

# AGP

Small but sturdy, offering sizeable return of 52%

Equity Research | Pharmaceutical | Tuesday, 17 September, 2019

We initiate our coverage on AGP Limited (AGP) with a DCF based Jun-20 TP of Rs.85 which provides an upside potential of 49%. A dividend yield of 3%, if incorporated gives a total return of 52%

Despite challenging macroeconomic conditions, the company has managed to grow its revenues and earnings at a 4-year CAGR of 9% and 17% respectively

Going forward, we expect the company's revenues to grow at a 5-year CAGR of 18% amid increase in prices along with volumetric growth, and subsequently 5-yr projected earnings CAGR at a robust 22% respectively. We expect earnings in CY19 to clock-in at PKR 1,432mn i.e. EPS of PKR 5.11

## Industry Overview

The size of the pharmaceutical industry in Pakistan is currently approximately US\$3.1 billion, with an annual growth rate of approximately 15%. There are more than 700 pharmaceutical manufacturing units in Pakistan, exporting products worth over US\$200 million to more than 60 countries. The outlook for the industry remains positive, which is encouraging for the Company's future aspirations & growth.

The recent economic conditions have raised challenges in the industry as a whole. It is a fact hidden from none that the chemical industry of Pakistan has capacity constraints to develop the basic components required for the manufacturing of drugs. Therefore, the industry resorts to imports of raw materials. Due to this significant dependability, fluctuation in exchange rates coupled with stiff price regulations directly affects the product margins and consequent commercial feasibility. The Pakistani rupee has recently experienced double-digit depreciation of approximately 33%, which has put pharma industry under immense pressure.

Furthermore, due to the overly regulated drug pricing mechanism, volatility in retail prices is a concern of paramount importance for the pharmaceutical sector as a whole. Delays in new product approvals also pose key threats for the industry as a whole. However, with the change in the recent political scenario, we will have to wait to assess future economic trends and modify our strategy.

The industry was facing serious economic challenges in its strive to produce quality drugs at affordable prices for the patients in Pakistan. The cost of production of the local Pharma industry had increased manifold since 2018 due to an unprecedented decrease in value of rupee as compared to the dollar while keeping in view the fact that up to 90% raw material of the industry was imported. Electricity tariff increased by 45%, the natural gas bill increased by 65% while diesel price also increased by 95% as all these factors also directly affect the cost of production of pharmaceutical manufacturers.

Keeping in view the difficulties of the pharma manufacturers government ordered a on January 11, 2019 allowed a 15 percent price increase for all medicines. This price hike was a breath of fresh air for the industry as price controls on the pharmaceutical sector have been in place since as early as 2001 and has been a long-standing problem for the sector.

## Key Statistics

TP - Jun 20	85
LDPC	57
Upside (%)	49
Current Mkt. Cap ('mn)	16,036
KSE Symbol	AGP
Beta	1.27
52-Week High	92.21
52-Week Low	51.47
30-Day Moving Average	55.91
180-Day Moving Average	66.80
Avg Vol (90 Day)	75,678
Avg Vol (10 Day)	22,800
Shares Outstanding	31,468,134
Float	98,000,000
% Held by Insiders	65.00
% Held by Institutions/Individuals	35.00
<hr/>	
Symbol	P/E
GLAXO	9.64
SAPL	9.81
ABOT	16.08
GSKCH	23.52
Peer Average	14.76
AGP	12.61
Discount (%)	14.56

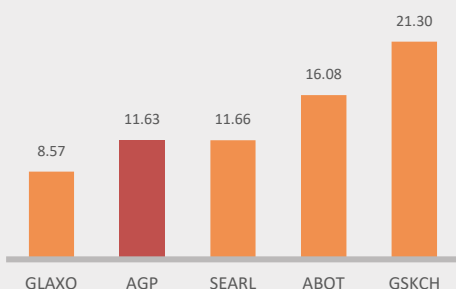
Source: ACPL Research, Company Financials



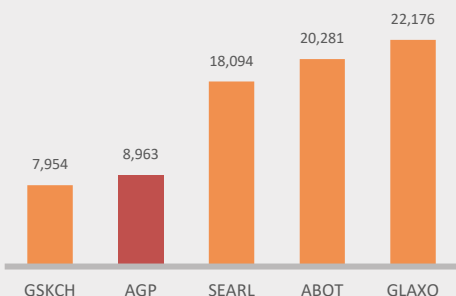
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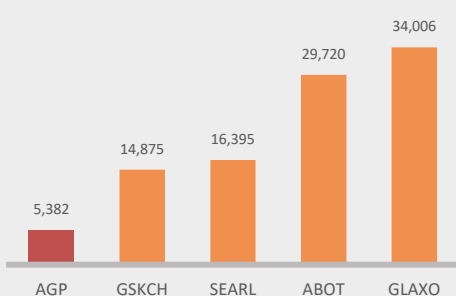
## Sector P/E (PKR)



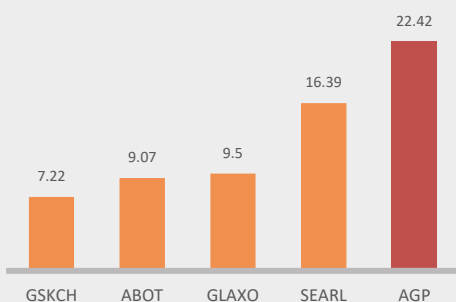
## Sector Assets (Rs'mn)



## Sector Sales (Rs 'mn)



## Sector Profit Margin (%)



Sources: ACPL Research, Company Financials

Companies have thus been unable to increase prices, in response to rising costs, due to factors such as rupee devaluation, rising inflation, etc. This has resulted in MNCs winding up operations in the country. On top of this price increase, it was also established previously that medicine prices would be linked to the Consumer Price Index (CPI). Non-essential medicines would be allowed an annual increase of 70 percent of the CPI, whereas all other medicine prices would be permitted 100 percent increase every year.

(BusinessRecorder)

## Sector Overview

Altogether 12 companies are listed on the Pakistan Stock Exchange in the Pharmaceutical Sector. But for the sake of this study, we'll only be discussing a few when comparing their financial performance with AGP.

The sector has a total Market capitalization of 32 billion rupees and weighs about 2.28% in the KSE-100 index. Only 5 companies including AGP fall under the ambit of KSE-100 index.

AGP when compared with the other five companies has the third lowest P/E ratio and the highest profit margin.

## Company Overview

AGP began its commercial operations in 1989. It has steadily grown through manufacturing and marketing products under licensing arrangements with many companies of international repute, as well as its own brands. The principal activities of the Company include import, marketing, export, dealership, distribution, wholesale and manufacturing of all kinds of pharmaceutical products.

AGP distributes its products through M&P, which is the largest pharmaceutical distribution network in Pakistan. M&P has more than 100 years of experience in this business with an annual turnover of more than Rs.100 Billion. M&P has over 60 branches across Pakistan with reach to over 32,000 pharmacies.

During the period the Honorable High Court of Sindh at Karachi vide its order dated May 7, 2019 has sanctioned the Scheme of Arrangement entered into between OBS Pakistan (Private) Limited, OBS Healthcare (Private) Limited, OBS Ophthalmics (Private) Limited and AitkenStuart Pakistan (Private) Limited. Further, effective 03 June 2019, OBS Pakistan (Private) Limited is no longer a related party.

Consequently, shares of AGP Limited (being a listed entity and subsidiary of OBS Pakistan (Private) Limited) held with OBS Pakistan (Private) Limited, have been amalgamated with and into AitkenStuart Pakistan (Private) Limited. Accordingly, the Company is now subsidiary of AitkenStuart Pakistan (Private) Limited (the Holding Company) which holds 50.53% of the share capital of the Company and the Ultimate Parent Company is West End 16 Pte Limited - Singapore.

(Company Financials, 2018)

## Financial Performance

Despite high import costs amid massive currency devaluation, political and geopolitical unrests, company's 6MCY19 Gross Margin grew by 3ppts YoY to 58% from 55%. Also, operating margin for 6MCY19 increased by 1ppt. However, net margins for the period remained the same as last year at 24%.

The company posted a Profit after Tax of PKR 743mn (EPS: PKR 2.65) in 6MCY19, up by 10% YoY. This surge came on the back of growth in value, change in product mix and production efficiencies. On a quarterly basis, earnings arrived at PKR 317mn (EPS: PKR 1.13) in 3QCY19, up by 11% YoY.

Total sales of the company during 6MCY19 increased by 10% YoY, clocking-in at PKR 3bn. This consists of local sales of PKR 3bn (down by 3% YoY) and export sales of PKR 140mn (up by 20% YoY). Company's exports stand at around 4% of total sales. However, sales from trading arrived at PKR 551mn (up by 108%). In 3QCY19, net sales swelled up by 19% YoY. The increase in sales growth was primarily driven by both value and volumetric growth. Other income during 6MCY19 witnessed a decline of 50% YoY.

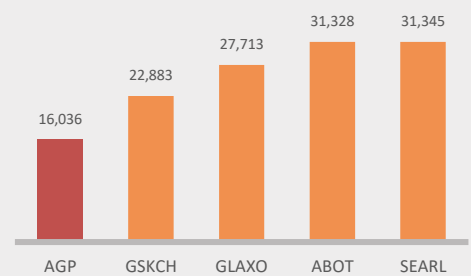
The unprecedented Policy Rate hike of upto 750 bps since Dec'17 has almost doubled the finance cost of the company in 6MCY19. However, as the company's debt to equity ratio is insignificant i.e. 1%, rising interest rate is of least concern for the company. Going forward, we expect the policy rate has been peaked out at 13.25% and we might see a rate cut of around 25-50 bps before the end of FY20.

Going forward we expect the company's revenue to grow by 18% YoY to PKR 6bn in CY19. Gross Margin to more or less stay at 58% in CY19, as we feel that 15% hike in the prices of local medicines along with Federal Budget 2019-20's new measure to reduce custom duty on 18 raw material items will help sustain margins and nullify the impact of rupee devaluation.

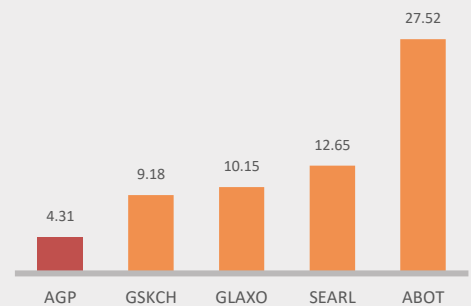
Furthermore, a rapidly growing population and the government's initiative to provide national health coverage and to increase the number of hospitals nationwide are also going to help boost sales. Earlier, sehat-insaf card scheme was launched by the KPK provincial government (now federal government) under which each person was entitled to get health insurance coverage of up to 300,000 rupees annually. It is expected that the same policy will be replicated nationwide. This facility when launched will not only enable poor families to get high-quality medical treatment and medicine in government and private hospitals but help boost sales of all the pharma companies' as well.

### Key Statistics

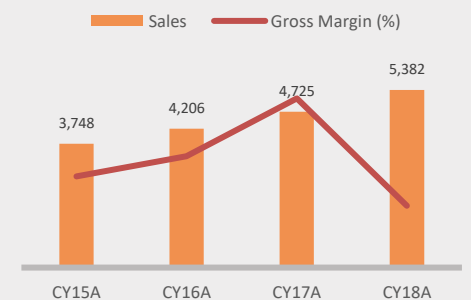
Sector Mkt Cap (Rs 'bn)



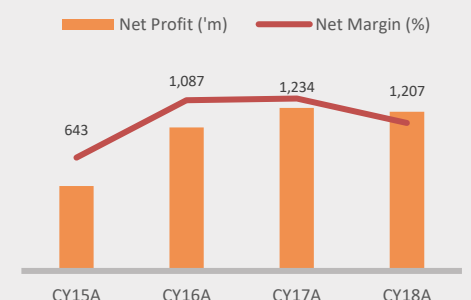
Sector EPS



Sales vs Gross Margins

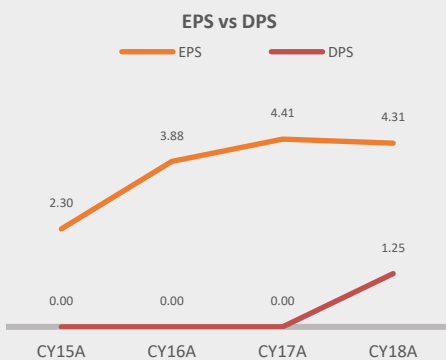
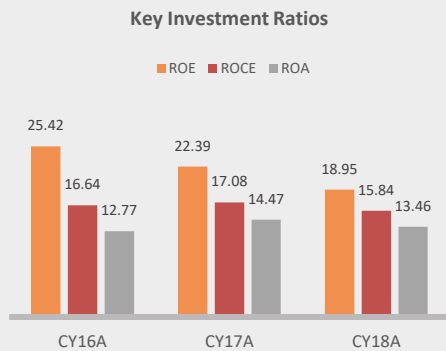
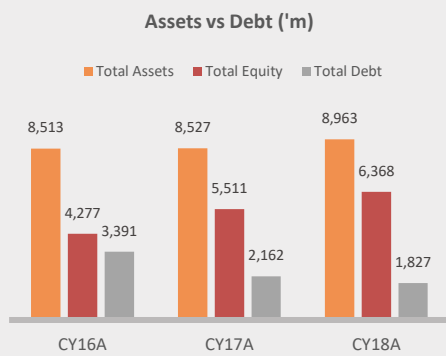
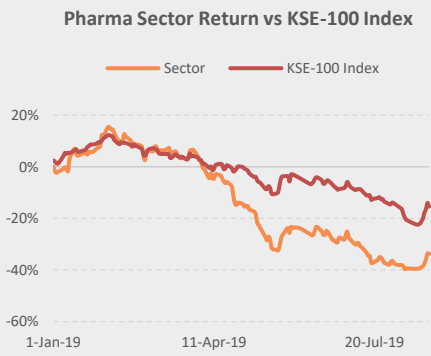


Net Profit vs Net Margins



Sources: ACPL Research, Company Financials

Key Statistics



Sources: ACPL Research, Company Financials

Future Outlook

Going forward, we strongly believe that this steadfast performance will continue. Sales will proliferate at a 5-year CAGR of 18%. Whereas earnings will grow at a 5-year CAGR of 22%. This can be backed by the fact that the government is fully committed in supporting local manufacturing industry be it pharma or any other industry. The recent price hike of 15 percent for all medicines is expected to boast well for the local pharma industry as a whole. Government initiative of Sehat Insaf cards will also play a pivotal role in broadening the scope of all local pharma manufacturers.

Valuation

AGP is currently trading at CY20E PE of 9.02x respectively. Furthermore, the script is trading at a CY20E P/B of 2.18x which offers a significant discount of 39% relative to its historical 4-year average of 3.55x. We have a BUY stance on the script with a DCF based Jun-20 TP of Rs.85 which provides an upside potential of 49% a dividend yield of 3% if incorporated makes the total return of 52%.

Key Risks to Valuation

- More than expected devaluation of PKR
- More than expected hike in the prices of raw material
- More than expected hike in energy, gas or fuel cost
- Less than expected growth in demand

## Key Ratios

Profitability Ratios		CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E	CY23E	CY24E	CY25E
GP Margin	%	57.68	58.49	60.83	56.50	57.50	57.50	57.50	57.50	57.50	57.50	57.50
NP Margin	%	17.17	25.85	26.11	22.42	22.55	23.73	24.62	25.29	25.54	25.57	25.59
OP Margin	%	33.85	35.35	33.67	29.89	31.80	31.80	31.80	31.80	31.80	31.80	31.80
ROE	%	20.17	25.42	22.39	18.95	19.43	20.64	21.48	22.02	22.17	22.13	22.09
ROCE	%	9.81	16.64	17.08	15.84	17.61	20.01	21.35	21.91	22.07	22.05	22.03
ROA	%	7.70	12.77	14.47	13.46	0.58	0.71	0.86	1.03	1.22	1.41	1.64
Liquidity Ratios		CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E	CY23E	CY24E	CY25E
Current	x	0.86	0.86	1.27	1.39	179.71	168.10	187.63	197.54	173.76	152.69	134.13
Acid-test	x	0.39	0.43	0.87	0.95	1.11	1.22	1.59	1.95	2.00	2.04	2.08
Cash to current Liab.	x	0.37	0.25	0.02	0.02	178.17	166.48	185.58	195.08	171.30	150.23	131.68
Activity Ratios		CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E	CY23E	CY24E	CY25E
Average Inventory		423,190	467,997	591,226	733,333	857,897	1,001,466	1,181,730	1,394,442	1,645,441	1,941,620	2,291,112
Inventory Turnover	x	4	4	3	3	3	3	3	3	3	3	3
Inventory Days		97	98	117	114	116	115	115	115	115	115	115
Receivables Days		27	32	38	35	35	35	35	35	35	35	35
Payables Days		98	137	158	103	103	103	103	103	103	103	103
Operating Cycle		26	-7	-3	46	49	47	47	47	47	47	47
Investment Ratios		CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E	CY23E	CY24E	CY25E
EPS	Rs.	2.30	3.88	4.41	4.31	5.11	6.35	7.78	9.43	11.23	13.27	15.67
DPS	Rs.	0.00	0.00	0.00	1.25	1.53	1.91	2.33	2.83	3.37	3.98	4.70
Div. Yield	%	0.00	0.00	0.00	2.18	2.68	3.33	4.07	4.94	5.88	6.95	8.21
Dividend Cover	x	n/a	n/a	n/a	3.45	3.33	3.33	3.33	3.33	3.33	3.33	3.33
BVPS	Rs.	11.39	15.28	19.68	22.74	26.32	30.77	36.21	42.81	50.67	59.96	70.92
Payout	%	0.00	0.00	0.00	29.00	30.00	30.00	30.00	30.00	30.00	30.00	30.00
Retention	%	100.00	100.00	100.00	71.00	70.00	70.00	70.00	70.00	70.00	70.00	70.00
No. of Shares	'000	280,000	280,000	280,000	280,000	280,000	280,000	280,000	280,000	280,000	280,000	280,000
P/E		24.92	14.75	13.00	13.29	11.20	9.02	7.36	6.08	5.10	4.32	3.66
Sales per share		13.39	15.02	16.87	19.22	22.68	26.76	31.58	37.27	43.97	51.89	61.23
P/BV		5.03	3.75	2.91	2.52	2.18	1.86	1.58	1.34	1.13	0.96	0.81
Price to Sales		6.38	5.68	5.06	4.44	3.76	3.19	2.70	2.29	1.94	1.64	1.39
Gearing Ratios		CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E	CY23E	CY24E	CY25E
Debt to Equity	%	18.15	9.84	3.53	1.21	1.02	0.86	0.73	0.00	0.00	0.00	0.00
Interest Cover	x	2.46	4.12	5.75	8.05	8.09	12.91	23.53	60.99	150.30	177.35	209.27

Source: ACPL Research, Company Financials

## Financial Projections

Rupees' millions	CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E	CY23E	CY24E	CY25E
Net sales	3,748	4,206	4,725	5,382	6,351	7,494	8,843	10,435	12,313	14,529	17,144
Cost of sale	1,586	1,746	1,851	2,341	2,699	3,185	3,758	4,435	5,233	6,175	7,286
<b>Gross profit</b>	<b>2,162</b>	<b>2,460</b>	<b>2,874</b>	<b>3,041</b>	<b>3,652</b>	<b>4,309</b>	<b>5,085</b>	<b>6,000</b>	<b>7,080</b>	<b>8,354</b>	<b>9,858</b>
Admin exp	126	109	134	127	152	180	212	250	296	349	411
Mkt and selling exp	698	763	1,050	1,153	1,283	1,514	1,786	2,108	2,487	2,935	3,463
Other exp	69	102	100	152	197	232	274	323	382	450	531
<b>Operating Profit</b>	<b>1,269</b>	<b>1,487</b>	<b>1,591</b>	<b>1,609</b>	<b>2,020</b>	<b>2,383</b>	<b>2,812</b>	<b>3,318</b>	<b>3,915</b>	<b>4,620</b>	<b>5,452</b>
Other income	20	42	20	17	9	10	12	15	17	20	24
Finance cost	515	361	277	200	250	185	120	54	26	26	26
Profit before taxation	773	1,168	1,333	1,426	1,779	2,209	2,705	3,278	3,907	4,615	5,450
Taxation	130	81	100	219	347	431	527	639	762	900	1,063
<b>Profit after taxation</b>	<b>643</b>	<b>1,087</b>	<b>1,234</b>	<b>1,207</b>	<b>1,432</b>	<b>1,778</b>	<b>2,177</b>	<b>2,639</b>	<b>3,145</b>	<b>3,715</b>	<b>4,387</b>
EPS	2.30	3.88	4.41	4.31	5.11	6.35	7.78	9.43	11.23	13.27	15.67

Source: ACPL Research, Company Financials

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## DEFINITION OF TERMS

<b>TP</b>	Target Price	<b>CAGR</b>	Compound Annual Growth Rate	<b>FCF</b>	Free Cash Flows
<b>FCFE</b>	Free Cash Flows to Equity	<b>FCFF</b>	Free Cash Flows to Firm	<b>DCF</b>	Discounted Cash Flows
<b>PE</b>	Price to Earnings Ratio	<b>PB</b>	Price to Book Ratio	<b>BVPS</b>	Book Value Per Share
<b>EPS</b>	Earnings Per Share	<b>DPS</b>	Dividend Per Share	<b>ROE</b>	Return of Equity
<b>ROA</b>	Return on Assets	<b>SOTP</b>	Sum of the Parts	<b>LDCP</b>	Last Day Closing Price

## VALUATION METHODOLOGY

To arrive at our Target Price, Abbasi & Company (Private) Limited uses different valuation methods which include:

- I. Discounted Cash Flow Model
- II. Dividend Discount Model
- III. Relative Valuation Model
- IV. Sum of Parts Valuation

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Stock Rating	Expected Total Return
BUY	Greater than 15%
HOLD	Between -5% to 15%
SELL	Less than and equal to -5%

Sector Rating	Sector Outlook
Overweight	Positive
Market Weight	Neutral
Underweight	Negative

Ratings are updated to account for any development impacting the economy/sector/company, changes in analysts' assumptions or a combination of these factors.

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