RATING REPORT

Saakh Pharma (Private) Limited

REPORT DATE:
October 25, 2018

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	BBB+	A-2
Rating Date	October 25, 2018	
Rating Outlook	Stable	
Rating Action	Initial	

COMPANY INFORMATION	
Incorporated in 2014	**External auditors:** KPMG Taseer Hadi & Co. Chartered Accountants
Private Limited Company	**Chairman & Chief Executive Officer (CEO):** Mr. Syed Abrar Hussain Kazmi
Key Shareholders (with stake 5% or more):	
Mrs. Syeda Sardar Bano – 100%	

APPLICABLE METHODOLOGY(IES)

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

Saakh Pharma (Private) Limited (SPPL)

OVERVIEW OF THE INSTITUTION

Saakh Pharma (Private) Limited (SPPL) was incorporated as a private limited company in 2014 and subsequently commenced commercial operations in August'2015 with its head office based in Karachi, Pakistan. Manufacturing facilities of SPPL is situated in Port Qasim Karachi.

Financial Snapshot
Net Equity: June 2018: Rs. 466.3m, June 2017: Rs. 433.2m

Net Revenue: FY18: Rs. 1.04b, FY17: Rs. 510.7m

RATING RATIONALE

Saakh Pharma (Private) Limited (SPPL) commenced operation in August'2015 and is engaged in the manufacture and sale of active pharmaceutical ingredients (APIs) to cater to raw material demand of local formulation firms. The Company aims to be a one stop solution of APIs for pharmaceutical companies. SPPL is currently involved in manufacturing of 2 major APIs product categories; **Semi Synthetic Penicillin (SSP)** (Amoxicillin, Ampicillin & Cloxacillin) and **Semi Synthetic Cephalosporin (SSC)** (Cefixime). Both SSP and SSC facilities are operating at high capacity utilization levels. SPPL has a cGMP certification issued from Drug Regulatory Authority Pakistan (DRAP) while management plans to acquire ISO certifications and set up an effluent treatment plant (a regulatory requirement).

SPPL is in the process of expanding its product portfolio by adding new API variants including **Paracetamol** (commercial production started from October'2018) and **Sitaglipton**. In addition, machinery for **Taste masking**[1] and **Pelletization**[2] services has been imported with revenues from the same is projected to commence from January'2019. Besides separate SSP and SSC production facility, SPPL has set up a separate manufacturing facility for Paracetamol at Port Qasim. Licensing requirements for all products planned to be launched in the ongoing year are completed. The management is in the process of procuring an additional land for setting up a manufacturing facility in interior Sindh for diversification in the herbal/nutraceutical segment through a joint venture. SPPL's will hold equity stake along with management control in the joint venture company.

Rating Drivers

Industry structure and market position
As per industry estimates, around 90% of the country's API requirement is fulfilled through imports. Currently, there are around half a dozen prominent API manufacturers in the country. While capital requirements and entry barriers are considered low, extensive time for licensing requirements and increasing working capital requirements may act as entry barriers. The largest API manufacturer is Pharmagen while SPPL is the fastest growing player in the industry. Market share of SPPL in local Amoxicillin and Cefixime production is estimated to be around 15% and 40%, respectively.

Business risk profile supported by strong and growing demand for APIs and advantage enjoyed by local API manufacturers' vis-à-vis imports. Regulatory & reputation risk along with rupee depreciation and low current product and therapeutic area diversity are key business risk factors

- **Off-take risk:** Pharmaceutical products have historically witnessed relatively stable demand. This along with country's demographic profile translates into growing healthy demand for products being manufactured by SPPL. Moreover, given that local production of APIs manufactured by SPPL is less than 50% of the requirement of pharmaceutical industry, product off-take risk is low.
- **Competition from imports:** Duty protection in the form of customs duty, additional sales tax and advance income tax provided price advantage to local API

[1] *Taste-masking techniques are used to mask or overcome the bitter or unpleasant taste of the drugs to achieve patients' acceptability.*
[2] *Pellets are defined as small, free-flowing, spherical particulates manufactured by the agglomeration of fine powders. The process is known as Pelletization.*

manufacturers. Moreover, convenience for pharmaceutical company due to lower lead time, limited exposure to exchange rate risk and facility of procuring desired quantity (vis-à-vis importers who have to buy in bulk) also provides competitive edge to SPPL.

- **Client, product and therapeutic area diversity:** SPPL has managed to build a sizeable client base in a very short span of time with total number of clients comprising over 250 pharmaceutical companies. Client concentration in sales is on the lower side with top 5 clients representing less than one-third of total sales during FY18 and 1QFY19. However, therapeutic area diversity is low with SPPL having a presence in the anti-biotic and anti-diabetic segments. While product-wise concentration in sales is high with revenues emanating almost entirely from two products, the same is expected to improve with launch of new products in the ongoing year. Contribution of paracetamol in total sales is projected to represent around one-fourth of total sales in FY19. Diversification in the organic/thermal segment is planned.
- **Reputation and regulatory risk:** Risk to reputation/brand as a result of inferior product quality or penalty by regulator due to manufacturing facilities not being up to the required standard is one of the major risks for API manufacturers. As per management, significant investment has been undertaken to ensure manufacturing facilities comply with regulatory requirements while stringent customer and regulatory audit is undertaken to ensure product quality.

Robust sales growth to continue on the back of new product launches and healthy sales from existing products

After having doubled in FY17, net sales increased by 105% during FY18 and crossed Rs. 1b. Growth in sales is a function of volumetric growth due to launch of Cefixime during the latter half of FY17 in the SSC segment. Moreover, higher quantities of amoxicillin sold due to full year impact along with increase in average selling prices also contributed to revenue growth. Going forward, momentum in sales growth is projected to continue with net sales budgeted to cross Rs. 2b. With both SSP and SSC segment operating at near full capacities, growth in revenues will primarily be a function of new products launched in the ongoing year. Increase in sales is subject to timely commencement of production of new products (Paracetamol, Taste masking & Pelletization and Sitaglipton) and achievement of projected volumes.

Profitability growth to be driven by increase in revenues and margins

Besides increase in sales, profitability growth has been supported by increase in gross margins. The same is attributable to volumetric increase in sales (product base extension), resulting in better absorption of fixed cost per unit. Gross margin during FY18 was reported at 9.2%. With major portion of raw material being imported, any unfavorable movements in currency exchange rates may increase the cost of production. Inability to pass cost increase to clients may impact margins. Accounting for finance cost, SPPL incurred loss before tax of Rs. 21.1m (FY17: loss before tax of Rs. 76.9m). Excluding the impact of depreciation, the company posted profit before tax of Rs. 12.7m (FY17: loss before tax of Rs. 48.8m) in FY18. Going forward, given the addition of new products in portfolio and anticipated increase in sales volumes, gross margin are projected to improve to over 10% in FY19. Volatility in raw material prices and fluctuation in exchange rates are key risk factors in achieving projected gross margins. Given the strong demand and limited local supply, management has projected to pass on any increase in manufacturing cost to clients. Despite significant increase in finance cost due to higher working requirements and increase in benchmark rates, overall profitability is expected to witness strong growth due to higher revenues and increase in margins.

Liquidity profile is expected to witness improvement in the ongoing year due to significant growth expected in cash flows.
Despite being negative, fund flow from Operations (FFO) has depicted a notable improvement during FY18. With improvement in profitability, FFO is expected to depict growth in FY19. The company's working capital cycle necessitates utilization of short-term debt with extended time to collect receivables and fund inventory levels. Trade debts represent around one-fifth of SPPL's annual sales. A documented provisioning policy defining time based criteria for provisioning is considered important. Increase in working capital cycle is partly attributable to change in procurement mode in order to limit exchange rate risk. Stock in trade and trade debts represented around 217% of outstanding short-term borrowings while current ratio of SPPL was reported at 1.19(x) at end-FY18. Cash held on balance sheet as at end-FY18 was reported at Rs. 65.5m.

Capitalization indicators supported by low leveraged capital structure and funding ongoing & planned capital investments through equity injection.
At end-FY18, net equity of SPPL was reported at Rs. 466.3m (FY17: Rs. 433.2m). Debt profile of the company is short term in nature with total debt amounting to Rs. 183.1m at end-FY18. Resultantly, debt leverage and gearing increased on a timeline basis to 0.39(x) and 1.02(x) respectively. Going forward, despite increase in short-term borrowings (to fund higher working capital requirements) leverage indictors are projected to remain within manageable levels. Planned capital investments for diversifying product range is planned to be funded through equity injection. Continued sponsor support for funding sizeable planned capex is considered important from a ratings perspective.

Corporate governance framework has room for improvement
Given the company's status as a private limited company, overall board composition and oversight has room for improvement through induction of additional directors on board (including independent directors) and enhancing discussion at the board level to include future strategy and feasibility of new projects. Given the rapid pace of growth, strengthening of policy and procedural framework and a more formalized internal audit setup is also considered important. External auditors of the company are KPMG Taseer Hadi & Co. Chartered Accountants. Auditors belong to category 'A' on the approved list of auditors published by the State Bank of Pakistan. Senior management team comprises experienced personnel.

Saakh Pharma (Private) Limited — Appendix I

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**FY18**	**FY17**	**FY16**
Fixed Assets	387.3	238.2	226.9
Stock-in-Trade	169.5	97.7	55.6
Trade Debts	226.9	112.9	67.9
Cash & Bank Balances	65.5	84.3	36.7
Total Assets	942.4	564.4	409.6
Trade and Other Payables	230.9	120.0	78.5
Short Term Debt	183.1	-	-
Total Equity	466.3	433.2	328.6
INCOME STATEMENT			
Net Sales	1,044.3	510.7	249.7
Gross Profit	95.8	0.2	1.3
Operating Profit	5.7	(80.0)	(31.4)
Profit After Tax	(32.7)	(93.2)	(33.7)
RATIO ANALYSIS			
Gross Margin (%)	9.2%	0.05%	0.5%
FFO to Total Debt (x)	(0.1)	-	-
Gearing (x)	0.39	-	-
Debt Leverage (x)	1.02	0.30	0.25
Debt Servicing Coverage Ratio (x)	5.7	-	-
ROAA (%)	-4.3%	-19.1%	-10.9%
ROAE (%)	-7.3%	-24.5%	-13.0%

RATING SCALE & DEFINITION — Appendix II

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 III

Name of Rated Entity	Saakh Pharma (Private) 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	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.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
25th Oct'2018	BBB+	A-2	Stable	Initial