



## Credit Rating Announcement

GCR upgrades Mecure Industries Limited's national scale ratings upon criteria review.

### Rating Action

Lagos, 5 August 2021 - GCR Ratings ("GCR") has upgraded Mecure Industries Limited's national scale long and short-term Issuer ratings to BBB<sup>+</sup><sub>(NG)</sub> and A2<sub>(NG)</sub> respectively. Concurrently, GCR has accorded a long term Issue rating of BBB<sup>+</sup><sub>(NG)(EL)</sub> to Mecure Industries Funding SPV Plc's Series 1 Senior Secured Bond ("Mecure SPV Series 1 Secured Bond"). The Outlook on the ratings is Stable

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
Mecure Industries Limited	Long Term Issuer	National	BBB <sup>+</sup> <sub>(NG)</sub>	Stable
	Short Term Issuer		A2 <sub>(NG)</sub>	
Mecure SPV Series 1 Secured Bond	Long Term Issue	National	BBB <sup>+</sup> <sub>(NG)(EL)</sub> *	Stable

\* The Series 1 Senior Secured Bond rating is based on an estimate of the expected loss in the event of an issuer default. As such, the rating carries an "(EL)" suffix.

### Rating Rationale

Mecure Industries Limited's ("Mecure; the Group; the Sponsor") ratings are supported by relatively strong market share in its niche, steady earnings progression, and above-peer profit margins. However, these are balanced against rising debt, and weak debt service metrics amid high working capital pressures induced by financial support to related parties.

Mecure maintains a mid-to-strong market position in the Nigerian pharmaceutical market, underpinned by a moderately diversified product base which includes over 140 drug formulations across nine therapeutic categories, in line with market demand. These are facilitated by its strong distributive network of over 100 distributors and long-term relationships with key input suppliers.

Underpinned by innovation and volumes growth, revenue has grown at a five-year CAGR of 10.2%, to a high of N17.4bn in FY20 (FY19: N15.8bn). However, revenue has underperformed expectations in both FY19 and FY20, due to capacity underutilisation in some of the product lines. Similarly, EBITDA progression has been slow with cumulative incremental earnings of only c.N800m between FY18 and FY20, even though earnings margins are above peer average. GCR expects a modest revenue growth (13%-16%) in FY21-22, driven by increase in capacity or acute medicines and the introduction of new products across other categories, albeit with modest contribution over the medium term. Slight margin enhancements could emerge from Mecure's plans to localise the production of nutraceuticals (currently imported as finished drugs), but the overall size will likely remain relatively small.

Management and governance are deemed neutral to the ratings, although GCR notes some deficiencies. The CEO is also the chairman of the Board of Directors and there are related party loans that are not under a solid contract or loan agreement. However, some of these shortcomings should be addressed ahead of the Company's planned listing on the Nigerian Stock Exchange in the near term.

Although, GCR considers Mecure's balance sheet to be fairly solid, debt service metrics are impacted by low EBITDA and weak operating cash flows. Specifically, operating cash flow coverage of debt has been low over the cycle, due to persistent rise in debt amid high working capital pressures. While we expect moderate improvement in cash flows on the back of lower interest payments and better working capital management, the coverage metric will remain

below intermediate level. Similarly, interest coverage has remained weak at around 2.8x since FY17. However, as Mecure has refinanced some of its expensive debt with concessional loan from the Central Bank of Nigeria and more recently, Bonds issued at favourable rate, we anticipate some improvement in the metric to a range of 4x-5x in FY21-22.

Given the significant investments in capacity expansion in the recent years, Mecure has increasingly made recourse to debt funding, with gross debt spiking from just N3.8bn in FY17 to N9.9bn in FY20. This notwithstanding, net debt to EBITDA has remained at a moderate level of 221% between FY18-20 (FY20: 241%). GCR anticipates an increase in debt by around N1.5bn in FY21, primarily for operational purposes, as Mecure now plans to scale back on capex spending. However, higher projected earnings should see gearing metrics trend below 200% in FY21-22. Access to diverse funding sources and the currently low short-term debt are positively noted.

The liquidity assessment is considered neutral to the ratings. Liquidity coverage is estimated at 1.56x and 1.1x over the next 12 and 24 months respectively, on the back of the low short debt redemption and moderate capex commitments. Given that cash holdings have been generally low and unutilised facilities are small (N240m at June 2021), adequate liquidity resources are contingent upon sound management of working capital which should help achieve expected solid operating cash flows. We note that there is ample covenant headroom, with loan covenants not including strict financial ratios. There is an all-asset debenture on Mecure's assets valued at a forced sale value of N6.5bn.

The final rating of the Series 1 Senior Secured Bond issued by Mecure Industries Funding SPV Plc<sup>1</sup> ("Mecure SPV") follows the receipt of final signed transaction documents and is obtained by applying a notching up approach, starting from the long term issuer rating of the Sponsor. The notching approach involves an assessment of the stressed estimated recovery rate expected from a forced sale of the assets that serve as security for the Issuer's outstanding bond obligation, under the assumption that the Issuer is in default. The stressed estimated recovery rate of 23.2% does not qualify the secured bond rating for any notch uplift. Nevertheless, the final Mecure SPV Series 1 Secured Bond rating is higher than the indicative rating due to an upgrade to the senior unsecured corporate rating of the Sponsor.

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## Outlook Statement

The Stable Outlook reflects GCR's expectation that Mecure will sustain steady revenue progression and remain profitable. We also anticipate that debt and gearing will remain at moderate levels over the rating horizon.

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## Rating Triggers

Upward rating migration is possible if Mecure significantly grows revenue and ramps up earnings, particularly, if this translates to improved cash flows. This will be dependent on the ability to successfully roll out meaningful number of new products (cutting across a more diverse range of therapeutic categories) over the outlook period. A sustainable improvement in credit protection ratios would also be positive.

Conversely, the ratings could be downgraded if debt materially rises beyond expectation, or if the Company makes higher recourse to short term debt which elevates refinancing risk and weakens liquidity coverage.

Should either of the long term rating assigned to the Sponsor, or the estimated recovery rate change, then the rating of Mecure SPV Series 1 Secured Bond will also change.

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## Analytical Contacts

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<sup>1</sup> Mecure SPV was incorporated as a special purpose vehicle with the sole object of raising debt capital through bond issuances for the purpose of purchasing the notes issued by the Sponsor.

## Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019  
Criteria for Rating Corporate Entities, May 2019  
Criteria for Secured Bond Expected Loss Credit Ratings, July 2021  
GCR Ratings Scales, Symbols & Definitions, May 2019  
GCR Nigeria Country Risk Scores, February 2021  
GCR Nigeria Corporate Sector Risk Scores, February 2021  
Mecure Industries Limited's Rating Report, 2020

## Ratings History

### Mecure Industries Limited

Rating class	Review	Rating scale	Rating	Outlook	Date
Long Term Issuer	Initial/last	National	BBB <sub>(NG)</sub>	Stable	March 2020
Short Term Issuer	Initial/last	National	A3 <sub>(NG)</sub>		
Long Term Issue	Initial/last	National	BBB <sub>(NG)(IR)</sub> <sup>+</sup>	Stable	December 2020

<sup>+</sup> IR stands for Indicative Rating

\* The Senior Secured Bond rating provides an estimate of the expected loss in the event of a default by the Issuer and is a function of the estimated probability of default of the Issuer and the potential losses that may be incurred. As such, the rating carries an 'EL' suffix. Should the Sponsor rating or the estimated recovery rate calculated by GCR change, the rating assigned to Mecure SPV Series 1 Secured Bond may also change. Prior to the publication of GCR's Criteria for Secured Bond Expected Loss Credit Ratings in July 2021, structured bond ratings did not carry the 'EL' suffix.

## Risk Score Summary

Rating Components & Factors	Risk scores
<b>Operating environment</b>	<b>7.00</b>
Country risk score	3.75
Sector risk score	3.25
<b>Business profile</b>	<b>0.50</b>
Competitive position	0.50
Management and governance	0.00
<b>Financial profile</b>	<b>(0.50)</b>
Earnings performance	0.50
Leverage and Cash flow	(1.00)
Liquidity	0.00
<b>Comparative profile</b>	<b>0.00</b>
Group support	0.00
Peer analysis	0.00
<b>Total Score</b>	<b>7.00</b>

## Glossary

Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.

Exposure	Exposure is the amount of risk the holder of an asset or security is faced with because of holding the security or asset. For a company, its exposure may relate to a product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an individual or company's vulnerability to various risks
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Leverage	Regarding corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Short Term	Current; ordinarily less than one year.

## Salient Points of Accorded Ratings

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

The credit rating has been disclosed to Mecure Industries Limited. The rating above was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the rating.

Mecure Industries Limited participated in the rating process via telephonic management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from Mecure Industries Limited and other reliable third parties to accord the credit ratings included:

- 2020 audited annual financial statement, and prior four years annual financial statements;
- management accounts for the period to 31 March 2021;
- Industry comparative data and regulatory framework and a breakdown of facilities available and related counterparties;
- Information specific to the rated entity and/or industry was also received;
- Final signed versions of Series 1 Trust Deed, Programme Trust Deed, Shelf Prospectus, Pricing Supplement, and Security Deed
- External Valuation Report by Adefila & Partners
- Legal Opinion from Banwo & Ighodalo
- Legal Opinion from Aluko & Oyebode

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