Pharmaniaga vs hovid assignment

Financial Accounting Workshop Group Assignment : Pharmaceutical Sectors If the shoe fits….. Buy it in every colour… 1 Financial Accounting Workshop Group Assignment : Pharmaceutical Sectors Pharmaceutical Companies Selected 1) Pharmaniaga Berhad 2) Hovid Berhad 2 Financial Accounting Workshop The presentation will cover : • Reason for choice of companies • Key indicators of comparison • Summary/recommendation 3 Financial Accounting Workshop 1) Pharmaniaga Berhad a)Generic Drugs Manufacturer b)Prescription and OTC Drugs c)Mass Market d)Government Hospitals Financial Accounting Workshop 2) Hovid Berhad a) “ Own Brand” Drugs Manufacturer b) Traditional Medicine & Herbal Supplements c) Niche Markets d) Predominantly traditional and health conscious markets 5 Financial Accounting Workshop Pharmaniaga & Hovid Sales growth Pharmaniaga 2007 2006 11. 92% Hovid 2007 2006 27. 5% – • Increase of Sales growth – Pharmaniaga • existing contracts with the government hospitals, • ventures into other developing countries • consolidation of revenue – acquiring of distribution arm in Indonesia. • Will this continue?

Yes, likelihood : • Diversify to non-government contracts – higher pricing • WTO ruling 6 Financial Accounting Workshop Pharmaniaga & Hovid • Hovid, the sales growth increase : • the expansion to developing markets • The expansion to Macau and Hong Kong • Emphasis on sales of health herbal supplement products • Will this continue for Hovid? • Moving into China, India, Vietnam as well as European countries • Developed successful patented health supplement products targeted to the European market. • Pending 200+ product registration in over 22 countries • Developing the biodiesel product Financial Accounting Workshop Pharmaniaga & Hovid •

Why sales growth of Pharmaniaga is lesser : • Pricing • Sales is pre-contracted with the Government • Anticipate – bigger divergence of sales growth for both companies 8 Financial Accounting Workshop Pharmaniaga & Hovid Gross Profit Margin Operating Profit Margin Pharmaniaga Hovid 2007 2006 2007 2006 16. 93% 14. 55 52. 30% 56. 50% % 7. 40% 3. 52% 17. 7% 18. 62% • Gross Profit Margin of Pharmaniaga increased – control its cost efficiency • Good OPM – control its overhead costs 9 Financial Accounting Workshop Pharmaniaga & Hovid Hovid's GPM impressive 52. 3% (2007). • Slight downward trend from 56. 5% (2006) : • higher raw material cost • CPO higher pricing in 2007 • increase of about 67% over the 12 months period. • Hovid " hedges" its CPO pricing – contract signed with its customers pass on the cost of hike in raw material to its customer. • Hovid's GPM higher than Pharmaniaga's due to : • Premium pricing of Hovid's products • Manufacturing its own products as compared to Pharmaniaga (which outsourced its manufacturing products of 79%. Margin is affected) 10 Financial Accounting Workshop Pharmaniaga & Hovid Hovid's overhead cost higher than Pharmaniaga's: • higher R&D cost (noted as an ammortisation of development costs as well as R&D cost in the P&L statement). • huge depreciation (huge investment in Property, Plant and Equipment noted in Investing Cash Flow and Non current Asset in the Balance Sheet) • Negative Investing Cashflow of Hovid (RM78M to RM92M) • Hovid manufactures all its products vs Pharmaniaga which outsourced its manufacturing activities. Therefore a bigger need for Hovid to invest in assets to generate the revenue. • Is the investment strategy paying off?

Yes, higher sales growth noted and most probably to continue. 11 Financial Accounting Workshop Pharmaniaga & Hovid • GPM of Hovid – likelihood to increase – moving some of its manufacturing arm to India. • GPM of Pharmaniaga – likelihood to remain flattish – no new strategy to lower its costs/change its sales strategy. • Earnings growth potential of Hovid more attractive than Pharmaniaga: • High GPM • to absorb any stiff competition in pricing • To absorb high cost of raw material increasing • To absorb extensive R&D to be done (more new products to be developed). 2 Financial Accounting Workshop Pharmaniaga & Hovid R&D Expenditure against Sales Pharmaniaga 2007 2006 0. 09% 0. 07% Hovid 2007 2006 0. 5% 0. 4% • Pharmaniaga increase in the R&D expenditure Y-O-Y. • Pharmaniaga trying to diversify – developing its own products with its own patents. • Hovid spent close to 6x that of Pharmaniaga in 2007 • Not enough. Need to look at components of intangible assets. • Product development expenditure capitalization is close to 20x that of R&D expense for Hovid. • Running new business strategy i. e. iodiesel and on hand 200+ patents waiting to be patented 13 • Pharmaniaga’s intangible assets mainly goodwill (80%) due to the acquisition of distribution arms in Vietnam, Indonesia etc. Financial Accounting Workshop Pharmaniaga & Hovid Pharmaniaga Cash Conversion Cycle 2007 152 days 2006 144 days Hovid 2007 126 days 2006 172 days • Cash conversion cycle of Pharmaniaga deteriorated slightly which is negligible. • Hovid’s has improved significantly • faster moving inventories • shorter collection period from debtors – 3rd party distribution arms. • greater awareness/demand for herbal supplements. Why Pharmaniaga’s cycle is significantly longer than Hovid’s? • Pharmaniaga’s customers are govt hospitals – slow paymasters. • Pharmaniaga’s sales are through their own distribution arms. 14 Financial Accounting Workshop Pharmaniaga & Hovid • Hovid registers better cash conversion cycle but paying its Trade Creditors faster. Why? • better discount given by its suppliers to reward faster payment – to offset the significant hike of its CPO price. • Confirmed in its cash from operations which dropped. • Pharmaniaga's Trade Creditors period is lengthened, – seen from the increase of its cash from operations. 5 Financial Accounting Workshop Pharmaniaga & Hovid Gearing Ratio Pharmaniaga 2007 2006 17. 2% 28. 9% Hovid 2007 2006 84. 5% 45. 0% • Hovid's gearing ratio > Pharmaniaga's. • Also risen dramatically. Worrying sign? • Hovid is in an expansionary mode • financing/borrowing is expected • Large term loan presence in Hovid's 2007 cash flow statement. • Hovid also manufactures its own products, which requires the need for continuous higher investments in PPE. • Also Hovid's new business strategy in producing biodiesel. Need new 16 investment. Financial Accounting Workshop

Pharmaniaga & Hovid • The lower gearing of Pharmaniaga is noted from the financing activities cashflow which registers a repayment of loans of 44M. • The higher gearing of Hovid is confirmed in the financing activities cashflow which registers a drawdown of loans by 88M. 17 Financial Accounting Workshop Pharmaniaga & Hovid PE ROSF Dividend Yield Pharmaniaga 2007 2006 6. 85x 42. 5x 15% 4% 5. 59x 2. 94x Hovid 2007 2006 15. 71 15. 09 22. 06% 19. 58% 7. 95% – • The PE ratio of Pharmaniaga dropped significantly – reflects the market view of the potential of this company. Not exciting? Low PE ratio can also mean a better prospect of price increase in the future. 18 Financial Accounting Workshop Pharmaniaga & Hovid • The PE ratio of Hovid is higher than Pharmaniaga – potential for growth is higher. Why? • New development of its herbal supplements which will be brought to new markets i. e. Europe • New production plants in India – lowers its cost of manufacturing • 200+ patents to be registered at overseas, 56 pending in Malaysia and 60 products still being developed • No wastage of its raw material with its biodiesel business to be taking off which is a new frontier as a product substitution for petrol. But high PE ratio may also reflect a peak in its market pricing. • ROSF of Pharmaniaga is also lower than Hovid – again Hovid's attractiveness as a company to be invested in. • The dividend yield of Hovid > attractive than Pharmaniaga. • Also market perception of Hovid as a more exciting company 19 Financial Accounting Workshop Conclusion and Recommendation • Hovid – niche market company appears more exciting as a company with its attractive PE ratio and ROSF. Its strategies : • Developed many new products, • lower cost of manufacturing, • better margin products and target markets • Its management helmed by the visionary David Ho, its Managing Director • Higher commitment is seen from management of Hovid as the shareholders are the same as the management of the company. However, there is no risk of lacking of transparency as Hovid is a listed company. 20 Financial Accounting Workshop Conclusion and Recommendation • Pharmaniaga – a government linked company • leaders picked with some political linked connections • May not reflect its true capabilities and expertise in the business. No exciting strategies • Still concentrating on developing generic products which does not provide good yield. • For investors with higher risk appetite – attracted to Hovid? • For investors with risk adverse appetite – attracted to Pharmaniaga? This perception may not exactly be correct: • any change in the political scene will also affect its future earnings. 21 Financial Accounting Workshop " I never attempt to make money on the stock market. I buy on the assumption that they could close the market the next day and not reopen it for five years. ” “ Our favourite holding period is…. forever” (Warren Buffet) 22