FINANCIAL ANALYSIS

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Financial ratios

	2018	2019	2020	2021	2022
FCFE (PKR)	1,180,314,291	1,984,748,532	3,442,156,777	4,482,804,703	4,637,161,442
Dividend payout ratio	50.80%	40.88%	35.23%	41.02%	33.88%
Dividend yield	3.74%	2.42%	2.50%	3.19%	3.70%
Long term debt	13.19%	11.08%	13.09%	8.17%	6.89%
Times Interest Earned	59.37	40.06	63.96	79.27	57.74
Cost of debt	1.82%	2.73%	1.55%	1.26%	1.84%
Long term debt to equity	17.84%	15.21%	18.93%	11.44%	9.86%
FCFF	755,401,851	826,680,955	98,031,595	796,715,482	2,913,191,937
Dividend	289,019,508	469,633,423	84,972,631	696,038,115	427,396,229
Equity ratio	73.93%	72.87%	69.15%	71.48%	69.87%

Standard deviation of prices	3.95%
Standard deviation of KSE 100	2.71%
Correlation of returns	0.466

Beta	0.678

Overview:

A thorough financial analysis of Highnoon Laboratories Limited is given in this publication. This study presents an examination of Highnoon Laboratories Limited with a focus on three primary areas: the company's capital structure, free cash flows, and dividend policy that has been in place for the last five years. The ratios in the report that follow provide information on the capital structure, financial position, and market risk of the company's PSX-traded shares. In addition to the statistics, a thorough analysis of the dividend and capital structure policies of the company is given. Highnoon is one of PSX's best companies, having stacked the "Forbes Asia's Best under a Billion" for three consecutive years.

About Highnoon limited:

Incorporation:

Incorporated in March 1984 as a Private Limited Company, Highnoon limited has its origins in the historical city of Lahore, Pakistan and became a Public Limited Company by 1995.

In collaboration with:

Highnoon supported the Internal Medicine Certificate Course that was organized by Aga Khan University (AKU) and Pakistan Society of Internal Medicine (PSIM) for capacity building of healthcare professionals around Pakistan.

Highnoon in collaboration with the European Society of Hypertension conducted a short course on Hypertension: Guidelines to Practice. The course was executed in 80 Cardiology & Medicine wards across the country. The Embassy of Japan and Pakistan Endocrine Society (PES), in collaboration with Highnoon, organized a live webinar about the Standardization of Diabetes Treatment. They are also in collaboration with other internationally recognized companies and universities on a recurring basis.

FINANCIAL ANALYSIS

CAPITAL STRUCTURE ANALYSIS:

For a company to finance its assets and continue with its aim of production and growth in the future, it is very important to set up and follow a well-thought-out and optimal capital structure to finance its required capital. The optimal capital structure varies from industry to industry. First of all, Capital Structure is the particular combination of **debt** and **equity** used by a company to finance its overall operations and growth. (*Capital Structure Definition, Types, Importance, and Examples*, n.d.)

Highnoon Laboratories, one of the major pharmaceuticals of Pakistan, uses the combination of **Long Term Debt** and **Equity** to finance its capital for overall operations and growth. The pattern we can observe in the capital structure adopted by the company is that during the years from 2018 to 2022, the company has overall increased its financing through long-term debt and has decreased the overall proportion of capital being financed by equity. In 2018, the long-term debt ratio was **13.19%**, which means that about 13% of the total assets were financed by the company taking long-term debt. In 2018, it dropped to **13%** and the reason for this was the issuance of shares against the transfer of plant and machinery and other assets.

Similarly, in 2019, it fell further from **13%** to **11%**. This shows that in 2019, company's assets now relied even less on long-term debt. There were several reasons for this, beginning with Highnoon successfully reducing long-term debt, issuing more equity against the transfer of plant, machinery, and other assets along with a sharp increase in assets; property, plant and equipment to be precise.

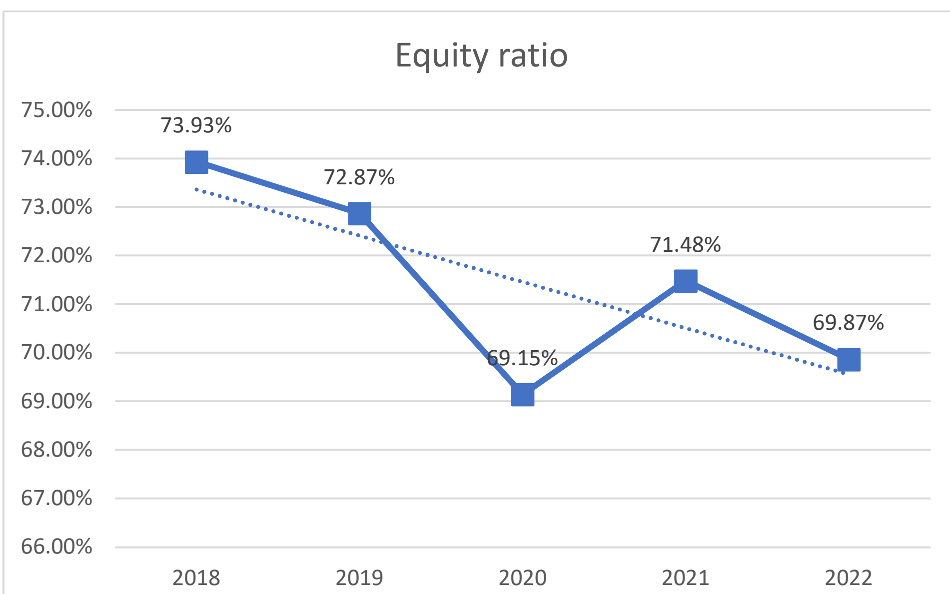
In 2020, the long-term debt ratio increased back to **13%**, and fell to **8%** in 2021. The reason for this fall commitment to debt reduction, leading to a further decline in its long-term debt by PKR 2.3 billion compared to 2019. Highnoon also experienced a surge in total assets. This significant expansion was primarily driven by a substantial rise in property, plant & equipment, and trade receivables. The report also mentioned additional refinancing of debt instruments, likely at even lower interest rates. This strategy, aimed at lowering the financial burden of debt, further improved Highnoon's financial standing. Not to mention strong operational performance, reflected in higher revenues and improved profitability, enhanced its ability to manage debt and maintain financial stability.

The combination of these factors led to a remarkable decline in Highnoon's long-term debt ratio from 13% in 2020 to a mere 8% in 2021. This significant improvement in debt management demonstrates the company's prudent financial strategies and ongoing commitment to financial sustainability.

The long-term debt ratio fell to its lowest for the period in 2022, reaching **6.89%**. This was also the result of a combination of factors, including the usual reduction in debt, issue of new shares and a rise in assets. Highnoon's profitability witnessed a significant improvement in 2022, reflected in higher gross profit margins and net income. This enhanced financial health enabled the company to comfortably manage debt obligations.

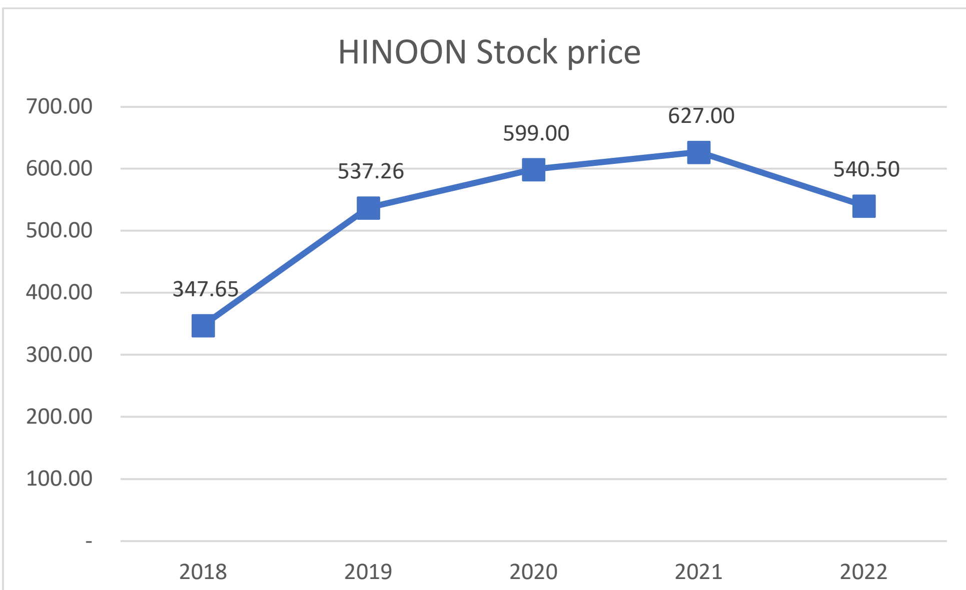
Now coming to the other portion of the capital structure opted by the company, which is the equity portion, it can be observed that the overall financing of the firm from issuing common shares on the PSX, rose sharply initially from 2018 to 2019 and stabilized only fluctuating by a little for the rest of the period, i.e., 2020 to 2022.

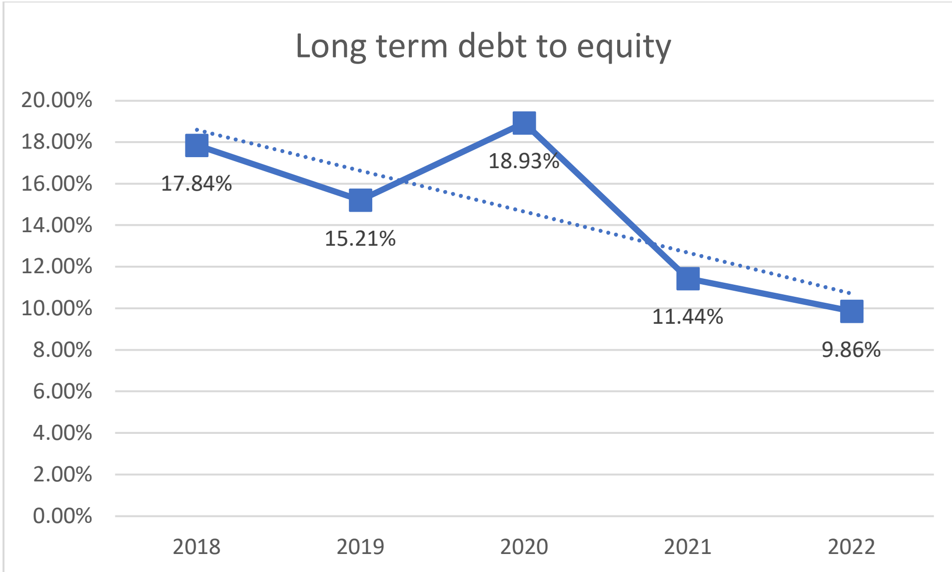
In 2018, Total Equity Ratio was **73.93%**, which shows that almost 74% of the total assets were financed through the funds obtained from total common equity, and in 2019, it declined slightly to **72.87%**. the overall trend is illustrated in the graph below.



The change in 2019 is simply the result of assets rising more than equity, mainly contributed by short term investments in various mutual funds, amounting to just over PKR 1 billion. In 2020, financing decreased to **69.15%**, which was due to an increase again in the short-term investments, amounting to around PKR 1 billion. This, like last year, led to the assets rising more sharply than the equity causing a decline in the ratio. The ratio continued to fluctuate in 2021 and 2022, calculated at a value of **71.48%** and **69.87%** respectively.

Overall, we can see that the financing from equity decreased during the 5 years from 2018 to 2022 and one of the major reasons for that was the impact of COVID-19 on the economic and business environment of Pakistan. Even though Highnoon being a pharmaceutical managed to find a silver lining in that cloud of uncertainty. The graph below shows the trend that the stock prices of Highnoon Laboratories followed from 2018 to 2022.





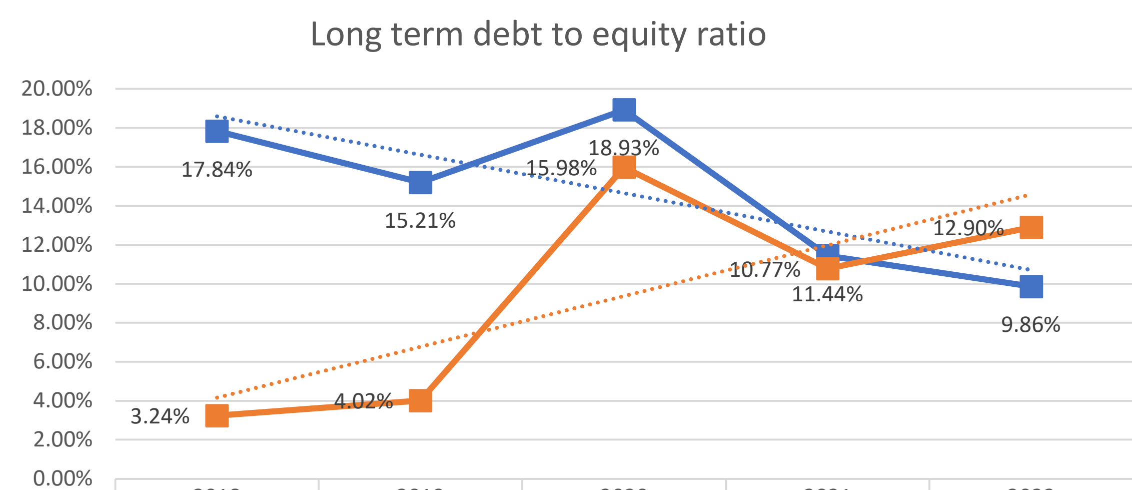
By looking at the graph above, we can notice that over the period of 5 years from 2018 to 2022, Highnoon has overall decreased its financing from long term debt.

In our opinion, the current capital structure and the pattern is following is not optimal according to the nature of the business and size of the firm. An optimal capital structure is the one which maximizes a company's market value and minimizes its cost of capital. Mostly, debt financing is considered a good way to move forward by many firms due to the tax benefit they get, but too much debt financing increases the credit risk of the firm and demotivates its shareholders and the value of its stocks. With the current pattern in the capital structure that we noticed above, we can see that Highnoon has leaned more and more towards equity and has overall focused on making their financial position safer as an 18.93% debt to equity ratio was pushing them to higher risk. Highnoon should still try to find the best fit between both sources of financing to minimize their cost of capital as much as possible, which is generally perceived to be a ratio between 10% to 20%.

If we compare the capital structure of Highnoon with one of its competitors in the industry, Abbot Laboratories, notice that both the companies follow quite a different trend in their structures, Highnoon initially inclines more towards debt financing and less towards equity financing, but Abbott has a much more financing from equity from debt and equity as two major sources of capital financing as compared to Highnoon.

The Graph below shows that although, both Highnoon and Abbott had very different financing decisions at the start of the period in 2018, the trend was inclining more towards debt, especially in 2020, where both companies financed more of their requirement from debt, indicating an impact from the pandemic.

As shown by the trendlines, both companies opted to balance their capital structures towards the later part, with Highnoon moving to more equity bring its ratio down to 9.86% in 2022, while Abbott went to increase debt % as earlier on they had most financing from equity.

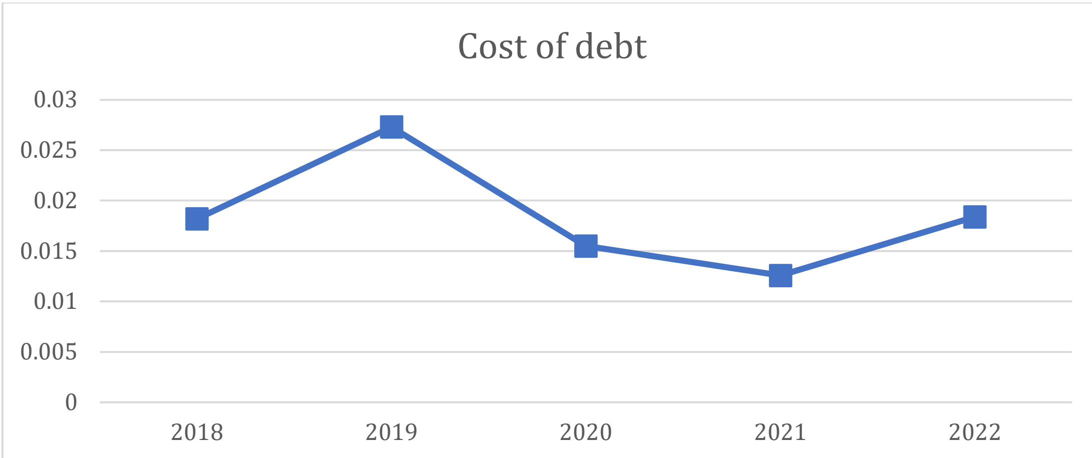


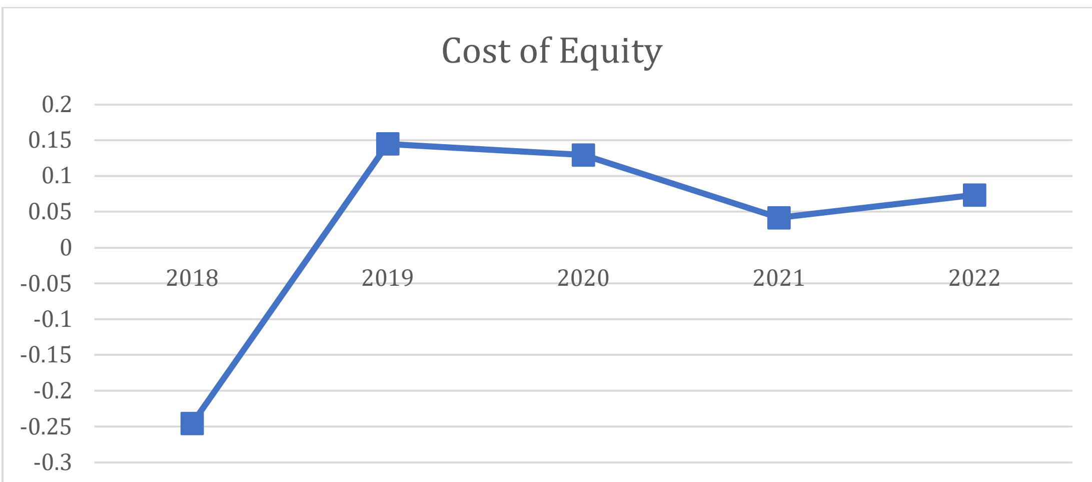
	2018	2019	2020	2021	2022
HINOON	17.84%	15.21%	18.93%	11.44%	9.86%
ABOT	3.24%	4.02%	15.98%	10.77%	12.90%

Debt, Equity and Dividend Analysis:

Cost of Debt and Cost of Equity:

The cost of debt refers to the post tax interest expense being paid over the total debt that a firm has. The cost of equity refers to the return a firm would have to pay to its investors and shareholders.

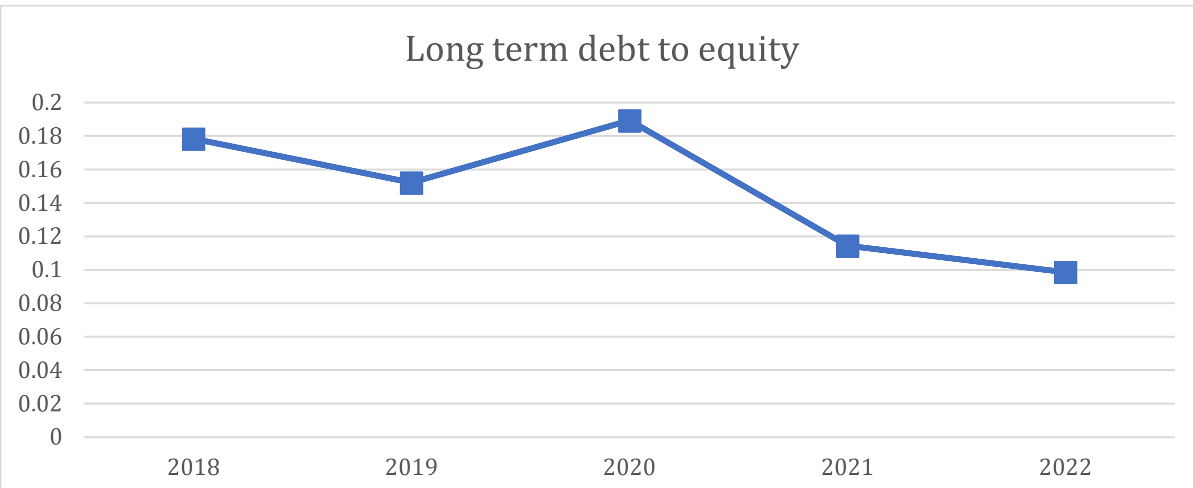




Highnoon saw its cost of debt moderately fluctuate, peaking at around 2.7% in 2019 and hitting a low in 2021 of roughly 1.3%. The cost of equity saw much greater fluctuations ranging from -25% to 15% the following year and then stabilizing around 10% after. Highnoon saw a major shift in its total capital from 2018 to 2022. Total assets were increased nearly 200% and these assets were financed largely through increasing equity. Despite this increase in capital by Highnoon, there was not a major shift in the capital structure. In 2018, the debt-to-equity ratio was 0.35, which went up to 0.44 but went back down to 0.39 the following year (now 0.43 in 2022). It appears Highnoon is keeping its debt at roughly 30% and its equity at roughly 70% through the years as they believe it to be optimal for their company. Highnoon did not increase its assets by a large amount from 2018 to 2020, so despite the cost of equity being in the negatives, and already having a larger share of their capital being through equity, they did not take on a great deal of equity or change their capital structure. The growth from 2020 (Covid-19 period) saw pharmaceutical companies like Highnoon see a great deal of opportunity. Although a portion of their growth was financed through equity (due to the falling or lower cost of equity in 2021), it was not disproportionate to their capital structure. This increase in capital is used to finance new research and development projects, infrastructure projects and an MCB loan which was granted is being utilized for solar projects keeping in line with goals to be more sustainable and environmentally friendly in the future.

Long term debt to equity:

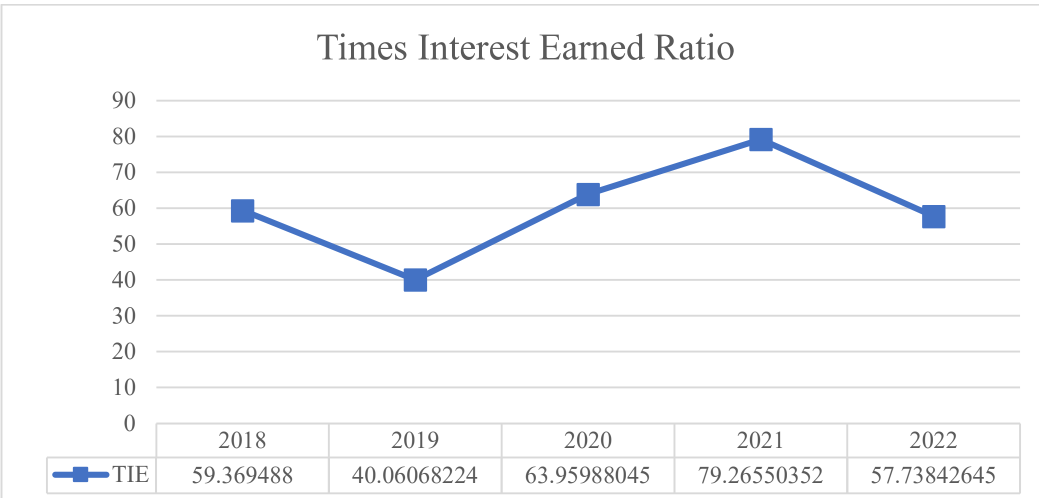
Long term debt to equity shows how much of a business' assets are financed through long term financial obligations. It is the long-term debt over shareholder equity.



Highnoon, being a largely equity-based firm, had a low long-term debt to equity ratio. This ratio has further fallen from just over 0.18 to 0.12 as Highnoon took on mostly short-term debt rather than long term debt. In fact, their long-term debt decreased from 2020 to 2021 by over 20%. Meanwhile, short term debt increased, for one due to long term liabilities becoming part of short-term liabilities, although that number did fall by a large portion in 2022 but are largely offset by a rise in unclaimed and unpaid dividends. There is a noticeable difference in short term borrowings as well particularly from 2021 to 2022 where it jumped over 10-fold. This is largely due to expansionary infrastructural and research projects as well as their solar and renewable power projects whose borrowing has increased the short-term debt significantly. It can be noted that trade and other payables are also sharply increasing 2020 to 2022 due to their expansions. These trends are likely to continue as Highnoon is reaping phenomenal increases in gross profit as well as EPS and after-tax profit in an ever-expanding market. Overall economic conditions in Pakistan may be unstable but certain local pharmaceutical companies are witnesses plenty of opportunities and growth.

Times Interest Earned (TIE):

TIE shows how many times the company's earnings could cover their interest expense.

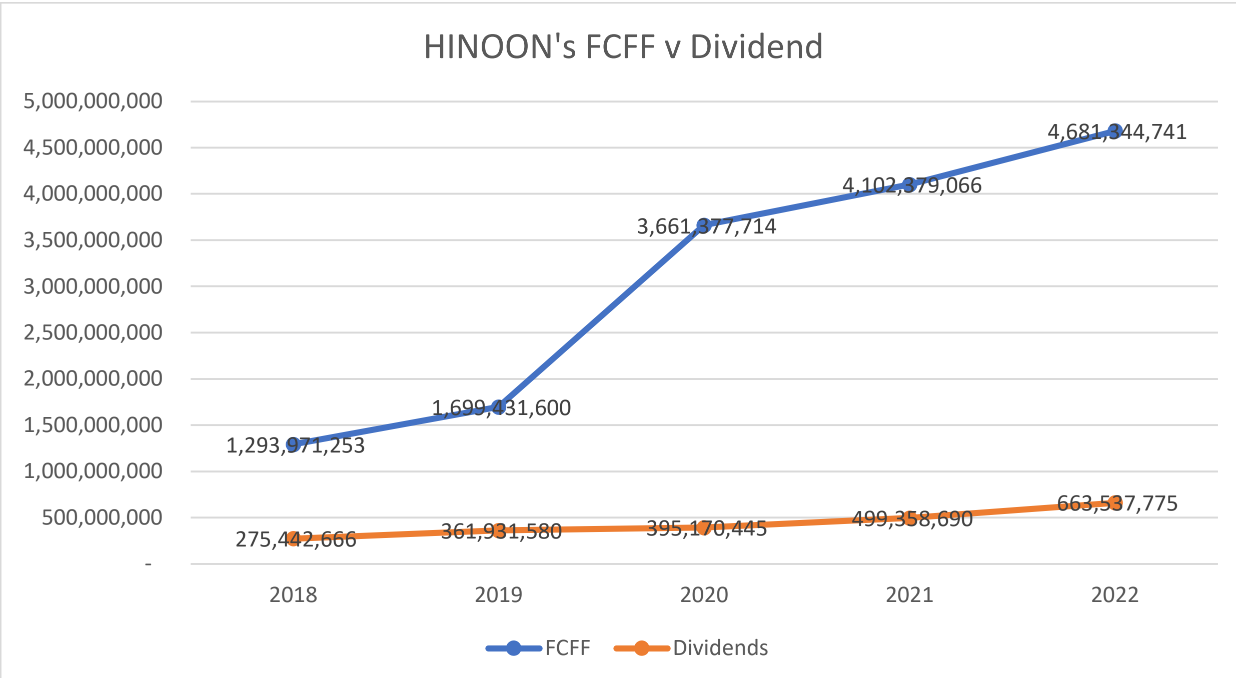


The increase in short term borrowing would naturally raise questions about loan repayment, as well as interest expenses. Highnoons' interest expense has increased from 18.25 million to over 60 million from 2018 to 2020 (31 million to 60 million from 2021 to 2022). For some firms this might be an alarming rate of increase or even a cause for concern. However, Highnoon is not one of those companies as it has a TIE ratio of just under 60 in 2018 and 2022, and it was as high as 79.2 in 2021. Highnoon is a largely equity-based company and the increase in short-term borrowing is no cause for concern at the moment, and probably will not be any soon. The ratio did fall significantly from 2021 to 2022, and with optimistic future plans it is likely to fall further with interest payment increasing despite EBIT increasing. Highnoon is also a cash-rich company with a fair share of its assets being cash and bank balances as well as short-term investments.

What is the relation of company's FCFF and dividends?

The free cash flow to the firm (FCFF) stands for the cash flow available for distribution after considering operational cash, depreciation, taxes, capital expenditures, and working capital. It serves as an indicator of a company's performance and its capacity to pay dividends. A higher

FCFF suggests the potential for increased dividend payouts, but the actual dividend changes are subject to the company's dividend strategy, investment initiatives, debt repayment, share buybacks, and other determining elements.



The graph indicates a positive correlation between the Free Cash Flow of the firm (FCFF) and the total dividends paid over a five-year period. The FCFF experienced a sharp rise compared to dividends.

From 2018 to 2019, FCFF increased from 1293 million to 1699 million primarily due to a 20% sales growth driven by the promotion of herbal and nutraceutical products. The herbal and nutraceutical segment generated Rs. 587 million in revenue, marking a 13% increase from the previous year. Additionally, control over distribution, selling, and marketing expenses resulted in a 1% decline in these costs relative to sales. Highnoon's dividend payout reduced from 50% to 40%, although a significant increase in net income led to a rise in total dividends paid, as seen in the less steep slope of the dividend line. The company kept funds for future expansion during this period.

Moving from 2019 to 2020, FCFF increased from 1699 million to 3661 million due to a 13% growth in profit margins attributed to enhanced efficiencies and marketing strategies. Notable improvements included batch-size enhancements, manpower optimization in printing and cartonating areas, and the installation of a pneumatic pump for solvent dispensing. Working capital increased from 2550 million to 3500 million due to growth in trade receivables. Dividends increased from 395 million to 499 million, with Highnoon maintaining a 38% payout ratio while improving its liquidity reserves.

From 2020 to 2021, the growth rate in FCFF declined but remained positive, increasing from 3661 million to 4102 million. Net profit improved by 27.3% due to a 22% increase in sales, driven by the launch of eight new products. Improvements in the supply chain, competitive sourcing, and efficient plant operations positively impacted overall FCFF. The dividend payout slightly improved from 38% to 41% to attract more shareholders.

In the transition from 2021 to 2022, FCFF rose to 4681 million due to a 34% rise in post-tax profit. Sales growth in exports and the launch of six new products contributed to this increase. However, there was a significant decline in working capital due to higher inventory and receivable turnover. The dividend payout policy fell to 33% as the company expects future growth, with general reserves rising from 5 million to 7 million. The firm plans to launch more than ten new products in the upcoming year.

The factors considered when paying dividends for each year.

Before determining annual dividend payments, various factors are assessed:

1. Financial Performance: The company's yearly earnings and financial health are crucial considerations to gauge its ability to distribute dividends.

2. Cash Flow: The availability of free cash flow post-operational expenses, investments, and financial commitments is pivotal.

3. Debt Situation: The company's debt structure and obligations are reviewed to ensure dividends won't compromise debt repayment or credit ratings.

4. Investment Plans: Evaluating planned capital expenditures, growth strategies, and expansion plans to secure funds for future growth.

5. Shareholder Expectations: Taking into account shareholders' expectations for dividend income, influencing dividend decisions.

6. Industry and Economic Trends: Analyzing economic landscapes, market trends, and industry conditions to anticipate potential impacts.

7. Regulatory Compliance: Ensuring adherence to legal regulations and any dividend-related restrictions.

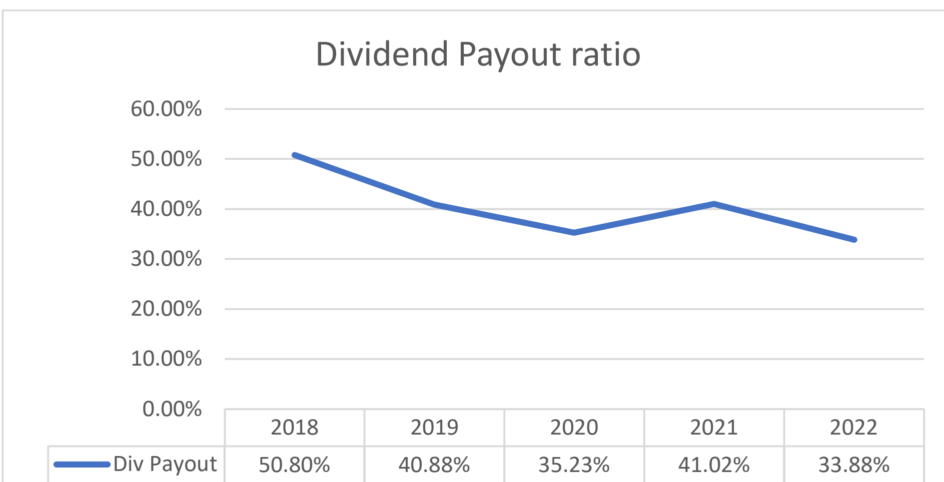
8. Cash Reserves: Maintaining adequate cash reserves and liquidity for unforeseen circumstances and operational needs.

9. Dividend History: Reviewing past dividend policies to maintain consistency or analyze changes in approach.

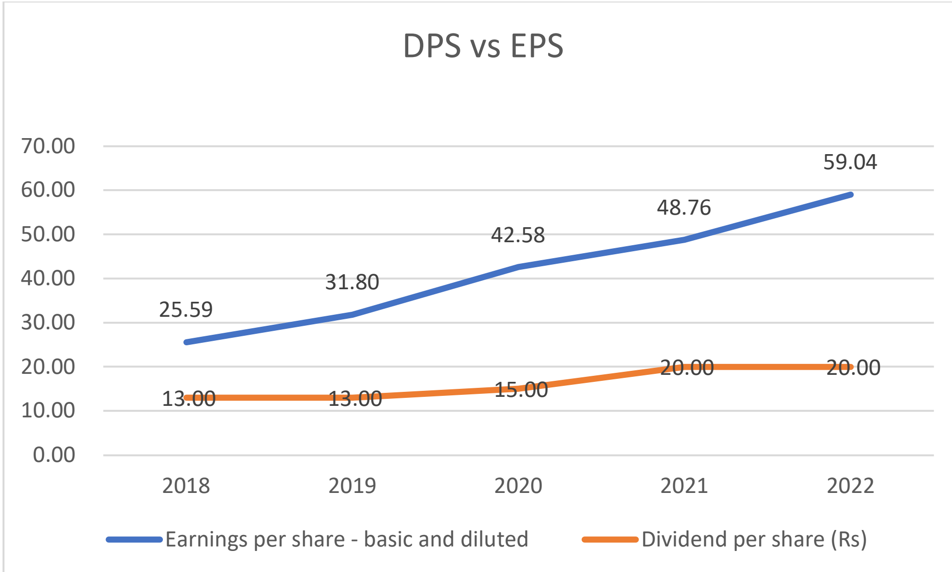
10. Management Strategy: Considering the company’s financial strategy and management’s stance on shareholder value through dividends.

These factors collectively guide the decision-making process around annual dividend distributions, aiming to balance shareholder interests, company growth, and financial stability.

Is the payout consistent? If changing, why?



	2018	2019	2020	2021	2022
Div Payout	50.80%	40.88%	35.23%	41.02%	33.88%



The dividend payout is not consistent and is intricately linked to the Earnings per Share (EPS). A higher EPS results in a lower payout ratio. Over the years from 2018 to 2022, the Earnings per Share increased significantly due to sustained sales growth. However, Highnoon, during this period, maintained a constant Dividend per Share at 13, which led to a decline in the payout ratio from 50% to 40%.

In 2020, there was a noticeable rise in EPS, increasing from 31 to 42.5, surpassing the rise in Dividend per Share, which moved from 13 to 15. This disbalance between EPS and dividend caused a further drop in the payout ratio.

The subsequent year, 2021, Highnoon decided to attract new shareholders and retain the existing ones by distributing Rs 20 per share as dividends. This move caused the payout ratio to increase from 35% to 40%.

In the final year under review, despite maintaining the Dividend per Share at 20, the company kept its focus on future growth. The EPS showed a significant rise from 48 to 59 due to the launch of new products. This led to a decrease in the payout ratio, dropping it to 33%.

Discussion of stock dividends/splits or repurchases.

In the year 2018, a bonus dividend of 12% was distributed to shareholders. This means that for every hundred shares an investor held, they received twelve additional shares from the company, effectively increasing the total number of shares they owned.

Subsequently, from 2019 to 2022, a 10% bonus dividend was issued each year. This 10% bonus dividend implied that for every hundred shares held by an investor in each of those years, they received ten additional shares from the company, consequently increasing the total number of shares they owned.

It's notable that during this entire five-year period (2018 to 2022), no shares were repurchased or bought back from the paid-up capital of the company. The increase in the number of shares outstanding was solely due to the issuance of these bonus dividends, which augmented the total number of shares held by investors without any reduction from the company's paid-up capital.