Company Name : Pharmaniaga Berhad
Date : 14 April 2017
Source : The Edge Financial Daily

Near-term headwinds ahead for Pharmaniaga

Pharmaniaga Bhd
(April 13, RM4.80)

Maintain sell with an unchanged target price (TP) of RM4.29: Pharmaniaga Bhd's uninspiring financial year ending Dec 31, 2016 (FY16) earnings (RM52.9 million; -40.3% year-on-year) largely reflected the government rationalising its expenditure and shifting towards a leaner procurement model.

We expect the trend of slower government offtakes to follow through in FY17 as evidenced by the healthcare allocation in Budget 2017 (RM4 billion versus RM4.6 billion for 2016). While the group has been working on a slew of measures aimed at diversifying its earnings base in the long run, which we are inherently positive on, its interim outlook still remains downcast on weaker demand from the concession business amid a rising cost environment.

To address immediate concerns, we expect Pharmaniaga to undergo an internal cost recalibration programme in FY17 to address some of the margin pressures it faces amid slower concession offtakes (inventory optimisation and the efficiency drive in its logistics department).

In the mid-term, we are upbeat on the prospect of Pharmaniaga's venture into the Indonesian market, which augurs well for the group's diversification strategy. Pharmaniaga's 55% subsidiary PT Millennium Pharmacon International Tbk had 31 distribution points across Indonesia as at FY16, and is in a strong position to benefit from the nation's increasing demand for medicines.

To note, GlobalData estimates that the Indonesian pharmaceutical industry is expected to grow to US$12.6 billion (RM55.69 billion) in FY20, from US$7 billion in FY15. Furthermore, PT Errita Pharma (manufacturing) is well positioned to benefit from the Jaminan Kesehatan Nasional (JKN) initiative, a universal healthcare programme which aims to provide 100% coverage of all Indonesians by 2019. This has fuelled demand for generic drugs in the nation. Indonesia accounted for 29% of its non-concession revenue in FY16 (FY15: 23%).

However, the success of the Indonesian venture largely hinges on successful registration of the right offerings in the JKN system, having passed the drug registration hurdle, and conquering the logistical challenge that Indonesia presents. We anticipate advancements into the private sector in FY17, on the back of a low-base effect. The group has turned its attention to capturing a greater share of the private business domestically amid waning concession orders. Despite its Indonesian and private-sector segments having shown positive signs, we anticipate near-term prospects to remain challenging for the bread-and-butter business, as lower concession orders (FY16: 51% of revenue; FY15: 56%) drag on earnings. Downside risks to the stock stem from lower-than-expected government offtakes and further depreciation of the ringgit. Our forecasts remain unchanged.

Despite its monopoly in the government concession business, we expect near-term headwinds driven by lower orders and higher finance cost to drag on earnings. As such, we maintain our "sell" rating on the stock. We maintain our TP of RM4.29 based on an FY18 price-earnings multiple of 15.6 times, on a par with international peers. — *Hong Leong Investment Bank Research, April 13*

Pharmaniaga Bhd

FYE DEC (RM MIL)	2015A	2016A	2017E	2018F
Revenue	2,189	2,189	2,314	2,380
Ebitda	184	151	159	178
Pre-tax profit	113	72	80	95
Patmi	84	44.7	60	71
Adj Patmi	89	52.9	60	71
Rep EPS (sen)	32.5	17.3	23.0	27.3
Adj EPS (sen)	34.3	20.4	23.0	27.3
Net DPS (sen)	30.0	16.0	15.0	17.8
Net dividend yield (%)	6.2	3.3	3.1	3.7
PER (x)	14.8	27.8	20.9	17.6
P/BV (x)	2.4	2.5	2.3	2.2
EV/Ebitda (x)	8.8	11.9	11.5	10.6
Net D/E (%)	0.7	1.1	1.2	1.2
ROA (%)	5.9	3.1	3.2	3.7
ROE (%)	15.8	9.5	10.4	11.8

Source: HLIB Research