes at 0.7x (FY22: 0.8x) and 1x (FY22: 0.9x) respectively, however during 9M'FY24 capitalization profile further improved, with gearing and leverage recorded at 0.5x and 0.7x respectively mainly on account of issuance of right shares for an amount of Rs. 4.2b. Consequently, equity at end 9M'FY24 was recorded at Rs. 31.9b (FY23: Rs. 27.6b). All equity proceeds were, however, channeled towards new acquisitions made in FY24.

#### **Company liquidity profile is considered adequate**

Liquidity metrics while depicting a decline remain adequate. Current ratio was recorded at 1.2x at 9MFY24, down from FY23: 1.5x (FY22: 1.8x) while short-term debt coverage improved to 1.7x. Improvement in working capital cycle from 113 days to 80 days supports liquidity profile although payable build up remains a concern. Moreover, short term cash flow support extended to subsidiaries also impacts the liquidity of the Company and will remain important for rating purposes, going forward.

**The Searle Company Limited**
**Appendix I**

<b>Financial Summary</b>					
<b>Balance Sheet (PKR Millions)</b>	<b>FY20A</b>	<b>FY21A</b>	<b>FY22A</b>	<b>FY23A</b>	<b>9M'FY24</b>
Property, plant and equipment	3,707.6	5,578.0	6,660.2	6,544.5	6,374.5
Stock-in-trade	2,632.9	2,206.9	2,086.6	2,716.2	2,221.5
Trade debts	7,801.8	8,755.0	9,318.2	11,570.1	10,295.9
Cash & Bank Balances	299.6	103.7	82.9	196.8	113.3
<b>Total Assets</b>	<b>25,381.2</b>	<b>43,925.5</b>	<b>47,831.0</b>	<b>50,800.3</b>	<b>53,130.0</b>
Trade and Other Payables	2,754.1	3,213.9	2,594.2	6,423.0	6,882.7
Long-term Debt (incl. current portion)	582.8	9,973.2	9,780.8	8,012.4	6,353.2
Short-Term Borrowings	4,840.8	5,763.4	7,849.0	8,178.3	7,186.4
<b>Total Debt</b>	<b>5,423.6</b>	<b>15,736.6</b>	<b>17,629.8</b>	<b>16,190.6</b>	<b>13,539.6</b>
<b>Total Liabilities</b>	<b>8,510.3</b>	<b>19,437.9</b>	<b>20,793.5</b>	<b>23,131.5</b>	<b>21,140.7</b>
Paid up Capital	2,124.3	2,400.4	3,120.5	3,900.7	5,114.9
Equity (excl. Revaluation Surplus)	15,424.3	21,736.4	23,444.8	23,951.7	28,396.4
<b>Income Statement (PKR Millions)</b>	<b>FY20A</b>	<b>FY21A</b>	<b>FY22A</b>	<b>FY23A</b>	<b>9M'FY24</b>
Net Sales	16,567.2	16,569.6	17,737.3	21,641.3	19,109.4
Gross Profit	8,272.0	8,548.7	8,648.0	9,543.7	9,148.1
Operating Profit	3,946.0	4,057.0	4,254.3	3,757.9	3,037.2
Finance Costs	641.5	1,322.4	1,924.8	3,348.1	2,670.2
Profit Before Tax	3,304.5	2,734.7	2,329.5	409.8	367.1
Profit After Tax	2,455.1	2,122.9	2,090.7	302.1	111.3
<b>Ratio Analysis</b>	<b>FY20A</b>	<b>FY21A</b>	<b>FY22A</b>	<b>FY23A</b>	<b>9M'FY24</b>
Gross Margin (%)	49.9%	51.6%	48.8%	44.1%	47.9%
Operating Margin (%)	23.8%	24.5%	24.0%	17.4%	15.9%
Net Margin (%)	14.8%	12.8%	11.8%	1.4%	0.6%
Funds from Operation (FFO) (PKR Millions)	3,253.3	2,526.0	2,113.7	-535.3	537.9
FFO to Total Debt* (%)	60.0%	16.1%	12.0%	-3.3%	5.3%
FFO to Long Term Debt* (%)	558.2%	25.3%	21.6%	-6.7%	11.3%
Gearing (x)	0.4	0.7	0.8	0.7	0.5
Leverage (x)	0.6	0.9	0.9	1.0	0.7
Debt Servicing Coverage Ratio* (x)	5.7	2.8	2.0	0.7	1.2
Current Ratio (x)	2.2	2.0	1.8	1.5	1.2
(Stock in trade + trade debts) / STD (x)	2.2	1.9	1.5	1.7	1.7
Return on Average Assets* (%)	10.1%	6.1%	4.6%	0.6%	0.3%
Return on Average Equity* (%)	17.0%	11.4%	9.3%	1.3%	0.6%
Cash Conversion Cycle (days)	32.5	99.9	113.5	80.6	9.2

\*Annualized, if required

A - Actual Accounts

REGULATORY DISCLOSURES		Appendix II			
<b>Name of Rated Entity</b>	The Searle Company Limited				
<b>Sector</b>	Pharmaceutical				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook/ Rating Watch</b>	<b>Rating Action</b>
<b><u>RATING TYPE: ENTITY</u></b>					
	07/10/2024	AA-	A-1	Stable	Maintained
	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
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	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.				
<b>Probability of Default</b>	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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<b>Due Diligence Meeting</b>	<b>Name</b>	<b>Designation</b>	<b>Date</b>		
	Mobeen Alam	CFO	30 <sup>th</sup> May 2024		
	Umail Siddiqui	Financial Analyst			
	Syed Asim Raza Zaidi	Financial Controller			