RATING REPORT

Muller & Phipps Pakistan Private Limited

REPORT DATE:

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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A+	A-1
Rating Outlook	Stable	
Rating Date	*December 31, 2018*	

COMPANY INFORMATION	
Formed in 1912 (incorporated in Pakistan in 1949)	**External auditors:** EY Ford Rhodes Chartered Accountants
Private Limited Company	**Chairman of the Board:** Mr. Zain A. Alavi
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Kamran Nishat
The Getz Corporation USA – 58.71%	

APPLICABLE METHODOLOGY(IES)
JCR-VIS Entity Rating Criteria: Industrial Corporates (May 2016) ***http://jcrvis.com.pk/docs/Corporate-Methodology-201605.pdf***

Muller & Phipps Pakistan Private Limited

RATING RATIONALE

Muller & Phipps (M&P) is the leading national distribution company in the country with a client base of 76 principals. The company provides logistics & distribution, cold chain warehousing, sales, marketing and after sales support services to its clients. The coverage of these services expands to a diversified range of segments including pharmaceuticals, telecommunication, health care and consumer sectors. Besides distribution, M&P also has investments in companies that complement and support its operations.

Business Segments

Pharmaceutical

The pharmaceutical segment has around 40 principals and generates around half of company's revenues. Principals include leading pharmaceutical companies (Getz Pharma Pvt Ltd, Bayer Pakistan Pvt Ltd, Glaxo Smithkline Pakistan Ltd, AGP Limited, and Novo Nordisk Pharma Pvt Ltd) where M&P has had a lengthy relationship with most principals. Growth posted by M&P principals has consistently outpaced overall pharmaceutical sales growth. The growth was recorded at 19% vis-à-vis 7.42% posted by the pharmaceutical industry in CY17. Increase in sales was a function of addition of new principals and expansion plans by the company via opening of new depots along with organic growth in sales from existing principals. Growth in sales is expected to be around 20% from the pharmaceutical segment in CY18.

Telecom

Telecom segment represents over one-fourth of the company's topline. M&P has distribution agreements with 7 players in the telecom segment (key players include Samsung Electronics Huizhou Company Ltd, Huawei Device Hong Kong and Apple South Asia Pte. Ltd.) for its nationwide distribution including the import of phone sets, warehousing and distribution. M&P has also entered into an agreement with a leading Information Technology company (Dell Global B.V) for the distribution of its ICT products. Implementation of Device Identification, Registration and Blocking System (DIRBS) by Pakistan Telecommunication Authority (deadline December'2018) along with new product launches are expected to be growth drivers for the segment, going forward. Whitelisting of phones would restrict smuggling and only legible importers like M&P will experience in more shipments and higher telecom segment revenues.

Consumer

The consumer segment has around 25 principals and represents around one-fourth of the overall revenues. Major principals in the segment include Unilever Pakistan Limited, Castrol Pakistan Pvt Ltd and Pepsi Cola International Pvt. Ltd. The overall consumer segment recorded growth in revenues of 9% during CY17. Unilever generates around half of the sales of the consumer segment. Given the favorable demographics and healthy growth of the FMCG segment, revenues of the segment are projected to increase at the historical CAGR level.

OVERVIEW OF THE INSTITUTION

Muller & Phipps was incorporated as a private limited company. The company is engaged in import and distribution of pharmaceuticals, consumers, telecommunication and hospital care products. It also undertakes contract marketing activities for certain pharmaceutical companies.

Profile of Chairman

Mr. Zain Ul Abideen serves as the chairman of the Company. He has been associated with the company for decades and has a professional experience of more than 40 years. He has attended various professional courses. He is also serving on the educational board of Hasnain Academy

Profile of CEO

Mr. Kamran Nishat serves as the Managing Director and the CEO of the company. He has been a part of M&P since 19 years. He is a fellow member of ICAP and serves on the board of Biogene Private Limited, AGP Limited and Cyan Limited. He is also serving on the boards of M&P Express Logistics (Private) Limited, TechSirat

(Private) Limited, TechSirat Technologies (Private) Limited, M&P Logistics (Private) Limited, Logex (Private) Limited and Veribest Brand Pakistan (Private) Limited.

Healthcare

While contribution of revenues of the segment to the overall topline remains limited, gross margins from the segment tend to be on the higher side. The segment involves distribution of medical devices and surgical instruments. The distribution of this segment covers more than 700 medical institutes providing round the clock product availability for critical surgical products. Leading principals from the segment include Johnson & Johnson Middle East, Convatec International Services and 3M Pakistan Pvt Ltd.

Investments

M&P Express Logistics (Private) Limited (formerly OCS Pakistan Private Limited)

During 2015, M&P acquired 100% shareholding in OCS Pakistan Private Limited and renamed the company as M&P Express logistics Private Limited in December 2016. The Company provides express courier, freight forwarding, transportation, warehousing and logistics services and owns 93 vehicles, more than 650 courier centers and 139 offices. Currently, the company covers more than 1,500 delivery locations across Pakistan and has a corporate clientele of over 12,000 customers. Post-acquisition, the company's organization structure has been revamped with increased focus on synergies. Moreover, a revised business strategy has been put in place which is expected to result in improved profitability, going forward. M&P has extended significant support to the Company in its business operations. The objective of this acquisition is to provide last mile reach to customers.

TechSirat (Private) Limited

M&P acquired 100% shareholding in TechSirat (Private) Limited in 2016 which is operating as the distribution company for Lenovo smartphones and i-Life laptops. The objective of this acquisition was to further enhance M&P's footprint in the telecommunication segment.

AGP Limited

During 2015, M&P acquired 18.9% stake in AGP Limited (AGP) which has been classified as an available for sale investment. In March'2018, M&P divested 5.36% stake in AGP through an offer for sale IPO arrangement and realized a sizeable capital gain. At end-Sep'2018, market value of AGP shares were 2.27(x) the cost of these investments and dividend income from the investment will complement profitability.

VeriBest Brand Pakistan (Private) Limited

The company is currently not operational. The objective of the Company is to establish, own, run or manage departmental stores, supermarkets, convenience centers, to act as merchant, retailers or wholesalers and import and distribution of pharmaceuticals, consumers, telecommunication and hospital care products.

Rating Drivers

Leading market position

The assigned ratings incorporate M&P's leading market position in the distribution industry. Within national level pharmaceutical distributors, M&P enjoys a market share of around 45%. Market share in overall pharmaceutical revenues is estimated at around 15%. M&P also enjoys national distribution from principals in other segments of business.

Extensive outreach and effective controls are a competitive advantage

The company's extensive outreach through its widespread and growing network of 119 locations comprising of central warehouses, depots and service centers and vast coverage of retail customers touching 32,400 pharmacies and 50,000 outlets across Pakistan is a competitive advantage. The logistics division is responsible for supply chain, fleet management, import handling and regulatory affairs. The department has a balanced mix of rented and owned vehicles for delivery to retail outlets & wholesale market which is undertaken through a well-defined permanent journey plan. With its structure and available resources, the company has sufficient capacity to serve a wide outreach as evident from sizeable proportion of retail sales in overall sales; strength of distribution network is among the rating drivers.

Business Risk

Competitive landscape: Distribution industry in Pakistan is very fragmented and competitive in nature resulting in low margins for industry players. Given the thin margins and high competition, pricing power in order to pass on increasing cost is considered low. However, increasing topline for large national level industry players partly facilitates in absorbing rising cost of doing business.

Demand stability: Pharmaceutical, health care and consumer segment representing around three-fourth of the company's revenues have a long history of steady demand through industry and economic cycles. While telecom sales may be slightly cyclical in nature with buyers delaying purchase of new models in times of economic slow-down, sales outlook remains healthy due to growth expected after implementation of Device Identification, Registration and Blocking System (DIRBS) by Pakistan Telecommunication Authority

Diversified operations & exposure to top-tier clients: Ratings also incorporate company's sizeable principle base with diversified operations in pharmaceutical, telecom, consumer and health care segments. M&P's exposure to top-tier clients who have had an established track record over the years of outperforming peers in terms of revenue growth bodes well for future sales.

Concentration risk: While number of principals is sizeable, customer concentration risk is high with top 10 principals accounting for four-fifth of total revenue. The risk is partly mitigated with most large clients having a lengthy association with the Company and high switch over cost for clients. Concentration risk is on the lower side vis-à-vis other peers in the distribution industry.

Interest Rate and Forex Risk: M&P is exposed to significant short term borrowing to cater to its working capital requirements which makes it vulnerable to any upward movement in interest rates directly impacting the bottom line of the company. Forex risk is hedged through adjustment in pricing in coordination with principals.

Financial Risk

Robust historical growth in sales with healthy sales growth outlook. Low margins, sizeable finance cost and high effective tax rate translate into limited net margins.
Revenue of the company has witnessed a healthy 3 year CAGR of 17%. Increase is due to organic growth from existing clients as well as new client additions. Telecom segment has recorded the highest growth in percentage terms during FY18 followed by pharmaceutical segment. While margins are fixed in percentage terms with most principals, gross margins have increased in absolute terms, though slight decline has been witnessed in % terms due to change in sales mix. With significant increase in benchmark rates, finance cost is projected to grow. Growth in topline is projected to offset higher finance cost and increase in administrative expenses. The effective tax rate has been on the higher side (FY17: 66.3%; FY16: 55.45%; FY15: 57.05%) due to peculiarity of tax regime on imported goods and super tax which have resulted in higher overall taxation. However, the impact of super tax shall be removed from the tax year 2020. Overall profitability for 2018 will be supported by a sizeable one-off capital gain on AGP shares sold.

Cash flow from operations sufficient to cover repayments, capital expenditure and dividend payout. Working capital cycle has room for improvement.
Cash flows have been sufficient to cover debt repayments, low capital expenditures and dividend payouts. Extended working capital cycle result in sizeable utilization of short-term debt; however, stock in trade and trade debt provide sufficient coverage of outstanding short-term borrowing. Ageing profile of trade debts is adequate. Moreover, sales return and expiry risk is borne by the principle. Current ratio of the Company has remained marginally over 1(x) over the last three years.

Equity base has increase on a timeline basis due to retained profits. Leverage indicators have remained elevated due to sizeable short-term borrowings; stock-in-trade and trade debt provide sufficient coverage of outstanding borrowings

Net equity of M&P increased on a timeline basis due to retained profits. Dividend payout ratio has remained conservative and stood at 24% (CY16: 15%) during CY17. However, increase in short-term borrowing has translated into leverage indicators remaining elevated; stock-in-trade and trade debt provide sufficient coverage of outstanding borrowings

Sound corporate governance infrastructure
M&P has instituted a well-designed organizational structure comprising separate teams for different business segments and control functions including finance, information technology, internal audit, human resources, corporate affairs and legal. The business divisions have independent management teams and organizational structure. An experienced management team with relevant industry expertise is in place. Given the importance of IT in distribution, an adequate IT infrastructure is in place with 3 separate but integrated systems in place for financials, human resource and sales & distribution. Moreover, adequate back-up procedures have been put in place. Policy and procedural framework is comprehensive. Given the company's nature as a private limited company, board composition is currently constrained.

ISSUE/ISSUER RATING SCALE & DEFINITIONS 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 III

Name of Rated Entity	Muller & Phipps Pakistan Private Limited
Sector	Distribution & Logistics
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				
31-Dec-18	A+	A-1	Stable	Initial