RATING REPORT

Renacon Pharma Limited

REPORT DATE:
November 16, 2020

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	BBB+	A-2
Rating Outlook	*Stable*	
Rating Action	Initial	
Rating Date	*November 16, '20*	

COMPANY INFORMATION	
Incorporated in 2009	External auditors: Aftab Nabi & Co. Chartered Accountants
Public Limited Company – Unquoted	**Chairman:** Syed Shahid Ali **CEO:** Dr. Salman Shakoh
Key Shareholders (with stake 5% or more):	
Treet Corporation Limited – 55.86% Dr. Salman Shakoh – 19.63% Mrs. Lubna Shakoh – 13.09%	

APPLICABLE METHODOLOGY
VIS Entity Rating Criteria: Corporates (May 2019) *https://www.vis.com.pk/kc-meth.aspx*

Renacon Pharma Limited

OVERVIEW OF THE INSTITUTION

Renacon Pharma Limited (RPL) was incorporated in July 2009 as a private limited company under the Companies Ordinance, 1984 (now Companies Act, 2017). RPL was converted into public limited company (unlisted) in January 2017. The registered head office is located at 72-B Industrial Area, Kot Lakhpat Lahore.

Profile of Chairman

Syed Shahid Ali is also the CEO of Treet Corporation Limited.
Mr. Ali holds a Master's degree in economics, a graduate diploma in development economics from Oxford University and a graduate diploma in management sciences from University of Manchester.

Profile of CEO

Dr. Salman Shakoh is the founding member of RPL and currently serves as the CEO. He has over 20 years of experience as Renal Physician, pioneering several nephrology procedures in Pakistan, including Hemoperfusion, CVVHD, CAVH, Catheterizations for Dialysis, and CAPD. He is also the Director of Shakoh's Hemodialysis Centre and Shakoh's Extracorporeal Therapies at Cardex Hospital, as well as President of Hope Kidney Foundation.

RATING RATIONALE

Renacon Pharma Limited (RPL) was incorporated as a private limited company in 2009, and subsequently, converted into public limited company (unlisted) in January 2017 whereby a controlling equity stake of 55.86% was acquired by Treet Corporation Limited (TCL). Dr. Salman Shakoh and Mrs. Lubna Shakoh own 19.63% and 13.09% stake in the company, respectively, while remaining shares are held by several individual investors.

RPL is mainly engaged in manufacturing and sale of various types of Hemodialysis Concentrates in solution and powder forms for the local and international markets. The company also supplies imported dialyzers, bloodlines and AVF needles as there is no manufacturing unit in Pakistan. Production facility is located at Lahore, which mainly comprises mixer machines and Reverse Osmosis (RO) plant to purify the water.

Bicarbonate component (sodium bicarbonate and sodium chloride) and acid concentrates (chloride salts of sodium, calcium, magnesium, and acetate) are mixed simultaneously with purified water to make the dialysate. Sodium bicarbonate and sodium dextrose chloride are imported from Europe as pharma-grade bicarbonate component is not being produced locally.

Market leader: There are around 22,000 registered kidney-failure patients in the country who require three dialysis session per week in order to survive. It is estimated that 3.3m dialysis sessions are performed annually in the government and private hospitals. RPL is the leader in the local hemodialysis concentrates market with a current market share of around 64% while remaining share is majority held by five foreign suppliers, namely Fresenius (Germany), Nipro (Japan), Dora (China), Sanxin (China) and Toray (Japan).

RPL has been able to capture a major market share since its dialysate products are approximately 20% cheaper than foreign products, making it suitable at cost-sensitive dialysis centers in Pakistan. Local players have also been unable to compete with RPL due to their small size and having low quality products. RPL's production facility is ISO 9001, ISO 13485, and CE 0120 certified, enabling the company to export without further testing.

Expansion plan to enhance exports as existing plant is operating at full capacity

RPL currently has the capacity to produce 2.1m sessions of dialysate per annum. The plant obtains electricity via an industrial connection from Lahore Electric Supply Company. Water is purified at the RO plant. The company is in process of capacity expansion with the aim to penetrate the export markets. A 10 acres of land has been acquired at Faisalabad Industrial Estate for the purpose. The existing facility will also be relocated to Faisalabad. The project comprises hemodialysis plant with production capacity of 15.3m sessions of hemodialysis concentrate and 9.6m sets of BTL and AVF needles. Capex for the project is to be financed through a mix of short-term borrowings, the SBP's Long-term Financing Facility (LTFF) or Technology Up-gradation Fund (TUF) Scheme. The company is targeting to complete the expansion by end-June'2021.

Sustained growth in revenue and profitability on account of increasing demand and higher selling price

Local sales are made to government and private dialysis centers while exports are made through distributors. Government dialysis centers on average account for 60% of local sales. Revenue of the company increased on a timeline basis during FY20, out of which 95% were local sales (FY19: 91%; FY18: 90%). Increase in local revenue was mainly driven by higher volumes and average selling price during FY20.

Remaining revenue came from exports, with Afghanistan, Sri Lanka, Kenya, Ethiopia, Philippines, and South Korea being the primary markets; though variation in sales has been witnessed over the year in these countries. According to the management, contribution of exports in revenue mix is low due to production capacity constraint, though it is expected to increase considerably after the capacity enhancement.

Raw materials on average account for three-fourth of cost of sales. Gross margins continued to increase to 20.7% (FY19: 18.3%; FY18: 17.3%) during FY20 on account of increasing trend in average selling price per session. Some increase in selling & distribution expense was witnessed owing to higher staff salaries and freight charges. Administrative expenses increased slightly as the company incurred legal and professional fee.

The company incurred higher finance cost due to higher interest rates despite reduction in average borrowings. Net profit, though remained modest, increased to Rs. 31.6m (FY19: Rs. 20.7m; FY18: Rs. 19.9m) with slightly higher net margin of 6.0% (FY19: 5.0%; FY18: 6.2%).

Liquidity and capitalization

In line with higher profits, funds from operations (FFO) improved to 34.6m (FY19: Rs. 11.1m; FY18: (1.6m)). With no long-term borrowings, debt service coverage stood higher at 5.8x (FY19: 5.9x; FY18: 0.34x) and FFO-to-total debt at 0.39x (FY19: 0.03x) at end-FY20.

Short-term borrowings decreased to Rs. 87.8m (FY19: Rs. 336.4m; FY18: nil) by end-FY20. During FY19, short-term borrowings were mobilized to partially finance capex and for working capital requirements. Paid-up capital of the company was unchanged at Rs. 623.5m, while interest-free loan from sponsor stood at Rs. 370m (FY19: Rs. 50m; FY18: nil). Equity base stood at Rs. 757.2m (FY19: Rs. 728.3m; FY18: Rs. 657.6m) while gearing and debt leverage ratios amounted 0.12x (FY19: 0.46x) and 0.54x (FY19: FY19: 0.55x) respectively, by end-FY20. While RPL currently has low leveraged capital structure, gearing is projected to increase by end-FY21 owing to mobilization of debt financing for expansion project.

Renacon Pharma Limited **Annexure I**

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**FY18**	**FY19**	**FY20**
Non-Current Assets	188.8	755.8	779.5
Long-term Investment	102.4	102.4	102.4
Receivables	98.4	80.8	97.1
Stock in Trade	37.8	155.0	61.2
Advances, Deposits & Prepayments	11.0	3.6	139.5
Tax Refund Due from Govt.	19.4	34.9	39.9
Cash & Bank Balance	276.9	14.1	44.3
Total Assets	**734.6**	**1,146.5**	**1,265.0**
Trade & Other Payables	69.4	51.1	348.8
Short-Term Borrowings	-	336.4	87.8
Long-Term Borrowings *(Inc. current matur)*	-	-	-
Tax Provision	7.6	11.2	15.4
Total Liabilities	77.0	398.7	488.1
Tier-1 Equity	657.6	728.3	757.2
Total Equity	**657.6**	**747.9**	**776.8**
Paid-up Capital	623.6	623.6	623.6
INCOME STATEMENT	**FY18**	**FY19**	**FY20**
Net Revenue	319.4	417.1	522.4
Gross Profit	55.4	76.3	108.0
Profit Before Tax	26.3	33.3	46.0
Profit After Tax	19.9	20.7	31.6
FFO	(1.6)	11.1	34.6
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**
Gross Margin (%)	17.3	18.3	20.7
Net Margin (%)	6.2	5.0	6.0
Net Working Capital	366.4	(110.3)	227.0
Current Ratio (x)	5.8	0.7	2.0
FFO to Long-Term Debt (x)	-	-	-
FFO to Total Debt (x)	-	0.03	0.39
Debt Servicing Coverage Ratio (x)	0.34	5.9	5.8
ROAA (%)	2.8	2.2	2.5
ROAE (%)	3.3	2.9	3.4
Gearing (x)	-	0.46	0.12
Debt Leverage (x)	0.12	0.55	0.64

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure II

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 Annexure III

Name of Rated Entity	Renacon Pharma Limited
Sector	Pharmaceutical
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
16-11-2020	BBB+	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mohtashim Aftab	CFO	September 4, 2020
Saqib Hameed	Head Treasury	September 4, 2020