# Pharmaniaga Berhad

(7081 | PHRM MK) Health Care | Pharmaceuticals

***Maintain* BUY**

**Net profit slip on staff cost and marketing expenses**

***Revised* Target Price: RM0.87**

*(previously RM0.97)*

## KEY INVESTMENT HIGHLIGHTS

- **Pharmaniaga's net earnings slipped -95%yoy; below yearly earnings forecast**
- **Earnings dropped due to higher expenses for staff, advertising**
- **Revenue down -35%yoy due to lower sales from MOH and lower demand during festive season**
- **Revise FY23-24 earnings forecast down by 61% and 46%**
- **Maintain BUY with revised TP of RM0.87 per share**

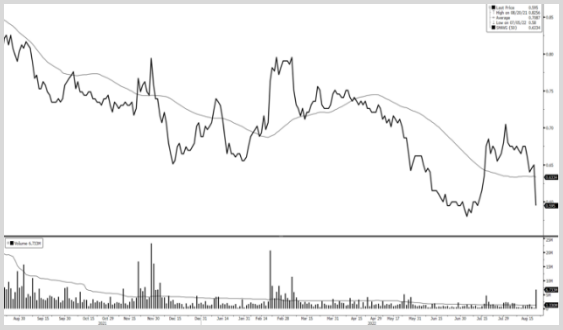
**-95%yoy earnings drop.** Pharmaniaga Berhad (Pharmaniaga) recently announced a sharp drop in earnings by -94.7%yoy and -97.4%qoq to RM722,000. Cumulatively for the first half, earnings declined by -22.8%yoy to RM28.5m; which came in below our expectations at 30% of our yearly earnings estimates, and at 52% of consensus'. This was mainly due to: (i) higher operating expenditure incurred from higher staff costs subsequent to the reorganisation exercise, (ii) higher marketing and promotion expenses, and (iii) higher finance costs on the back of higher borrowings.

**Revenue down by -35%yoy.** The group also reported a revenue drop by -35.3%yoy and -20.9%qoq to RM761.1m. For the first half of the year, revenue slipped -12.6%yoy to RM1.72b. The lower revenue in comparison with a year prior corresponded to the shift into a Covid-19 endemic phase. Additionally, Pharma reported lower sales from its non-concession segment due to timing of orders from MOH on products under the tender business. Meanwhile, Indonesia dragged the revenue further due to festive seasons during the reporting quarter, although mitigated by improvement in efficiency in its operations and sales. Nevertheless, the group recorded a robust growth in concession segment attributed by additional products being listed in the list, and improved contribution from the private sector by +30% from increased promotional marketing efforts.

**Logistics and Distribution.** This segment's revenue slipped -12.6%yoy and -24.4%qoq to RM534.6m, while earnings lost >100% to a deficit of -RM10.5m, from a loss of -RM1.1m in 2QFY22 and a profit of RM30.7m in 1QFY22. For the cumulative first half, revenue rose up by +3.2%yoy to RM1.24b, while earnings dropped by -5.9%yoy to RM20.2m. This was mainly attributable to higher operating expenses, offset by stronger contributions from the concession business on the back of: (i) additional products in the concession list, (ii) higher demand of inhouse products from MOH, and (iii) higher sales from increased advertising and promotional activities.

| RETURN STATISTICS | |
|---|---|
| Price @ 19th August 2022 | 0.60 |
| Expected share price return (%) | +46.2 |
| Expected dividend yield (%) | +6.6 |
| **Expected total return (%)** | **+52.8** |

**SHARE PRICE CHART**



| Share price performance (%) | Absolute | Relative |
|---|---|---|
| 1 month | -11.9 | -16.3 |
| 3 months | 0.0 | -14.3 |
| 12 months | -35.3 | -34.9 |

| KEY STATISTICS | |
|---|---|
| FBM KLCI | 1,504.44 |
| Syariah compliant | Yes |
| F4GBM Index | Yes |
| ESG Grading Band | ☆ |
| Issue shares (m) | 1309.96 |
| Estimated free float (%) | 34.82 |
| Market Capitalisation (RM'm) | 779.43 |
| 52-wk price range | RM0.57 - RM0.94 |
| Beta vs FBM KLCI (x) | 0.74 |
| Monthly velocity (%) | 0.00 |
| Monthly volatility (%) | 19.93 |
| 3-mth average daily volume (m) | 1.33 |
| 3-mth average daily value (RM'm) | 0.87 |
| Top Shareholders (%) | 0 |
| Boustead Holdings Bhd | 51.85 |
| Lembaga Tabung Angkatan Tentera | 8.62 |
| UBS AG | 1.44 |

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**Manufacturing.** This segment recorded a drop in revenue by -83.1%yoy and -2.6%qoq to RM534.6m, while earnings saw a >100% loss from RM8.3m in 2QFY21 and RM14.2m in 1QFY22 to a loss of -RM1.2m in the reporting quarter. Cumulatively for 1HFY22, revenue lost -70.7%yoy to RM134m and earnings declined by -30.8%yoy to RM13m. This is likely due to the expansion of the group's pharmaceuticals portfolio, offset by its increased capacity utilisation via its contract manufacturing business. Additionally, demand for supplements had been down during the second quarter due to the festive seasons affecting sales.

**Indonesia.** The group's Indonesian division recorded a rise in revenue by +2.8%yoy but a lost by -9.3%qoq to RM224.4m. Earnings however declined >100% from a deficit of -RM3,000 in 2QFY21 and from RM8.9m in 1QFY22 to a loss of -RM5.1m. For the cumulative first half, revenue jumped +12.4%yoy to RM471.9m, and similarly earnings surged >100%yoy to RM3.8m from a deficit of -RM1.1m in 1HFY21. This was primarily due to its operational efficiency through digitalisation as well as aggressive sales efforts.

**Moving forward.** Pharmaniaga's Indonesian business is expected to sustain with the aim of capitalising the Indonesian population of 280 million population. On the local front, the group is focusing to continue leveraging its portfolio and boost sales in the private market, especially for over-the-counter and supplement products, whilst concentrating on the extension of its logistics and distribution agreement with MOH - targeted to be executed by 4QCY22. A recent surge in demand of its generic drugs by 4-fold is due to Government's approval to release the national medicine stockpile to the private sector, which resulted in shortages. However, it is expected that the shortage will begin to normalise by the end of the year. The group will also to continue on its R&D for halal products and preparedness for signs of a resurgence of covid-19 in the near future. Pharmaniaga remains cautious yet positive of its prospects; taking into consideration of various market uncertainties impacting the global economy such as the rise in raw material prices and increased in interest rates.

**Risks and challenges.** While the uncertain results of the marketing strategies are a challenge on their own in the near term, drug security remains a major concern for Pharmaniaga and the subsector as a whole. Both biopharmaceutical products (such as insulin) and vaccines are mostly imported, and plants for such products are very new and expensive to manage. The high reliance on imported drugs threatens Malaysia's drug security, in addition to the stockpile security in situations when demand in local and regional fronts upsurge. Another challenge is the lack of in-house drug formulations that could assist in a more efficient manufacture and distribution business. However, this is mitigated by the group's continuous investment in R&D and policymakers as an advisory collective for the creation of its products, especially biopharmaceuticals. Other minor risks include: (i) high Active Pharmaceutical Ingredient (API) prices, (ii) increased tax rates, and (iii) increased fuel cost.

**Revised FY23-24 earnings estimates.** In consideration of the above, we revise our earnings estimates for FY23 and FY24 downwards by -61% and -46% respectively. As such, we reduce our **target price to RM0.87** (previously RM0.97) based on pegging a PER of 14x to the revised EPS23 of 6.3sen. We based our PER on the group's 5-year average.

**Maintain BUY.** All in all, we maintain our **BUY** call on Pharmaniaga with the **revised target price of RM0.87.**

Despite the lower net profit in the reporting quarter due to extensive employment and marketing expenses, as well as mellowed Covid-19 vaccine request locally and regionally, gross profit had seen an increase in comparison to a year prior, indicating a positive trajectory to its operations. Marketing strategies are expected to continue 3 to 5 years more, with an estimated investment budget of RM10 – 15 million per annum. The group is also planning to tender at least 40 new products with MOH, which will be finalised by end-year. Vaccine-wise, most of its fill-finish vaccines has an expiry date of up to 2HCY24, hence sales on the vaccines can proceed to carry value in the group's orderbook. The group reported that it will be discussing further distribution plans to Africa for its vaccines and other consumables. Pharmaniaga's in-house over-the-counter (OTC) and supplement products had yet to touch 5% of local consumers as its OTC products has a small presence in the market (approximately <1%). As such, the group is aggressively hiring new marketing staff while pushing for more initiatives to make its brands more known while demand for said products are high.

Pharmaniaga's participation in WHO as elected by the Government is a solid proof of its robust portfolio and resilient operations. We believe its move to invest in a proper marketing plan would greatly benefit its operations in the long run, as well as its initiatives in: (i) establishing its own brand of pharmaceuticals as household names, (ii) digitalisation of product distribution and sales, (iii) long-term efficient cost management in its logistics and manufacturing segments, and (iv) halal vaccines, consumables and biopharmaceuticals.

## INVESTMENT STATISTICS

| Financial year ending 31st December (in RM'm, unless otherwise stated) | 2020A | 2021A | 2022E | 2023F | 2024F |
|---|---|---|---|---|---|
| Revenue | 2,725.1 | 4,815.0 | 4,574.3 | 4,803.0 | 5,283.3 |
| Cost of sales | (2,726.5) | (4,185.0) | (4,116.8) | (4,298.7) | (4,596.4) |
| Gross profit | (1.5) | 630.0 | 457.4 | 504.3 | 686.8 |
| **Profit after tax** | **(270.4)** | **172.2** | **74.3** | **78.0** | **120.2** |
| **Normalised PATAMI** | **(81.5)** | **172.2** | **76.6** | **82.0** | **126.2** |
| Normalised EPS (sen) | 2.1 | 13.1 | 5.8 | 6.3 | 9.6 |
| EPS growth (%) | -86.0 | 526.0 | 30.4 | 129.1 | 183.3 |
| PAT margin (%) | -9.9 | 3.6 | 1.6 | 1.6 | 2.3 |
| Normalised PATAMI margin (%) | -3.0 | 3.6 | 1.7 | 1.7 | 2.4 |
| PER (x) | 46.3 | 7.8 | 14.9 | 13.9 | 9.0 |
| Dividend per share (sen) | 0.0 | 5.0 | 5.3 | 5.8 | 9.2 |
| Dividend yield (%) | 0.0 | 4.9 | 6.0 | 6.6 | 10.5 |

*Source: Company, MIDFR*

## Table 1: Pharmaniaga's quarterly earnings review

| Financial year ending 31st December (in RM'm unless otherwise stated) | Quarterly results | | | | | Cumulative results | | |
|---|---|---|---|---|---|---|---|---|
| | 2QFY21 | 1QFY22 | 2QFY22 | QoQ (%) | YoY (%) | 1HFY21 | 1HFY22 | YoY (%) |
| Revenue | 1,177.1 | 962.2 | 761.1 | (20.9) | (35.3) | 1,970.6 | 1,723.3 | (12.6) |
| Cost of sales | (1,079.4) | (846.4) | (676.3) | (20.1) | (37.4) | (1,782.1) | (1,522.6) | (14.6) |
| **Gross Profit** | **97.7** | **115.8** | **84.8** | (26.7) | (13.2) | **188.5** | **200.6** | 6.4 |
| Other income | 0.3 | 0.2 | 0.1 | (64.9) | (79.2) | 0.5 | 0.3 | (52.1) |
| Operating expenses | (67.6) | (70.7) | (71.0) | 0.4 | 5.0 | (121.9) | (141.7) | 16.3 |
| **EBIT** | **30.4** | **45.3** | **13.9** | (69.3) | (54.3) | **67.2** | **59.2** | (11.9) |
| Finance cost | (8.4) | (8.2) | (9.6) | 17.0 | 14.3 | (13.8) | (17.8) | 28.6 |
| Interest income | 0.2 | 0.3 | 0.2 | (32.5) | (8.3) | 0.4 | 0.5 | 46.8 |
| **Profit Before Tax and Zakat** | **22.2** | **37.4** | **4.5** | (87.9) | (79.7) | **53.8** | **42.0** | (22.0) |
| Zakat | (0.6) | (0.6) | (0.6) | 0.0 | 0.0 | (1.2) | (1.2) | 0.0 |
| Income tax | (7.8) | (8.0) | (3.0) | (62.3) | (61.2) | (15.9) | (11.0) | (30.7) |
| **Profit After Tax** | **13.9** | **28.9** | **0.9** | (96.8) | (93.4) | **36.7** | **29.8** | (18.9) |
| Minority interest | 0.2 | 1.1 | 0.2 | (82.9) | 4.3 | (0.1) | 1.3 | (1,159.7) |
| **PATAMI** | **13.7** | **27.7** | **0.7** | (97.4) | (94.7) | **36.8** | **28.5** | (22.8) |
| **Normalised PATAMI** | **13.7** | **27.7** | **0.7** | (97.4) | (94.7) | **36.8** | **28.5** | (22.8) |
| Basic EPS (sen) | 1.1 | 2.1 | 0.1 | (97.2) | (94.3) | 9.9 | 2.2 | (78.0) |
| Diluted EPS (sen) | 1.1 | 2.1 | 0.1 | (97.2) | (94.3) | 197.9 | 2.2 | (98.9) |
| DPS (sen) | 1.5 | 9.3 | 0.0 | (100.0) | (100.0) | 5.5 | 9.3 | 69.1 |
| | | | | *+/-ppts* | | | | *+/-ppts* |
| GP margin (%) | 8.3% | 12.0% | 11.1% | (0.0) | 0.0 | 9.6% | 11.6% | 0.0 |
| PBT margin (%) | 1.9% | 3.9% | 0.6% | (0.0) | (0.0) | 2.7% | 2.4% | (0.0) |
| PATAMI margin (%) | 1.2% | 2.9% | 0.1% | (0.0) | (0.0) | 1.9% | 1.7% | (0.0) |
| Normalised PATAMI margin (%) | 1.2% | 2.9% | 0.1% | (0.0) | (0.0) | 1.9% | 1.7% | (0.0) |
| Effective tax rate (%) | 34.9% | 21.3% | 66.5% | 0.5 | 0.3 | 29.5% | 26.2% | (0.0) |
| | | | | | | | | |
| **Segmental** | | | | | | | | |
| ***Revenue*** | | | | | | | | |
| Logistics & Distribution | 611.5 | 707.4 | 534.6 | (24.4) | (12.6) | 1,203.0 | 1,242.0 | 3.2 |
| Manufacturing | 391.4 | 67.9 | 66.1 | (2.6) | (83.1) | 456.8 | 134.0 | (70.7) |
| Indonesia | 218.2 | 247.5 | 224.4 | (9.3) | 2.8 | 420.0 | 471.9 | 12.4 |
| | | | | | | | | |
| ***Net Profit*** | | | | | | | | |
| Logistics & Distribution | (1.1) | 30.7 | (10.5) | (134.3) | 850.1 | 21.4 | 20.2 | (5.9) |
| Manufacturing | 8.3 | 14.2 | (1.2) | (108.3) | (114.2) | 18.8 | 13.0 | (30.8) |
| Indonesia | (0.0) | 8.9 | (5.1) | (157.5) | 171,066.7 | (1.1) | 3.8 | (437.8) |
| | | | | | | | | |
| ***EBIT margin (%)*** | | | | *+/-ppts* | | | | *+/-ppts* |
| Logistics & Distribution | (0.2) | 4.3 | (2.0) | (6.3) | (1.8) | 1.8 | 1.6 | (0.2) |
| Manufacturing | 2.1 | 20.9 | (1.8) | (22.7) | (3.9) | 4.1 | 9.7 | 5.6 |
| Indonesia | (0.0) | 3.6 | (2.3) | (5.9) | (2.3) | (0.3) | 0.8 | 1.1 |

*Source: Company, MIDFR*

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| **MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS** | |
|---|---|
| **STOCK RECOMMENDATIONS** | |
| BUY | Total return is expected to be >10% over the next 12 months. |
| TRADING BUY | Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow. |
| NEUTRAL | Total return is expected to be between -10% and +10% over the next 12 months. |
| SELL | Total return is expected to be <-10% over the next 12 months. |
| TRADING SELL | Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow. |
| **SECTOR RECOMMENDATIONS** | |
| POSITIVE | The sector is expected to outperform the overall market over the next 12 months. |
| NEUTRAL | The sector is to perform in line with the overall market over the next 12 months. |
| NEGATIVE | The sector is expected to underperform the overall market over the next 12 months. |
| **ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell** | |
| ☆☆☆☆ | Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell |
| ☆☆☆ | Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell |
| ☆☆ | Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell |
| ☆ | Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell |

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology