RATING REPORT

OBS Pakistan (Private) Limited

REPORT DATE:
September 25, 2023

RATING ANALYST:
Saeb Muhammad Jafri
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RATING DETAILS

	Current Rating		Previous Rating	
Rating Category	**Long-term**	**Short-Term**	**Long-term**	**Short-Term**
Entity Long-term	A	A-2	A	A-2
Rating Date	*September 25, 2023*		*September 23, 2022*	
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Initial	
Sukuk 1	A+	-	A+	-
Rating Date	*August 23, 2023*		*April 18, 2023*	
Rating Outlook	Stable		Stable	
Rating Action	Final		Preliminary	
Sukuk 2	A+	-		
Rating Date	*September 25, 2023*			
Rating Outlook	Stable			
Rating Action	Preliminary			

COMPANY INFORMATION

Incorporated in 2021	**Group Chairman:** Mr. Tariq Moinuddin Khan
Private Limited Company	**CEO:** Mr. Muhammad Kamran Mirza
Key Shareholder:	**External Auditors:** Grant Thornton Anjum Rehman
AGP Limited- 91.82% as of September 25, 2023	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Industrial Corporates (May 2023)
https://docs.vis.com.pk/docs/CorporateMethodology.pdf

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:
https://docs.vis.com.pk/docs/VISRatingScales.pdf

OBS Pakistan (Private) Limited

OVERVIEW OF THE INSTITUTION

OBS Pakistan (Private) Limited (OBS-Pak), was incorporated in December'2021. The Company is a subsidiary of AGP Limited. Ultimate parent company is West End 16 Pte Limited, Singapore.

The Company commenced operations in April 2023 following the acquisition of 17 pharmaceutical brands from Viatris Inc. and Pfizer Pakistan.

Profile of Board Chairman:

Mr. Tariq Moinuddin Khan is the founder and sponsor shareholder 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

Group Profile

Aitkenstuart is the holding arm of OBS Group, through which it owns five pharmaceutical companies namely, AGP Limited, Aspin Pharma (Pvt.) Limited, OBS AGP (Pvt.) Limited, OBS Pakistan (Pvt.) Limited and OBS Pharma (Pvt.) Limited. OBS Group is one of Pakistan's leading corporations in the healthcare segment with a strong presence in Pakistan and the region. At present, OBS ranks 8th amongst the pharmaceutical groups in Pakistan with a group turnover of ~Rs.19,000 mln in CY22. The Group currently operates five (5) manufacturing facilities, four of which are located in Karachi and one in Lahore. Out of the five manufacturing facilities, four are dedicated to pharmaceutical production, while one is dedicated to nutraceutical production. The shareholding structure of the group is as follows:

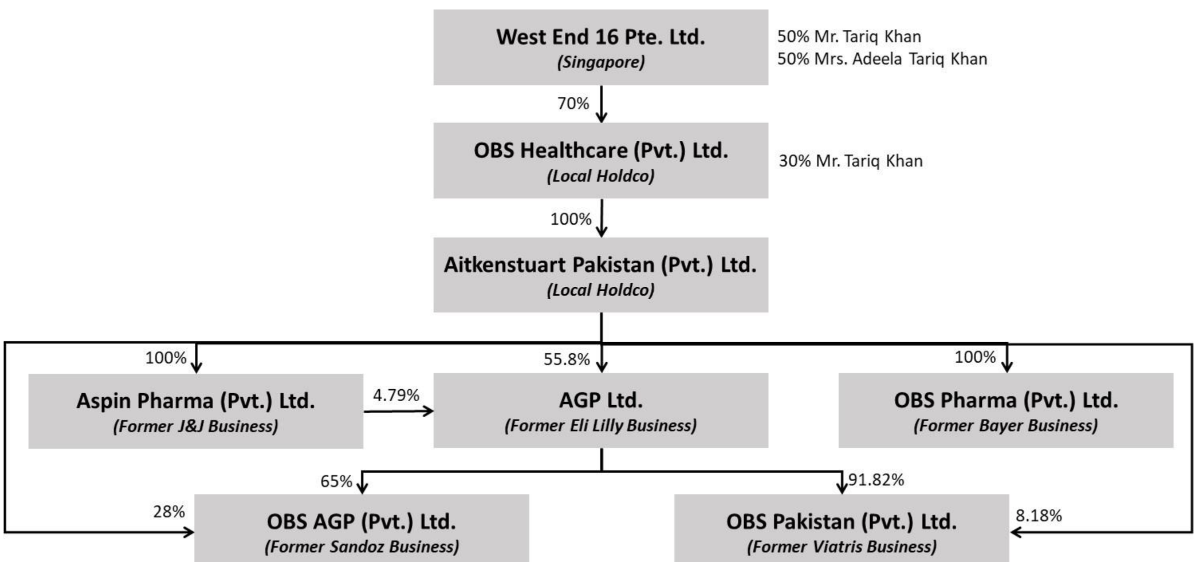

Figure 1 Group Structure

Industry Review

The pharmaceutical sector encompasses the development, manufacturing, and marketing of branded and generic pharmaceuticals. Additionally, companies provide contract development and manufacturing services to other firms, covering the entire drug development and manufacturing process.

In CY22, Pakistan's pharmaceutical industry achieved revenue of ~Rs.705 bln, marking a ~14.3% YoY growth from the previous year's ~Rs.616 bln. The sector's landscape is dominated by the top 100 local and multinational companies, collectively commanding ~97.2% of the market share, while over 500 other companies constitute the remaining ~3%.

The industry is notably shaped by regulatory dynamics, with the Drug Regulatory Authority of Pakistan (DRAP) governing drug pricing and product introduction. Moreover, the sector imports ~95% of its raw material including Active Pharmaceutical Ingredients (APIs), thereby exposing the sector to exchange rate variability. With regulatory pricing constraints, currency depreciation has the potential to trigger significant shifts in manufacturing costs, ultimately impacting the sector's overall financial performance.

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, Anafortan, Spasler-P etc. Major shareholding of the company (55.8%) is held by Aitkenstuart Pakistan (Private) Limited (APPL) which is a wholly owned subsidiary of OBS Healthcare (Private) Limited. OBS group, as explained in the illustration above, has strong presence in the pharmaceutical industry and currently operates in the country via five companies i.e., AGP Limited, Aspin Pharma (Private) Limited, OBS AGP (Private) Limited, OBS Pakistan (Private) Limited and OBS Pharma (Private) Limited. AGP Limited has 3 manufacturing facilities while Aspin Pharma (Private) Limited and OBS Pharma (Private) Limited have one each. Four of OBS Group's manufacturing facilities are located in Karachi while one is in Lahore.

Company Profile:

Revised Financing Cost Rs. 9.3b	**Sukuk of Rs. 3.6b**	**Sukuk of up to Rs. 3.3b**	**Equity investment of Rs. 2.4b**
Pattern of Shareholding of OBS Pakistan (Pvt.) Limited			
Existing		**Ultimate**	
Aitkenstuart Pakistan (Pvt.) Limited	8.2%	AGP Limited	Up to 92.5%
AGP Limited	91.8%	Other Shareholders	7.5%

OBS Pakistan (Private) Limited (OBS-Pak) was incorporated in December 2021 and entered into an asset purchase agreement in June 2022 with Viatris Inc. and Pfizer Inc. for a pharmaceutical product portfolio acquisition. The total cost, estimated at Rs. 9,300 million, is being financed primarily through debt (75%, Rs. 6.9 billion) and equity injection (25%, Rs. 2.4 billion). AGP currently owns 91.8% of OBS-Pak, set to increase to up to 92.5%. OBS-Pak commenced its operations in April 2023 and is undergoing a two-year transition period, during which Marketing Authorizations transfer will occur.

During the transition period, OBS-Pak will procure all locally manufactured/imported products from Pfizer Pakistan Limited. Upon the transfer of Marketing Authorizations, it has been planned to commence local manufacturing of majority products at AGP's manufacturing facilities for which sufficient capacity is available and AGP will incur minimum capex to commence the operations.

The debt portion is to be arranged through the issue of two Sukuks. First Sukuk of Rs. 3.6 bln has already been issued while the Company is in the process of issuing the second Sukuk of up to Rs. 3.3 bln.

Product Portfolio Acquired:

The Acquired Brands encompass a diverse array of therapeutic classes, including anti-depressants and anti-hypertensive medications. With this acquisition, OBS-Pak has taken possession of 17 brands, with 11 currently in active promotion (notably, one is presently marketed by AGP), while the remaining are not presently under active marketing initiatives.

Approximately 23.4% of revenue is attributed to imported products; nevertheless, management has outlined strategies for the initiation of domestic manufacturing for these products within the manufacturing facilities of the OBS Group. This transition is expected to occur following the transfer of marketing authorizations.

The following are the10 active brands slated for marketing by OBS-Pak (amounts in Rs. mln unless stated otherwise):

Table 1 Active Brands

S. No.	Brand	Indication	Molecule Rank	Imported /Local	Net Sales CY22	Weight CY22 (%)	Market Share (%)
1	Norvasc	Blood Pressure & Coronary disease	1	Local	1,304	57.3%	44.0%
2	Zoloft	Anti-Depressant	2	Local	289	12.7%	22.0%
3	Xalatan	Ocular Hypertension	1	Imported	115	5.1%	51.0%
4	Cardura	Anti-Hypertensive	1	Local	148	6.5%	98.0%
5	Lyrica	Anti-Epileptics	7	Imported	144	6.3%	3.0%
6	Detrusitol	Urinary Incontinence	1	Imported	125	5.5%	63.0%
7	Efexor	Anti-Depressant	2	Imported	50	2.2%	22.0%
8	Lipitor	Cholesterol	7	Imported	40	1.8%	1.0%
9	Xalacom	Ocular Hypertension		Imported	59	2.6%	51.3%
10	Zeldox	Antipsychotics		Imported	-	0.0%	0.0%
	Total	**Rs. Millions**			**2,275**		

Apart from these 10 brands, the company has also acquired Clozaril which is already being marketed by AGP.

Sukuk 1:

The transaction amount of the first issue is of Rs. 3.6 bln. The tenor of the facility is 7 years with a grace period of 18 months from disbursement. Specific terms include:

- Profit rate applicable on the Sukuk is of 3M KIBOR plus 1.60% (previously 1.75%) spread.
- Principal payment is to be redeemed over 22 quarters (previously 18 quarters).
- Profit payment is also to be made quarterly in arrears with the first profit payment being due 3 months from the disbursement date.
- Security Structure:
  - Exclusive hypothecation charge on future fixed assets of OBS-Pak.
  - Pledge of AGP's shares by Aitkenstuart Pakistan (Pvt.) Limited, the major shareholder, of AGP inclusive of 40% security margin.
  - Corporate Guarantee from AGP for the Outstanding Issue Amount plus Profit.
  - Collection Account to be maintained under lien in which all revenue of OBS-Pak will flow.

- Financing Payment Account (FPA) to be filled in with upcoming installment amount (Principal + Profit) 2 working days prior to installment due date. The FPA shall be reset to zero after settlement of each installment and shall be replenished in the same manner subsequently.

Sukuk 2-Proposed:

The transaction amount of the issue is up to Rs. 3.3 bln. The tenor of the facility is 7 years with a grace period of 18 months from disbursement. Specific terms include:

- Profit rate applicable on the Sukuk shall be the 3M KIBOR plus 1.60% spread.
- Principal payment to be redeemed over 22 quarters. The first such instalment shall fall due at the end of twenty-one months from the disbursement date.
- Profit payment will also be made quarterly in arrears with the first profit payment being due 3 months from the disbursement date.
- Security Structure:
  - Mortgage/Hypothecation Charge on the fixed assets of AGP with 20% margin.
  - Corporate Guarantee of AGP for the Outstanding Issue Amount plus Profit.
  - Collection account to be maintained with Security Agent or any other commercial bank under lien of the Security Agent wherein all revenue receipts/cash flows of the Company are to be routed. This account shall be a checking and remunerative account.
- Financing Payment Account (FPA) to be filled in with upcoming installment amount (Principal + Profit) 2 (two) working days prior to installment due date. This account shall be held under lien of Security Agent. The FPA shall be reset to zero after settlement of each installment and shall be replenished in the same manner subsequently.

<u>Key Rating Drivers</u>

Low business risk due to non-cyclical industry dynamics; however, exchange rate risks and regulatory constraints persist.

Being a non-cyclical industry, the pharmaceutical sector enjoys consistent demand driven by population growth, prevalent diseases, emerging health issues, and suboptimal hygiene standards in the country. As such, the sector's business risk is regarded as 'low' by VIS.

The pharmaceutical industry in Pakistan faces regular profitability pressures due to a stringent regulatory framework that includes reliance on the DRAP for approval of new products and pricing increases.

Moreover, industry's substantial reliance on imported raw materials translates to a significant portion of product costs tied to foreign currency. This exposes the Company to exchange rate vulnerabilities.

Strong sponsor strength along with financial support.

Assigned ratings are underpinned by the strong market presence and extensive industry experience of the Parent Company, AGP Limited, in the pharmaceutical sector. AGP's longstanding track record positions it to provide substantial operational, managerial, and financial backing to OBS Pakistan. In CY22, AGP reported a consolidated annual turnover of Rs. 14.5 bln (CY21: Rs. 9.3 bln), reflecting consistent sales growth and a strong liquidity profile. These ratings also reflect AGP's healthy cash flow generation ability and its low-leverage capital structure, both on a consolidated and stand-alone basis. As of the end of CY22, AGP's consolidated equity base amounted to Rs. 11.1 bln (CY21: Rs. 10.2 bln).

Nevertheless, it's important to consider the ratings in light of the prevailing economic challenges impacting the group's profitability. Furthermore, significant fresh portfolio acquisitions by the group through its various Special Purpose Corporations (SPCs) have placed pressure on its consolidated capitalization metrics. In 6MCY23, AGP Limited's consolidated capitalization indicators were impacted due to acquisition financing, with leverage increasing to 1.4x (CY22: 0.5x) and gearing increasing to 0.6x in 6MCY23 (CY22: 0.3x). This is on account of buildup of payables to Viatris by OBS Pakistan due to the acquisition, amounting to approximately Rs. 5 bln as well as fresh borrowings for equity injection into OBS Pakistan. Management anticipates leverage ratios to improve going forward as debt repayments are made and cash flow benefits of the acquisitions materialize in the group's financials. Ratings will remain sensitive to the group’s ongoing performance and its ability to navigate these challenges effectively.

Concentration risk persists; portfolio brand value and diversity provide comfort.

The Company's portfolio exhibits a noticeable concentration, with the principal contributions in CY22 attributed to the top three products: Norvasc, Zoloft, and Xalatan, constituting 57.3% (CY21: 59.7%), 12.7% (CY21: 9.8%), and 7.6% (CY21: 4.8%) of total revenue, respectively. Nevertheless, there is a level of reassurance stemming from the diverse therapeutic areas covered and the substantial market share commanded by each product. Notably, Norvasc holds a commanding 44.0% market share, while Zoloft and Xalatan maintain steady market positions with 22.0% and 51.0% shares, respectively.

Supply constraints impacted topline growth; margins also remain under pressure.

Under the acquisition terms, supply is committed by Viatris/Pfizer for the 2-year transition period. As a result of the global demerger of Viatris and Pfizer, there were certain unexpected supply disruptions, as a result of which sales remained impacted during the year prior to the acquisition. As per management, the issues have been resolved and are not expected to impact future growth. In addition, while overall gross margins remain comfortable at 67.8% as of 6MCY23, they do depict a decline compared to initial projections primarily due to unprecedented fluctuations in foreign exchange rates during the period. As a result, cash flows have been impacted with debt servicing under pressure. Nonetheless, Management foresees a recovery in gross margins, driven by price adjustments, enhanced volumes, and a normalization of the supply chain in collaboration with Viatris and Pfizer. Additionally, OBS-Pak's management is actively planning regular introduction of new products, aimed at bolstering revenue.

The risk associated with price variability has been mitigated through pre-negotiated product costs during the 2-year transition phase. However, exchange rate fluctuations remain a key risk.

Early-stage challenges; acquisition financing impacting debt and liquidity profile

OBS-Pak's capitalization, liquidity, and debt servicing metrics have shown varying trends, reflecting the early stage of its operations. The gearing and leverage ratios are expected to be impacted by the substantial debt incurred for the acquisition of portfolios from Viatris and Pfizer, consequently affecting the debt servicing coverage ratio (DSCR) at year-end CY23. In 6MCY23A, the current ratio was notably low due to the company's recent initiation of operations, with limited sales and cash generation, while materials were accumulated with outstanding payables.

Looking ahead, as OBS-Pak's operations mature and cash flows from the portfolio materialize, gradual improvements in the equity base and a reduction in debt levels are anticipated over the rating horizon. These developments are expected to contribute to the recovery of capitalization factors.

However, as result of high quantum of current portion of debt, the current ratio is expected to be limited throughout the rating horizon, serving as a key constraint. Nevertheless, ratings take significant comfort from the Company's strong sponsor support from AGP limited.

Rating of OBS-Pak will remain sensitive to these evolving dynamics, especially the effective management of liquidity, reduction of leverage, and the strengthening of debt servicing capacity. Balancing growth aspirations with financial stability will be pivotal in determining OBS-Pak's rating trajectory.

REGULATORY DISCLOSURES — Appendix I

Name of Rated Entity	OBS Pakistan (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: Sukuk				
25-09-2023	A	A-2	Stable	Reaffirmed
23-09-2022	A	A-2	Stable	Initial
Rating Type: Sukuk 1				
23-08-2023	A+	-	Stable	Final
18-04-2023	A+	-	Stable	Preliminary
23-09-2022	A+	-	Stable	Preliminary
Rating Type: Sukuk 2				
25-09-2023	A+	-	Stable	Preliminary

Instrument Structure(s)

Sukuk 1:
The first Sukuk issuance amounted to Rs. 3.6 billion with a 7-year tenor and an 18-month grace period from disbursement. It carries a profit rate of 3M KIBOR plus 1.60% spread, with principal payments scheduled over 22 quarters. Profit payments are also made quarterly, with the first payment due 3 months from disbursement. The security structure includes a hypothecation charge on future fixed assets of OBS-Pak, share pledges by the major shareholder of AGP, a corporate guarantee from AGP, and a collection account for OBS-Pak's revenue flow. The Financing Payment Account (FPA) is replenished two working days before each installment due date.

Sukuk 2:
The second Sukuk, with a 7-year tenor and 18-month grace period, aims to raise up to Rs. 3.3 billion. It will carry a profit rate of 3M KIBOR plus a 1.60% spread, with principal payments spread over 22 quarters. Profit payments will also be made quarterly, with the first payment due 3 months from disbursement. Security will include a mortgage/hypothecation charge on AGP's fixed assets, a corporate guarantee from AGP, and a collection account for revenue receipts. Similar to the first Sukuk, the FPA will be replenished two working days before each installment due date.

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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified

	nature of audited accounts and diversified creditor profile.

Due Diligence Meetings Conducted

S.No.	Name	Designation	Date
1.	Kamran Mirza	CEO	August 24, 2023
2.	Shahzaib Tariq	CFO	August 24, 2023
3.	Bosco Firmin	Dep. General Manager Investments & New Ventures (OBS Group)	August 24, 2023