Pharmachem Private Limited: Rating reaffirmed

March 18, 2024

Summary of rating action

Instrument*(Amount in NPR million)	Last rated amount	Current rated amount	Rating Action
Fund-based; short-term loans	360.0	460.0	[ICRANP] A2; reaffirmed
Non-fund based; short-term loans	300.0	300.0	
Total	**660.0**	**760.0**	

**Instrument details are provided in* *Annexure-1*

Rating action

ICRA Nepal has reaffirmed short-term rating of [ICRANP] A2 (pronounced ICRA NP A two) assigned to the short-term loan limits of Pharmachem Private Limited (Pharmachem or the company).

Rationale

The rating reaffirmation factors in Pharmachem's long track record of operation since 1988, its experienced promoters, and its established relationship with various foreign/domestic manufacturers/suppliers developed over the years. The assigned rating also derives comfort from Pharmachem's strong revenue profile with CAGR of ~17% over last four years ending FY2023, its stable profit margins and retention of profits. This has resulted in strong capitalisation profile with gearing of less than 1 time over the years translating into healthy interest coverage indicators amid low debt utilisations. This along with comfortable liquidity position with adequate headroom in drawing power also remains positive. ICRA Nepal also positively notes the company's super distributorship arrangements with reputed Indian pharmaceutical companies, wide range of product portfolio, diversified customer profile and positive demand outlook for pharmaceutical business in the country.

The rating, however, remains constrained by recent uptick in Pharmachem's working capital cycle amid ongoing overall demand/economy slowdown which coupled with unsecured debtor could lead to receivable risk. Gradual buildup in working capital cycle could also necessitate additional debt financing. Rating concerns also arises from intense competition in the highly fragmented Nepalese pharmaceutical market characterized by presence of large manufacturers and traders, and low barriers to entry. Moreover, supply chain risk, supplier risk and regulatory risk also remain among the key rating concerns.

Going forward, the company's ability to manage liquidity while maintaining/improving its scale of operation, margins and debt coverage indicators will remain key rating monitorable.

Key rating drivers

Credit strengths

Established track record of operation and experienced promoters – Established in 1988 as a part of Kabra Group, Pharmachem has over three decades of track record in trading of pharmaceuticals in the country. This has resulted in established relationship with various manufacturers, mostly in India, and large-scale stockists and wholesalers across the country. Being a super distributor of various products of established Indian pharma manufacturers, the company has been able to achieve healthy growth over the years supported by wide range of products ranging from over-the-counter to chronic medicines.

Strong revenue profile with stable profit margins – Pharmachem has registered healthy growth over the years with a 4-year CAGR ending FY2023 at ~17% and is among the top pharmaceutical traders in the country. Wide range of products, established supply chain and diversified customer profile (top 10 customers contributed less than 25% of sales in FY2022 and FY2023) has helped the company achieve sustained growth over the years. Although the company operates at low operating margins of ~5-6% (margins generally set by the suppliers), the scale growth has supported the company's overall financial metrices.

Healthy capitalisation, adequate coverage indicators and liquidity – Pharmachem's financial profile remains strong characterised by low gearing level of below 1 time and TD/OPBDITA[1] of ~1-2 times over the last five years ending FY2023. Healthy retention of profits over the year and low debt utilization towards the year end also partly supports strong capitalisation ratio. Although the company's TOL/TNW remains relatively high at ~3 times in FY2023 amid high creditor float, long established relation with the creditors as super distributor remains a comfort. Similarly, Pharmachem's coverage indicators remained strong to service regular debt obligations with ICR[2] of ~5 times during FY2023 (above ~5 times between FY2019 to FY2022). Moreover, the company's liquidity profile also remains comfortable with adequate headroom in drawing power during the year ends, despite the low on-balance sheet liquidity.

Credit Challenges

Unsecured debtors and recent slowdown in economy – Although the customer profile remains sound and diversified with established dealers and stockists in pharma trading, majority of them remains unsecured which accentuates receivable risk, given the current scenario of slowdown in overall demand/economy and the liquidity stress among the borrowers. Any write-offs of such debtors or delays in recovery is likely to result in increased reliance on bank loan financing for working capital management which could impact the company's profitability and liquidity profile.

High competition – Nepalese pharmaceutical industry already comprises of large number of players[3], across manufacturing and trading sector. Low entry barriers for new players and fragmented market also aggravates competition in the pharmaceutical sector. Moreover, increasing contribution of local manufacturing industry in the total market size over the years also remains a challenge for import-based businesses over the longer term.

Supplier risk and regulatory risk – Pharmachem is entirely reliant on finished medicines imported from various manufacturers in India which exposes it to supply chain disruption risk. Any bottlenecks in the supply chain can impact the company's revenue profile. This risk is accentuated by high supplier concentration with top 10 suppliers accounting for ~95% of total purchase in the last three financial years ending FY2023. Moreover, Pharmachem's financial profile also remains vulnerable to the risk of discontinuation distributorship agreement with the suppliers. At present, imported medicines are subjected to no or low (up to 1%) import tariffs. Any increment in import duty/tariff could reduce the competitiveness/margins for imported products and could have an impact on the company's incremental revenue, profitability, and debt coverage indicators.

Analytical approach

For arriving at the ratings, ICRA Nepal has applied its rating methodology as indicated below.

Links to applicable criteria:

[Corporate Credit Rating Methodology]

Link to previous rating rationale:

[Rationale Pharmachem Private Limited Fresh Bank Loan Rating December 2022]

About the company

Incorporated in 1988 as a private limited company, Pharmachem is engaged in trading of pharmaceuticals. The company primarily deals in both generic and chronic medications. The company procures medicines largely from manufacturers/suppliers in India before selling it in the local market through its network of dealers/distributors.

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[1] *Total Debt/Operating Profit before Depreciation, Interest, Tax, Amortization*

[2] *Interest Coverage Ratio*

[3] *As per the Department of Drug Administration (DDA) of Nepal, there are 123 registered medicine importers and 128 domestic manufacturers in Nepal as on 29th September 2022.*

It is a family-owned business wherein Mr. Aatmaram Kabra holds 1% stake, Mr. Hari Narayan Kabra holds 50% and Mr. Rajendra Kumar Kabra holds 49% stake in the company.

Key financial indicators

	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)	FY2023 (Audited)
Operating income-OI (sales in NPR million)	2,261	2,778	3,201	3,639
OPBDITA/OI (%)	5.2%	5.1%	5.1%	5.7%
Total debt/Tangible net worth (TNW; times)	0.8	0.4	0.5	0.6
Total outside liabilities/TNW (times)	3.8	2.7	2.8	2.8
Total debt/OPBDITA (times)	2.0	1.0	1.4	1.5
Interest coverage (times)	5.2	8.3	9.2	5.0
DSCR (times)	4.2	6.6	7.2	4.1
NWC/OI (%)	19%	13%	16%	19%
Current ratio	1.2	1.2	1.2	1.3

Source: Company data

Annexure-1: Instrument Details

Instrument (Amount in NPR million)	Last Rated Amount	Current Rated Amount	Rating Action
Short Term Limits			
Fund based (Demand loan/ Overdraft/TR loans)	360.0	460.0	[ICRANP] A2; reaffirmed
Non-fund based (LC/ Bank guarantee)	300.0	300.0	
Grand Total	**660.0**	**760.0**	

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About ICRA Nepal Limited:

ICRA Nepal Limited, the first Credit Rating Agency of Nepal, is a subsidiary of ICRA Limited (ICRA) of India. It was licensed by the Securities Board of Nepal (SEBON) on October 3, 2012. ICRA Nepal is supported by ICRA Limited through a technical support services agreement, which envisages ICRA helping ICRA Nepal in areas such as rating process and methodologies, analytical software, research, training, technical and analytical skill augmentation.

Our parent company, ICRA Limited, was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency. Today, ICRA and its subsidiaries together form the ICRA Group of Companies.

For more information, visit www.icranepal.com

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