

Pakistan Pharmaceuticals Sector

CITI PHARMA LIMITED (CPL)

API and Formulation expansion to lead earnings — subscribe IPO up to PKR 39.2/sh.

Citi Pharma Limited (CPL) is planning to raise PKR 2.04Bn to expand its production capacity of Active Pharmaceutical Ingredient (API) products, formulation business and build a health care facility in Lahore. The equity component is to be raised through an Initial Public Offering (IPO) at a floor price of PKR 28.0/sh with the book building process scheduled to commence from 15th June, 2021. To achieve this, the company plans to issue 72.7Mn new ordinary shares (35% of post-IPO paid up capital) to the general public, of which 54.5Mn shares will be offered through the book building process and 18.2Mn to retail investors. CPL owns the largest pharmaceutical plant in Pakistan and produces 9 API's that it sells to local and international clients. The company's concrete fundamentals promise impressive growth potential going forward. Our liking for the company is premised on: 1) Impressive 3 year sales CAGR of 30% (FY17-20); 2) Strong hedge against imported API's due to high custom duties; and 3) diversified Revenue stream including high margin areas (API, formation and healthcare business). Comparing it with pharmaceutical industry multiples, we recommend subscribing Citi Pharma Ltd up to PKR 39.2/sh, offering an upside of 34% from its Jun'22 target price of PKR 52.7/sh. The management has a very bullish stance given the expansion discussed above and expects earnings to clock-in at PKR 1.83, PKR 3.19, PKR 5.08 per share for FY 21, 22 and 23, respectively.

Investment thesis: We think the target P/E multiple of 21.5x is justified given the upcoming increase in production capacity of its best selling API (i.e Paracetamol 3,600 to 6,000 tons, utilization stood at 86% in 1HFY21), expanding foot print in the formulation segment (GM of 38% in FY20) and penetration into the health care facility segment, which should provide synergies and forward integration. The management also plans to provide brand and contract manufacturing to other companies at its enhanced facility to further diversify its revenue streams.

Valuation: Compared to industry average, the scrip is trading at an attractive P/E, P/B and P/S multiples of 15.3x, 0.9x, and 1.4x respectively, we recommend subscribing CPL up to PKR 39.2/sh.

Key risk: Risk to our investment thesis include; 1) delay in project timeline; 2) adverse drug regulations/policy; and 3) reduction in imported API duty structure.

Table 5: Jun 21 Comparative Valuations

Company	P/E	P/B	P/S	ROE	3yr Sales CAGR
11-Jun-21	x	x	x	%	%
CPL*	15.3	0.9	1.4	17%	30%
AGP	17.2	3.6	3.0	21%	14%
ABOT	14.3	2.0	3.8	32%	11%
FEROZ	11.2	1.6	1.8	17%	8%
GLAXO	12.3	1.3	2.6	20%	2%
GSKCH	17.1	1.5	4.4	40%	34%
HINOON	14.5	1.9	4.1	34%	21%
IBLHL	19.5	5.9	4.3	10%	31%
MACTER	53.7	1.1	4.8	9%	15%
OTSU	13.1	1.5	12.4	129%	7%
SAPL	16.6	0.6	1.9	12%	4%
SEARL	20.6	2.5	2.8	16%	15%
Weighted Avg	16.5	2.1	3.4		

*At floor price and post-IPO shares in issue

Source: BMA Research, Citi Pharma Limited Investor Presentation

Table 1: IPO Details

IPO strike price - floor (PKR/sh.)	28.0
IPO strike price - ceiling (PKR/sh.)	39.20
Stock issuance (Mn)	72.7
Pre - IPO Shares (Mn)	135.0
Post - IPO shares (Mn)	207.7
M.Cap at floor (PKR Mn)	5,815
M.Cap at floor (USD Mn)	37.3
M.Cap at ceiling (PKR Mn)	8,142
M.Cap at ceiling (USD Mn)	52.2

Source: Citi Pharma Limited Prospectus

Table 2: Shareholding pattern

%	Pre IPO	Post IPO
New issue	-	35%
Nadeem Amjad	40%	26%
Rizwan Ahmad	30%	20%
Muhammad Naeem	10%	7%
Naveed Amjad	10%	7%
Ateeq Ur Rehman	10%	7%
Total	100%	100%

Source: Citi Pharma Limited Prospectus,

Table 3: Funding sources

	PKR (Mn)
IPO proceeds	2,035.4
LTFF	503.4
Total Source	2,538.8

Source: Citi Pharma Limited Prospectus

Table 4: Expenditure Heads

	PKR (Mn)
API Segment	555.2
Formulation Segment	557.6
Hospital segment	1426.0
Total expenditure	2,538.8

Source: Citi Pharma Limited Prospectus

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How are IPO proceeds to be utilized?

Paracetamol API Expansion to 6,000 MT

API Expansion: CPL intends to expand their existing capacity of 3,600 tons per annum of Paracetamol to 6,000 tons per annum. CPL also plans to add new APIs to its existing product line, i.e. Ascorbic Acid, Chloroquine Phosphate, and Hydroxychloroquine Sulfate with production capacities of 1,200, 50, and 50 Tons respectively. The same products will add to formulation segment in the Company's portfolio.

Table 6: Formulation segment Expansion

Capacity (Per day)	Existing	Post Expansion
Injectables Vials (Per day)	-	200,000
Dry Powder/Suspension (Per day)	20,000	60,000
Capsules (Per day)	100,000	4,200,000
Tablets (Per day)	2,000,000	4,500,000

Source: Citi Pharma Limited Prospectus

Formulation segment to undergo major capacity growth

Formulation Segment Expansion: The company intends to build three manufacturing facilities to increase total capacity of vials/injectables, dry powder/suspension and tablets as shown in Table 6. These include separate manufacturing lines for Penicillin, Cephalosporin and Psychotropic & Narcotics drugs.

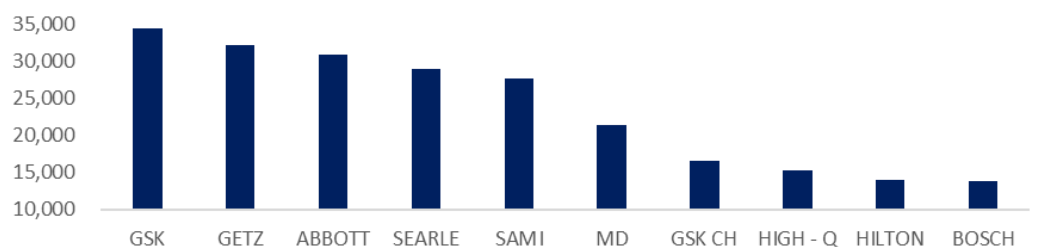
Entering the health care business

Health Care Operations: To enter the business of Health care, the company plans to build a modern 50 bed hospital facility in main Gulberg III, Lahore. This facility will include Out Patient Department (OPD), Consultancy Clinics, General Operations and Diagnostic Services (i.e, X-rays, Laboratory, MRI/CT scan). This segment should contribute to the topline from FY23 onwards with project completion in 1QFY23.

Pharmaceutical Industry

Overview: Formulation companies, API manufacturers, and Health Care Operations contribute 1.1% to the country's GDP. Standing at PKR 501Bn, the industry has witnessed a 4 year sales CAGR of 11.5% (FY16-20). The country has 650 registered pharmaceutical companies, out of which only 31 are MNC's. The local industry caters to 69% of the industry, while MNC's hold 31% share. The largest 50 Pharmaceutical companies make up 80% share of the industry's revenues.

Chart 1: Top Pharma companies by Revenue (PKR Mn)



Source: Citi Pharma Investor Presentation

Pakistan import 90% of API's due to lack of R&D in the local industry

Pakistan imports around 90% of APIs, mainly from China and India. During the COVID-19 pandemic, the local pharmaceutical companies faced unprecedented demand for APIs since their imports faced restrictions. The pandemic induced panic buying of medicines coupled with higher hospitalizations. Globally, governments have increased their focus on health care spending, which will likely present tremendous opportunities for the pharmaceutical sector.

Pricing and challenges : The yearly price increase in MRP of essential and non essential drugs is set at 70/100% increase of annual CPI, provided the respective company issues a prior 30-day notice to DRAP. The challenges faced by Pakistan's pharmaceutical industry include the government's price regulation through CPI with no consideration of increase in cost of production. Furthermore, the industry is also subject to less innovation due to lack of focus on R&D facilities in the country.

Citi Pharma Limited (CPL)

Acquired Askari Pharmaceutical in 2013

About the company: Citi Pharma Limited's plant is located in Phool Nagar, Kasur which was established as Askari Pharmaceutical plant (Pvt.) Limited and then acquired by the sponsors of CPL in March 2013. Its primary business is API manufacturing and pharmaceutical formulation. It is one of Pakistan's prominent players in the API industry and deals in 9 APIs which include Paracetamol, Ciprofloxacin, Cefixime (Cephalosporin), Amoxicillin (Penicillin), Levofloxacin, Norfloxacin hydrochloride, Cephadrin, and Aspirin. CPL currently serves international as well as local clients such as GlaxoSmithKline Pakistan Ltd. (53% of sales in FY20), The Searle Company Ltd., Abbott Laboratories (Pakistan) Ltd. Novartis Pharmaceuticals Pakistan among others.

Formulation business is growing and yields higher margins

Table 7: Sales breakup and margins

Yr End: June	FY18		FY19		FY20	
	Sales %	GM	Sales %	GM	Sales %	GM
API	99%	12%	97%	12%	93%	11%
Formulation	1%	39%	3%	34%	7%	38%

Source: Citi Pharma Limited Prospectus

Over the last three years, the company has seen rise in the revenue share of formulation segment. Additionally, the formulation segment has historically offered higher gross margins. Further expansion of formulation segment will lead to overall higher margins of around 17% by FY24. According to CPL, it imports 90% of the required raw materials in both APIs and formulation from China and India which make up to 87% of the cost of goods sold.

Capacity expansion to meet rising demand

Table 8: Capacity, expansion and utilization of Paracetamol

PKR Mn	FY16	FY17	FY18	FY19	FY20	1HFY21
Capacity	2,200	2,600	3,000	3,000	3,600	1,800
Production	1,868	2,545	2,778	2,399	2,527	1,545
Utilization	85%	98%	93%	80%	70%	86%

Source: Citi Pharma Limited Prospectus

Expansion rationale: Over the last fiscal year, the company has effectively expanded its production capacity to cater to fresh demand. In FY20, CPL utilized 70% of its production capacity and in 1HFY21, it rose to 86%. Paracetamol and Penicillin accounted for 59/26% of total FY20 sales. Foreseeing future demand and rising utilization levels, CPL intends to expand its existing capacity. The company expects a rise in utilization of the facilities as a result of new formulation line and new customers. Furthermore, in order to develop its clientele base, CPL needs to be consistent in its supply, which can only be achieved through expansion of its current operations.

Duties and levy to safeguard local API production

Table 9: Import duty on API's produced by CPL

Top 4 best selling APIs	Custom duty	Additional Custom Duty
Paracetamol	20%	7%
Ciprofloxacin	20%	7%
Cefixime	16%	4%
Amoxicillin Trihydrate	20%	7%

Source: Citi Pharma Limited Prospectus

Duty structure: The duty structure for the 4 API's produced by CPL are steep enough to safeguard CPL from international pressure in terms of pricing and market share loss.

Competitors: The API segment mainly consists of unlisted players like Pharmagen Ltd., Saakh Pharma (Pvt.) Ltd. and Zafa Pharma (Pvt.) Ltd. On the other hand, the formulation segment is highly competitive in Pakistan and the major players alongside Citi Pharma are Abbott Laboratories, GlaxoSmithKline Pakistan Ltd., AGP Ltd., Highnoon Laboratories Ltd., The Searle Company Ltd. and Wyeth Pakistan Limited.

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Buy	>15% expected total return
Hold	10%-15% expected total return
Underperform	<10% expected total return
*Total stock return = capital gain + dividend yield	

Old rating system

Overweight	Total sector return > expected market return
Marketweight	Expected market return
Underweight	Total stock return < expected market return

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)