

Bloomberg : PHRM MK

KLCI : 1,233.43

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Pharmaniaga Berhad

Prescription For Growth

Price (RM) : 3.22
 Target Price (RM) : 4.35
 Market Capitalisation (RMmn) : 344
 Board : Main
 Sector : Trading/Service
 Stock code : PHARMA (7081)
 Recommendation : BUY

KEY STOCK STATISTICS

YE 31 Dec	2007	2008F
EPS	46.8	60.6
P/E	6.9	5.3
Div / Share	18.0	
BV / Share	7.6	
Issued Capital	107	
52 weeks price change	-15%	
Major shareholders	UEM Berhad - 72.5%	

PER SHARE DATA

YE 31 Dec	2007	2008F	2009F	2010F
Book Value (RM)	7.6	8.1	8.7	9.5
Cash Flow (Sen)	5.3	60.3	48.1	94.9
Earnings (Sen)	46.8	60.6	88.0	102.9
Gross Dividend (Sen)	18.0	18.2	26.4	30.9
Dividend Yield (%)	5.6	5.6	8.2	9.6
PER (x)	6.9	5.3	3.7	3.1
ROE (%)	7.3	8.7	11.6	12.4

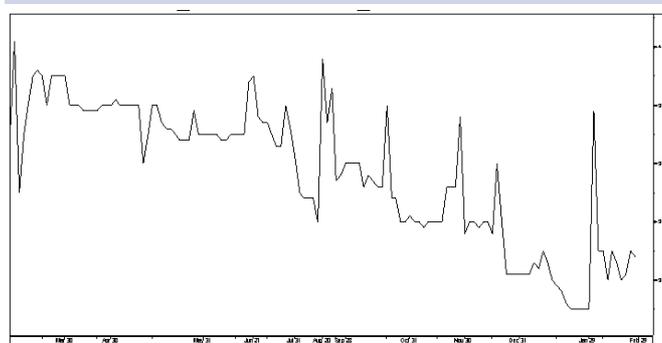
P&L ANALYSIS (RM mil)

YE 31 Dec	2007	2008F	2009F	2010F
Revenue	1184.0	1338.9	1482.8	1646.6
Cost of Revenue	1080.8	1217.3	1329.8	1473.5
EBITDA	103.2	121.6	153.0	173.0
Net Interest	5.4	1.5	1.2	0.9
Depreciation	21.6	21.9	22.3	22.7
Net Profit	50.1	64.9	94.2	110.1

We had the opportunity to meet with Pharmaniaga recently, and it gave us the pleasure to initiate coverage. The company offers a very exciting growth story, away from its traditional source of income - Government concession. Facing the perceived economic slowdown locally, the company is taking steps to fine tune its operation wherever possible. One of which is its cost control measure that has been fruitful since the last two quarters and shall be the impetus for future earnings escalation.

We are comfortable to initiate coverage with a BUY call to reflect our confidence in the company. Its fundamentals are intact. Their two-pronged strategy of 1) to sustain local market share by continuously fine-tuning its cost structure via efficient asset

Share Price Chart



Source: Bloomberg

utilization and 2) to diversify its geographical revenue base from overseas, underline our conclusion. Broadly speaking, the company is poised to grow with further upside potential stemming from better margin, as a result of a better cost control.

Background

Pharmaniaga is involved in healthcare industry. It has secured government concession that made close to 60% of its revenue stream. The business is non-cyclical and defensive in nature with demand for pharmaceutical products on the rise. Since 2006, Pharmaniaga has been aggressively diversifying its reliance on government concession by expanding into the private sector and foreign market. The quality certification, product rebranding and marketing team building can be viewed as a first step towards the diversification.

Growing industry

The market for pharmaceutical products is fast growing locally and regionally. The rising demand is due to an improvement in the standard of living because as consumers become more affluent, they pay greater attention to their health. As a basic necessity, pharmaceutical industry is recession-proof whereby demand would not be significantly affected during economic downturn.

From 1995 to 2004, domestic demand for pharmaceutical products has grown at an average of 16.3%. The market is estimated to grow at 11% a year for the next 5 years. In addition, the Government's effort towards improving healthcare services to the public through the construction of new hospitals and health clinics and the upgrading of existing hospitals has boosted sales for pharmaceutical and medical products.

Government Concession

Pharmaniaga has secured a 15 years concession agreement expiring in year 2009 to supply pharmaceutical and medical products to government hospital under the Health Ministry. Traditionally, this was its main source of revenue, making up almost 90% in the years prior to 2002. However, the company's current revenue mix has shifted to - 60% government concession and 40% non-government concession. The current concession would expire in November 2009. Not wanting to wait until the last minute before the actual expiry, it has already submitted the necessary documentation for extension/renewal of the current contract. Under normal circumstances, the government shall announce its decision latest by November 2008, a year before the actual expiry. In our opinion, the likelihood of getting an extension/renewal is high as a change in the vendor to supply to government hospital would require them to re-train its staff.

New Minister in MoH

Everybody knows what happened up there in MoH. We are not repeating the same story one too many times. Let's move on to assessing the impact it could have on the prospect of the company to renew its concession period, scheduled to end in November 2009. We asked the management regarding this. Simple answer given was - no impact on the prospect of a renewal. The main reason given by the management is that, the government is unlikely to want to re-train all the staff in hospitals. After all it's not a one man's decision. We concur with the management on this matter. We assumed continuation from government concession in building up our earnings estimates.

Overseas Expansion

Pharmaniaga best bet for growth lies overseas. Affirmative plans have been drafted to pave way for overseas expansion. To date, to countries is set to become its main destination. One is Kazakhstan, while the other in close to home, Vietnam.

Opportunities in Kazakhstan are very encouraging.

For a country of 15.4million people and GDP of USD7,730 per capita, the country has a lot to promise. Its citizens spend USD4.06bil or only USD264 per capita on healthcare and pharmacy. This is less than 3.4% of per capita income. This is good signal to tell us that opportunities are plenty in this resource laden country where the GDP is growing in excess of 9% since 2004. To put this into perspective, comparing a similar resource-based economy, for example, citizens in neighbouring Iran are spending 7.5% of their annual income for healthcare and pharmaceutical purposes. In the region, only Azerbaijan spends less, in terms of percentage, than Kazakhstan. In fact, to compare with general wealth of citizens of a country, Kazakhtanis are among the wealthiest but the thriftiest when it comes to spending on healthcare and pharmacy.

This tells us one thing. Opportunities are plentiful in Kazakhstan. As the GDP grow, more people would want access to better healthcare system. This translates into demand for pharmaceutical products. It's only a matter of time before all these could happen. Barring any political turmoil, it is safe to assume its GDP would be on steady march.

This said, we are approaching this with slight concern especially over Pharmaniaga's entrance strategy. It has not been unveiled just yet. But given the recent shame over the failure of Chinese venture, we hope the company would learn to be more prudent in appraising an entrance strategy. It could not afford to take another dent in its coffers.

Country	Population (mn)	GDP		Spending on healthcare	
		Per capita at PPP (USD)	Growth	USD per capita	% of GDP
Kazakhstan	15.4	7,730	9.0	264	3.4
Kyrgyzstan	5.3	1,870	6.5	102	5.4
Azerbaijan	8.4	4,890	31.0	138	2.8
Uzbekistan	26.7	2,020	8.1	160	8.0
Iran	69.5	8,050	4.3	604	7.5

Source: CIA World Factbook, WHO

Vietnam is nearby

Vietnam has a population of 84.3million people with GDP per capita of USD3,010, the mass market is certainly a lucrative one. The company had previous approach the country in a very ad-hoc manner. In recent years, Vietnam's pharmaceutical market increased constantly. During the past 16 years, the pharmaceutical consumption per capita of Vietnam posted over 10 times, from USD15 in 1990 to USD184 in 2006. Given that Pharmaniaga has some, albeit limited experience there, we are pleased to hear that the company is trying to tackle the market more seriously.

Country	Population (mn)	GDP		Spending on healthcare	
		Per capita at PPP (USD)	Growth	USD per capita	% of GDP
Vietnam	84.3	3,010	8.2	184	6.1
Cambodia	14.7	2,490	8.5	140	5.6
Thailand	64.3	8,440	4.3	293	3.5
Malaysia	24.3	10,320	6.0	445	4.3
Singapore	4.3	29,700	7.3	1,118	3.7

Source: CIA World Factbook, WHO

Valuation

Based on these points, we built our earnings estimates. Our forecasted numbers are based on two main assumptions i) cost cutting activities to increase margin ii) continuation of concession period which expires in Nov 2009. However there is further upside to our numbers as we are yet to factor in earnings from overseas venture. We are giving the company an undemanding valuation of 7.2x PER 2008, as the company seems to always be in a discount mode. In addition, the stock also suffers from lack of liquidity. This is effectively a 25% discount against the industry. We arrived at a fair value of RM4.35. We are recommending a BUY on the stock.

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