Pharmaniaga

Surging Ahead

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OUTPERFORM ↔

Price: RM6.14

Target Price: RM6.95 ↑

We came away from Pharmaniaga's company visit feeling positive about its prospects going forward. The key take-aways include: (i) Indonesian unit PT ERRITA expected to turn around in FY15, (ii) recent supply agreement with three teaching hospitals to boost revenue, and (iii) PHIS system is only expected to be implemented nationwide somewhere in FY15 and FY16. We maintain OUTPERFORM call on the stock with a higher TP of RM6.95 to reflect our higher revised earnings forecast and PE target of 16.5x compared to 14.5x previously, and rolling forward our valuation from FY15E to FY16E. Although Pharmaniaga's share prices have been performing well since our initiating coverage back in Nov 2014, rising 36%, we believe that the stock has further upside.

New supply agreement with three teaching hospitals could raise revenue. Recall, Pharmaniaga has over the past few months signed exclusive agreements to solely undertake the services of purchasing, storing, supplying and delivering drugs and non-drugs to three teaching hospitals namely Hospital University Sains Malaysia, Hospital University Kebangsaan Malaysia and Hospital University of Malaya. All three agreement concessions will end in Nov 2019. We expect the three teaching hospitals to contribute RM160m per annum or 7% to Pharmaniaga's topline. We expect topline contribution to double from the low base of which we have yet to factor into our earnings model. However, gross profit margins are expected to be lower by 2-3ppts compared to the Government hospitals' concession. We are not overly concerned as the higher volume would make up for the lower margins.

Pharmacy Information Systems (PHIS) to only be fully implemented nationwide somewhere in FY15 and FY16. We understand that the PHIS system is only expected to be rolled out nationwide somewhere between 2015 and 2016. As such, we believe the higher cost from the PHIS implementation is expected to hit Pharmaniaga in end FY15 or starting from FY16. However, the slack from lower margin in the logistics & distribution division (PHIS system cost incurred in this division) will be more than taken up by the manufacturing division. We have sufficiently factored in this cost into our earnings model. PHIS plays a vital and integral role in ensuring the dispensing of drugs to patients and management of stock levels under the concession agreement.

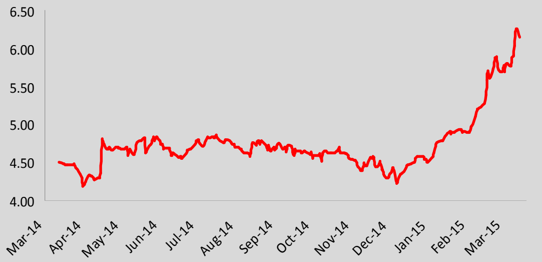
Indonesia unit PT Errita Pharma expected to turn around in FY15. Pharmaniaga' 75%-owned Indonesian manufacturing based PT Errita Pharma, which suffered a loss in RM2.9m in FY14 is expected to turn around in FY15. The reasons are: (i) the low utilisation rate of 50-60% in FY14 was due to delay in the registration of ten new products, which was rectified and approved in end 2014, and (ii) absence of kitchen sinking or provision made in FY14.

Separation of drugs prescription and dispensing could pose risk to earnings? Speculation is rife that the Health Ministry may soon prohibit doctors from dispensing drugs to their patients and hence diminish their roles to only prescribing. It was also reported in the media that organisations representing doctors and pharmacists have agreed, in principle, that dispensing be left to the pharmacists. Pharmaceutical players are unlikely to be affected since they still be supplying to the dispensers (whoever they may be) and consumption of drugs are essential for healthcare reasons. Specifically, revenue generated by Pharmaniaga (under our coverage) is supported by government concessions, non-government purchasers and exports to a smaller extent.

Raising our FY15E and FY16E net profit by 2-3% Overall, we are raising our FY15E and FY16E net profits by 2-3% as we assume higher revenue contribution from the new supply agreements with the teaching hospitals. Correspondingly, we raised our TP from RM5.45 to RM6.95. Apart from the higher earnings forecasts, the upgrade in our TP also reflects a higher 1-year forward PER rating of 14.5x to 16.5x and rollover in valuation from FY15E to FY16E.

Maintain OUTPERFORM. We continue to like Pharmaniaga for: (i) its defensive earnings being a prime beneficiary as the sole concession holder to purchase, store, supply and distribute approved drugs and medical products to Government hospitals and clinics nationwide, (ii) its growth exposure in the healthcare and pharmaceuticals industry supported by an ageing population, and (iii) decent dividend yield of 5%.

Share Price Performance



KLCI	1,795.85
YTD KLCI chg	2.0%
YTD stock price chg	34.1%

Stock Information

Bloomberg Ticker	PHRM MK Equity
Market Cap (RM m)	1,589.5
Issued shares	258.9
52-week range (H)	6.25
52-week range (L)	4.10
3-mth avg daily vol:	230,300
Free Float	26%
Beta	0.8

Major Shareholders

BOUSTEAD HOLDINGS BH	56.4%
LEMBAGA TABUNG ANGKA	12.4%
VALUECAP SDN BHD	5.4%

Summary Earnings Table

FYE Dec (RM m)	2014E	2015E	2016E
Turnover	2122.9	2324.6	2545.4
EBIT	140.2	155.2	176.2
PBT	125.5	145.6	163.4
Net Profit (NP)	93.8	100.0	109.0
Core NP	93.8	100.0	109.0
Consensus (NP)	-	100.9	104.7
Earnings Revision	-	+3%	+2%
Core EPS (sen)	36.2	38.6	42.1
Core EPS growth (%)	69.9	6.7	9.0
NDPS (sen)	28.0	29.9	29.5
BVPS (RM)	2.03	2.12	2.25
PER (x)	16.9	15.9	14.6
Price/NTA (x)	3.0	2.9	2.7
Net Gearing (%)	32.1	39.9	41.6
Net Div Yield (%)	4.6	4.9	4.8

Income Statement

FY Dec (RM m)	2012A	2013A	2014A	2015E	2016E
Revenue	1812.3	1946.6	2122.9	2324.6	2545.4
EBITDA	160.3	160.4	189.9	209.2	229.1
Depreciation	-44.1	-54.5	-49.7	-54.0	-52.9
Operating profit	116.3	105.8	140.2	155.2	176.2
Other income	1.1	1.3	1.3	3.3	4.2
Interest Exp	-15.0	-14.7	-16.8	-13.8	-17.8
Associate	0.0	0.0	0.0	0.0	0.0
PBT	103.3	93.0	125.5	145.6	163.4
Taxation	-40.1	-36.2	-31.4	-45.1	-53.9
Minority Interest	-1.5	-1.6	-0.4	-0.4	-0.5
Net Profit	61.7	55.2	93.8	100.0	109.0

Balance Sheet

FY Dec (RM m)	2012A	2013A	2014A	2015E	2016E
Fixed Assets	339.7	353.4	369.8	410.2	451.6
Intangible Assets	149.5	124.5	233.0	233.0	233.0
Other FA	10.3	18.7	35.7	35.7	35.7
Inventories	464.9	410.5	427.0	490.2	536.8
Receivables	199.5	132.4	142.9	156.5	171.4
Other CA	24.4	38.6	2.3	2.3	2.3
Cash	34.6	32.9	32.0	87.1	109.8
Total Assets	1,222.8	1,111.0	1,242.7	1,415.0	1,540.6
Payables	306.2	337.4	448.6	491.2	537.8
ST Borrowings	341.0	199.6	200.1	260.0	300.0
Other ST Liability	76.6	52.9	6.5	8.1	8.1
LT Borrowings	0.1	0.3	1.1	46.2	51.9
Other LT Liability	11.2	17.6	34.5	34.5	34.5
Minorities Int.	15.8	15.6	25.5	25.9	26.4
Net Assets	**472.0**	**487.6**	**526.5**	**549.1**	**581.9**
Share Capital	117.7	129.4	129.4	129.4	129.4
Reserves	354.3	358.2	397.1	419.7	452.4
Equity	**472.0**	**487.6**	**526.5**	**549.1**	**581.8**

Cashflow Statement

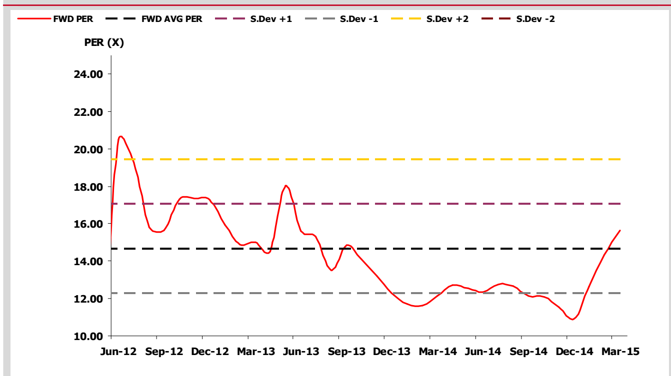
FY Dec (RM m)	2012A	2013A	2014A	2015E	2016E
Operating CF	16.7	254.9	213.5	120.3	147.5
Investing CF	(127.3)	(84.0)	(154.5)	(60.0)	(60.0)
Financing CF	89.5	(171.3)	(60.1)	(5.1)	(64.9)
Change In Cash	(21.1)	(0.4)	(1.2)	55.1	22.6
Free CF	(5.8)	211.4	123.5	60.3	87.5

Financial Data & Ratios

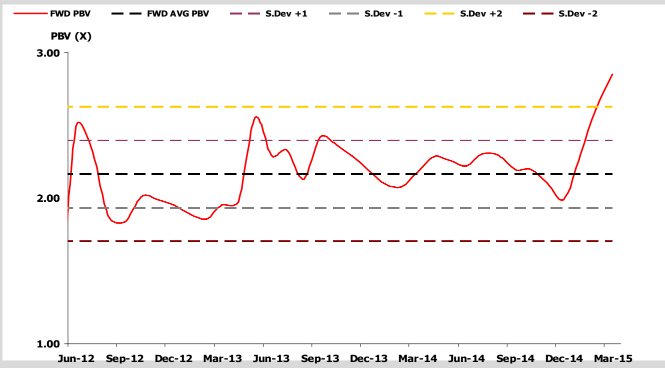
FY Dec (RM m)	2012A	2013A	2014A	2015E	2016E
Growth					
Turnover (%)	19.2%	7.4%	9.1%	9.5%	9.5%
EBITDA (%)	39.9%	0.0%	18.4%	10.2%	9.5%
Operating Profit (%)	56.4%	-9.0%	32.5%	10.7%	13.5%
PBT (%)	41.2%	-10.0%	35.0%	16.0%	12.2%
Core Net Profit (%)	18.3%	-10.5%	69.9%	6.7%	9.0%
Profitability (%)					
EBITDA Margin	8.8%	8.2%	8.9%	9.0%	9.0%
Operating Margin	6.4%	5.4%	6.6%	6.7%	6.9%
PBT Margin	5.7%	4.8%	5.9%	6.3%	6.4%
Core Net Margin	5.50%	8.10%	8.50%	6.60%	6.50%
Effective Tax Rate	38.8%	39.0%	33.0%	31.0%	33.0%
ROA	5.0%	5.0%	7.5%	7.1%	7.1%
ROE	13.1%	11.3%	17.8%	18.2%	18.7%
DuPont Analysis					
Net Margin (%)	3.4%	2.8%	4.4%	4.3%	4.3%
Assets Turnover (x)	0.7	0.6	0.6	0.6	0.6
Leverage factor (x)	2.6	2.3	2.4	2.6	2.6
ROE (%)	13.1%	11.3%	17.8%	18.2%	18.7%
Leverage					
Debt/Asset (x)	0.3	0.2	0.2	0.2	0.2
Debt/Equity (x)	0.7	0.4	0.4	0.6	0.6
Net Cash/(Debt)	-306.5	-167.0	-169.2	-219.1	-242.1
Net Debt/Equity (x)	0.6	0.3	0.3	0.4	0.4
Valuations					
EPS (sen)	23.8	21.3	36.2	38.6	42.1
NDPS (sen)	6.3	16.0	28.0	29.9	29.5
BVPS (RM)	1.82	1.88	2.03	2.12	2.25
PER (x)	25.8	28.8	16.9	15.9	14.6
Net Div. Yield (%)	1.0	2.6	4.6	4.9	4.8
P/BV (x)	3.4	3.3	3.0	2.9	2.7

Source: Kenanga Research

Fwd PER Band



Fwd PBV Band



Source: Bloomberg, Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10% (an approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%).
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of 3% to 10%.
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than 3% (an approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate).

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10% (an approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%).
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of 3% to 10%.
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than 3% (an approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate).

***_**Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**_

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