COMPANY UPDATE

HINOON

A fundamentally strong script offering mammoth return of 44%

Equity Research | Pharmaceutical |Monday, 29 August, 2019

We initiate our coverage on Highnoon Laboratories Limited (HINOON) with a DCF based Jun-20 TP of Rs.351 which provides an upside potential of 37%. A dividend yield of 7%, if incorporated gives a total return of 44%

Despite challenging macroeconomic conditions, the company has managed to grow its revenues and earnings at a 5-year CAGR of 19.36% and 27.82% respectively

Going forward, we expect the company's revenues and earnings to grow at a 5-year CAGR of 13% and 19.89% respectively. Drug price hike of 15 percent for all medicines (9 percent for life saving medicines), Government's Sehat Insaf Card Initiative, Products awaiting licensing approval and last but not least company's strong liquidity position. All these factors pose well for the company in the future

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.

Further, 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 (9 percent allowed for life saving 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.

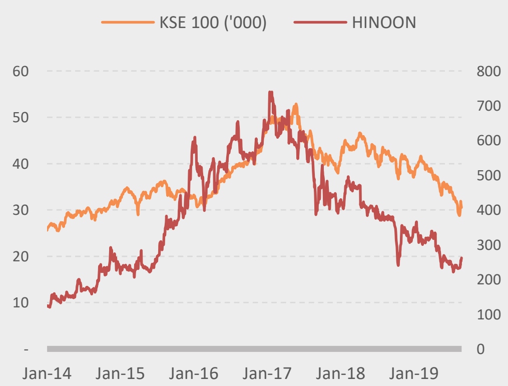
Key Statistics

TP - Jun 20	**351**
LDCP	257
Upside (%)	37
Current Mkt. Cap ('mn)	8,077
KSE Symbol	HINOON
Beta	0.90
52-Week High	387.76
52-Week Low	220.00
30-Day Moving Average	239.72
180-Day Moving Average	273.83
Avg Vol (90 Day)	331.44
Avg Vol (10 Day)	265.08
Shares Outstanding	31,468,134
Float	12,587,253
% Held by Insiders	60
% Held by Institutions/Individuals	40

Symbol	P/E
SEARL	9.89
GLAXO	9.97
AGP	12.25
IBLHL	12.48
ABOT	19.90
FEROZ	20.57
Peer Average	**14.18**
HINOON	8.27
Discount (%)	**41.69**

Source: ACPL Research, Company Financials

HINOON vs KSE 100 index



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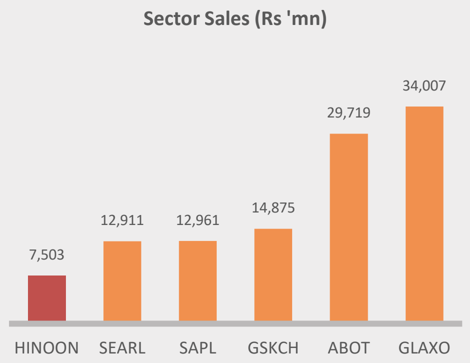
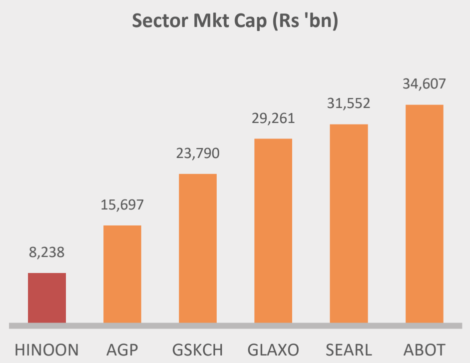
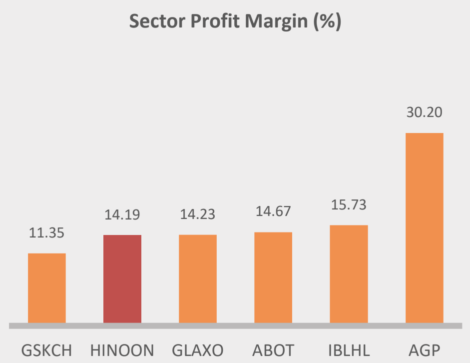
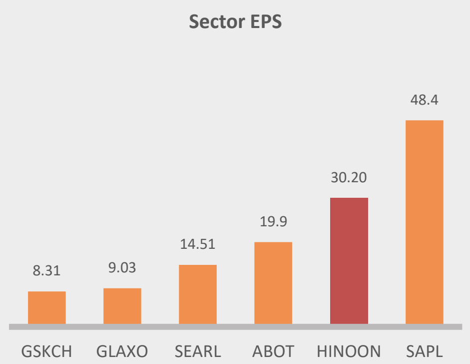








Sources: ACPL Research, Company Financials

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 HINOON.

The sector has a total Market capitalization of 158 billion rupees and weighs about 11% in the KSE-100 index. Only 5 companies come under the ambit of KSE-100 index and HINOON is not part of the 100 index.

HINOON has the lowest Market Capitalization and P/E amongst all its major local and multinational competitors. Also, it has the second-lowest profit margin in contrast with its competitors.

On the flip side, HINOON has the second-highest EPS of Rs.30.20 per share

Company Overview

Highnoon Laboratories Limited was incorporated in 1984 and has been allied with the best-known research houses of the global pharmaceutical industry. The company leads in terms of therapeutics and boasts a wide portfolio of cardiovascular, respiratory, alimentary tract and metabolism, and diabetes products. Among others, its star products include Kestine, Tres Orix Forte, Combivair, and Uslanic.

Revenue from respiratory, cardiology and alimentary tract segments constitutes about 80% of the company's portfolio. HINOON is among the top three companies in the respiratory segment and market leader in the cardiovascular portfolio. It has also made forays in the herbal medicines segment, which are marketed as an adjunct and complementary medicines. Unlike companies like GSK and Searle, it doesn't have a consumer health care segment.

Approvals and product registrations are currently pending in various countries for export. Currently, exports make a small but important portion of sales as they provide a hedging mechanism against raw materials and packaging imports. After successful approval, they are expected to boost sales.

(Company Financials, 2018)

Product Portfolio

Company's product portfolio contains products for all major therapeutic areas, with focus on Alimentary Tract & Metabolism, Anti-Infectives, Cardiovascular etc. Company's four brands Combivair, Kestine, Tagipmet, and Cyrocin are featured among the top 200 brands.

Sales revenue from the alimentary tract and metabolism segments grew to Rs. 2,264 million showing an increase of 20% over last year (IMS MAT 12/2018). The growth in this segment exceeded the industry growth by 5%. In this segment, company's core brands namely Tres Orix Forte, Ulsanic and Skilax maintained their market position, whereas Tagipmet, which is a relatively a new brand rose by 51% over last year by recording a turnover of Rs. 586 million.

Growth in the respiratory segment remained phenomenal. In a short span of few years, respiratory portfolio of the company is at the leadership position and their flagship brands Combivair and Tiovair are the most prescribed brands in this therapeutic category. Combivair crossed Rs.700 million to become the largest brand of the inhalation market. The respiratory business grew by 27% as compared to segment growth of 17% (IMS MAT 12/2018). Kestine, an anti-histamine is another successful brand registering a growth of 25% with the topline of Rs. 500 million

The cardiovascular portfolio grew by 21% (IMS MAT12/2018) as compared to the market growth of 13%. This growth is being driven by the newly launched products and variants. Misar, an angiotensin receptor blocker (ARB) for the management of hypertension grew by over 3 8%. Similarly, growth of Nebix, a cardioselective beta-blocking agent also remained in limelight and registered a growth of 30%. Triforge, a combination tablet of amlodipine, valsartan, and hydrochlorothiazide has been well received by the cardiologist and has netted a revenue of Rs.122 million. We are confident that Triforge will soon become the drug of choice prescribed by the medical practitioners. In the meanwhile, we are working on several new cardiology products that will augment and build a constant revenue base.

The herbal portfolio of the company is also progressing well. Bonnisan, herbal medicine for common GI disorders in infants and children crossed sales of Rs. 139 million. **(Company Financials, 2018)**

Financial Performance

Highnoon Laboratories Limited has consistently been producing excellent financial results for the last few six years now and CY18 performance is no different. Despite high import costs amid massive currency devaluation, political and geopolitical unrest, company's 6MCY19 gross margin only slightly reduced by 1.03 ppts to 46% from 47.35% SPLY. On the flip side, operating and net margins for 6MCY19 have both increased by 2.9 ppts and 1.5 ppts to 28.2% and 11.1% from 25.3% and 9.6% in SPLY.

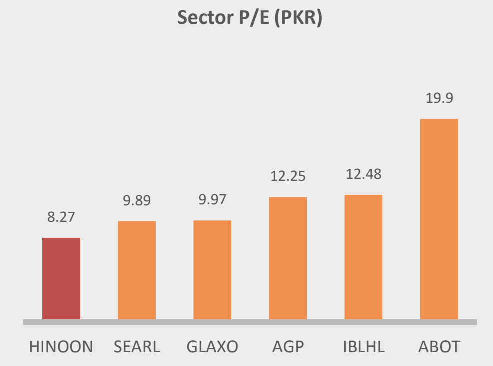
HINOON is the first company of Pakistani origin to have achieved international presence and is currently exporting products to Afghanistan, United Arab Emirates, France, Tanzania, and several other countries. Though the total share of exports in the company's sales mix is very minimal and stands at meager 5% of total sales in CY18A. However, due to escalating tensions between the border and intermittent closure of border and change of distribution setup in Afghanistan disrupted exports of the company. As exports in CY18A declined by 1% as compared to CY17A. However, it is expected that the exports of the company will grow in the future as the company is expanding its operations to CIS countries, Africa, and the Far East. Furthermore, the company is also widening its product base as several drugs are in the approval stage and when approved will add to the company's topline

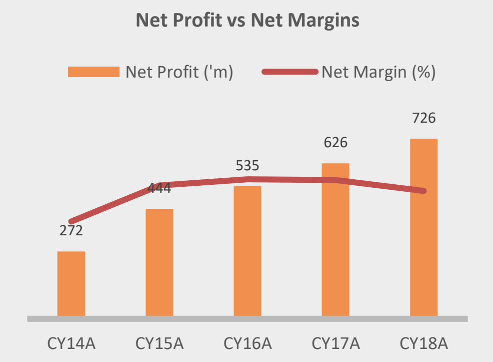
Furthermore, a rapidly growing population and the government's initiative to provide national health coverage and increase the number of hospitals nationwide are also going to help boost sales. Earlier, sehat-insaf card scheme was launched by the KPK provincial government (now federal government) under 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.

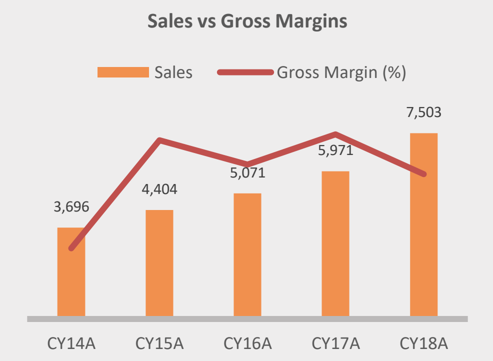
Despite unprecedented Monetary Policy Rate hike finance cost in 9MFY19 has only slightly increased. As the company has very minimal amount of debt on its balance sheet. Currently debt to equity ratio of the company stands at 2.84%. EPS in CY18A increased to 23.07 from 19.91(restated) in SPLY.

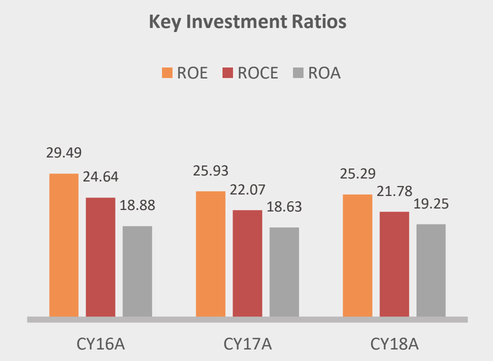
(Company Financials, 2018)

Key Statistics









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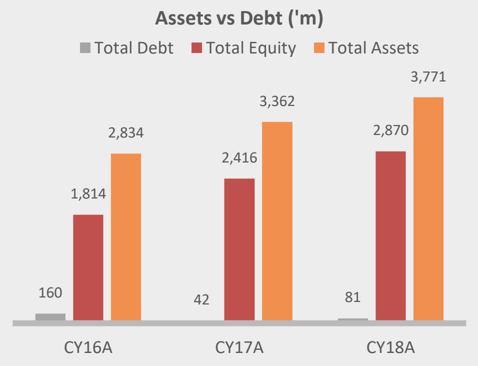

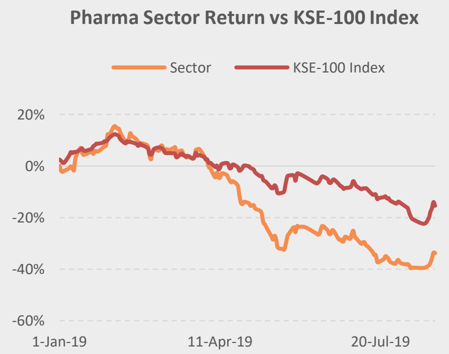

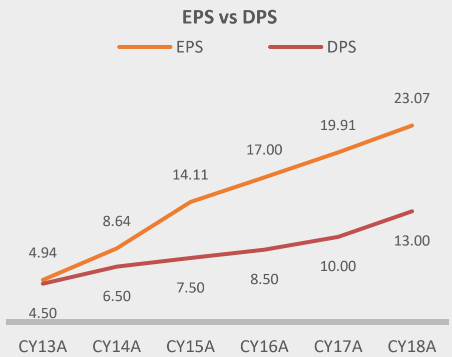

Sources: ACPL Research, Company Financials

Future Outlook

Going forward, we strongly believe that this steadfast performance will continue. Sales will proliferate at a 5-year CAGR of 13%. Whereas earnings will grow at a 5-year CAGR of 20%. 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 all medicines (9 percent for life saving 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

HINOON is currently trading at CY20E PE of 6.96x respectively. Furthermore, the script is trading at an CY20E P/B of 2.12x which offers a significant discount of 53% relative to its historical 5-year average of 5.21x. We have a BUY stance on the script with a DCF based Jun-20 TP of Rs.351 (1% liquidity premium has also been charged) which provides an upside potential of 37%. Furthermore, it also offers a dividend yield of 7% which makes the total return of 44%.

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		CY14A	CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E
GP Margin	%	44.78	47.51	46.90	47.66	46.65	45.74	46.54	46.83	46.72
NP Margin	%	7.36	10.08	10.55	10.49	9.67	11.52	12.12	12.33	12.26
OP Margin	%	11.28	14.66	15.31	14.87	13.75	15.54	16.34	16.63	16.52
ROE	%	29.78	36.23	29.49	25.93	25.29	29.44	30.40	30.40	29.77
ROCE	%	22.18	28.63	24.64	22.07	21.78	25.84	27.11	27.50	27.27
ROA	%	13.98	19.39	18.88	18.63	19.25	29.65	23.55	19.65	16.89

Liquidity Ratios		CY14A	CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E
Current	x	2.25	2.66	2.80	4.19	5.83	4.32	7.02	9.56	11.80
Acid-test	x	1.43	1.77	1.61	2.80	3.73	3.83	3.92	4.00	4.08
Cash to current Liab.	x	0.67	0.67	1.03	1.17	1.78	4.32	7.02	9.56	11.80

Activity Ratios		CY14A	CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E
Inventory Turnover	x	3	3	3	3	3	3	3	3	3
Inventory Days		107	118	126	123	113	115	117	117	116
Receivables Days		8	6	6	17	15	15	15	15	15
Payables Days		73	65	67	46	31	31	31	31	31
Operating Cycle		42	59	65	93	97	99	100	100	99

Investment Ratios		CY14A	CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E
EPS	Rs.	8.64	14.11	17.00	19.91	23.07	31.05	36.89	42.44	47.66
DPS	Rs.	6.50	7.50	8.50	10.00	13.00	17.70	21.02	24.19	27.16
Div. Yield	%	2.53	2.92	3.31	3.90	5.06	6.89	8.19	9.42	10.58
Dividend Cover	x	1.33	1.88	2.00	1.99	1.77	1.75	1.75	1.75	1.75
BVPS	Rs.	29.02	38.95	57.66	76.77	91.22	105.48	121.35	139.60	160.09
Payout	%	75.22	53.15	50.00	50.23	56.36	56.99	56.99	56.99	56.99
Retention	%	24.78	46.85	50.00	49.77	43.64	43.01	43.01	43.01	43.01
No. of Shares	'000	31,468	31,468	31,468	31,468	31,468	31,468	31,468	31,468	31,468
P/E		29.71	18.19	15.10	12.89	11.13	8.27	6.96	6.05	5.39
Sales per share		117.46	139.95	161.14	189.75	238.43	269.43	304.46	344.04	388.76
P/BV		8.85	6.59	4.45	3.34	2.81	2.43	2.12	1.84	1.60
Price to Sales		2.99	2.51	2.18	1.85	1.47	1.30	1.15	1.02	0.90

Gearing Ratios		CY14A	CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E
Debt to Equity	%	6.98	2.97	8.83	1.74	2.84	2.45	2.13	1.85	1.62
Interest Cover	x	33.69	73.75	127.91	179.03	122.99	166.11	197.42	227.08	254.86

Source: ACPL Research, Company Financials

Financial Projections

Rupees' millions	CY14A	CY15A	CY16A	CY17A	CY18A	CY19E	CY20E	CY21E	CY22E	CY23E
Net sales	3,696	4,404	5,071	5,971	7,503	8,479	9,581	10,826	12,234	13,824
Cost of sale	2,041	2,312	2,693	3,125	4,003	4,601	5,122	5,756	6,518	7,370
Gross profit	**1,655**	**2,092**	**2,378**	**2,846**	**3,500**	**3,878**	**4,459**	**5,070**	**5,716**	**6,454**
Selling and distribution	969	1,126	1,279	1,600	2,027	2,120	2,395	2,707	3,058	3,456
Administration expenses	220	245	245	270	350	314	354	401	453	511
R & D	4	3	4	4	4	4	5	5	6	7
Other operating expenses	46	73	74	84	89	123	139	157	177	200
Operating Profit	**417**	**646**	**777**	**888**	**1,032**	**1,317**	**1,565**	**1,801**	**2,021**	**2,280**
Other operating income	10	30	19	29	33	38	43	49	55	63
Finance cost	12	9	6	5	8	8	8	8	8	8
Profit before taxation	414	667	790	912	1,056	1,348	1,601	1,842	2,068	2,334
Taxation	143	223	255	286	330	370	440	506	569	642
Profit after taxation	**272**	**444**	**535**	**626**	**726**	**977**	**1,161**	**1,335**	**1,500**	**1,692**
EPS	**8.64**	**14.11**	**17.00**	**19.91**	**23.07**	**31.05**	**36.89**	**42.44**	**47.66**	**53.78**

Source: ACPL Research, Company Financials

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TP	Target Price	CAGR	Compound Annual Growth Rate	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	LDCP	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

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