# RATING REPORT

## OBS AGP (Private) Limited

**REPORT DATE:**
May 3, 2021

**RATING ANALYSTS:**
Talha Iqbal
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Muhammad Tabish
*muhammad.tabish@vis.com.pk*

| RATING DETAILS | | |
|---|---|---|
| **Rating Category** | **Initial Rating** | |
| | **Long-term** | **Short-term** |
| **Entity** | A | A-1 |
| **Rating Outlook (Entity)** | Stable | |
| **Sukuk** | A+ | |
| **Rating Outlook (Sukuk)** | Stable | |
| **Rating Date** | May 3, 2021 | |

| COMPANY INFORMATION | |
|---|---|
| **Incorporated in 2020** | **Board Chairman (Parent Company):** Mr. Tariq Moinuddin Khan |
| **Special Purpose Entity** | **MD & CEO (Parent Company):** Ms. Nusrat Munshi |
| **Key Shareholders (with stake 5% or more):** | |
| *AGP Limited* | |
| *Aitkenstuart Pakistan (Private) Limited* | |

| APPLICABLE METHODOLOGY(IES) |
|---|
| **VIS Entity Rating Criteria Methodology – Industrial Corporates (May 2019)** |
| **https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Corporate-Methodology-201904.pdf** |

## OBS AGP (Private) Limited

**OVERVIEW OF THE INSTITUTION**

*OBS AGP (Private) Limited, a Special Purpose Vehicle (SPV) incorporated by Aitkenstuart Pakistan (Private) Limited and will become a subsidiary (65%) of AGP Limited upon its investment in the company..*

**Profile of Chairman (Parent Company):**

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

**RATING RATIONALE**

**Sponsor Profile**

AGP Limited (AGP) is a public listed local pharmaceutical company engaged in manufacturing and marketing of medicines (of its own brands and under licensing arrangements with other companies) for over three decades. Few recognized brands include Rigix, Ceclor, Osnate-D, Rubifer, Keflex etc. Major shareholding of the company (52.98%) is held by Aitkenstuart Pakistan (Private) Limited (APPL) which is a wholly owned subsidiary of OBS Healthcare (Private) Limited. OBS group (Structure in Annexure to the Report) has strong presence in the pharmaceutical industry and currently operates in the country via two companies (AGP Limited and Aspin Pharma Private Limited). Manufacturing facilities of both companies are located in Karachi.

**Formation of Special Purpose Vehicle (SPV)**

OBS AGP (Pvt.) Limited has entered into an agreement with Sandoz AG to acquire up to 28 pharmaceutical brands of Sandoz Business Division in Pakistan. The total capital requirements for the acquisition is estimated at Rs. 3,700m. Sandoz is a global leader in generic pharmaceuticals. The division was established in 2003 when Novartis united all of its generics businesses under one name, Sandoz. The acquisition is being conducted through OBS AGP (Private) Limited, a Special Purpose Vehicle (SPV) that will become a subsidiary of AGP. As per the management, the brands would be acquired upfront and the process of transferring Marketing Authorizations (MAs) would commence immediately following the acquisition. During this transition period till the MAs are transferred, existing toll manufacturing / import arrangement will continue for all products. Upon the transfer of MAs, majority of the local portfolio is planned to be produced at AGP's manufacturing facilities while the remaining local portion will continue to be manufactured via third-party toll manufacturing. At present, ~7.5% of the portfolio (mainly oncology products) is directly imported and the same arrangement will continue.

**Transaction Structure**

- Funding Mix/Structure: The transaction would be financed 30% through equity contribution (65% by AGP and 35% by APPL) while the remaining will be funded by Sukuk issue. As a result, SPV created will have a debt to equity ratio of 70:30.

| SPV's Equity/Debt Structure | Funding Sources | Rs. in millions |
|---|---|---|
| Equity | AGP | 715 |
| | APPL | 385 |
| Debt | Sukuk Issue | 2,600 |

- Tenor: 5-Years
- Grace Period: 1-Year

- Repayment Schedule: Principal amount will be redeemed through 16 consecutive, fixed, quarterly installments of Rs. 162.5m each commencing from the 15th month. Profit will be payable on a quarterly basis at a rate of Kibor plus 155bps per annum.
- Detailed Security Structure: Security structure of Sukuk would entail a pari-passu charge on fixed assets of AGP (Rs. 2,600m inclusive of a margin of 20%), pledge of shares of AGP held by APPL (Rs. 1,400m inclusive of a margin of 53.57%) and corporate guarantee from AGP of up to Rs. 2,600m covering the entire principal amount. Moreover, one upcoming rental payment shall, at all times, be available in a rental payment reserve account.

**Key Rating Drivers**

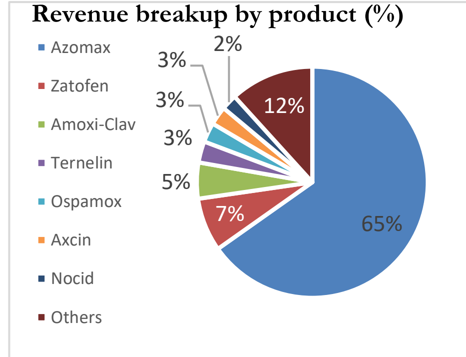
**Strong sponsor strength along with financial support available from the ultimate holding company lends comfort.**
Assigned ratings take comfort from the Parent Company's (AGP) established market position, long track record in the pharmaceutical industry and the resulting operational, managerial and financial support available to the SPV (Both from AGP and cash available at the holding Company level). AGP has an annual turnover of Rs. 6.9b (as at Dec 31, 2020) with continuous growth recorded in sales while profitability profile has also been improving. Ratings incorporate AGP's healthy cash flows and low leveraged capital structure. Free cash flows (after accounting for capital expenditure and debt servicing) amounted to Rs. 1,363m (2019: Rs. 718.7m) in 2020.

| AGP Key Financials Figures | | | | |
|---|---|---|---|---|
| **(Rs. in millions)** | **2017** | **2018** | **2019** | **2020** |
| **Sales** | 4,725.0 | 5,382.1 | 6,253.2 | 6,946 |
| **GP Margin** | 60.8% | 56.5% | 58.5% | 55.6% |
| **Net Margin** | 26.1% | 22.4% | 23.1% | 22.9% |
| **FFO** | 1,068.3 | 1,288.4 | 1,625.7 | 1,881.2 |
| **FFO/ LT Debt** | 49.4% | 76.6% | 134.6% | 176.6% |
| **Gearing** | 0.39 | 0.29 | 0.16 | 0.13 |
| **Leverage** | 0.55 | 0.41 | 0.29 | 0.24 |

**Business risk profile is supported by non-cyclical nature of the industry and steady demand growth.**
Given the non-cyclical nature of the sector with relatively stable (inelastic) demand, revenues and profitability of pharmaceutical industry are likely to remain unaffected by economic downturns. Sales of the sector are supported by geographical diversification, growing population and continuous emergence of new diseases. Thus the business risk of the sector is considered to be low. Regulatory risk including changes in pricing policies and sharp rupee devaluation remain key challenges for the sector.

**High market share and strong brand value of leading products. Concentration in product portfolio and therapeutic area coverage.**

Product portfolio being acquired caters primarily to 6 broad therapeutic segments; of which top three are Anti-infective (77%), Respiratory System (8%) and Oncology (6.4%), which cumulatively represent around 92% of revenue base. As per management, future business strategy will focus on volumetric sales growth in existing therapeutic classes.




On the other side, product-wise concentration in sales of the portfolio being acquired is also considered high with around two-thirds of revenues emanating from one brand, Azomax (market leader with share of around 65% of total molecules sales). Of the other brands, top leading revenue generating drugs are Zatofen (7.5%), Amoxi-Clav (5.0%), Ternelin (3.0%),Ospamox (2.7%) and Axin (2.6%).

**Deployment of dedicated sales & marketing team will support the future business growth.**

In order to ensure smooth running of sales and marketing operations while aligning the focus of these functions to achieve targeted growth objectives, the management has planned to deploy a dedicated sales force comprising the existing sales team of Sandoz Business Division (around 150 existing employees of Sandoz Business Division have been offered to join OBS AGP). Going forward, the management intends to consider undertaking their distribution through one of the renowned and largest pharmaceutical distributor which would significantly enhance product availability, market coverage and penetration.

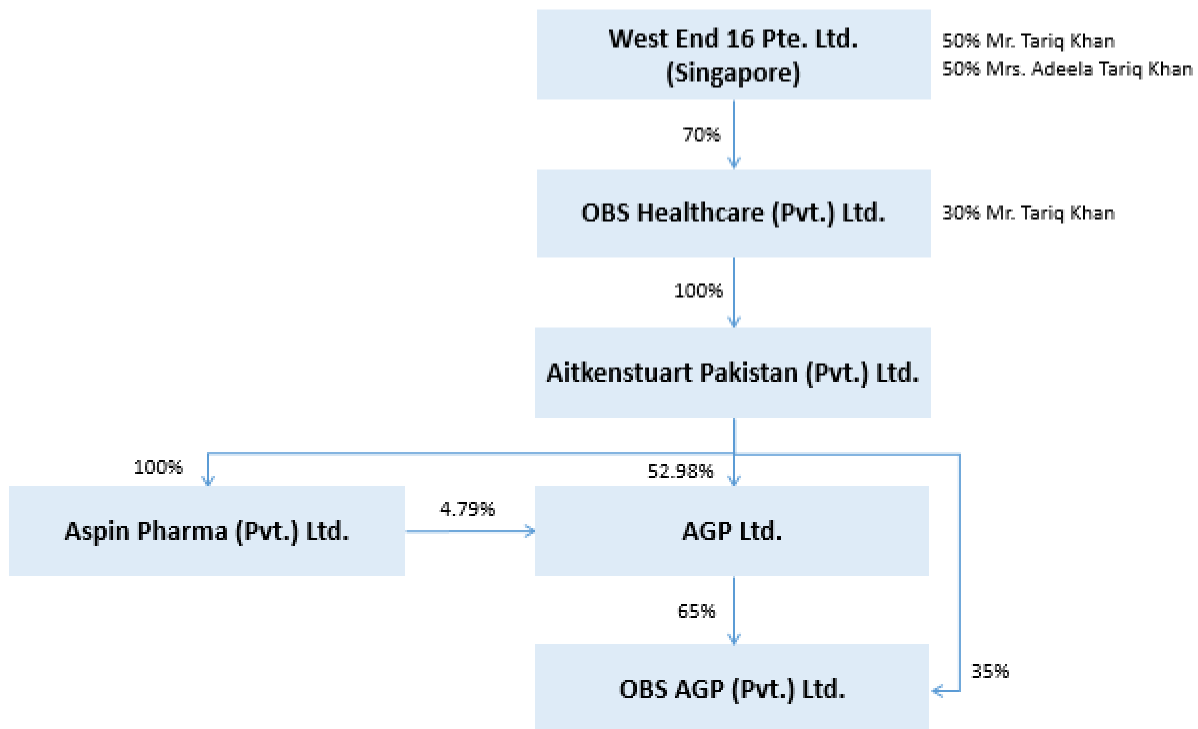
**Healthy organic growth in sales and strong gross margins are expected to support profitability profile over the rating horizon.**

Sales over the past five years (2016-20) have grown at a compound annual growth rate (CAGR) of 5.2%. Going forward, sales are projected to grow at a CAGR of 10% till 2026 which is a conservative estimate (considering the industry growth rate of 11.48% and AGP's 5-year CAGR of 13.13%). Growth in future sales is expected to emanate from increase in prices as per current pricing policy and volumetric growth (conservative projected unit growth has been assumed) which is planned to be achieved through increased market penetration as a result of focused marketing and sales efforts. Historically, gross margins have been ranged between 50%-55%. Management expects upside in gross margins through efficient procurement and negotiation with existing suppliers.

**Debt servicing cushion is expected to remain satisfactory over the rating horizon**

Given the higher gross margins, cash flows are higher than Sukuk repayments while comfort is drawn from cash cushion built over the rating horizon. Debt servicing coverage ratio (DSCR) is expected to remain over 1x throughout the tenor of the Sukuk. Leverage indicators will be elevated in initial years of operations; however the same are projected downwards post 2021 on account of internal cash generation and timely reduction in debt level. Ratings remain dependent on maintaining sound debt servicing cushion and reduction in leverage indicators in line with projections.

## GROUP STRUCTURE Annexure I



## RATING SCALE & DEFINITION Appendix I

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 | Appendix II | | | | |
|---|---|---|---|---|---|
| **Name of Rated Entity** | OBS AGP (Private) Limited | | | | |
| **Sector** | Pharmaceutical | | | | |
| **Type of Relationship** | Solicited | | | | |
| **Purpose of Rating** | Entity & Sukuk Rating | | | | |
| **Rating History** | **Rating Date** | **Medium to Long Term** | **Short Term** | **Rating Outlook** | **Rating Action** |
| | **Rating Type: Entity** | | | | |
| | **05-03-2021** | A | A-1 | Stable | Initial |
| | **Rating Type: Sukuk** | | | | |
| | **05-03-2021** | A+ | - | Stable | Initial |
| **Instrument Structure** | OBS AGP (SPV) intends to issue a Privately Placed and Secured Islamic Certificates Issue ("Sukuk" or the "Issue" or the "Transaction") of Rs. 2,600m. The funds will be used to finance the acquisition of a specific business division of leading multinational pharmaceutical company. The issue has a tenor of five years inclusive of one year grace period. The principal will be redeemed by the company in sixteen equal quarterly installments, starting from the thirteen month of the issue date. The issue offers quarterly profit payments with a base rate of 3-Month KIBOR plus a spread of 1.55% per annum. The Sukuk is secured by a pari-passu charge on fixed assets of AGP and pledge of shares of AGP held by APPL. | | | | |
| **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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