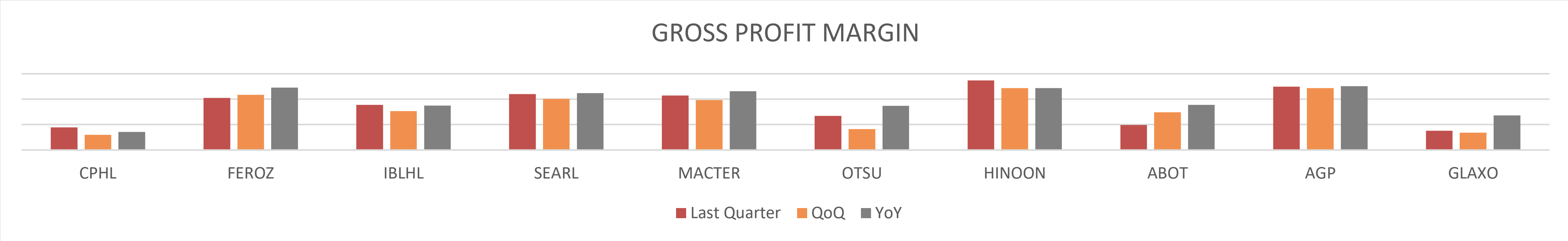
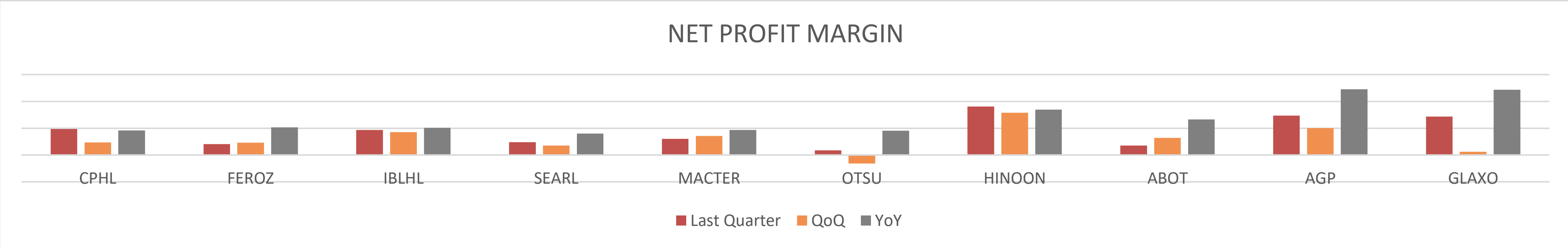
Pharmaceuticals to Gain Momentum Amid Assurance of Increase in Prices

Thursday, 16 March, 2023

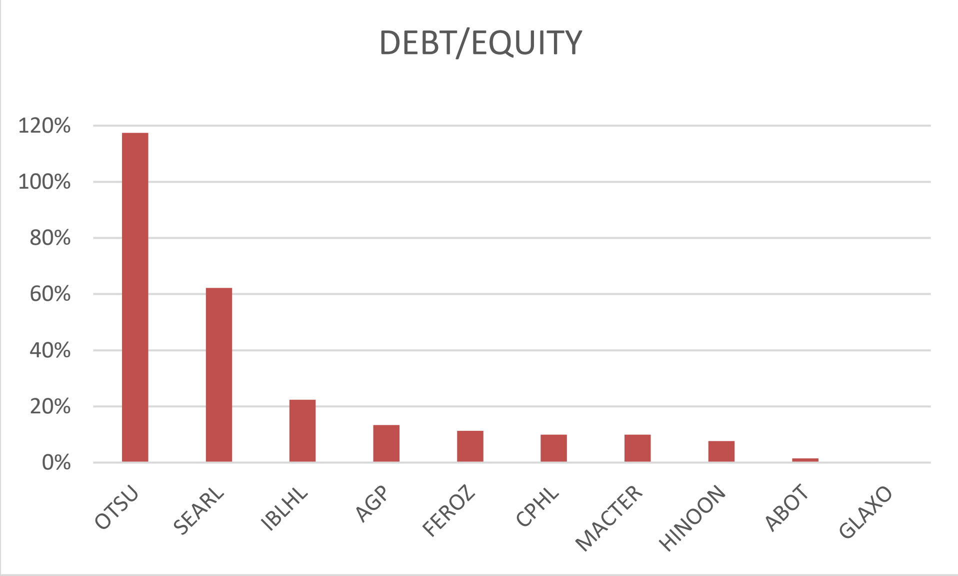


Despite inflationary pressures, the pharmaceutical industry's margins began to recover during the 2nd quarter from their lower base in the first quarter of FY23. However, in contrast to the same period last year, the margins were still modest. The rapid decline in net earnings was primarily caused by a sharp increase in the cost of raw materials, which was exacerbated by the depreciation of PKR as well as higher distribution and finance costs. The companies' failure to pass on the expense to the end consumer, the lack of price adjustment by DRAP, and the government's imposition of the super tax also impacted the margins negatively.



Pakistan’s pharma industry is heavily reliant on imports, with about 95 percent of pharmaceuticals requiring raw materials from other countries, especially China. Though the government expressed the commitment to resolving the issues of LCs, the country’s inability to import essential medications or Active Pharmaceutical Ingredients (API) used in domestic production has been hampered by a lack of foreign exchange reserves and the companies are facing extreme difficulty in ensuring availability of drugs in the market. The current state of economic instability, which includes the depreciation of the PKR, an increase in interest rates, along a rise in the cost of raw materials, is expected to present continuous challenges for the pharmaceutical business. Companies with large debt, such as SEARL and OTSU, are susceptible to a decline in profitability brought on by higher finance expenses, which could have a detrimental effect on their overall performance.

However, the meeting between the joint delegation of the PPMA and Pharma Bureau with DRAP officials on March 14 has given the industry some hope as the government officials gave the representatives of pharma companies an assurance that they would increase the drug prices while keeping in view the raising manufacturing costs. Going forward, the finance and health ministers' commitment to take steps to ensure an uninterrupted supply of medicines, as well as raise drug prices, has made the fundamentals of the pharmaceutical industry much more attractive. Investment in firms with solid fundamentals is thus necessary in order to profit from the anticipated upward trend. The following are a handful of them:



- **AGP Limited (AGP):** Currently, the company is trading at the P/E (TTM) ratio of 11.37x. The gross profitability of the company has consistently hovered near 50% and in the most recent quarter, the net margins improved. While the gross margins increased from 48.6% to 49.8% QoQ in 4QFY23 (50.2% YoY), the net margins climbed from 10.1% to 14.3% (24.3% YoY). Moreover, in 3QCY22, the debt-to-equity ratio stood near 13%.
- **Highnoon Laboratories Limited (HINOON):** The company is currently trading at the P/E (TTM) ratio of 8.13x. The profitability of the company has been consistent over the period and it posted the highest gross and net margins among its competitors during the last quarter. The company's gross margins increased from 48.7% to 54.7% QoQ in 2QFY23 (48.7% YoY), while net margins increased from 15.8% to 18.1% (17% YoY). The company has one of the lowest debt-to-equity ratio.
- **GlaxoSmithKline Pakistan Limited (GLAXO):** GLAXO is the only company in the sector with the debt/equity ratio under 1%. It is currently trading at P/E (TTM) ratio of 10.69x. The margins of the company increased from the previous quarter; it posted a gross margin of 15.1% compared to 13.6% QoQ and the net margins improved significantly to 14.3% compared to 1.2% in 4QCY22.
- **IBL HealthCare Limited (IBLHL):** The scrip is currently trading at P/E (TTM) ratio of 7.88x. The company has consistently been profitable and during the last quarter, it reported gross margins of 35.4% compared to 30.6% QoQ (34.9% YoY) and net margins of 9.4% compared to 8.5% QoQ (10.2% YoY).

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TP	Target Price	DDM	Dividend Discount Model	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DCF	Discounted Cash Flows
PE	Price to Earnings Ratio	PB	Price to Book Ratio	BVPS	Book Value Per Share
EPS	Earnings Per Share	DPS	Dividend Per Share	ROE	Return of Equity
ROA	Return on Assets	SOTP	Sum of the Parts	JPB	Justified Price to Book

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III. Relative Valuation Model
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HOLD	Between -5% to 15%
SELL	Less than and equal to -5%

Sector Rating	Sector Outlook
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Market Weight	Neutral
Underweight	Negative

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