Pymepharco JSC (HSX:PME)

Pioneer in Promoting Technology of Domestic Manufacturers

Pymepharco JSC (HSX:PME) is one of the largest western medicine manufacturers in terms of revenue and profit, second only to DHG. With the support from STADA (Germany), PME is the first pharmaceutical company in Vietnam having the antibiotic workshop that meet EU-GMP standard since 2013. As the company is expecting another EU-GMP certification for its Cephalosporin injection plant in 2018, its facilities remain its great advantage in the next 2–3 years, until other domestic players could catch up with the standard.

As its chairperson is also the vice president of Vietnam Pharma Association, PME has been a pioneer in promoting technology improvement in the industry to meet international standards and to enhance the ability of domestic manufacturers. With supportive policies to be released soon, this is the hinge moment for domestic players to break through. As the dream of replacing imported drugs with domestic high quality drugs at competitive prices is almost coming true, pioneers like PME will be the first to enjoy the fruits.

In terms of valuation, the leading pharmaceutical companies are trading at a high P/E of about 20 times, a significant premium compared to the 16 times of the VNIndex. For PME, we believe that the company is worthy of P/E of a growth company. It should be able to maintain a growth rate of 20% per year, thanks to support from the upcoming policies and competitive advantage brought by its modern facilities. Using P/E and FCFF method, we estimate the reasonable price of PME to be **VND124,000/share**. This target price, combined with a cash dividend of VND2,000/share, yields a total return of 85% from the listing price of VND68,000/share. Therefore, we recommend investors to **BUY** the stock.

Investment rationale:

- A series of supportive policies targeting domestic manufacturers
- Competitive advantage of EU-GMP factories

Risk:

- Policy changes takes too much time to implement or twist in a negative way

Key financial ratios

Y/E Dec(VND B)	FY2015	FY2016	FY2017F	FY2018F
Net revenue	1,309	1,508	1,734	2,081
%change	13.9%	15.2%	15.0%	20.0%
PAT	184	239	298	366
% change	23.9%	30.3%	24.5%	22.8%
Net margin (%)	14.0%	15.9%	17.2%	17.6%
ROA (%)	13.3%	14.8%	15.3%	16.4%
ROE (%)	16.9%	18.0%	18.4%	19.7%
EPS (VND)	4,574	4,768	4,520	5,550
Adjusted EPS (VND)	2,815	3,668	4,520	5,550
Book value (VND)	27,116	26,431	24,851	28,412
Cash dividend (VND)	0	0	2,000	2,000
P/E (x)	N/A	N/A	N/A	N/A
P/BV (x)	N/A	N/A	N/A	N/A

Source: PME, RongViet Research

BUY

Listing price (VND)	68,000
Target price (VND)	124,000
Cash dividend (VND)*	2,000

** Expected in the next 12 months*

Stock Info

Sector	Pharmaceutical
Market Cap (VND billion)	N/A
Share O/S (mn)	65.2
Beta	N/A
Free Float (%)	N/A
52 weeks high	N/A
52 weeks low	N/A
Average trading volume (20 sessions)	N/A

Major shareholders (%)

Stada Service Holding B.V	49.0
Truong Viet Vu	13.2
Well Light Investment JSC	10.0
Foreigner Investor Room (%)	*49.0*

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INVESTMENT RATIONALE

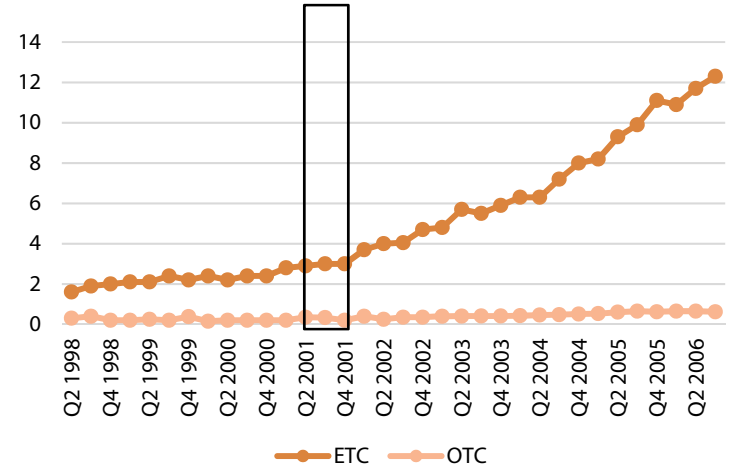
Benefit from supportive policies for domestic manufacturers, especially those focused on ETC

Over the past two years, the government has shown determination to accelerate the impementation of Universal Health Coverage (UHC), in particular, with **Decision No.1167/QD-TTg dated 28 August 2016, increasing the target coverage**. As a result, the coverage ratio has increased from 76% of the population in 2015 to 82% at present.

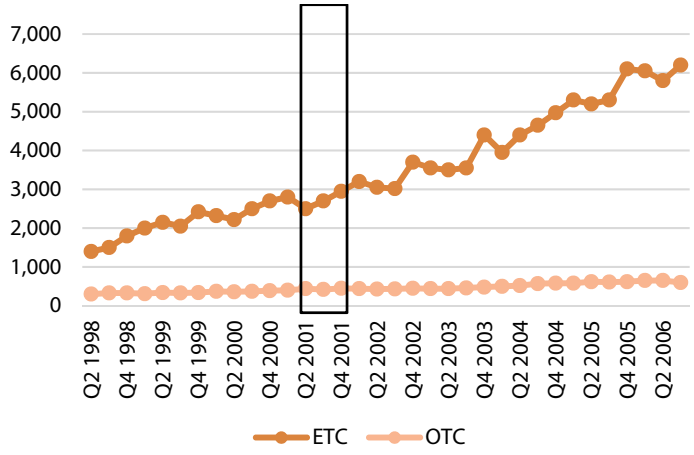
In the case of Thailand, which implemented the UHC since 2001 and reached a coverage rate of 95.5% of the population in 2004, there were two most significant effects of this policy:

(1) Hospital (ETC) sales surged over time. Since the rollout of UHC, patients have swamped hospitals for treatment of diseases they could not afford before. According to BMJ Open, the UHC was associated with long-term increases in the hospital sector sales of medicines for chronic diseases that are usually treated in primary care setting, such as diabetes, high blood pressure and high cholesterol. The policy did not appear to increase the sales of medicines for more severe diseases like heart failure, arrhythmia and cancer, which are often treated in secondary or tertiary settings. The reform had little impact on sales volume in the retail sector (OTC channel).

Figure 1, 2: Total volume by quarter (standard units per capita) for insulin (left) and antihypertensives (right) in hospitals in Thailand surged over time



Source: BMJ Open



Source: BMJ Open

(2) Domestic drugs claimed a big market share in ETC channel. To achieve and sustain UHC, payers will have to finance and deliver UHC by reducing inefficiencies in healthcare delivery that is increasing costs for the government and finding more cost-effective medicines. Five years after Thailand implemented UHC, generic drugs produced by state-owned companies have replaced the use of branded generics and generics produced by other foreign firms in some areas. The Government Pharmaceutical Organization supplies 80% of the drugs in public hospitals, as government produced drugs receive preferential status from hospital purchasers.

The situation is replicating in Vietnam with the recent push by the central government for the majority of public tenders to manufacture drugs locally. Domestic companies that target ETC channel such as IMP will benefit greatly in the coming years. Specifically, the supporting documents include:

Law No.105/2016/QH13 on pharmacy

This law states that bidding is not open for imported drugs when domestic drugs meet the requirements of treatment, price and availability.

Although the law became effective from the beginning of 2017, it has not yet affected the ETC bidding of domestic companies. The reason is that health facilities are still awaiting supporting documents for specific guidance. **It is only after the finalization and approval of the new circular in the near future, that the impact will start to materialize.**

The draft circular on drug bidding process at the public health facility

The Draft includes a list of over 100 out of 500 expired patent drugs that must be replaced by generic drugs. The list includes many Cephalosporin antibiotics (both injection and oral), which PME is capable of manufacturing.

Table 1: List of some Cephalosporin antibiotics that must be replaced by generic drugs

Patent drug name	Active substance	Dosage	Type/Units
Cefobid	Cefoperazone sodium	1g	Injection
Fortum	Ceftazidime	1g	Injection
Rocephin 1g I.V	Ceftriaxone	1g	Injection
Zinnat tablets 250mg	Cefuroxim (in Cefuroxim axetil form)	250mg	Tablet
Zinnat tablets	Cefuroxime (in Cefuroxime axetil form)	500mg	Tablet
Zinacef	Cefuroxime (in Cefuroxime natri form)	750mg	Injection

Source: RongViet Research

Official Letter 3794/BHXH-DVT

What is more, the Official Letter 3794/BHXH-DVT limits the use of patent drugs to 30% of total drug cost at national hospitals and 5% at provincial hospitals, while district hospitals are not allowed to use them.

Draft on the list of drugs for centralized bidding by Vietnam Social Insurance.

Besides the list of bidding drugs under Circular No. 09/2016/TT-BYT, Vietnam Social Insurance is likely to organize a nationwide bidding for five common injection antibiotic drugs to synchronize the costs of drug purchase. Of these drugs, PME can provide all active substances but Levofloxacin. The nationwide bidding not only requires the winner to meet the price and quality standards but also the ability to supply in bulk. Therefore, high scale of production will be an advantage for PME.

Table 2: List of 5 antibiotic active substances for centralized bidding by Vietnam Social Insurance.

Active substance	Dosage	Type	Unit
1. Levofloxacin	500mg	Injection	Bottle
2. Meropenem	500mg/1g	Injection	Bottle
3. Ceftriaxon	1g	Injection	Bottle
4. Cefepim	1g	Injection	Bottle
5. Cefoperazon + sulbactam	500mg+500mg	Injection	Bottle

Source: RongViet Research

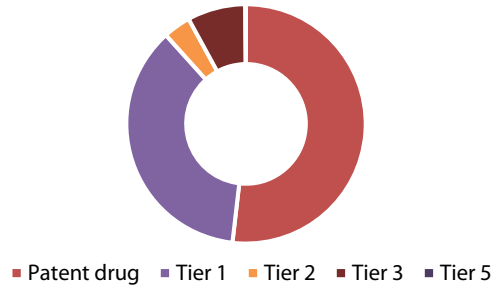
Competitive advantage of EU-GMP factories

We believe that the replacement of foreign drugs with domestic drugs in medical facilities will be a clear trend in the near future. In this trend, domestic manufacturers who own EU-GMP lines will have a big advantage compared to their rivals. The reason is that generic drugs produced in EU-GMP lines is categorized in Tier 2 bidding (and Tier 1 if it has export license), and will be the first option to replace patent drugs and imported generic drugs in those Tiers. **To quantify the potential amount of drugs that PME could replace, RongViet Research estimates the demand of some injectable antibiotics in 2016.**

A. Demand for active substances for centralized bidding by Vietnam Social Insurance:

Table 3 and Figure 3: The amount and value of Ceftriaxon 1g

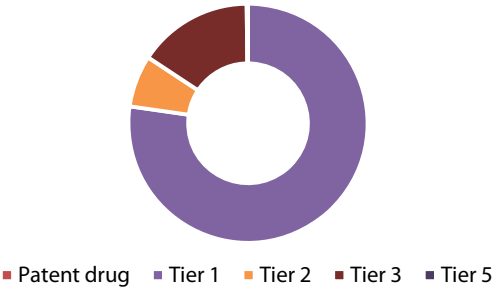
Tier	Manufacturer	Amount (bottle)	VAT price (VND)	Value (VND B)
Patent drug	Switzerland - Rocephin	276,230	181,440	50.1
Tier 1	Spain, Poland, France	1,275,790	20,000-54,800	35.3
Tier 2	Poland, India, Vietnam (Tenamyd)	262,700	11,900-19,600	3.6
Tier 3	Vietnam	515,149	7,500-12,800	7.6
Tier 5	Vietnam, China	17,000	8,280	0.1
Total		**2,346,869**		**96.7**



Source: Vinapharm, RongViet Research

Table 4 and Figure 4: The amount and value of Cefepim 1g

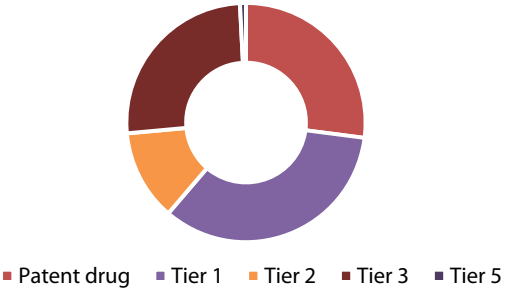
Tier	Manufacturer	Amount (bottle)	VAT price (VND)	Value (VND B)
Patent drug				
Tier 1	Cyprus, Greece, Spain	509,530	78,800-110,000	45.2
Tier 2	India	109,440	28,500-44,500	4.1
Tier 3	Vietnam	276,330	17,900-19,500	9.1
Tier 5	Vietnam	4,340	18,820	0.1
Total		**899,640**		**58.5**



Source: Vinapharm, RongViet Research

Table 5 and Figure 5: The amount and value of Cefoperazon + sulbactam (500mg + 500mg)

Tier	Manufacturer	Amount (bottle)	VAT price (VND)	Value (VND B)
Patent drug	Italy - Sulperazol	64,170	205,000	13.2
Tier 1	Japan	128,600	130,000	16.7
Tier 2	India, China	200,300	28,000-34,000	6.0
Tier 3	Vietnam	485,932	11,400-13,500	12.5
Tier 5	Vietnam, India, Korea	36,430	11,400-12,000	0.4
Total		**915,432**		**48.8**



Source: Vinapharm, RongViet Research

Total demand for patent, Tier 1 and Tier 2 drugs of Ceftriaxone, Cefepim and Cefoperazone are 1.8 million bottles, 619,000 bottles, and 393,000 bottles, respectively. Multiplying this quantity by the average price of drugs in Tier 2, the value that Tier 2 domestic products (including PME's) could replace are 29 billion, 23 billion and 12 billion, respectively.

B. Demand for active substances bidding in the health departments or individual medical facilities:

Table 6 and Figure 6: The amount and value of Cefotaxim 1g

Tier	Manufacturer	Amount (bottle)	VAT price (VND)	Value (VND B)
Patent drug	UK - Claforan	232,870	69,000	16.1
Tier 1	Spain, Poland, Italy	1,096,524	19,000-28,000	24.3
Tier 2	China, Ukraine, Vietnam (Tenamyd)	2,621,326	9,100-15,800	47.3
Tier 3	Vietnam	2,621,614	6,300-6,800	20.1
Tier 5	Vietnam	186,870	6,200-6,800	1.2
Total		**6,759,204**		**109.0**

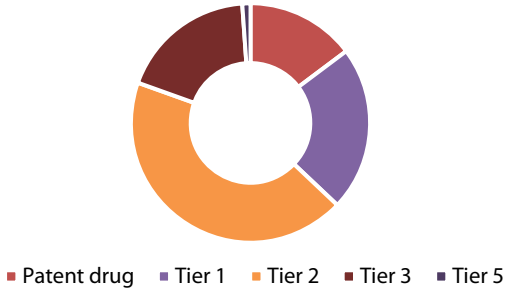


Table 7 and Figure 7: The amount and value of Ceftazidim 1g

Tier	Manufacturer	Amount (bottle)	VAT price (VND)	Value (VND B)
Patent drug	Italy - Fortum	350,880	75,600	26.5
Tier 1	Spain, Poland, Portugal, Greece	854,701	32,000-45,000	29.8
Tier 2	Korea, Vietnam (Tenamyd)	631,813	17,000-25,600	13.3
Tier 3	Vietnam	1,468,624	11,500-12,900	29.8
Tier 5	Vietnam	38,500	8,280	0.5
Total		**3,344,518**		**99.9**

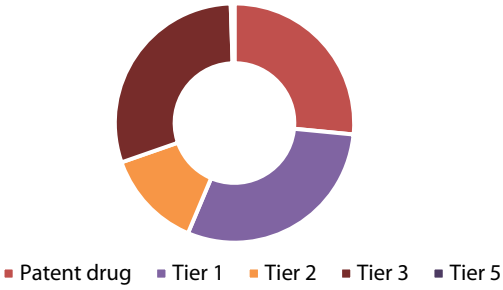


Table 8 and Figure 8: The amount and value of Cefoperazon

Tier	Manufacturer	Amount (bottle)	VAT price (VND)	Value (VND B)
Patent drug	Italy - Cefobid	84,800	125,700	10.7
Tier 1	Cyprus	183,660	47,500	8.7
Tier 2	Korea, Ukraine	418,210	38,400-54,000	30.4
Tier 3	Vietnam	203,230	11,700-12,400	6.1
Tier 5	Korea, Vietnam	13,000	11,700-13,000	0.2
Total		**902,900**		**56.1**

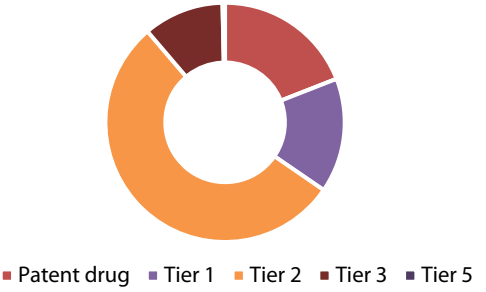
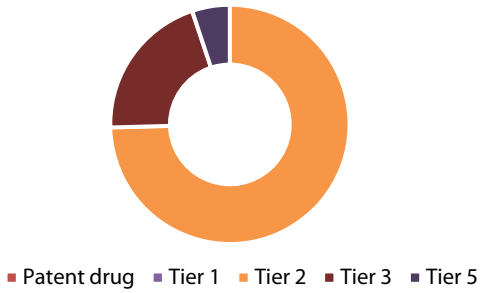


Table 9 and Figure 9: The amount and value of Ceftizoxim

Tier	Manufacturer	Amount (bottle)	VAT price (VND)	Value (VND B)
Patent drug				
Tier 1				
Tier 2	Korea, Taiwan, Vietnam (Tenamyd)	981,700	48,500-71,000	55.5
Tier 3	Vietnam	333,750	20,900-23,600	15.1
Tier 5	Vietnam	89,300	23,000-23,400	3.8
Total		**1,404,750**		**74.5**



Source: Vinapharm, RongViet Research

Similarly, the quantity that Tier 2 domestic products (including PME drugs) could replace are 4 million bottles (VND50 billion) for Cefotaxime, 1.8 million bottles (VND39 billion) for Ceftazidim, and 686,000 bottles (VND31 billion) for Cefoperazon.

These are just some active substances in PME's portfolio. Moreover, the data above is collected from the 2016 bidding results of central hospitals and 15 health departments only. This means that the figures above do not include all health departments in Vietnam, especially medical facilities and hospitals in Ho Chi Minh City, which accounted for approximately 25% of national medical demand. Therefore, total demand is much bigger than the presented figures. **Supposing PME's products are able to claim 10–15% of this market, the amount could reach hundreds of billions of VND's.**

The company is expecting another EU-GMP certification for its Cephalosporin injection workshop in early 2018. This is a high achievement as the building or upgrading of a factory qualified for the EU-GMP standard requires a lot of time and effort (at least 2 years). An EU-GMP antibiotic injection factory requires even stricter standards for sterility, air treatment system and high-skilled labor. Therefore, having these facilities will remain as an advantage for PME in the next 2–3 years, until other domestic companies could catch up with this standard.

Table 10: Not many manufacturers in Vietnam can accquire EU-GMP standards

Manufacturer	Products	Granting Agency	Bidding Tier
Pymepharco	Nonsterile drugs: cefalosporin antibiotics	Germany	2
	Cefaclor Stada (Cefaclor 500 mg)		1
	Cepoxitil 200 (Cefpodoxime 200 mg)		
Joint venture Stada-VN	Nonsterile drugs	Germany	2
	Bisoprodol, Pantostad 40, Paracetam 800 & 1200, etc		1
Imexpharm	Sterile and nonsterile drugs: beta-lactam antibiotic	Spain	2
	Imetoxim 1g (Cefotaxim 1g)		1
Medochemie (Far East)	Sterile and nonsterile drugs	Cyprus	2
Tenamyd	Sterile drugs: beta-lactam injections	Slovakia	2

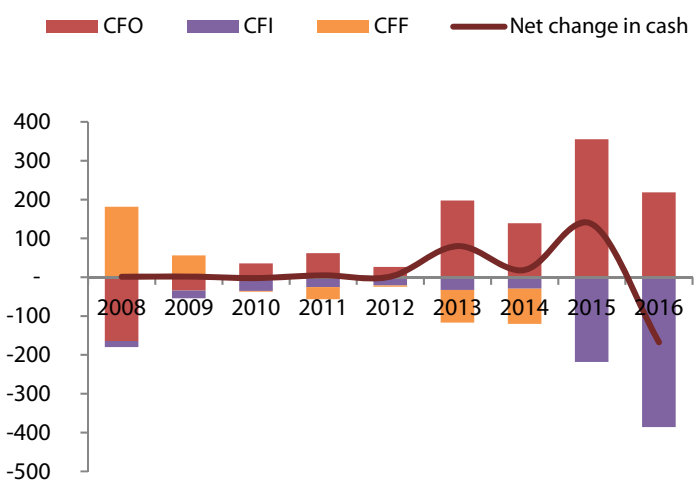
Source: DAV, RongViet Research

Financial management is flexible and harmonizes with shareholder's interest

Reviewing the developments of PME, we appreciate that the company is quite flexible in financial management to harmonize with the interests of the firm and the shareholders. Thanks to the private issuance in 2008, PME has overcome its shortage of cash. Meanwhile, the issuance in 2013 (1:1 ratio at a price of VND12,000/share) and 2014 (1:1 ratio at a price of VND10,000/share), as well as the application of stock dividends instead of cash dividends for 2015–2017 period, has helped the company complete its debt restructuring. PME was also able to upgrade its dry injection and Cephalosporin injection workshop.

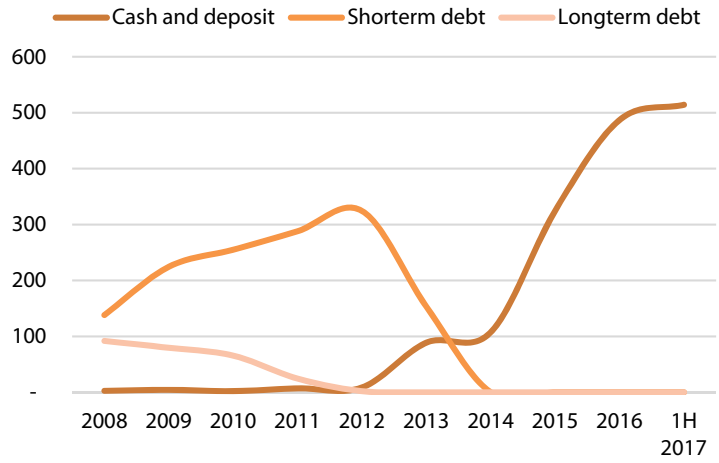
As of June 2017, PME is not only free from debts but also has nearly VND500 billion in cash and deposits, which will be used to finance its new EU-GMP non-betalactam factory in 2018. The remaining cash that PME generates, according to the management, will be distributed to shareholders in the form of cash dividends, at least 20% per year. We think that if the business operation is favorable, the cash flow from business activities in the coming years may reach VND300 billion – 400 billion/year, meaning that the annual dividend may be higher than the stated plan.

Figure 10: PME's CFO has increased over the years



Source: Pymepharco financial statements

Figure 11: Restructuring helped PME to reduce debt and boost cash



Source: Pymepharco financial statements

RISK

Adverse effects from the management policies

The BUY recommendation on the stock is based on our expectation that domestic products will be able to replace foreign drugs in the upcoming times. As such, the biggest risk for this recommendation is that the replacement trend is slower, or may not be as optimistic as expected. Adverse policy changes (see appendix), if any, will inevitably affect the trend mentioned in this report.

Occupied capital in ETC reduces the usage efficiency of the company capital

Since ETC revenue is usually paid by the insurance system, the procedure takes longer than in OTC. This is because the Day Sales Outstanding ratio of PME much higher than that of companies with revenues in favor of OTC such as DHG and TRA.

INVESTMENT RECOMMENDATION

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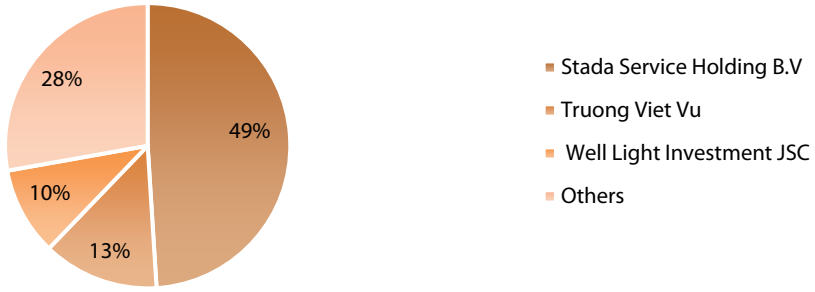
COMPANY OVERVIEW

Pymepharco JSC, previously known as Phu Yen Pharmaceutical and Medical Supplies Company, was established on 23 July 1989, and transformed into joint stock company model on May 2006. Its main business is manufacturing western medicine as well as wholesaling and retailing of pharmaceutical materials, chemicals and medical equipment.

Shareholder structure

By the end of August 2017, major shareholders of PME include Mr. Truong Viet Vu and Well Light Investment JSC. Currently, PME has already reached its foreign ownership limit Stada Service Holding BV, a subsidiary of Stada Arzneimittel AG (Germany), has possessed 49% stake in PME since 2011.

Figure 12: PME shareholder structure as of 29 August 2017

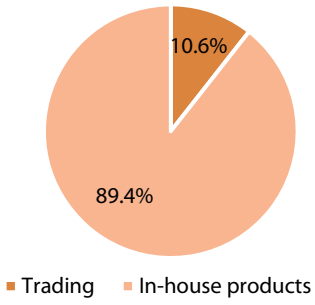


Source: Pymepharco prospectus

Business overview

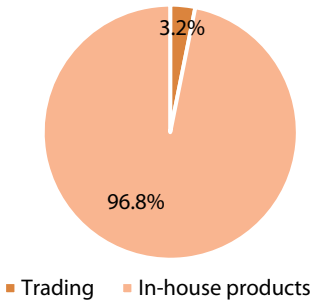
PME has two business segments: **(1) in-house products selling** and (**2) pharmaceutical trading**, of which in-house products account for the majority of revenue and profit. Commercial activities include western and traditional medicines, and medical equipment trading, which have a much lower margin than in-house products.

Figure 13: Revenue structure in 2016



Source: Pymepharco financial statement

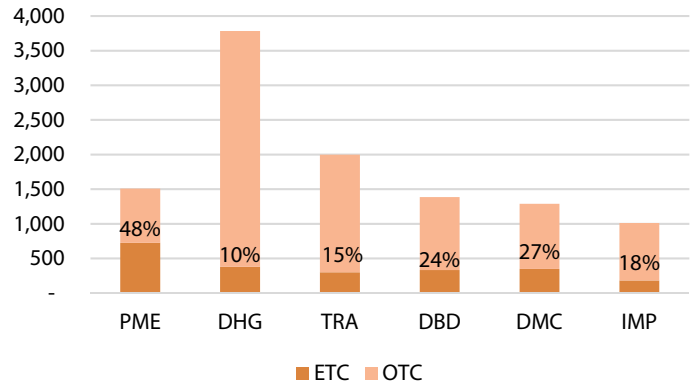
Figure 14: Gross profit structure in 2016



Source: Pymepharco financial statement

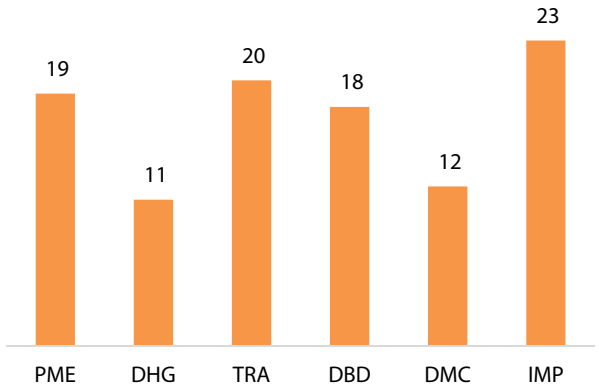
The company has 19 branches to distribute its drugs to dealers, pharmacies and hospitals nationwide. With 48% revenue coming from the ETC channel (equivalent to around VND700 billion in 2016), PME has the highest ETC revenue among all the listed pharmaceutical companies (Figure 15). After establishing a strong ground in ETC channel, the company targets to shift the revenue ratio to 65% in OTC and 35% in ETC in the future.

Figure 15: ETC revenue of PME is the highest in 2016



Source: RongViet Research

Figure 16: Number of branches of listed companies



Source: RongViet Research

Production capacity

At present, PME has two factories producing tablets and injections, of which the Cephalosporin (tablets) line has been receiving EU-GMP certification since early 2013. The company is expecting another EU-GMP certification for its Cephalosporin injection workshop, and is planning for the construction of a new EU-GMP non-betalctam factory in 2018. Once the factory is complete, PME will possess a complete EU-GMP facility, including both betalactam (capsules and injections) and non-betalactam factories. This facility is the trump card for PME to take advantage of the upcoming supportive policies and be able to compete with foreign drugs in the near future.

Table 11: List of PME's factories

Factory	Standard	Invested capital (VND)	Designed capacity
1. Capsule factory (2003)			**800 mn units**
Betalactam workshop	EU-GMP		
Non-betalactam workshop	WHO-GMP		
Soft capsule workshop	WHO-GMP		
2. Injection factory (2008)			**37 mn units**
Injection solution workshop	WHO-GMP		
Dry injection workshop	WHO-GMP		
Cephalosporin injection workshop	WHO-GMP (waiting for EU-GMP approval)		
Eye drop workshop	WHO-GMP		
3. Non-betalactam factory (completed in 2019)	**EU-GMP**	**>500 B**	**1,200 mn units**

Source: Pymepharco prospectus

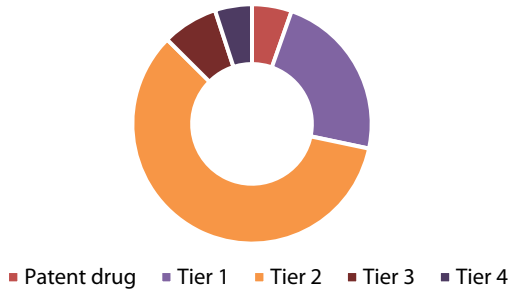
Key products

Cephalosporin antibiotics

Manufacturing under EU-GMP line and technology transferred from Stada GmbH Pharm-Germany, PME's Cephalosporin tablet products (for active substances like Cefaclor, Cephalexin, Cefuroxim, Cafadroxil, and Cefixim) have been well known as "antibiotics with European technology". The products from this workshop win a big proportion at the bidding in healthcare facilities. The detail figures are shown in the table below:

Table 12 and Figure 17: The amount and value of Cefaclor 500mg (tablet form)

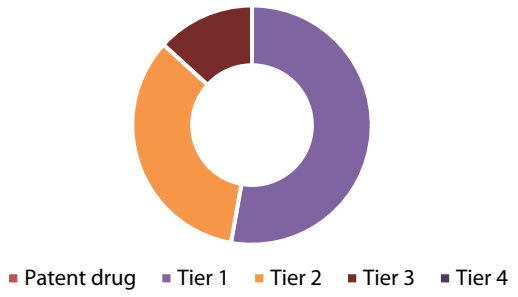
Tier	Manufacturer	Amount (tablet)	VAT price (VND)	Value (VND B)
Patent drug	Italy (Ceclor)	109,000	13,912	1.5
Tier 1	Cyprus	591,000	8,900-14,000	6.4
Tier 2	**Pymepharco**	3,694,677	4,200-4,700	16.5
Tier 3	Vietnam	274,142	1,400-1,900	2.1
Tier 4	VDP, **Pymepharco**	536,283	1,500-4,750	1.4
Total		**5,205,102**		**27.9**



Source: Vinapharm, RongViet Research

Table 13 and Figure 18: The amount and value of Cephalexin 500mg (tablet form)

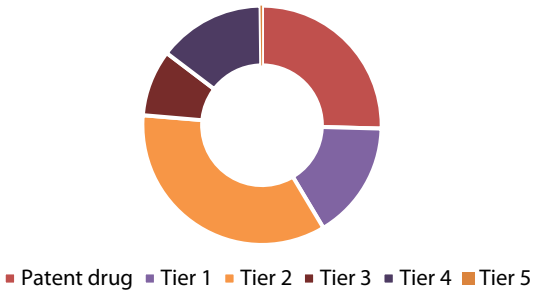
Tier	Manufacturer	Amount (tablet)	VAT price (VND)	Value (VND B)
Patent drug				
Tier 1	Rumania, Cyprus	6,858,666	3,280-3,780	24.3
Tier 2	Malaysia, **Pymepharco**	13,387,948	945-1,400	15.6
Tier 3	Vietnam	8,594,279	690-735	6.1
Tier 4				
Total		**28,840,893**		**46.0**



Source: Vinapharm, RongViet Research

Table 14 and Figure 19: The amount and value of Cefuroxim 250mg (tablet form)

Tier	Manufacturer	Amount (tablet)	VAT price (VND)	Value (VND B)
Patent drug	UK (Zinnat)	390,756	13,166	5.1
Tier 1	Poland, Austria	473,000	6,500-7,300	3.2
Tier 2	India, **Pymepharco**	1,562,524	3,000-6,000	7.0
Tier 3	Vietnam	1,288,510	1,360-1,900	1.8
Tier 4	Vietnam	1,970,013	1,390-2,300	2.9
Tier 5	Vietnam	30,000	1,400	0.0
Total		**5,714,803**		**20.1**



Source: Vinapharm, RongViet Research

Meanwhile, its Cephalosporin injection products also win the bidding into Phu Yen Health Department, namely Cefepim (VND13 B), Ceftazidim (VND12B), Cefmetazol (VND12B), Ceftizoxim (VND9B).

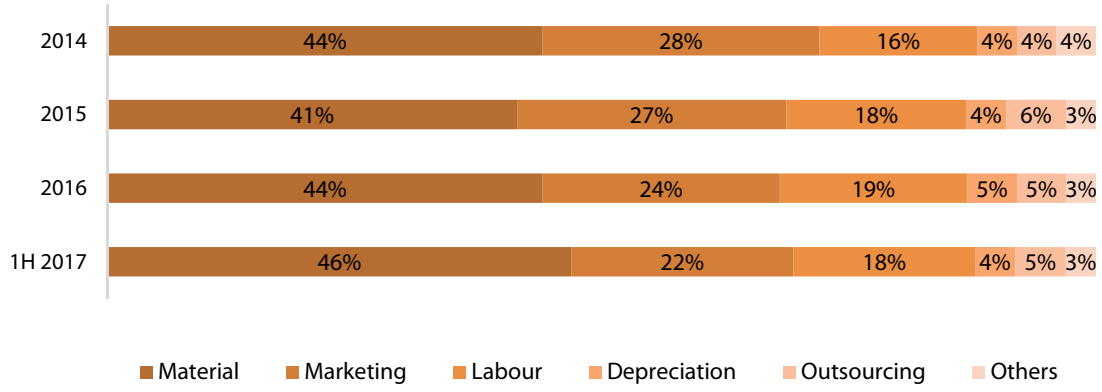
Bioequivalent drugs

As mentioned above, using Generic drugs to minimize the treatment cost is an inevitable trend in Vietnam. However, Generic drugs must be tested for bioequivalence first. PME has received bioequivalence and therapeutic equivalence on 62 products (such as Tatanol, Mobimed, Negacef, Pycip, cardiovascular drugs Amlodipine PMP, Tenocar 50, and Pidocar), 0f which, 25 products are approved by the Ministry of Health, 23 products are awaiting for publication and 14 products are in testing progress.

Material cost, labor and selling expense are there main expenditures

Material cost usually accounts for approximately 50% of PME's production expenses. In order to meet the EU-GMP requirements, raw materials have to be imported from major manufacturers such as Mallinckrodt INC, Spi Polyols Inc (America), ACS Dobfar, and Zach-System (Italy). Moreover, because of the business nature that heavily rely on ETC channel, selling expense also accounts for a significant proportion of company's expenses.

Figure 20: Manufacturing expenses structure of PME



Source: Pymepharco financial statements

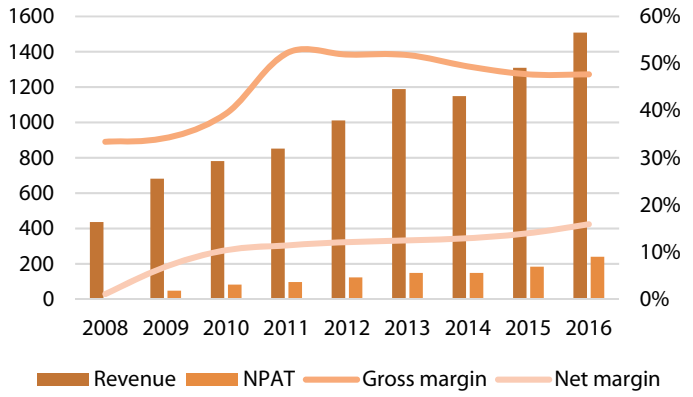
FINANCIAL ANALYSIS

Steady and high growth of revenue and NPAT

Except in 2014, revenue and net profit of PME has been increasing highly and steadily. The company's CAGR of revenue and NPAT in 2009–2016 are the highest among listed pharmaceutical firms.

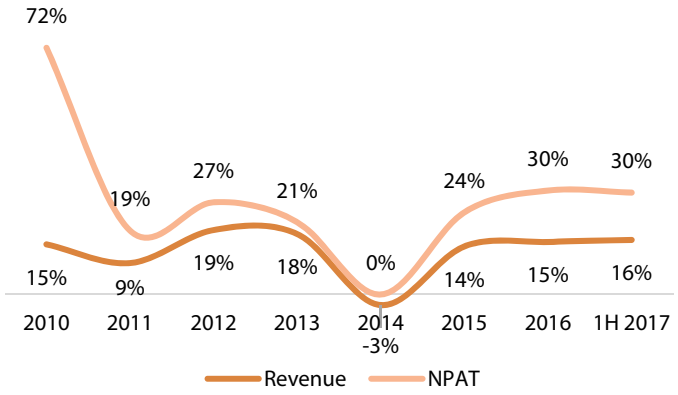
In 2008–2012, its net profit margin was just over 10% due to heavy interest expense. Since 2013, the net profit margin has improved remarkably, thanks to being relieved from the interest burden and good control of marketing expense. The fact that its revenue is still growing highly without spending too much on marketing activities is what we highly appreciate in PME.

Figure 21: Revenue and NPAT 2008–2016



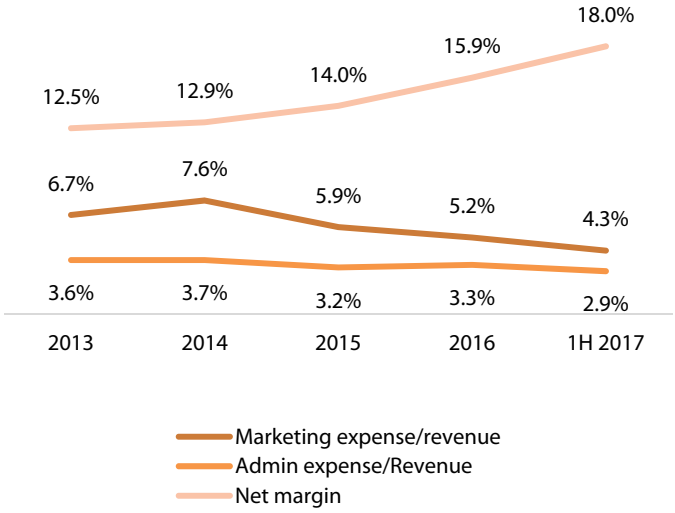
Source: Pymepharco financial statement, RongViet Research

Figure 22: YoY growth of revenue and NPAT 2010–1H 2017



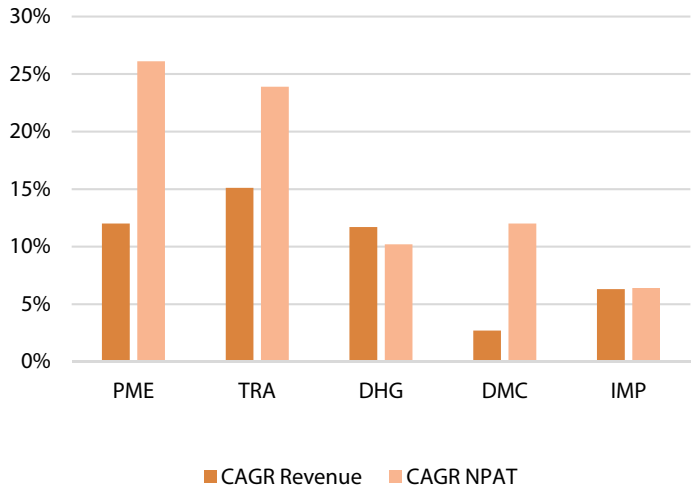
Source: Pymepharco financial statement, RongViet Research

Figure 23: Improved net margin resulting from good control of marketing and administration expense



Source: Pymepharco financial statement, RongViet Research

Figure 24: Highest CAGR for PME during 2009–2016



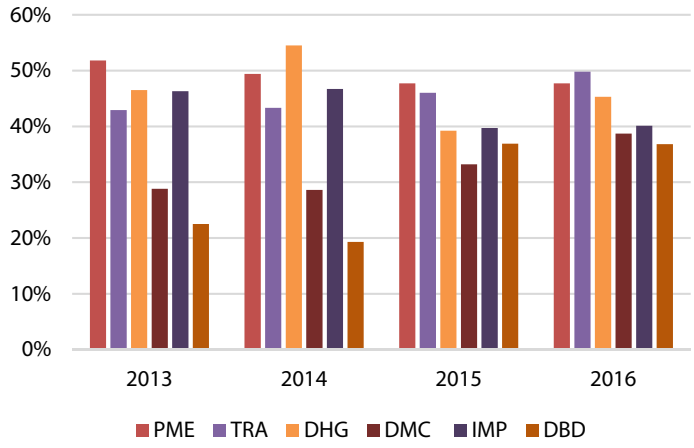
Source: RongViet Research

Profitability and operation efficiency

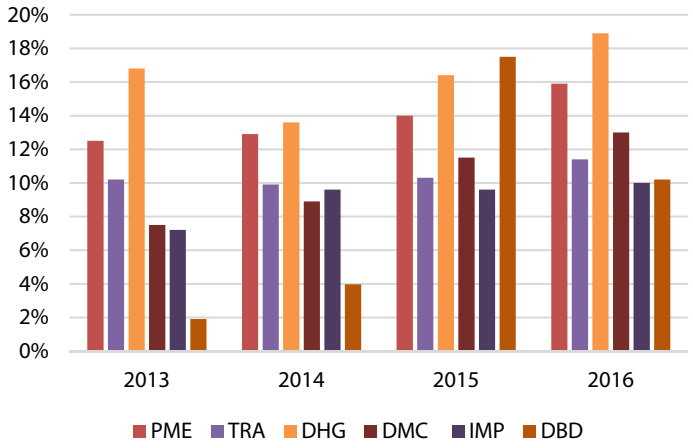
The gross margin of PME has always been on top of the industry, as shown in figure 25 and 26. Reducing debt and retaining a large amount of cash to prepare for the construction of a new factory has caused its

ROE to drop to 18% in 2016 from 26% in 2012. However, this ROE level was not too far away in comparison with the top companies in the industry.

Figure 25,26: Gross margin (left) and net margin (right) of listed pharmaceutical companies



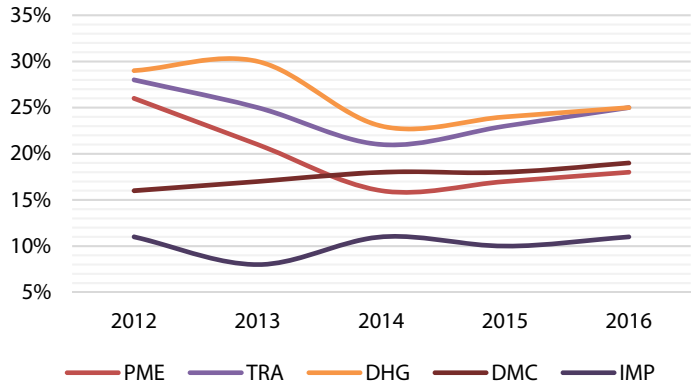
Source: RongViet Research



Source: RongViet Research

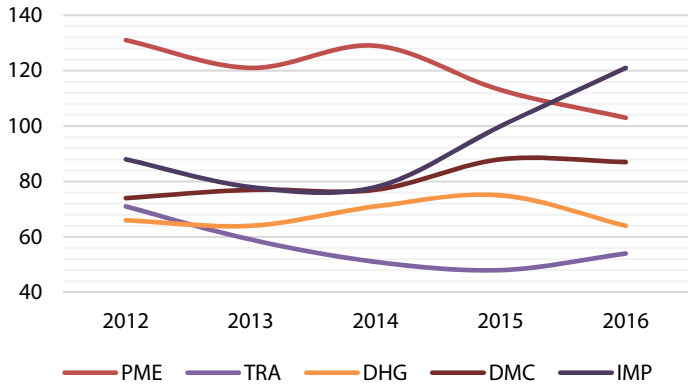
Due to high proportion of ETC revenue, PME has an above-average DSO. The reason is that payment in ETC channel is made by an insurance system, which usually takes much longer than the payment process in OTC channel. Figure 28 displays clearly that businesses favoring OTC channel like DHG and TRA have much lower DSO, especially TRA which applies a very strict sales policy.

Figure 27: ROE of listed pharmaceutical companies



Source: RongViet Research

Figure 28: DSO of listed pharmaceutical companies (days)

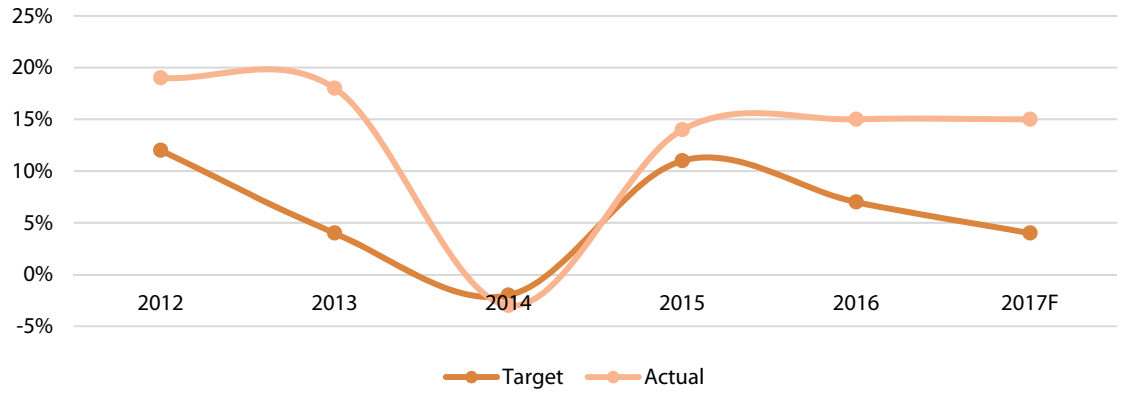


Source: RongViet Research

FORECAST AND VALUATION

From 2018 onwards, PME will start manufacturing franchised products of EG LABO (France). This, coupled with rising demand for domestic drugs caused by new policies becoming effective, should guarantee a 20% growth in revenue per year, exceeding its 15% annual target. The company has a long historical to beat its yearly target.

Figure 29: PME's long history of beating its revenue target



Source: RongViet Research

PME revenue has grown steadily without the need to increase marketing expense in the recent years. If this trend continues, its gross margin will remain positive in 2017.

In conclusion, RongViet Research estimates revenue of PME in 2017 and 2018 to be VND1,734 billion (+15% YoY) and VND2,081 billion (+20% YoY), respectively. NPAT in 2017 and 2018 will be VND298 billion (+24% YoY) and VND366 billion (+23% YoY), respectively. This translates to EPS of VND4,520 in 2017 and **VND5,550** in 2018.

Table 15: PME's business forecast

	2015	2016	1H 2017	2017E	2018F
Revenue	**1,308**	**1,508**	**825**	**1,734**	**2,081**
Gross margin	47.7%	47.7%	48.0%	48.0%	48.0%
Gross profit	**624**	**720**	**396**	**832**	**999**
Selling expense/revenue	26.7%	25.6%	24.0%	24.8%	24.2%
Administration expense/revenue	3.2%	3.3%	2.9%	3.2%	3.0%
NPAT	**184**	**239**	**148**	**298**	**366**

Source: RongViet Research

Valuation

FCFF method

We discounted the cash flow of the company in five years and estimated the exit value in the fifth year. According to Bloomberg, among the 239 M&A transactions and investment deals in the pharmaceutical industry from 2012 until now, the average value of the deals is 15.5 times of EBITDA. Because the pharmaceutical firms in Vietnam are worse than many other global companies in terms of technology and R&D, we chose a discount EV/EBITDA of 14 times. With this multiple EV/EBITDA, the price of PME should be VND131,000/share.

Table 16: Projection of PME's cash flow in 5 years

WACC = 11,5%	2017	2018	2019	2020	2021
FCFF	**154**	**(26)**	**52**	**380**	**457**
Discount factor	0.98	0.88	0.79	0.70	0.63
Present value	151	(22)	41	268	289

Source: RongViet Research

P/E method

PME is a leading company in the industry with modern facilities, and is one of the companies that will benefit the most from the upcoming policies. Therefore, it should trade at a **21x P/E**, a comparable P/E with other top pharmaceutical firms. As 2018F EPS is VND5,550, the price using this method will be VND116,550/share.

Table 17: Peer group comparison

Company	Nation	Marketcap (USD M)	Revenue 2016 (USD M)	ROE trailing (%)	ROA trailing (%)	Gross margin (%)	Inventory TO	P/E trailing
DHG	Vietnam	610	169	24.9	19.8	45.4	3.0	21.2
Imexpharm	Vietnam	119	45	9.4	9.1	44.0	2.5	22.2
Traphaco	Vietnam	213	89	23.4	16.0	57.8	3.2	22.1
Domesco	Vietnam	164	58	22.9	18.1	41.1	2.6	19.2
Bidiphar	Vietnam	115	62	18.8	11.3	36.8	4.3	17.9
CCM Duopharma Biotech	Malaysia	146	76	6.1	2.8	42.4	1.4	17.6
Apex Healthcare	Malaysia	141	141	11.5	8.4	22.4	7.2	16.7
YSP Southest Asia	Malaysia	94	57	10.3	7.9	42.8	1.6	14.0
Kotra Industries	Malaysia	58	39	10.0	5.2	N/A	N/A	19.6
Euro-Med Laboratories	Philippines	133	102	6.6	4.0	38.1	2.9	19.7
Kalbe Farma TBK	Indonesia	5,797	1,457	20.8	15.5	48.7	3.1	33.1
Kimia Farma Persero TBK	Indonesia	1,115	437	12.1	6.1	40.7	4.6	56.2
Tempo Scan Pacific TBK	Indonesia	628	687	11.8	7.6	38.7	4.4	15.9
Merck TBK	Indonesia	288	78	29.0	20.5	46.4	2.5	24.7
Darya Varia Laboratories	Indonesia	155	109	17.7	12.1	55.7	3.2	11.0
Pyridam Farma TBK	Indonesia	8	16	3.6	2.2	59.4	2.1	28.0
Average		**611**	**226**	**14.9**	**10.4**	**44.0**	**3.2**	**19.0***

*Source: Bloomberg as of 2 Oct 2017 *average P/E with weighted market cap, excluding 2 outliers from Indonesia*

Combining the two methods, we estimate the fair value of PME at **VND124,000/share.**

Table 18: Valuation matrix

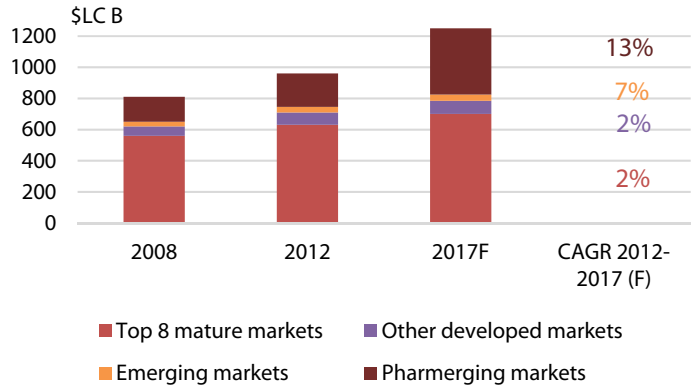
Method	Value	Weight	Contribution
FCFF	131,300	50%	65,650
P/E	116,550	50%	58,275
Target price			**124,000**

PHARMACEUTICAL INDUSTRY REVIEW

Ample room for growth in the long term

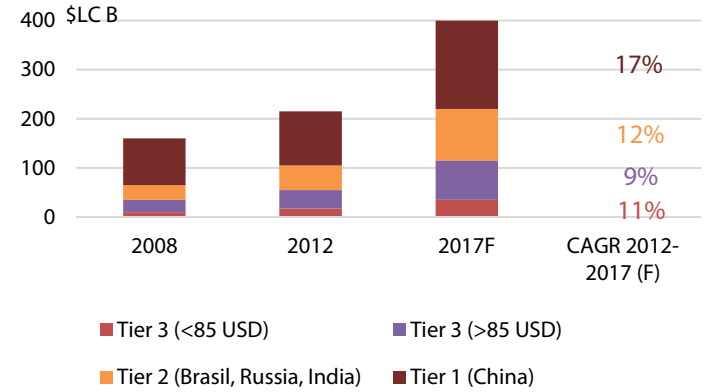
Vietnam is one of the 21 countries classified as pharmerging markets by the IMS Health. These countries are the growth drivers of the global pharmaceutical market, and are expected to soon account for a third of the market. Currently, Vietnam belongs to the Lower tier 3 as its medicine spending per capita is much lower than the group average. In addition, Viet Nam is soon to pass its golden population structure and heading towards aging population. This implies higher demand for drugs in the future. Therefore, the market still has ample room to grow in the long run.

Figure 30: Global pharma sales



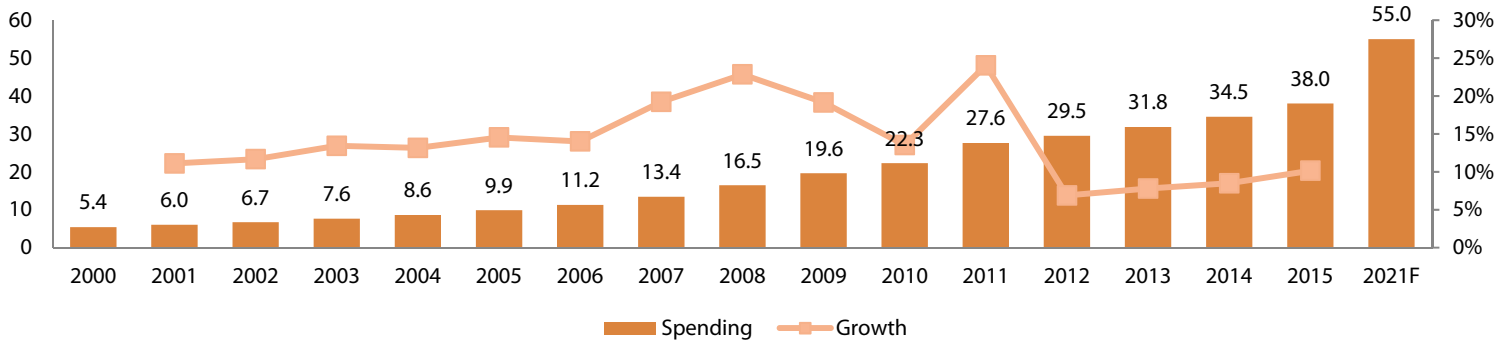
Source: IMS Health Market Prognosis

Figure 31: Pharmerging market sales



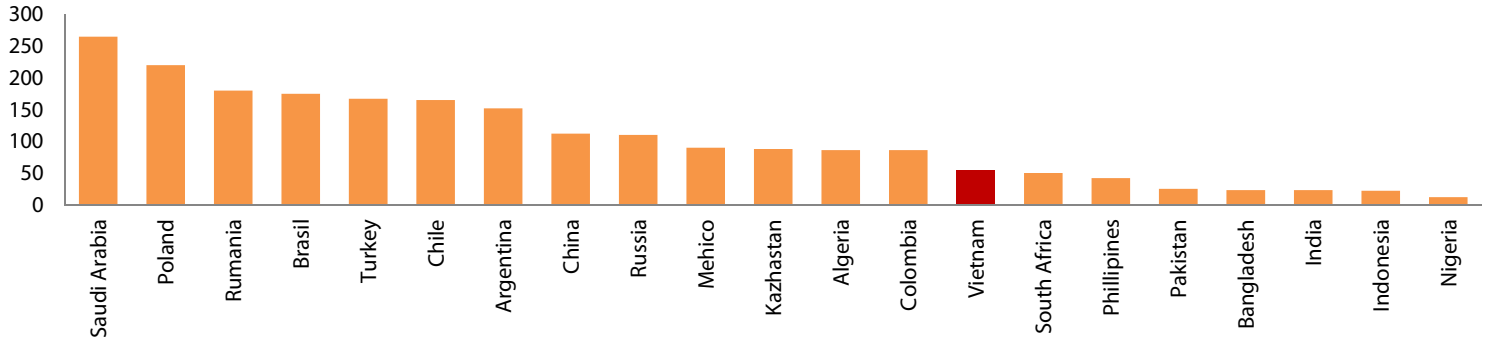
Source: IMS Health Market Prognosis

Figure 32: Medicine spending per capita in Vietnam (USD)



Source: DAV, RongViet Research

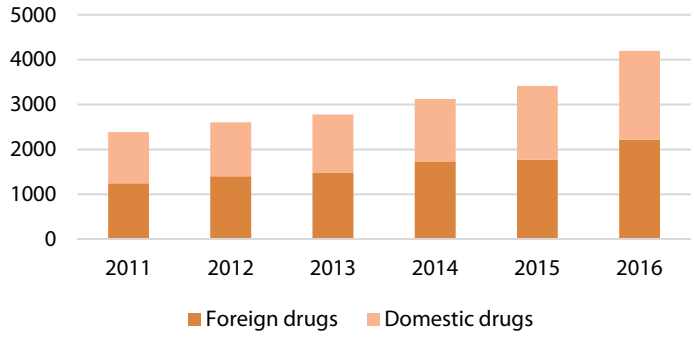
Figure 33: Pharmerging countries medicine spending per Capita in 2021 (USD)



Source: IMS Health Market Prognosis

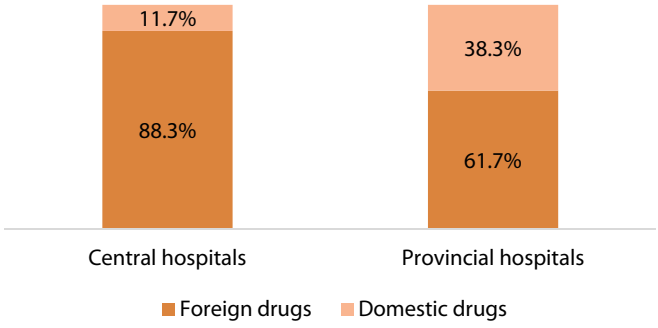
Despite strong growth potential, domestic manufacturers are strongly affected by fierce competition by foreign rivals. Not only domestic companies have to import over 90% of raw materials, they are also constricted to own just about half of the market share. The remaining market share is dominated by foreign products, which are superior in terms of quality. In the ETC channel, the proportion of imported products is even larger.

Figure 34: Domestic drugs only account for nearly 50% of total market (USD M)



Source: DAV, RongViet Research

Figure 35:Very low proportion of domestic drugs in the ETC channel (2015)



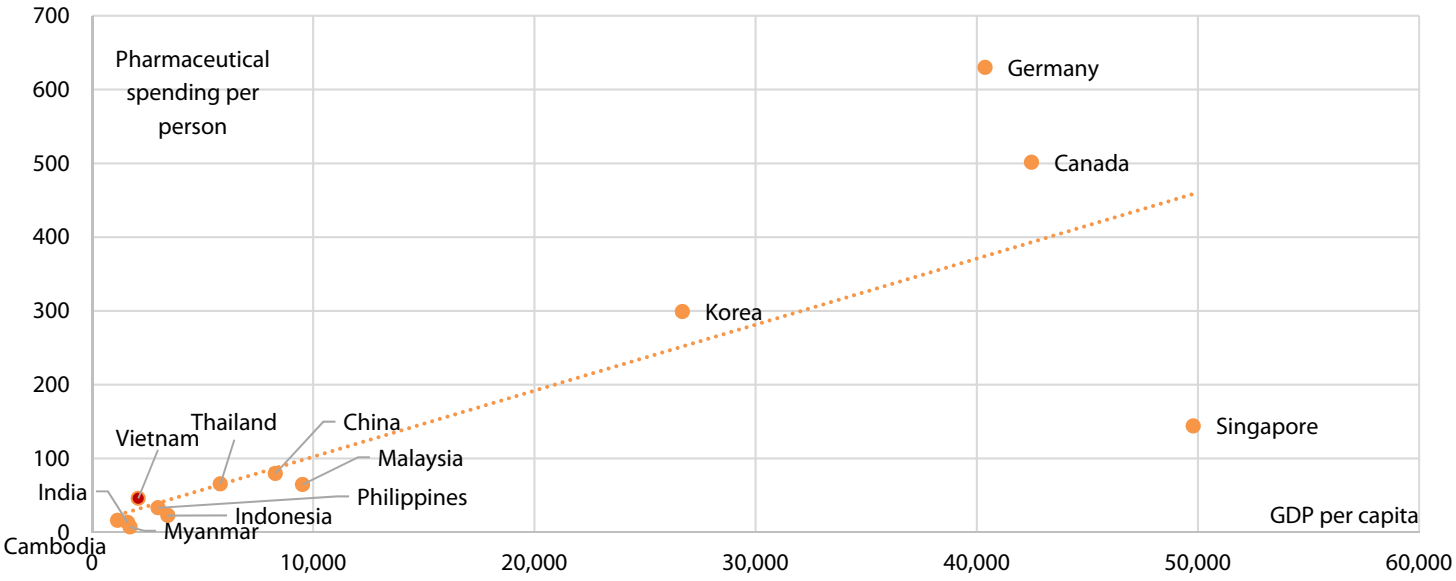
Source: DAV , RongViet Research

However, Vietnam's pharmaceutical industry promises to experience certain changes in major trends ahead:

Megatrend 1. Reducing treatment cost and improving efficiency in healthcare industry

While figure 33 shows that medicine spending per capita in Vietnam is low, figure 36 displays another angle, that is, the spending is actually quite high in comparison with countries with similar GDP level. Nevertheless, this high spending does not translate to high efficiency. One of the reasons is that Vietnamese have to buy imported drugs at very high prices. To solve the inefficiency problem, reducing drug cost and narrowing the price gap among different layers of hospitals are a must. This is one of the objectives of the upcoming policies mentioned at the beginning of this report.

Figure 36: Medicine spending per capita in Vietnam is higher than that of countries with comparable GDP (2015)



Source: BMI, tradingeconomic

Megatrend 2. Upgrading factories to EU-GMP or PIC/S standard to take advantage of supportive policies

Circular 01/2012/ TTLT-BYT-BTC on drug bidding process in public health facilities (refer to Appendix) has forced changes in domestic enterprises. Companies that follow WHO-GMP standards with simple and duplicate portfolios could barely survive, as they are drowned in a price war with each other and with low quality drugs from India and China. This led to a wave of upgrading or building new plants following EU-GMP or PIC/S standards to (1) improve drug quality and (2) avoid Tier 3 bidding group in which price competition is fierce.

With the upcoming policy changes to encourage domestic production, there will be an excellent opportunity for domestic enterprises to break through. Companies that have pioneered in this upgrading trend such as Tenamyd, PME, IMP, or Savipharm are promising to be the first to enjoy the fruits. Opportunities still exist for the second group (DHG, TRA, DMC, DBD, etc) if these companies could find the output of new plants to make up for the high investment cost.

Megatrend 3. Increasing the number of M&A activities initiated by foreign pharmaceutical corporations

With great growth potential, Vietnam is considered a promise destination in the eyes of foreign pharmaceutical corporations. However, as the pharmaceutical industry is a conditional business in Vietnam, the involvement of these corporations in the value chain of the industry is under control. For example, foreign companies are not allowed to directly distribute drugs but through domestic companies. More recently, Decree 54/2017/ND-CP has required even a stricter requirements as it redefined the concept of "distribution", which now include additional requirements for transportation, storage, warehousing and operation personnel. Although foreign enterprises are still finding ways to deal with these new regulations, these restrictions could not be removed in a day or two.

As a result, foreign corporations are targeting local businesses for M&A to make use of their available facilities, extensive distribution network, and low cost advantage in Vietnam. The acquisition of Glomed and DMC by Abbott, and the acquisition of DHG by Taisho are prudent examples of this trend. These FOL lifting cases of DMC and DHG have shed some hopes for overseas companies seeking their way into the Vietnam market by M&A activities with listed pharmaceutical companies.

Appendix: The evolution of the circular guiding the drug bidding process in the public health facilities

Circular No.01/2012/TTLT-BYT-BTC (effective on 1 June 2012). According to this circular, of all the drugs that overcome the technical hurdle rate, **the drug with lowest price wins the bid**. The problem of Circular 01 is that the bidding groups are not clearly separated and that the technical criteria are not hard to overcome. Therefore, after this circular is applied, there were many complains about the poor quality of the winning drugs.

To amend Circular 01, **Circular No.36/2013 / TTLT BYT- BTC** (effective on 1 January 2013) was born. This Circular reclassified the bidding groups, of which the most important adjustment was to separate medicines produced by manufacturers that meet EU-GMP or PIC/S in countries that belong to the ICH (USA, Japan, EU) from medicines produced by manufacturers that meet EU-GMP or PIC/S in countries that do not belong to the ICH (India, Taiwan, Vietnam). Thanks to this classification, **the medicines of Europe, USA, Japan, which have higher quality and price, were no longer competing with Indian medicines**. This somewhat improved the quality of the winning drugs.

After that, **Circular No.31/2014/TT-BYT** (effective on 26 September 2014) provided the score board to assess drug quality. Qualified medicines needed to achieve at least 80% of the total technical points, rising from the initial 70%.

Most recently, **Circular No.11/2016/TT-BYT** became effective on 1 July 2016 and replaced all the circulars mentioned above. According to the new circular, the bidding process use an additional scoring method in which **not only price but quality criteria are also taken into account**. Under this method, the contractor has the highest combination score of price and quality would be ranked first.

We are expecting another change in the near future. In Article 5, Section 1, the newest draft on drug bidding process in the public health facility has recommended the following changes in the Tier classification:

Old	New
Tier 1: Medicines produced by manufacturers that meet EU-GMP or PIC/S standard in countries that belong to the ICH and Australia. Medicines produced by manufacturers that meet WHO-GMP standard recognized by the Ministry of Health of Vietnam (MoH), and having license for use in countries that belong to the ICH or Australia. **Tier 2**: Medicines produced by manufacturers that meet EU-GMP or PIC/S standard in countries that do not belong to the ICH and Australia **Tier 3**: Medicines produced by manufacturers that meet WHO-GMP standard, recognized by MoH. **Tier 4**: Medicines that have bioequivalence, recognized by the MoH. **Tier 5**: Others.	**Tier 1**: Medicines produced by manufacturers that meet EU-GMP standard in countries that belong to the ICH and Australia. Medicines produced by manufacturers that meet WHO-GMP standard recognized by the Ministry of Health of Vietnam (MoH), and having license for use in countries that belong to the ICH or Australia. **Tier 2**: Medicines produced by manufacturers that meet EU-GMP standard in countries that do not belong to the ICH and Australia **Tier 3**: Medicines produced by manufacturers that meet WHO-GMP standard, recognized by MoH. **Tier 4**: Medicines that have bioequivalence, recognized by the MoH. **Tier 5**: Others.
- The medicines meeting Tier 1 requirements are eligible for bidding into Tier 1, Tier 2, and Tier 5; - The medicines meeting Tier 2 requirements are eligible for bidding into Tier 2 and Tier 5;	- The medicines meeting Tier 1 requirements are eligible for bidding into Tier 1, Tier 2, and Tier 5; - The medicines meeting Tier 2 requirements are eligible for bidding into Tier 2 and Tier 5;

- The medicines meeting Tier 3 requirements are eligible for bidding into Tier 3 and Tier 5;	- The medicines meeting Tier 3 requirements are eligible for bidding into Tier 3 and Tier 5; if the medicines have bioequivalence recognized by MoH, they are eligible for bidding in Tier 2
- The medicines meeting Tier 4 requirements are eligible for bidding into Tier 4 and other tiers if meeting the criteria of that tier	- The medicines meeting Tier 4 requirements are eligible for bidding into Tier 4 and other tiers if meeting the criteria of that tier
- The medicines not meeting Tier 1,2,3 or 4 requirements are only eligible for bidding into Tier 5	- The medicines not meeting Tiers 1,2,3 or 4 requirements are only eligible for bidding into Tier 5

Accordingly, there are two big changes:

First, drugs meeting PIC/S standard will no longer be in the same tier with drugs meeting EU-GMP. It is expected that they will be classified in separate tiers.

Second, if the drugs classified in Tier 3 have bioequivalence recognized by MoH, they are eligible for bidding in Tier 2. They will compete with drugs meeting EU-GMP standard, which have higher quality and higher price.

The second change has raised many concerns that Tier 3 drugs with bioequivalence, which have great advantage of lower prices, will compete directly with Tier 2 drugs like IMP's. Referring to the view of people working in the industry, the analyst has received a rather multidimensional view. There are case-by-case views expressing that there will still be discrimination in the bidding process between Tier 2 drugs and Tier 3 drugs with bioequivalence. Other opinions stated that Tier 3 drugs with bioequivalence may target oher segments rather than the antibiotic segment of PME.

In general, as the draft is still in the discussion process, the comments above are just views and researches of each party. The impact of this change (if any) remains uncertain. Therefore, **we think that this issue is still a certain risk when investing in PME at the moment.**

Unit: VND billion

INCOME STATEMENT	2015A	2016A	2017F	2018F
Revenue	1,309	1,508	1,734	2,081
COGS	684	788	902	1.082
Gross profit	**624**	**720**	**832**	**999**
Selling expense	349	386	430	504
G&A expense	41	50	55	63
Financial income	5	23	34	34
Financial expense	9	8	9	8
Other income/loss	0	1	1	1
Gain/(loss) from JV	0	0	0	0
PBT	**230**	**300**	**372**	**457**
Tax expense	46	61	74	91
Minority interests	0	0	0	0
PAT	**184**	**239**	**298**	**366**
EBIT	234	284	347	431
EBITDA	267	332	395	507

Unit: %

FINANCIAL RATIO	2015A	2016A	2017F	2018F
Growth				
Revenue	13.9	15.2	15.0	20.0
EBITDA	11.7	24.7	19.0	28.2
EBIT	12.4	21.5	22.2	24.4
PAT	23.9	30.3	24.5	22.8
Total Asset	26.1	17.8	19.9	14.5
Total Equity	20.1	21.8	22.2	14.3
Profitability				
Gross profit margin	47.7	47.7	48.0	48.0
EBITDA margin	20.4	22.0	22.8	24.4
EBIT margin	17.8	18.8	20.0	20.7
Net profit margin	14.0	15.9	17.2	17.6
ROA	13.3	14.8	15.3	16.4
ROIC or RONA	20.4	20.5	20.8	22.8
ROE	16.9	18.0	18.4	19.7
Efficiency (x)				
Receivables turnover	3.3	3.3	3.2	3.2
Inventories turnover	2.5	2.6	2.2	2.2
Payables turnover	3.0	3.3	3.3	3.3
Liquidity (x)				
Current	4.4	5.2	5.9	5.1
Quick	3.2	3.9	4.4	3.6
Financial Structure				
Total debt/ Equity	0.0	0.0	0.0	0.0
ST debt / Equity	0.0	0.0	0.0	0.0
LT debt/ Equity	0.0	0.0	0.0	0.0

Unit: VND billion

BALANCE SHEET	2015A	2016A	2017F	2018F
Cash and cash equivalents	244	77	219	182
Short term investment	80	410	450	350
Accounts receivable	391	456	538	645
Inventories	278	305	406	487
Other current assets	13	6	6	6
Tangible Fixed Assets	293	280	241	461
Intangible Fixed Assets	42	42	44	48
Long term investment	7	26	26	26
Other non-current assets	27	19	15	20
Total Asset	**1,376**	**1,621**	**1,944**	**2,225**
Account Payable	230	240	275	330
Short term borrowings	0	0	0	0
Long term borrowings	0	0	0	0
Other non-current liabilities	40	49	39	30
Bonuses and Welfare fund	17	6	9	12
Technology – Science dev fund	0	0	0	0
Total Liabilities	**288**	**295**	**323**	**372**
Common stock and APIC	571	672	822	822
Treasury stock	0	0	0	0
Retained Earnings	184	239	298	366
Other comprehensive income / (loss)	0	0	0	0
Investment and Development Fund	333	415	501	665
Total Equity	**1,088**	**1,326**	**1,621**	**1,853**
Minority Interest	0,0	0,0	0,0	0,0
Total Resources	**1,376**	**1,621**	**1,944**	**2,225**

CASH FLOW STATEMENT	2015A	2016A	2017F	2018F
Profit before tax	230	300	372	457
Depreciation	31	45	49	76
Adjustment	(23)	(16)	0	0
Working capital	96	(111)	(222)	(229)
Net Operating CFs	**334**	**219**	**199**	**308**
Fixed Asset	(156)	(22)	(9)	(309)
Deposit, equity investment	(62)	(364)	(40)	100
Interest, dividend, cash profit received	0	0	0	0
Net Investing CFs	**(218)**	**(386)**	**(49)**	**(209)**
Capital	134	100	0	0
Debt	0	0	0	0
Dividend paid & other	(134)	(100)	(8)	(136)
Net Financing CFs	**0**	**0**	**(8)**	**(136)**
Net Cash flow	116	(167)	142	(37)
Beginning cash & equivalents	**107**	**244**	**77**	**219**
Effect of exchange rate	0,0	0,0	0,0	0,0
Ending cash & equivalents	**244**	**77**	**219**	**182**

COMPANY REPORT

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RATING GUIDANCE

Ratings	BUY	NEUTRAL	SELL
Total Return including Dividends in 12-month horizon	>20%	-20% to 20%	<-20%

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