RATING REPORT

Aspin Pharma (Private) Limited

REPORT DATE:
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RATING ANALYSTS:
Talha Iqbal
talha.iqbal@jcrvis.com.pk

Mohammad Ibad Desmukh
ibad.deshmukh@jcrvis.com.pk

RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A	A-2	A	A-2
Rating Date	*December 14, 2018*		*October 18, 2017*	
Rating Outlook	Stable		Stable	
Sukuk	A		A	
Rating Action	Final		Preliminary	

COMPANY INFORMATION

Incorporated in 2013	**External auditors:** Ernst & Young Ford Rhodes Sidat Hyder & Co. Chartered Accountants
Private Limited Company	**Chairman of the Board:** Mr. Tariq Moinuddin Khan
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Tariq Moinuddin Khan
OBS Pakistan (Pvt.) Limited – 100%	

APPLICABLE METHODOLOGY(IES)

Applicable Rating Criteria: Industrial Corporates (May, 2016) ***http://www.jcrvis.com.pk/kc-meth.aspx***

Aspin Pharma (Private) Limited

OVERVIEW OF THE INSTITUTION

Aspin Pharma (Private) Limited (APL) was incorporated in Pakistan as a private limited company in 2013. The company is wholly owned by OBS Pakistan (Private) Limited.

Profile of Chairman & CEO

Mr. Tariq Moinuddin Khan is founder and CEO of OBS Group. He carries over three decades of domestic and international professional experience. Mr. Khan is a graduate of Concordia University Canada and acquired Certified Public Accountant designation from USA.

RATING RATIONALE

Aspin Pharma (Private) Limited (APL) is engaged in manufacture and sale of pharmaceuticals. In 2017, OBS Pakistan (Private) Limited (the Holding Company) (OBS) increased its shareholding in APL from 70% to 100% by acquiring remaining shares from other shareholders. During 2017, APL acquired 4.79% stake in AGP Limited (a related party). AGP limited is listed on the Pakistan Stock Exchange and reported profit after tax of Rs. 953m (9MCY17: Rs. 937.1m) during 9MCY18.

Capacity utilization of the company has increased on a timeline basis under single shift extended hour operation. Given new product launches and enhanced penetration in new cities, head count of the sales force has increased since last review while doctor coverage has crossed 15,000. Over the medium term, management plans to further augment sales team to 200 individuals and increase outreach to over 20,000 doctors.

Rating Drivers

Low business risk profile is a key rating driver

JCR-VIS considers pharmaceutical sector as low business risk given the relatively stable demand and demographic profile of the country. Key sector risks include regulatory risk (delay in new product approvals), rupee depreciation and significant dependence on Drug Regulatory Authority of Pakistan (DRAP) for approval of hardship cases. Despite significant rupee depreciation, margins have improved primarily on account of better negotiated input prices with suppliers.

Low overall market share in pharmaceutical industry but high relative market share in leading products

Overall market share of APL remains low at below 1%. Top 5 products accounting for 82% (2016: 91%) of APL's total sales continue to enjoy high relative market share (Motilium: FY18: 27.2%; FY17: 27.9%[1]), (Daktarin: FY18: 52%; FY17: 53.9%), (Vermox: FY18: 39%; FY17: 37.2%) and (Imodium: FY18: 85% FY17:88.3%) and enjoy strong brand value.

Leading pharmaceutical distribution company responsible for ensuring outreach across the country

Muller & Phipps Pakistan (Private) Limited (M&P) is the distributor of APL and is responsible for Pan Pakistan distribution of APL products. M&P has vast experience in pharmaceutical distribution /marketing services and has coverage of around 32,400 pharmacies across Pakistan.

Concentration in product portfolio and therapeutic area coverage. Diversification plans are ongoing with significant new product launches planned over the rating horizon; JCR-VIS believes that a more diversified pharma business profile is only expected to emerge over the medium term.

In line with plans, the company launched three new products in 2017 namely Gabolest, Virunix and Sepidyl and in 1H2018, three more drugs were launched namely Dasavir, Sofvel and Sofhep. Contribution of new product launched during 2017 and 2018 represented around 2% of total sales in 2018 in value terms. Product portfolio continues to primarily cover a single therapeutic category (alimentary tract & metabolism) indicating room for diversification. Currently, the topline is largely driven by treatments for acute therapeutic classes. Therefore, to further enhance stability in sales, management envisages launch of drugs within diverse chronic therapeutic category (diabetes, hepatitis-C and cardiovascular diseases) and line extension within existing product lines. Going forward, several new products planned to be launched. Management also plans to launch products in proton pump inhibitors, anti-biotic and pediatric segments. JCR-VIS believes that a more diversified pharma business profile is only expected to emerge over the medium term.

Profitability declined despite revenue growth and improved margins on account of high expenses

[1] IMS Data Plus MAT June 2017 secondary sales data. All market share data of the subsequent products are from this source.

pertaining to launch of new products and significant jump in finance cost. Planned prepayment of a sizeable chunk of the outstanding debt along with better API procurement rates negotiated with suppliers is expected to bode well for profitability in FY19.
During 2018, APL's net sales (on an annualized basis) increased by around 14%. Although product concentration in sales has reduced on a timeline basis, the same remains on the higher side.

Increase in volumetric sales and better API procurement rates negotiated with suppliers, translated into significantly improved gross margins of 47.1% (2016: 42.6%) in 2017. However, improvement in gross margins could not be fully reflected in earnings on account of sizeable (41%) increase in marketing and selling expenses. As per management, these expenses were incurred on account of sales and marketing efforts relating to new product launches. As a result, profit before taxation increased by just 5% to Rs. 328.6m (2016: Rs. 313.4m) in 2017.

In 1H2018, the company reported net sales of Rs. 1,130.1m while gross margins amounted to 47.7% (1H2017: 44.5%). Marketing and selling expenses increased by 45% compared to same period last year. This, along with significantly higher finance cost (1H2018: Rs. 149.4m; 1H2017: Rs. 65.6m) resulted in a decline in profit before tax to Rs. 138.6m (1H2017: Rs. 163.0m) during 1H2018. Going forward, higher volumetric sales (from both existing and new products), negotiation of competitive API rates with suppliers and projected normalization of expenses is expected to support profitability profile. Translation of projected improvement in revenues and margins into bottom line and cash flow growth in order to ensure adequate coverages is considered important from a ratings perspective.

Capitalization and liquidity indicators have weakened significantly due to sizeable debt undertaken to fund investments and lower than projected cash flows. Cash flow from investments is projected to remain limited vis-à-vis debt repayments. Sizeable prepayment of outstanding debt along with improved cash flows is expected to result in capitalization and liquidity profile remaining commensurate with the assigned ratings.
Given higher margins and profitability, Funds flow from Operations (FFO) increased to Rs. 330.1m (2016: Rs. 266.3m) in 2017. However, due to higher debt repayment, debt servicing coverage ratio decreased to 1.01x (2016: 1.35x). Moreover, FFO in relation to outstanding obligations declined to 9% (2016: 23%). In 2017, the following long-term debt facilities were acquired.

- In November 2017, APL successfully issued Sukuk of Rs. 1.5b at rate of 3M KIBOR + 1.50%. The Sukuk was issued to repay debt on balance sheet. Principal repayments are to be made on quarterly basis commencing from February'2019. The Sukuk will reach maturity in November 2023.

- Additionally, APL acquired term loan amounting to Rs. 1.15b in 2017. The facility has a tenor of 8 years. Markup repayment is to be done semi-annually while principal repayment is to be done in 10 equal semiannual installments commencing from June 2021 and maturity in December 2025. Rate on this facility is 6M KIBOR + 1.00%.

- The company acquired long term financing facility of Rs. 500m at rate of 12% with quarterly principal repayment commencing from March 2019 and maturity in December 2023. The loan is expected to be prepaid in the ongoing year from funds received from the holding company.

As a result of aforementioned debt undertaken by the company, gearing and debt leverage of the company increased to 2.72x (2016: 1.10x) and 2.99x (2016: 1.43x) respectively at end-2017. Equity base has improved on account of profit retention.

RATING SCALE & DEFINITION — Appendix I

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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	Aspin Pharma (Private) Limited
Sector	Pharmaceutical
Type of Relationship	Solicited
Purpose of Rating	Entity and Sukuk Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
14-12-2018	A	A-2	Stable	Reaffirmed
18-10-2017	A	A-2	Stable	Initial
RATING TYPE: SUKUK				
14-12-2018		A	Stable	Final
18-10-2017		A	Stable	Preliminary

Instrument Structure	APL has issued a Privately Placed and Secured Islamic Certificates Issue ("Sukuk" or the "Issue" or the "Transaction") of Rs. 1,500m. The funds were used to refinance the existing long-term loan of the company which stood at Rs. 1,000m (as of June 30, 2017), and remaining proceeds were utilized for funding capital expenditure and business operations of the company. The issue has a tenor of six years inclusive of one year grace period. The principal will be redeemed by the company in twenty equal quarterly installments, starting from the fifteenth month of the issue date. The issue offers quarterly profit payments with a floating rate of 3-Month KIBOR plus a spread of 1.50% p.a. The Sukuk is secured by a pari-passu charge on all present and future fixed assets of the company inclusive of a 15% margin over and above the issue size.
Statement by the Rating Team	JCR-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	JCR-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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