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Fidson Healthcare Plc

Nigeria Corporate Analysis **September 2015**

Rating class	Rating scale	Rating	Rating Watch	Expiry date
Long term	National	BBB (NG)		March 2016
Short term	National	A3 (NG)	Yes	March 2016
N2bn Secured Fixed Rate Bond	National	BBB (NG)		March 2016

Financial data:

(USD'm comparative)

	31/12/13	31/12/14
N/USD (avg.)	159.3	165.1
N/USD (close)	161.1	182.6
Total assets	78.3	86.3
Total debt	25.5	26.5
Total capital	33.5	31.5
Cash & equiv.	0.9	1.1
Turnover	58.2	58.9
EBITDA	10.0	10.3
NPAT	1.0	3.8
Op. cash flow	5.2	10.7
Market share#	6%	
Market cap *	USD24.4m	

** As at 07/08/2015, @ N199.5/USD.*
#Management's estimate of overall domestic market share

Rating history:

Initial rating (January 2014)
Issuer Long term: BBB(NG)
Issuer Short term: A3(NG)
Rating outlook: Stable

Last rating (September 2014)
Issuer Long term: BBB(NG)
Issuer Short term: A3(NG)
Rating outlook: Stable

Related methodologies/research:

Criteria for rating Corporate entities, (updated February 2015)

Fidson Healthcare Plc ("Fidson" or the Company") rating reports January 2014
N2bn secured bond indicative rating report, September 2014

Glossary of terms/ratios, February 2015

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Summary rating rationale

- Fidson is one of the players in the Nigerian pharmaceutical sector with its range of products enjoying widespread acceptance among the populace. The business is enhanced by a strong marketing base and good distribution network, as well as strong relationships with international suppliers and government agencies.
- The regulatory environment remains somewhat uncertain, with delays in the implementation of government's new distribution system, resulting in a more cautious approach by private distributors, leading to lower purchases from manufacturers like Fidson. Thus, although revenue peaked at N9.7bn in F14, growth was slower at 5% and fell short of the anticipated N11.1bn
- Scale economies and tight cost management saw the gross margin edge up to 55.9% in F14 and 55.6% in 1H F15. However, cost pressure in terms of marketing and distribution expenses saw the operating margin remain at a stable 14.7% in F14, before rising to 19.2% at 1H F15. Moreover, Fidson saw its net interest charge increase significantly to N550m in F14. Thus, although operating income rose to N1.4bn in F14, NPBT (after excluding exceptional items) was somewhat lower at N871m. A similar dynamic was evident in 1H F15 as a large interest payment of N271m reduced the firm operating profit of N773m.
- Higher year-end balance of finished goods resulted in a rare absorption in F13, as the Company reported working capital releases in all years under review. In this regard, stronger cash generation and the working capital release in F14 saw cash flow from operations almost double to a high of N1.8bn in F14 (F13: N891m).
- Gross debt rose from N982m at FYE10 to N4.9bn at 1H F15, utilised to fund the ongoing expansion programmes. Accordingly, gearing metrics have remained elevated, with gross gearing peaking at 84% at FYE14 (budget: 69%) and gross debt to EBITDA rose to 285% (FYE13: 252%). However, firmer earning in 1H F15 saw these metrics reduce to 79% and 259% respectively. Revised forecasts anticipates a further rise in debt to N5.1bn at FYE15, but with the expected increase in production volumes from the new plant, debt should gradually decline over the forecast period to around N2.8bn by FYE18.
- The Rating Watch is reflective of impact of the unforeseen developments affecting Fidson, worsened by challenges in the operating environment.
- As GCR can no longer extend the indicative rating accorded on the N2bn fixed rate bond, GCR will reconsider the additional rating uplift provided by the security package once the security is perfected in full. GCR's calculations suggest that, based on the most recent asset valuation (November 2013) recovery prospects can be expected to be 'Superior'.

Factors that could trigger a rating action may include

Positive change: The successful commissioning of the Biotech plant, with the enhanced capacity contributing to the attainment of set revenue targets over the medium term. The increased revenue and diversified product range would help to strengthen the Company's competitive position.

Negative change: Earnings underperformance and higher than anticipated debt levels remain a concern, and could lead to a deterioration in credit protection metrics. Should this persist, negative rating action would be considered.

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Background and recent developments

Fidson commenced operations in 1995 as a distributor of pharmaceutical products before venturing into production of its own brand of finished medicines in 1996. Since then it has grown rapidly and currently ranks among the top three pharmaceutical companies in Nigeria. Fidson's product range includes medicines treating chronic diseases, infections and malaria, as well as over the counter ("OTC") medicines and life style products (including nutraceuticals). A significant portion of its branded products is imported, while production is carried out from the plant in Otta, Ogun State, with separate lines for tablets, capsules, creams and gels, oral liquid and dry powders. Fidson has been listed on the Nigerian Stock Exchange ("NSE") since 2008.

Having pioneered various innovative products in the past, Fidson is currently building a new manufacturing plant ("Biotech factory") for the production of parenterals and intravenous fluids, both of which are in high demand in Nigeria. In addition, the 5 existing production lines are to be moved to the new factory when completed. The project commenced in 2011 and was initially expected to be completed by 3Q F14 and later 1Q F15. However, shipping & port clearing delays, higher importation costs and the currency devaluation delayed the project, with production now only expected to begin in 4Q F15, and is still subject to a timely regulatory approval process.

Shareholding and corporate governance

Fidson is managed by a board of directors comprising three executive directors[1] and four independent non-executive directors, including a non-executive chairman. In order to ensure that principles of good governance are engendered in the company, the board activities are governed by a charter, stipulating responsibilities, power and processes. The directors come from different backgrounds with significant experience, including nutrition, business administration, medicine, healthcare, pharmacy among others. Some of the directors also hold other directorships in notable listed companies.

Table 1: Corporate governance summary	
Description	**Findings**
Number of Directors	3 executive 4 independent
Separation of Chairman	Yes
Number of board committees	Four; Nomination, Remuneration, Finance and General Purpose and Credit Control
Internal control and compliance	Yes
External auditor	Ernst & Young

As a listed company, Fidson is required to meet the corporate governance standards as demanded by the Securities & Exchange Commission ("SEC") through its code of corporate governance, as well as the NSE's listing rules. In addition, the Companies and Allied Matters Act (CAMA") of 2004 outlines required regulations.

Fidson's Board meets quarterly and is responsible for the review of financial performance and the Company's operations. Board Committees are mandated with policy development and review, remuneration, financial reviews and the appraisal of investment decisions and capex, amongst others. Fidson also has an audit committee, comprising an equal number of directors and shareholder representatives. Operations are subjected to periodic examinations and audits by regulators.

The Managing Director/Chief Executive Officer, Dr. Fidelis Ayebae has significant stake in the Company, holding 35.5% of the issued share capital as at June 2015. No other director holds more than 5% of the issued share capital.

Table 2: Shareholding structure	Holding (%)
Dr Fidelis Ayebae	35.5
Other directors (cumulative holding)	8.3
Nigerian Public	56.2
Total	**100.0**

Nigerian Pharmaceutical Industry Overview

Although, Nigeria accounts for around 60% of the total volume of drugs consumed in the West African region, the pharmaceutical industry has remained largely underdeveloped. A number of factors currently militate against development, including lack of effective intellectual property protection, poor and inconsistent policies, low patronage from government, drugs counterfeiting, and inadequate investment in research and development activities. These shortcomings have led to a chaotic distribution system, curtailing availability of medicines, which has been further compounded by the inadequate funding and running of hospitals, and poor storage and transportation facilities.

The estimated size of the pharmaceuticals and healthcare products market in Nigeria is in excess of USD2bn annually. The bulk of demand is met by imported finished medical products, but the industry boasts a number of local manufacturers. However, local manufacturing has been impeded by high cost due to low capacity utilisation (around 40%) and the need to source the majority of raw materials and equipment utilised in local manufacturing from abroad. According to management, Fidson's has an estimated 6% market share, with significant growth potential underpinned by the expanding scope of locally manufactured products. This is supported by relationships and synergies with various local and international suppliers that should guarantee a steady source of raw materials and consumables.

The main regulatory agency is the National Agency for Food and Drug Administration and Control

[1] Previously four, the Finance director retired in December 2014

("NAFDAC"), which regulates all drugs and medicinals. NAFDAC also inspects the manufacturing premises to ensure that the facilities are satisfactory for production before issuing GMP certification. As part of policies guiding pharmaceutical production and marketing, the Federal Ministry of Health published the National Drug Distribution Guidelines in 2012. The guidelines provide for States to establish State Drug Distribution Centres ("SDDCs"), which would be supplied by Mega Drug Distribution Centres ("MDDCs") operated by the private sector. The model would eliminate a significant number of small distributors who would be unable to meet the stringent requirements under the guideline. Given the contentious nature of the model, the implementation (initially scheduled for June 2014, and later pushed to July 2015) is yet to commence and dialogue with stakeholders is still ongoing. The issue is also the subject of litigation in the court.

As part of measures to enhance economic integration and raise local production capacity in the ECOWAS sub-region, a tariff structure was recently introduced, in respect of which the first phase of implementation would be from 2015 to 2019. The structure of the Common External Tariff ("CET") makes provision for between 5-20% tariff on raw materials, while allowing zero duty on imported finished goods.

Earnings diversification

Fidson remains one of the leading names in the pharmaceutical sector, with its range of products enjoying widespread acceptance among the populace. This is enhanced by the strong marketing base, regular sales promotion and a good distribution network, spanning registered distributors, hospitals, pharmacy shops, medical laboratories and government institutions. Major brands include the *Astymin* range of products, which, according to management, enjoys an estimated market share of 30%. Other notable products include *Ciprotab*, *Arthocare Forte*, *Arthocare*, *Tribotan cream*, *Tuxil syrup.*

Table 3: Revenue diversification	**2013**		**2014**	
	N'm	**%**	**N'm**	**%**
OTC drugs	6,022.1	65.1	6,050.8	62.2
Ethical drugs	3,213.0	34.7	3,668.4	37.7
Rental Income	12	0.13	6	0.1
Total	**9,247.1**	**100**	**9,725.2**	**100**

As in previous years, the bulk of revenue derived from OTC drugs in F14, albeit at a reduced 62% of total revenue. Whilst OTC receipts were largely unchanged, revenue from Ethical drugs rose by N455m to N3.7bn, accounting for a higher 38% of revenue. Over the last few years, Fidson's major business operation has shifted from the marketing and sales of drugs towards manufacturing. Aside from its own brands, the Company offers toll manufacturing services to other pharmaceutical companies, with agreements in place to guide this service. Although negligible, rental income accrues to Fidson from its old factory.

As part of revenue drive to diversify the product range, new products were recently introduced and have enjoyed some level of success. These include Avstat 20mg Tablets, Ranicef 125 and 250mg/5ml suspension, Clavamox Tablets and Gascol Sugar. According to management, once the new plant becomes operational, a new set of products, including Infusions products, will be introduced to the market, alongside some other quality brands.

Table 4: Market share per segment	**Key products**	**(%)**
Multivitamins	Astymin range	**30**
Antibiotics	Ciprotal, Sparflox	14
Anti-Ulcer	Gascol, Meprasil	11
Blood tonics	Astyfer range, Ferobin	9
Cough Expectorant	Tuxil range	9
Osteoarthritis	Arthocare, Arthocare Forte	7
Anti-Malarial	Arthemed, Emal	3
HIV	Virex range	1
Diarrhoea	Motitec	0.5
Analgesics	Paracetamol	0.5

Financial performance

A five year financial synopsis including the 6-month period to 30 June 2015 is reflected at the end of this report, and commentary follows hereafter. Fidson's financial statements were compiled in line with CAMA, IFRS and Financial Reporting Council of Nigeria. The first year of the synopsis is presented according to the previous NGAAP standard. The Auditors, Ernst & Young issued an unqualified opinion on the 2014 financial statements.

Fidson has reported consistent growth in revenue over the review period, largely driven by a combination of rising production and higher traded volumes. Although revenue peaked at N9.7bn in F14 (underlying the slower 5% growth), it fell short of the anticipated N11.1bn. The variance was attributed to a decline in sales to distributors (around mid-2014) due to the uncertainties surrounding the planned implementation of the new drug distribution model. This resulted in a number of key distributors suspending trade for fear of elimination from the value chain. NAFDAC also closed down traders not in compliance with the Mobile Authentication Service (which had earlier been introduced), contracting sales further, with the goods remaining unsold in the warehouse. Nevertheless, the economy of scale benefits from higher revenue saw the gross margin edge higher to 55.9% (F13: 55.2%), which resulted in a 7% increase in gross profit to N5.4bn.

On the back of better cost management in terms of personnel (resulting from the discontinuation of the gratuity scheme[2]), travel, insurance and legal

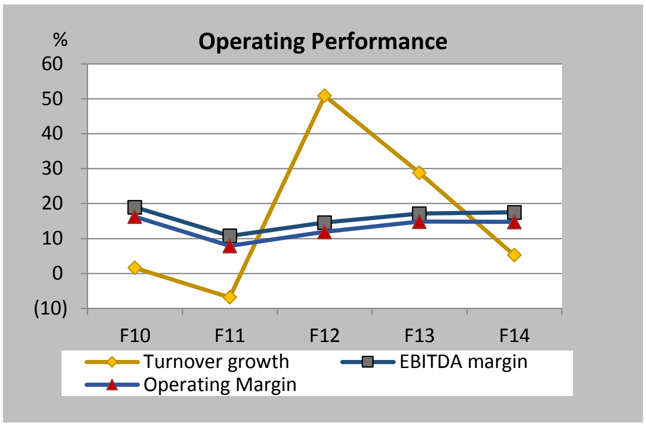
[2]The Company discontinued the gratuity programme in December 2014, replacing it with the contributory pension scheme. Based on actuarial valuation, a reversal in provision (amounting to N165m) was made for staff members who had served for less than 5 years.

expenses, administrative expenses declined by 10% to N2.2bn. The Company also benefitted from a reduced bad debt charge due to tighter accounts management. In contrast, marketing and distribution expenses rose by N460m to N1.7bn (18% of turnover), largely attributed to increased distribution costs to the far North (as a result of the insecurity) and higher promotional and advertising spend. This underlines the competitive pressure and high overheads prevalent in the pharmaceutical industry. Depreciation also registered at a higher N267m (F13: N213m) as a result of the higher asset base. Overall, however, the firmer gross profit offset the higher operational costs, resulting in slightly improved operating profit of N1.4bn, but a weaker operating margin of 14.7%, (albeit ahead of budget of 11.6%).

Table 5: Income statement (N'm)	F13	F14		% Achvd.	Growth (%)
		Actual	Forecast		
Revenue	*9,235.1*	*9,719.2*	*11,096.0*	*87.6*	*5.2*
Gross Profit	5,101.9	5,433.6	6,103.0	*89.0*	*6.5*
EBITDA	**1,581.1**	**1,698.5**	**1,607.0**	*105.7*	*7.4*
Depreciation	(213.1)	(266.8)	(325.0)	*82.1*	*25.2*
Op. Profit	**1,368.0**	**1,431.7**	**1,282.0**	*111.7*	*4.7*
Net interest	(402.7)	(549.7)	(676.0)	*81.3*	*36.5*
Other	(715.7)	(11.2)	(49.0)	*n.a*	*n.a*
NPBT*	**249.6**	**870.8**	**557.0**	*156.3*	*248.9*
Key ratios (%)					
Gross margin	55.2	55.9	55.0	-	-
EBITDA margin	17.1	17.5	14.5	-	-
Op. margin	14.8	14.7	11.6	-	-
Net int. cover (x)	3.4	2.6	1.9	-	-

Given its reliance on debt to fund its expansion, Fidson has reported correspondingly high finance costs over the review period, including interest payments on bank loans, finance lease and more recently, the N2bn bond. This saw the gross interest charge rise to N555m in F14 (F13: N408m), with the N5m interest income reducing the net interest charge slightly to N550m (F13: N403m). Thus, net interest cover declined to 2.6x in F14, from 3.4x in F13.

As operating profit exceeded budget and the interest charge was lower, NPBT of N871m was 56% ahead of expectations. While this marked a substantial improvement in the N250m NPBT reported in F13, the F13 result was impacted by a N716m impairment charge related to Fidson's share of the loss upon the liquidation of an associate. Excluding the impairment charge, NPBT would have been lower in F14. In line with the firmer earnings, the tax charge rose to N239m, comprising an operating tax charge of N85m (F13: N14m) and a deferred tax charge of N125m (F13: N71m) relating to temporary differences. Thus, net income increased by N477m to register at a high of N632m in F14.



Cash flows

Cash generated by operations has consistently grown over the review period in line with the expansion in activities, increasing by 7% to peak at N1.9bn in F14. The Company has reported working capital releases in all the years under review, excluding F13, where an absorption of N365m was reported as a result of higher year-end balance of finished goods and receivables. In F14, the working capital release of N449m was largely driven by factors unrelated to normal operating activities. Thus, trade and payables increased by a significant N1.4bn, largely attributed to accrued expenses and a payable due to other shareholders of its liquidated associate- Fidson Product Limited ("FPL"). As part of the liquidation of FPL, its assets were transferred to Fidson, but it also assumed the liability of other shareholders. Also included in creditors is the supply of equipment for the plant. In contrast, trade payables were largely unchanged in F14.

Fidson generally enjoys between 90 to 120 days credit terms from its overseas suppliers, while receiving 30-day terms on most local purchases. With the bulk of raw materials sourced abroad, around three months' worth of raw materials inventory is held in order to provide a buffer against transportation and port clearing delays (1-2 months for locally sourced raw materials and consumables). Once the products are sold, distributors are provided 30-day payment terms, but special consideration is usually given to government agencies, health institutions and hospitals who enjoy 120 days payment period, although some government institutions have remained on the debtors' list for several years. This equates to a three to four months cash conversion cycle, which needs to be funded by internal sources such as retained earnings or by short term debt facilities.

Given the high proportion of government debtors, collection days have historically averaged above 80 days, with the exception of F12 and F13 when stricter credit control measures implemented resulted in a moderate collection period of 48 days. However, the collection period returned to 82 days in F14 as management chose to temporarily relax the collection policy in view of the harsh economic realities, and extend the credit period to certain distributors for up to 90 days. As a consequence, trade debtors increased by N1.5bn to N2.9bn in F14, albeit partly offset by a N725m release from related party receivables, following the liquidation of FPL and subsequent transfer of its assets to Fidson.

Stronger cash generation and the working capital release saw cash flow from operations almost double to a high N1.8bn in F14 (F13: N891m), despite higher net finance payments and taxes. Similarly, discretionary cash flow remained high, more than doubling to N1.5bn (F13: N678m), after accounting for depreciation. Despite the capex requirements, Fidson maintained its trend of paying annual dividend but it was slightly reduced at N150m in F14 (F13: N180m).

A cumulative N7.1bn has been spent over the review period, in line with the ongoing capacity expansion. Nevertheless, with the construction of the Biotech plant nearing completion, net expansionary capex declined to a 4-year low of N986m. A further N256m was invested in the bond repayment reserve account and product licences, partly offset by a N133m inflow from the sale of property and financial assets. Capex and investments were largely financed by cash that had been raised from debt in F13, whilst the N2bn bond issue was used to settle existing loans. Although, actual debt in the books rose by N863m in F14, this had minimal cash flow impact as the incremental debt was assumed upon the liquidation of FPL.

Interim review

Revenue declined by an annualised 17% to N4bn in the six months to June 2015, representing one third of budget. The underperformance is largely attributed to the uncertain operating environment in the first 4 months of the year ahead of the elections, with the apprehension during the build-up to the elections severely affecting economic activity. Thus, a considerable number of distributors stayed away from the market, while others reduced volumes. Fidson's turnover only began to recover after the April elections, with the bulk of revenue earned in 2Q. Management also attributed the poor performance in relation to forecast to delays in the completion of the Biotech plant, as earnings from the new product line (infusions) did not materialise as anticipated.

The devaluation of the naira also resulted in higher importation costs for raw materials and supplies, leading to increased costs of sale. As a result, the gross margin narrowed slightly to 55.6% in 1H F15 (F14: 55.9%).

Strict cost containment measures were implemented during the period, including a reduction in personnel, a limit on non-essential appointments, as well as a reduction in travelling, fuelling and other operating expenses. As a result, selling and administrative expenses declined by an annualised 29% to N2.8bn. Combined with a much lower than forecast depreciation charge (due to the plant not being complete), this helped bolster operating profit by an annualised 8% to N773m in 1H F15. Consequently, the operating margin widened to 19.2% (F14: 14.7%), well ahead of the 12.6% budget. As the interest accrued on loans to fund the Biotech plant was capitalised, the net finance cost fell to N271m, and was slightly moderated by interest income of N25.4m. Consequently, gross interest coverage remained unchanged at 2.6x, while net interest cover rose to 2.9x. Overall, NPBT was in line with budget, rising by an annualised 15% to N502m at 1H F15

Table 6: Interim performance (N'm)	1H F15	F15 Forecast	% Achvd.	Annualised Growth (%)
Revenue	*4,034.3*	*13,316.0*	*30.3*	*(17.0)*
Gross profit	2,244.1	7,324.0	*30.6*	*(17.4)*
EBITDA	**914.9**	**2,005.0**	*45.6*	***7.7***
Depreciation	(142.0)	(326.0)	*43.5*	***6.4***
Op. Profit	**772.9**	**1,679.0**	*46.0*	***8.0***
Net interest	(270.7)	(517.0)	*52.4*	*(1.5)*
Other	0.0	(54.0)	*n.a*	*n.a*
NPBT	**502.2**	**1,108.0**	*45.3*	***15.3***
Key Ratios (%):				
Gross margin	55.6	55.0	-	-
EBITDA margin	22.7	15.1	-	-
Op. Margin	19.2	12.6	-	-
Net int. cover (x)	2.9	3.2	-	-

Funding Profile

Fidson's expansion has seen assets double from N7.9bn at FYE10 to N16.6bn at 1H F15 (FYE14: N15.8bn). This has mainly been the result of additions to fixed assets, which have increased 5-fold over the period to account for 69% of assets at FYE14 (compared to 28% at FYE10), reflecting the shift in focus from the sale and marketing of medicines, to the manufacture of drugs and other related medical supplies. The remaining assets comprise largely of inventories and receivables, which, while registering at a lower combined 26% at FYE14, have risen in real terms. Cash remained low around N205m at FYE14 and 1H F15 (1% of total assets), as excess cash has been utilised for capex requirements. However, N226m of investments at FYE14 relate to contributions to the reserve fund account, which is held in liquid assets and available to service interest and principal repayment obligations on the bond as per the trust deed.

After having remained around N5.2bn for 4 years, shareholders' equity rose by 10% to N5.7bn at FYE14 and further to N6.2bn at 1H F15 on the back of higher retained earnings. Nevertheless, with the increased utilisation of debt to fund expansion (in contrast to the equity funded expansion previously evidenced), shareholders' equity as a percentage of funding remained relatively low at low 36% at FYE14 and 38% at 1H F15 (down from 66% at FYE10).

Table 8: Funding profile (N'm)	FYE13	FYE14		1H 15 Actual	2015 forecast
		Actual	Forecast		
Total Debt	**3,980.9**	**4,843.9**	**3,773.0**	**4,939.9**	**3,136.0**
Cash	(137.0)	(204.2)	(821.0)	(205.5)	(500.0)
Net Debt	**3,843.8**	**4,639.8**	**2,952.0**	**4,734.4**	**2,636.0**
Equity	5,242.1	5,742.8	5,444.0	6,225.3	5,996.0
Key ratios (%):					
Total debt: equity	75.9	84.3	69.3	79.4	52.3
Net debt: equity	73.3	80.8	54.2	76.1	44.0
Total debt: EBITDA*	251.8	285.2	234.8	270.0	156.4
Net debt: EBITDA*	243.1	273.2	183.7	258.7	131.5

**1H F15 EBITDA is annualised*

Gross debt has steadily risen from N982m at FYE10 to N4.9bn at 1H F15 to fund the ongoing expansion programme. Although, a significant portion of proceeds from the N2bn bond was utilised to settle some existing obligations, debt remained well above the forecast of N3.1bn. This was largely attributed to the debt taken-up after the liquidation of FPL as well as the rising cost of the Biotech plant and working capital requirements. In effect, whilst Fidson was able to reduce its debt, the assumed debt from FPL resulted in the higher overall balance.

Table 7: Bank/Credit source	Loan type	Limit (N'm)	Interest rate (%)	FYE14 (N'm)	Maturity
Bond	Bond	2,000.0	15.5	1922.2	2019
Access Bank	Term loan	525.0	7.0	248.6	2021
Access Bank	IFF	320.0	9.0	249.6	2015
Access Bank	Overdraft	100.0	22.0	105.2	2015
BOI	Term loan	1336.8	10.0	1038.9	2018
FCMB	IFF	195.0	19.5	36.5	2015
FCMB	Overdraft	100.0	22.5	76.7	2015
Fidelity Bank	Term loan	300.0	7.0	166.9	2024
GTBank	Overdraft	250.0	23.0	251.7	2014
Mainstreet	Lease	11.3	22.0	8.0	2016
Stanbic IBTC	Lease	110.5	22.0	27.3	2015
Sterling Bank	Lease	189.6	23.0	125.5	2017
Non-bank	Various	725.4	19.8-23.0	303.8	2016 to 2018
Other Loans	Various			283.1	
Total		**6,163.5**		**4,843.9***	

*Debt registered at a higher N4.9bn at 1H F15.

In line with the nature of assets being funded, much of the increase has been in long tenor debt. Such facilities are provided by a number of commercial banks, as well as by the Bank of Industry ("BOI"). In 4Q F14, Fidson issued a N2bn Medium Term Note from the capital market to refinance existing obligations and thereby reduce strain on the cash flow. The bond is priced at 15.5% and is secured on the Company's Mortgage and an all asset debenture, with full repayment not due until 2019. Nevertheless, perfection of security documents on the bond is yet to be finalised, owing to bureaucratic delays on the part of the government agency. Term loans from GTBank (N277m) and First City Monument Bank (N400m) were settled in full.

Aside from term loans, Fidson has also consistently utilised trade finance facilities and short term debts like overdrafts and commercial paper to finance working capital requirements. Of the current outstanding debt on the loan book at FYE14, around 86% is expected to be fully liquidated by FYE19.

In anticipation of the commencement of production at the new plant, the Company secured an equipment lease facility in March 2015 (N108m) to purchase a gas powered generator for the plant, resulting in a further increase in debt to N4.9bn at 1H F15. The initial plan was to power activities at the plant with a diesel generation, but factory requirements and specification were modified to include gas generator which should cost less to maintain in the long run.

The effect of the higher than anticipated debt and weaker earnings, saw gearing metrics rise and exceed budget at FYE14, whilst still remaining high at 1H F15. Thus, gross gearing increased to 84% at FYE14 (budget: 69%), but fell slightly to 79% at 1H F15 due to the higher equity value. Net gearing increased to 81% at FYE14, before reducing to 76% on the back of higher earnings. Similarly, gross and net debt to EBITDA increased to 285% and 273% at FYE14 respectively (FYE13: 252% and 243%). However, with firmer earnings reported at 1H F15, gross and net debt to EBITDA declined marginally to 270% and 259% respectively, albeit still above forecast of 156% and 132%.

Update on the N2bn Secured Fixed Rate Bond

In November 2014, Fidson raised N2bn from the capital market through the issue of bonds, with a 5 year tenor (maturity in November 2019). The bond was issued at interest rate is 15.5% p.a, payable semi-annually in arrears (in May and November each year), while the principal will be redeemed by eight equal semi-annual instalments, following the expiration of a 12-month moratorium period. Net bond proceeds have been applied towards debt refinancing and working capital as reflected in Table 8.

Table 8: Utilisation of proceeds	N'm	%
Refinancing of Debt	1,430.8	71.54
Working Capital	502.9	25.15
Issue expenses	66.3	3.31
Total	**2,000.0**	**100.0**

The bond was to be secured by an all asset debenture, covering the mortgages on Fidson's 5 properties (4 in Ogun State, 1 in Lagos State) as well as other fixed assets. Premised on the security structure and 'Superior' recovery prospects detailed in the secured bond report, GCR assigned an indicative rating of A- to the N2bn bond (2 notches above the Issuer rating) in September 2014.

The Trust Deed required the stamping of the security documents and all applicable registrations to be completed within 6 months from the Closing Date. However, while Fidson was able to successfully file the deed of variation with the Corporate Affairs Commission noting the interest of the bondholders in the security package for Lagos State, the perfection process for the properties in Ogun State (which comprises the bulk of assets) has not been completed. The inability to complete the process has been attributed to bureaucratic delays at the lands registry and other government agencies. Recognising that the delays were out of the control of Fidson, GCR extended the initial expiry of the indicative secured bond rating from March 31 2015 to May 31 2015 and thereafter, August 31 2015.

Aside from the inability to perfect security, Fidson has complied with all terms of the bond issuance. GCR has reviewed the bond performance report from ALM Trustees and notes that the first coupon payment (N154m) was made on 7 May 2015. The next coupon payment is due on 7 November, 2015. Funds in the transaction accounts have been invested in short term money market instruments per the trust deed. According to the Trustees' investment report, the minimum reserve account, perfection reserve and payment accounts had balances of N931,898.76, N49,657.73, and N75,797.38 respectively as at September 21 2015. In addition, the transaction accounts had running investments totalling N266.9m. The applicable bank statements and investment account statements as at September 21, 2015 were provided to GCR. It was also reported that there has been no breach to covenants or negative pledges.

Table 9	
Recovery rate calculations*	**NAIRA**
Principal amount outstanding upon default[1]	2,000,000,000
Other secured indebtedness as at June 2015[2]	2,874,928,000
Assumed missed interest to give time to realise recoveries3	310,000,000
Aggregate exposure Senior Lenders	**5,184,928,000**
Assumed recoveries on sale of properties[4]	(4,229,275,000)
Funds in transaction accounts including investments made with funds as at May 2015	(267,961,562)
Unsecured claim on Issuer	903,810,213
Assumed sales and legal costs[5]	211,463,750
Unsecured claim on Issuer	**1,115,273,963**
Overall estimated recovery rate	83%

[1]While the principal amount outstanding during the life of the Bonds will amortise from year 2, it is assumed the Issuer defaults prior to the first principal payment being made.
[2]Total outstanding balance on secured debt as at 30 June 2015 was N4.9bn (inclusive of the N2bn bond and unsecured CP of N65m)
[3] The first semi-annual coupon has been paid. GCR assumes that interest payments cease during the assumed recovery period (12 months). This equates to 2 semi-annual interest payments in total. The bond interest rate of 15.5% has been utilised for calculations.
[4]Stressed value of the assets
[5]GCR applied 5% costs to the stressed value of the assets.

As GCR can no longer extend the indicative rating accorded, GCR will reconsider the additional rating uplift provided by the security package once the security is perfected in full. As is indicated by table 9, GCR's calculations suggest that, based on the most recent asset valuation (November 2013) recovery prospects can be expected to be 'Superior'. This could result in a two notch uplift on the N2bn secured fixed rate bond. Until this process is completed, the N2bn secured fixed rate bond have been accorded an unsecured credit rating of BBB(NG), in line with the corporate credit rating of Fidson.

Outlook and forecasts

The following operating and capital forecast are as provided by management, and contains a more conservative outlook from earlier projections provided in August 2014. In arriving at the revised revenue projections, Fidson has taken cognisance of the persistent challenges in the operating environment since the start of 2015, resulting in slower revenue growth and increased direct costs. In addition, earlier projections were premised on the new plant being operational in 3Q F14, but commencement is now only expected at the end of F15.

This notwithstanding, revenue is anticipated to remain robust over the medium term, with an 8% rise to N10.5bn expected in F15. Although, revenue for the half year fell short at about N4bn, management remains optimistic about attaining budget, given the relatively stable economic environment since the elections and the increased economic activities associated with the latter part of the year. As production is ramped up at the Biotech plant, however, annual revenue growth of 20% is forecast from F16. This should be supported by the higher demand expected from the reorganisation of the pharmaceutical industry.

The direct cost of raw materials and other supplies is anticipated to rise by 5% in F15, underpinned by higher importation cost. Notwithstanding the effect of cost saving measures on operations, the impact of higher direct cost would result in a 9% decline in EBITDA to N1.5bn in F15. Similarly, budgeted operating income would be lower. Nevertheless, margins are expected to widen over the forecast period, due to the economies of scale and improved efficiencies. Net finance cost is anticipated to decrease by 19% to N444m in F15 in respect of lower payments on some commercial loans. Nevertheless, a lower NPBT of N795m is forecast for F15 (1H F15: N502m) before rising to N1.1bn in F16 as volumes increase.

Table 10: Income forecasts (N'm)	F15	F16	F17	F18	F19
Revenue	10,500.0	12,600.0	15,120.0	18,144.0	21,772.8
Gross profit	5,250.0	6,300.0	7,560.0	9,072.0	10,886.4
EBITDA	**1,541.2**	**1,960.7**	**2,483.0**	**3,131.9**	**3,995.9**
Depreciation	(302.3)	(353.7)	(413.9)	(484.2)	(561.7)
Op. profit	**1,238.8**	**1,607.0**	**2,069.1**	**2,647.7**	**3,434.2**
Finance charges	(443.8)	(519.3)	(607.5)	(710.8)	(824.5)
NPBT	**795.0**	**1,087.7**	**1,461.6**	**1,936.9**	**2,609.7**
Key Ratios (%)					
Gross margin	50.0	50.0	50.0	50.0	50.0
EBITDA margin	14.7	15.6	16.4	17.3	18.4
Op. margin	11.8	12.8	13.7	14.6	15.8
Net int. cover (x)	2.8	3.1	3.4	3.7	4.2

As per budget, total debt is anticipated to remain elevated, rising to N5.1bn at FYE15 as additional loans are drawn to fund operation and meet requirements at the Biotech plant. Nonetheless, debt is expected to gradually reduce once the new plant becomes operational.

Table 11: Gearing forecasts (N'm)	FYE15	FYE16	FYE17	FYE18
Total debt	**5,078.3**	**4,438.2**	**3,508.7**	**2,731.4**
Cash and bank bal	(247.4)	(92.1)	(287.7)	(1,258.2)
Net debt	**4,830.9**	**4,346.2**	**3,221.0**	**1,473.2**
Equity	6,111.3	6,657.2	7,432.0	8,496.2
Key ratios (%):				
Total debt: equity	83.1	66.7	47.2	32.1
Net debt: equity	79.0	65.3	43.3	17.3
Total debt :EBITDA	329.5	226.4	141.3	87.2
Net debt: EBITDA	313.5	221.7	129.7	47.0

Conclusion

Fidson is one of the leading pharmaceutical companies in Nigeria with a wide range of products covering several therapeutic segments. Since the shift from sales and marketing of drugs to manufacturing, the Company has evidenced growth in revenue and profitability as benefits from scale economies accrue, which has seen it become the 3rd largest pharmaceutical supplier in Nigeria. This is supported by strong relationships with various overseas and local suppliers.

As part of its strategy to strengthen its market leadership, Fidson has increased its advocacy with the government so as to ensure that policies are tailored towards strengthening the industry. In recent months, Fidson and other stakeholders have been providing regulators with suggested policy amendments to protect local manufacturers against unhealthy foreign competition. Furthermore, the Company has embarked on a drive to increase its brand awareness and ensure its products are easily accessible and affordable, while also keeping to the highest standard in the manufacturing process. Several distribution depots have been provided in strategic parts of the country to ensure products are available on a regular basis to satisfy the needs of consumers. Fidson has also introduced the position of head of divisional marketing who is tasked with driving sales across the country through direct marketing, hospital visitations and informing the public on health issues and the use of medication. Such initiatives are expected to increase total demand for pharmaceuticals in Nigeria and improve the ease of doing business.

Financial performance has been hampered by delays to the completion of its new Biotech facility, aggravated by uncertainties during the election, resulting in lower volume production than forecast and persistently high gearing. This has been exacerbated by the more challenging operating environment, with the devaluation of the naira, making imports more expensive and leading to increased construction costs. Accordingly, revenue has fallen short of budget in both F14 and 1H F15. Positively, however, stringent cost containment measures have seen operating profit track in line with budget and the 1H F15 performance indicates that the full year forecast may be surpassed. Of greater concern than the earnings is the elevated gearing metrics (well ahead of budget), given additional loans assumed upon FPL's liquidation. Such high gearing remains a concern, particularly if profitability falls short of budget, and needs to be monitored. Should this persist, negative rating action would be considered.

Key to a positive earnings trajectory is the completion and successful commissioning of the factory, as this would not only boost revenue and further diversify product range, but also strengthen the Company's competitive position. Added to this, Fidson will be granted pioneer status from the date of commencement of commercial production and thus enjoy a 3-year tax holiday, as part of government's measures to boost investments in local manufacturing in specific areas. According to management, the plant is nearing completion and should begin production in 4Q F15.

Fidson Healthcare Plc

(Naira in Millions except as Noted)

	30 June	31 December				
Statement of Comprehensive Income	**2010**	**2011***	**2012**	**2013**	**2014**	**1H 2015**
Turnover	5,100.5	7,127.9	7,168.9	9,235.1	9,719.2	4,034.3
EBITDA	**966.7**	**765.3**	**1,044.7**	**1,581.1**	**1,698.5**	**914.9**
Depreciation	(137.9)	(204.4)	(190.3)	(213.1)	(266.8)	(142.0)
Operating income	**828.8**	**560.9**	**854.5**	**1,368.0**	**1,431.7**	**772.9**
Net finance charges	(186.6)	(346.7)	(314.4)	(402.7)	(549.7)	(270.7)
Share of loss of associate	0.0	0.0	0.0	(715.7)	(11.2)	0.0
NPBT	**642.2**	**214.3**	**540.1**	**249.6**	**870.8**	**502.2**
Taxation charge	(176.3)	(158.7)	(333.2)	(94.6)	(239.0)	(152.6)
Profit from continuing operations	**465.9**	**55.6**	**206.9**	**155.0**	**631.8**	**349.6**
Other comprehensive income	0.0	(34.6)	(18.8)	41.9	38.1	0.0
Total comprehensive income	**465.9**	**21.0**	**188.1**	**196.9**	**669.9**	**349.6**
Statement of cash flows						
Cash generated by operations	**967.3**	**758.9**	**1,044.7**	**1,823.1**	**1,949.4**	**1,033.7**
Utilised to increase working capital	31.7	210.8	555.3	(364.8)	449.1	(448.1)
Net finance charges/Net interest paid	(186.6)	(346.7)	(314.4)	(412.7)	(559.3)	(302.4)
Taxation paid	(112.0)	(269.8)	(263.1)	(154.6)	(70.0)	0.0
Cash flow from operations	**700.5**	**353.2**	**1,022.5**	**891.0**	**1,769.3**	**283.2**
Maintenance capex‡	(137.9)	(204.4)	(190.3)	(213.1)	(266.8)	(142.0)
Discretionary cash flow from operations	**562.6**	**148.9**	**832.3**	**677.9**	**1,502.5**	**141.2**
Dividends paid	(330.0)	(150.0)	(150.0)	(180.0)	(150.0)	0.0
Retained cash flow	**232.6**	**(1.1)**	**682.3**	**497.9**	**1,352.5**	**141.2**
Net expansionary capex	(173.4)	(2,223.8)	(1,705.4)	(1,142.6)	(985.7)	(120.0)
Investments and other	(229.8)	729.7	460.0	(42.9)	(198.9)	19.1
Proceeds on sale of assets/investments	15.3	28.1	9.0	243.6	133.3	56.9
Shares issued	0.0	0.0	0.0	0.0	0.0	0.0
Cash movement: (increase)/decrease	(153.6)	211.6	(222.2)	106.4	(67.1)	(1.4)
Borrowings: increase/(decrease)	309.0	1,255.5	776.3	337.6	(234.0)	(95.8)
Net increase/(decrease) in debt	**155.4**	**1,467.1**	**554.1**	**444.0**	**(301.1)**	**(97.2)**
Statement of financial position						
Ordinary shareholders interest	5,230.9	5,185.0	5,226.2	5,242.1	5,742.8	6,225.3
Outside shareholders interest	0.0	0.0	0.0	0.0	0.0	0.0
Pref shares and conv debentures	0.0	0.0	0.0	0.0	0.0	0.0
Total shareholders' interest	**5,230.9**	**5,185.0**	**5,226.2**	**5,242.1**	**5,742.8**	**6,225.3**
Current debt	966.8	714.6	1,375.1	2,201.8	1,851.7	1,839.7
Non-current debt	15.0	1,522.8	1,638.6	1,779.1	2,992.2	3,100.2
Total interest-bearing debt	**981.9**	**2,237.3**	**3,013.7**	**3,980.9**	**4,843.9**	**4,939.9**
Interest-free liabilities	1,689.5	1,987.3	2,538.8	3,016.9	5,163.3	5,399.5
Total liabilities	**7,902.3**	**9,409.6**	**10,778.7**	**12,239.8**	**15,750.1**	**16,564.7**
Property, Plant and Equipment	2,224.1	3,447.6	4,679.4	7,043.5	10,790.8	11,027.9
Investments and other non-current assets	2,813.9	2,125.1	1,328.9	426.7	304.9	230.3
Cash and cash equivalent	232.8	21.2	243.4	137.0	204.2	205.5
Other current assets	2,631.5	3,815.7	4,527.1	4,632.7	4,450.3	5,101.0
Total assets	**7,902.3**	**9,409.6**	**10,778.7**	**12,239.8**	**15,750.1**	**16,564.7**
Ratios						
Cash flow:						
Operating cash flow : total debt (%)	71.3	10.5	33.9	22.4	36.5	5.7
Discretionary cash flow : net debt (%)	75.1	4.5	30.0	17.6	32.4	6.0
Profitability:						
Turnover growth (%)	1.6	(6.8)	50.9	28.8	5.2	(17.0)
Gross margin (%)	55.3	56.9	56.8	55.2	55.9	55.6
EBITDA : revenues (%)	19.0	10.7	14.6	17.1	17.5	22.7
Operating profit margin (%)	16.2	7.9	11.9	14.8	14.7	19.2
EBITDA : average total assets (%)	13.1	6.0	10.5	14.0	12.3	11.5
Return on equity (%)	9.0	0.7	4.0	3.0	1.9	1.9
Coverage:						
Operating income : gross interest (x)	4.0	1.6	2.7	3.4	2.6	2.6
Operating income : net interest (x)	4.4	1.6	2.7	3.4	2.6	2.9
Activity and liquidity:						
Trading assets turnover (x)	2.7	2.5	3.3	6.4	3.2	1.5
Days receivable outstanding (days)	105.7	103.7	47.5	47.7	81.7	136.4
Current ratio (:1)	1.1	2.1	1.7	1.2	0.8	0.9
Capitalisation:						
Net debt : equity (%)	14.3	42.7	53.0	73.3	80.8	76.1
Total debt : equity (%)	18.8	43.2	57.7	75.9	84.3	79.4
Total debt : EBITDA (%)	101.6	438.5	288.5	251.8	285.2	270.0
Net debt : EBITDA (%)	77.5	289.6	265.2	243.1	273.2	258.7

‡ Depreciation used as a proxy for maintenance capex expenditure

* 18 month period from June 2010 to December 2011

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument; and d.) the ratings expire in March 2016.

Fidson Healthcare Plc participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit rating/s has been disclosed to Fidson Healthcare Plc with no contestation of the rating.

The information received from Fidson and other reliable third parties to accord the credit rating included the 2014 audited annual financial statements (plus four years of comparative numbers), projections (operating and capital) for the years 2015 to 2019, unaudited management accounts to June 2015, industry comparative data and regulatory framework and a breakdown of facilities available and related counterparties. In addition, information specific to the rated entity and/or industry was also received.

The ratings above were solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the ratings.