

RATING REPORT

OBS Pharma (Private) Limited

REPORT DATE:

September 23, 2024

RATING ANALYST:

 Muhammad Meeran Siddique
meeran.siddiqui@vis.com.pk
RATING DETAILS

| Rating Category | Current Rating | | Previous Rating | |
|-----------------------------|--------------------|------------|-----------------|------------|
| | Long-term | Short-term | Long-term | Short-term |
| Entity | A | A-1 | A | A-1 |
| Rating Date | September 23, 2024 | | June 16, 2023 | |
| Outlook/Rating Watch | Stable | | Stable | |
| Rating Action | Reaffirmed | | Initial | |
| Bank Loan Rating | A+(blr) | - | A+(blr) | - |
| Rating Date | September 23, 2024 | | March 28, 2024 | |
| Outlook/Rating Watch | Stable | | Stable | |
| Rating Action | Reaffirmed | | Final | |
| STS-2 | - | A-1(plim) | - | - |
| Rating Date | September 23, 2024 | | - | |
| Rating Outlook | - | | - | |
| Rating Action | Preliminary | | - | |

COMPANY INFORMATION
Incorporated in 2022
Board Chairman: Mr. Tariq Moinuddin Khan

Private Limited Company
CEO: Mr. Shahzad Khan

Key Shareholders:
Aitken Stuart Pakistan (Pvt.) Limited – 79.98%
OBS Employees – 20.02%
APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Industrial Corporates
<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 Pharma (Private) Limited

| OVERVIEW OF THE INSTITUTION | RATING RATIONALE |
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| <p><i>OBS Pharma (Pvt.) Limited” was incorporated on November 18, 2022, as a Special Purpose Company (“SPC”) to acquire pharmaceutical brands and a manufacturing facility from Bayer. The Company is a majorly owned subsidiary of Aitkenstuart Pakistan (Pvt.) Limited. Ultimate parent company is West End 16 Pte Limited, Singapore.</i></p> <p>Profile of Board Chairman <i>Mr. Tariq Moinuddin Khan is the 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.</i></p> | <p>Company Profile</p> <p>OBS Pharma (Pvt.) Limited (the “Company”) is a Special Purpose Company (SPC) established to acquire specific pharmaceutical brands and a manufacturing facility from Bayer AG and its affiliates. The Company is majorly owned by Aitkenstuart Pakistan (Pvt.) Limited, which holds 79.98% of its shares. The Company’s primary activities include the import, marketing, export, dealership, distribution, wholesale, and manufacturing of various pharmaceutical and healthcare products. The ultimate parent entity of the group is West End 16 Pte Limited, based in Singapore.</p> <p>On November 21, 2022, the Company finalized an agreement with Bayer AG and its affiliates to acquire the aforementioned assets. The portfolio included 12 brands, mostly focused on women’s health, including Ciproxin, Gravibinan, Travocort, Primolut N, and several others. Additionally, the agreement included the transfer of manufacturing rights for two brands, Femi-Ject and Nova-Ject, produced by Bayer Pakistan for Greenstar Social Marketing.</p> <p>The manufacturing facility acquired is located at Plot 108, Quaid-e-Azam Industrial Estate, Lahore, and covers 3 acres. Total cost of the acquisition was Rs. 7,000.0 mn, which was funded through a combination of debt (75.0%) and equity (25.0%).</p> <p>Mr. Shahzad Khan has been appointed as the new CEO of OBS Pharma (Pvt.) Limited. With 26 years of experience in the pharmaceutical industry, he most recently held the position of Managing Director and CEO of CCL Pharmaceuticals.</p> <p>Auditors’ Report</p> <p>The CY23 financial statements were audited by Grant Thornton, categorized as 'Category A' on the SBP's Panel of Auditors. The auditor issued an unmodified and unqualified opinion on the financial statements.</p> <p>Industry Update</p> <p>The Pakistani pharmaceutical market comprises around 650 companies, with less than 26.0% being multinational. The industry contributes approximately 1.0% to the country's GDP and grew by 15.0% over the past year, reaching an estimated \$3.0 bn. Local companies dominate the market with a 74.0% share, while multinationals hold the remaining 26.0%. The top 25 companies account for 74.0% of the market, and the top 50 make up 90.0%. Approximately 11,000 drugs are actively marketed in Pakistan, and sold through licensed pharmacies based on prescriptions. The Drug Regulatory Authority of Pakistan (DRAP) regulates the sector, overseeing medicine registration, manufacturing site approvals, and the setting of Maximum Retail Prices (MRP).</p> <p>The industry heavily relies on imports, with over 90.0% of raw materials sourced from abroad and only 12.0% of Active Pharmaceutical Ingredients (API) produced locally. This reliance exposes the sector to risks from currency devaluation, inflation, and rising utility costs. Price controls further</p> |

compress profit margins, leading to the exit of some multinational companies. However, recently in February 2024, the government deregulated drug prices for medicines not listed on the National Essential Medicines List (NEML). Previously, price increases were capped based on the Consumer Price Index (CPI). Now, non-essential medicines can be priced without regulatory caps, potentially benefiting companies with a significant proportion of non-essential drugs.

According to data from IQVIA, a healthcare analytics firm, Pakistan's pharmaceutical industry recorded sales of Rs. 916.0 bn in FY24, reflecting a 24.0% year-on-year (YoY) increase in rupee terms. The fourth quarter of FY24 saw the highest-ever quarterly sales of Rs. 237.0 bn, representing a 25% increase compared to the same period last year (SPLY). Of this growth, approximately 20.0% was driven by price increases, while the remaining 5% resulted from volumetric gains. The price increase was influenced by the one-time price adjustment allowed by DRAP in May 2023 to absorb the significant rupee devaluation.

Sponsor Profile

Aitkenstuart functions as the holding company for OBS Group, which controls five pharmaceutical entities: AGP Limited, Aspin Pharma (Pvt.) Limited, OBS AGP (Pvt.) Limited, OBS Pakistan (Pvt.) Limited, and OBS Pharma (Pvt.) Limited. OBS Group operates within Pakistan's healthcare industry and has established a significant presence both locally and across the region. The Group currently holds the 8th position among all pharmaceutical groups in Pakistan, generating a group turnover that exceeds Rs. 32.0 bn.

The Group's operations are supported by five manufacturing facilities, four located in Karachi and one in Lahore. Of these facilities, four are focused on the production of pharmaceuticals, while one is dedicated exclusively to the production of nutraceuticals.

Key Rating Drivers

Ratings incorporate low business risk of the pharmaceutical sector

Ratings account for stable demand and low economic sensitivity of the pharmaceutical industry, which ensures steady revenue and profitability. Factors such as population growth, a high incidence of diseases, the emergence of new illnesses, and inadequate hygiene practices are expected to sustain the demand for pharmaceutical products in the country.

However, the pharmaceutical industry in Pakistan faces profitability pressures due to a stringent regulatory framework, including the reliance on the Drug Regulatory Authority of Pakistan (DRAP) for the approval of new products and pricing increases. The Company also encounters challenges in accessing raw materials, with 70.0-80.0% of ingredients sourced from overseas. This results in a significant portion of product costs being denominated in foreign currency, exposing the Company to exchange rate risks.

The recent deregulation of drug prices for Non-Essential Medicines provides companies with the autonomy to independently raise prices, which further supports the business risk profile of the sector.

Ratings draw comfort from market positioning of product line

OBS Pharma's portfolio primarily comprises women's healthcare and dermatology products. Some of the well-known brands in the portfolio include Ciproxin, Gravibinan, Travocort, and Primolut N, among others. Of the 12 products acquired, 10 are market leaders in their respective molecular categories. Additionally, new products are in the pipeline and will be gradually introduced to complement the existing product line, with a primary focus on the women's health segment.

Revenue growth facilitated by price increase

Since the acquisition in July 2023, CY23 financials reflect six months of sales. The products acquired by OBS Pharma in July 2023 generated five-month cumulative revenue of Rs. 2,912.2 mn, compared to Rs. 2,700.0 mn during the same period in CY22. Additionally, these products reported HYCY24 revenue of Rs. 3,443.0 mn. Sales remained largely concentrated in the local market, with exports accounting for only 5.0% of total sales.

In CY23, the Company achieved a higher-than-projected gross margin, mainly due to a one-time discount on the purchase of finished goods inventory from Bayer Pakistan. Additionally, as the Company's production plant was not operational during CY23, costs remained lower, resulting in a gross margin increase to 61.6%.

However, in HYCY24, despite a 14% and 20% price increase for essential and non-essential medicines, respectively, margins were constrained due to limited production capacity utilization, as stocks had been purchased upfront from Bayer Pakistan. Furthermore, two products—Ciproxin and Resochin—continue to be produced by Novartis Pharma Pakistan Limited, affecting cost efficiencies. Going forward, the Company plans to internalize the manufacturing of these products, which is expected to support margins.

Alternate sourcing arrangements to contribute towards margin improvement

Following the acquisition of major brands from Bayer Pakistan, OBS Pharma (Pvt.) Limited began negotiating with various suppliers for the procurement of Active Pharmaceutical Ingredients (API) and other raw materials, resulting in cost efficiencies. These efforts are expected to improve margins starting in CY25, positioning the Company for sustainable growth over the coming years.

Enhanced Market Coverage

To enhance sales growth, the Company has built a sales team comprising both OBS management and newly hired personnel. Initially, the acquired brands were marketed by approximately 160 employees at Bayer Pakistan; this number has since increased to 350 following the acquisition. OBS Pharma (Pvt.) Limited plans to deploy sales teams in smaller towns, leveraging its presence across more than 60 towns and cities. This strategy aims to broaden market coverage and capture a larger market share, with projected net revenue in excess of Rs. 8,000.0 mn by the end of CY24. However, higher projected marketing expenses are expected to constrain the bottom-line profitability in the medium-term.

Liquidity profile supported by positive working capital cycle and sound coverages

The Company maintained an adequate liquidity profile, with a current ratio of 1.04x by end-CY 23, and 0.94x as of HYCY24. The mismatch is due to funding of acquisition costs partly through short-term sources as well as a one-time upfront purchase of 9-month finished goods and ~9-month raw materials inventories from Bayer Pakistan as part of the acquisition. Resultantly, OBS Pharma (Pvt.) Limited recorded a buildup of inventories and corresponding payables/short-term borrowing, thereby impacting the liquidity metrics. Nevertheless, liquidity profile draws comfort from a positive working capital cycle of the Company. Going forward, the management expects the liquidity metrics to streamline overtime as inventories run down.

The cashflow coverage metrics also remain comfortable with FFO/Long-term debt and Debt-Service-Coverage-Ratio (DSCR) standing at 0.38x and 2.74x respectively by end-CY23. However, as of HYCY24, the Company reported a lower FFO due to reduced profitability. Consequently, FFO/Long-term debt and DSCR ratios reduced to 0.18x and 1.38x respectively.

Albeit higher, capitalization indicators are expected to streamline over the rating horizon

In Feb'24, the Company issued a short-term Sukuk of Rs. 1,500 mn to fund upfront inventory as part of the business acquisition from Bayer AG and its associates. Subsequently, as of Jun'24, the Company's total debt rose to Rs. 6,655.3 mn (Dec'23: Rs. 5,017.0 mn). In contrast, total equity decreased to Rs. 2,007.0 mn (Dec'23: Rs. 2,218.7 mn), due to a dividend payout of Rs. 350.0 mn. As such, at the end of HYCY24, the gearing ratio increased to 3.32x (CY23: 2.26x), while the leverage ratio was higher at 3.96x (CY23: 3.62x).

Going forward, with increase in the projected profitability, both gearing and leverage ratios are expected to improve overtime. The successful execution/achievement of the projected plan and retention of profitability will remain important for the Company's ratings.

OBS Pharma (Private) Limited
Appendix I

| Financial Summary | | |
|--------------------------------------------------|------------------|-----------------|
| Balance Sheet (PKR Millions) | 6MCY23A | 6MCY24A |
| Property, plant and equipment | 3,986.21 | 3,997.09 |
| Stock-in-trade | 1,792.07 | 1,313.07 |
| Trade debts | 303.04 | 541.33 |
| Cash & Bank Balances | 23.08 | 184.46 |
| Other Assets | 4,135.66 | 3,911.04 |
| Total Assets | 10,240.06 | 9,946.98 |
| Creditors | 2,598.75 | 710.87 |
| Long-term Debt (incl. current portion) | 5,016.99 | 5,155.31 |
| Short-Term Borrowings | 0.00 | 1,500.00 |
| Total Debt | 5,016.99 | 6,655.31 |
| Other Liabilities | 405.61 | 573.76 |
| Total Liabilities | 8,021.35 | 7,939.95 |
| Paid up Capital | 0.13 | 0.13 |
| Equity (excl. Revaluation Surplus) | 2,218.72 | 2,007.04 |
| Income Statement (PKR Millions) | | |
| Net Sales | 2,912.17 | 3,442.98 |
| Gross Profit | 1,793.38 | 1,449.83 |
| Operating Profit | 1,182.62 | 962.02 |
| Finance Costs | 412.30 | 741.37 |
| Profit Before Tax | 770.32 | 220.65 |
| Profit After Tax | 557.96 | 138.32 |
| Ratio Analysis | | |
| Gross Margin (%) | 61.58% | 42.11% |
| Operating Margin (%) | 40.61% | 27.94% |
| Net Margin (%) | 19.16% | 4.02% |
| Funds from Operation (FFO) (PKR Millions) | 949.73 | 459.49 |
| FFO to Total Debt* (%) | 37.86% | 13.81% |
| FFO to Long Term Debt* (%) | 37.86% | 17.83% |
| Gearing (x) | 2.26 | 3.32 |
| Leverage (x) | 3.62 | 3.96 |
| Debt Servicing Coverage Ratio* (x) | 2.74 | 1.38 |
| Current Ratio (x) | 1.04 | 0.94 |
| (Stock in trade + trade debts) / STD (x) | 605.52 | 1.06 |
| Return on Average Assets* (%) | 10.90% | 2.74% |
| Return on Average Equity* (%) | 50.30% | 13.09% |

*Annualized, if required

A - Actual Accounts

P - Projected Accounts

M - Management Accounts

| REGULATORY DISCLOSURES | | | | | Appendix II |
|----------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------|--------------------|-----------------------|----------------------|
| Name of Rated Entity | OBS Pharma (Private) Limited | | | | |
| Sector | Pharmaceutical | | | | |
| Type of Relationship | Solicited | | | | |
| Purpose of Rating | Bank Loan Rating | | | | |
| Rating History | Rating Date | Medium to Long Term | Short Term | Rating Outlook | Rating Action |
| | Rating Type: Entity | | | | |
| | 23-Sep-2024 | A | A-1 | Stable | Reaffirmed |
| | 16-June-2023 | A | A-1 | Stable | Initial |
| | Rating Type: BLR | | | | |
| | 23-Sep-2024 | A+(blr) | | Stable | Reaffirmed |
| | 28-Mar-2024 | A+(blr) | | Stable | Final |
| | 03-July-2023 | A+(blr) | | Stable | Preliminary |
| | Rating Type: Sukuk 2 | | | | |
| | 23-Sep-2024 | | A-1(plim) | | Preliminary |
| Instrument Structure | <ol style="list-style-type: none"> OBS Pharma (Pvt) Ltd has secured a Rs. 5.125b through an Islamic Syndicated Finance facility for the acquisition of 12 pharmaceutical brands from Bayer AG. The tenor of the facility is 7 years with a grace period of 18 months. The facility entails quarterly profit payments with a base rate of 3-Month KIBOR plus a spread of 1.70% per annum. The Facility is secured against. A First Pari Passu charge by way of hypothecation over the hypothecated assets of OBS Pharma, in favour of the Musharaka Agent in the amount of Rs. 3,706,491,849/- A First Pari Passu charge by way of hypothecation over the hypothecated assets of Aspin Pharma (Pvt.) Limited, an associated concern of the OBS Group, in favour of the Musharaka Agent in the amount of Rs. 3,625,000,000. A mortgage by way of a constructive deposit of title deeds over the Mortgaged property of Aspin Pharma (Pvt) Ltd in favour of the Musharaka Agent in the sum of Rs. 3,625,000,000. A Corporate Guarantee provided by Aitkenstuart Pakistan (Pvt.) Ltd., the parent company of OBS Pharma, covering the outstanding amount of the Musharaka facility. A Lien in favour of Musharaka Agent on the Collection and Finance Payment Account. For each payment period, the Company to maintain the respective payment amount in the account at least 2 days prior to the payment 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. | | | | |
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| Due Diligence Meeting conducted | S.No | Name | Designation | Date | |
| | 1. | Mr. Shahzad Khan | C.E.O. | July 29, 2024 | |

| | | | |
|----|--------------|-------------------------------------------------------------------------|---------------|
| 2. | Bosco Firmin | Dep. General Manager Investments & New Ventures (OBS Group) | July 29, 2024 |
| 3. | Muhammad Ali | Senior Manager - Treasury | July 29, 2024 |