

Friday, 27 September 2019

BUY

Innition

Last price (IDR)	1,390
Target Price (IDR)	1,800
Upside/Downside	+29.5%
Previous Target Price (IDR)	1,800

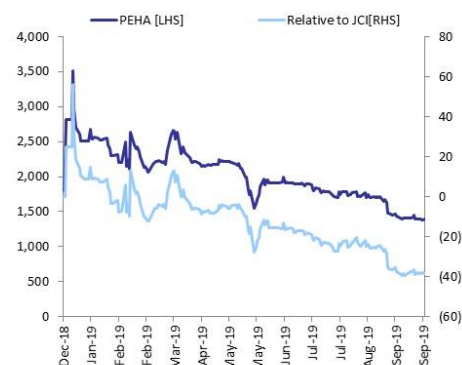
Stock Statistics

Sector	Pharmaceutical
Bloomberg Ticker	PEHA IJ
No of Shrs (mn)	1,703
Mkt. Cap (IDRbn/USDmn)	2,367/167
Avg. daily T/O (IDRbn/USDmn)	0.1/0.0

Major shareholders (%)

Kimia Farma	56.8%
Masrizal A. Syarif	9.0%
Estimated free float	34.0%

PEHA relative to JCI Index



Source : Bloomberg

Pharos (PEHA IJ)

A prescription for growth

We expect Pharos to book solid earnings growth ahead supported by: (1) consolidation with KAEF that leads to greater economies of scale and a more extensive distribution network and (2) ongoing expansion with 12 new products in the pipeline coupled with new facilities to tap the growing pharmaceuticals market. The company trades at an attractive valuation of FY20F PE of 12.8x. We initiate coverage on the stock with a BUY.

Positive catalyst from consolidation with Kimia Farma. Post consolidation with KAEF, it is estimated that the two companies will have total combined market share of around 4-5% in the prescription drugs market. With 14 plants (3 owned by Pharos and subsidiaries, the rest belonging to KAEF), we believe the company will have greater capacity to tap the increasing demand from BPJS Kesehatan. Bear in mind that the e-catalog tender has been continued for the second time in a 2-year period. On the costs side, the consolidation should lead to greater bargaining power to secure better prices of Active Pharmaceutical Ingredients (API) and raw materials in the future. Kimia Farma's extensive distribution network coupled with having the largest pharmacies chain in Indonesia will also support higher top line growth for Pharos going forward.

Expansion mode; 12 new products in the pipeline & the development of new facilities. The greater coverage of BPJS Kesehatan will lead to higher demand for drugs and the supported medical devices in Indonesia. Therefore, Pharos plans to launch 12 new drugs on an annual basis, mostly in the Ethical category – to tap the market for widely-used drugs to treat common diseases in the country. Pharos also plans to develop new facilities to produce intravenous liquid for CAPD, for coronary angioplasty, cartridge ampoule pehacain for dental anesthesia and other facilities to support product innovation that will sustain margins.

Solid growth and attractive valuation, we initiate coverage with a BUY. Higher production capacity should support the FY19-20 top line growth of 27.9% and 23.7% yoy, respectively. With a maintained contribution from generic medicine of around 50% to total revenues, we estimate FY19-20 earnings growth of 11.9% and 24.5% yoy, or FY18-20 CAGR of 13.7%. We initiate coverage on the stock with a BUY call and TP of IDR1,800 – based on DCF (WACC: 10.4%, Terminal Growth 3%). At the current share price, PEHA is trading at FY20F PE of 12.8x, a 56% discount to the average FY20F PE of Kalbe Farma and Kimia Farma.

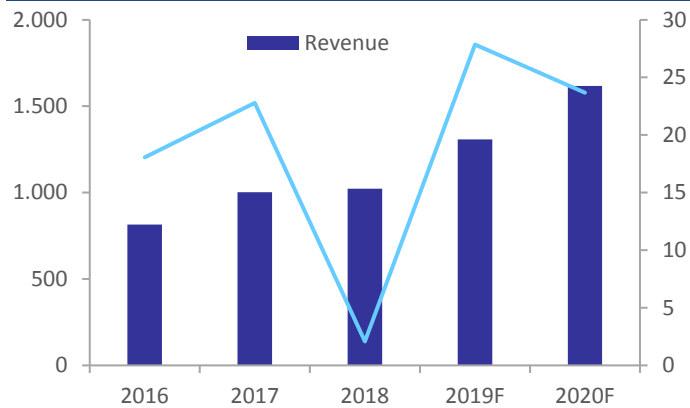
Key Financials

Year to 31 Dec	2017A	2018A	2019F	2020F	2021F
Revenue (IDRbn)	1,002	1,023	1,308	1,618	1,988
EBITDA (IDRbn)	205	220	282	309	399
EBITDA Growth (%)	43.8	7.3	28.4	9.5	29.2
Net profit (IDRbn)	125	132	148	184	217
EPS (IDR)	745.6	157.5	86.9	108.2	127.6
EPS growth (%)	44.0	(78.9)	(44.8)	24.5	17.9
BVPS (IDR)	4,174.9	916.6	1,146.3	1,211.0	1,284.5
DPS (IDR)	258.9	104.4	38.8	43.5	54.1
PER (x)	1.9	8.8	16.0	12.8	10.9
PBV (x)	0.3	1.5	1.2	1.1	1.1
Dividend yield (%)	18.6	7.5	2.8	3.1	3.9
EV/EBITDA (x)	1.6	8.6	7.5	8.3	7.0

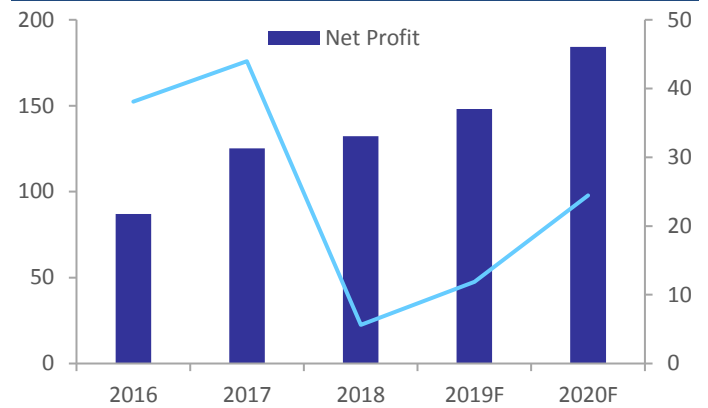
Source : PEHA, Danareksa Estimates



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Exhibit 1. Revenues and Growth


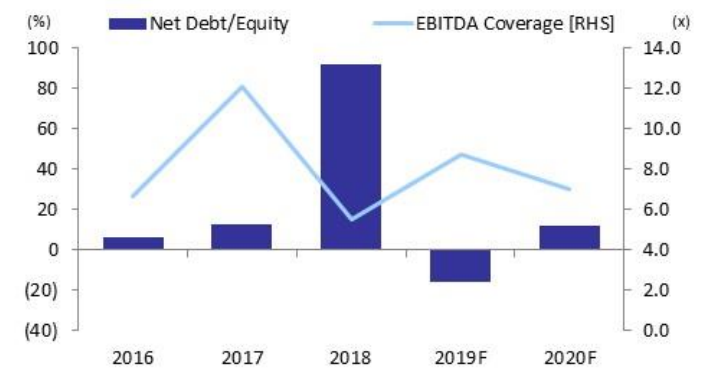
Source: Company, Danareksa Sekuritas estimates

Exhibit 2. Net Profits and Growth


Source: Company, Danareksa Sekuritas estimates

Exhibit 3. Margins


Source: Company, Danareksa Sekuritas estimates

Exhibit 4. Gearing Level


Source: Company, Danareksa Sekuritas estimates

Valuation

We initiate coverage with a BUY recommendation. We initiate coverage on PEHA with a BUY recommendation and target price of IDR1,800 based on DCF valuation, WACC of 10.4% and terminal growth of 3%. We foresee further growth for the company in the future supported by:

a) The recent consolidation with Kimia Farma

- **Enlarged market share.** In March 2019, KAEF acquired the majority stake of Phapros from another SOE – Rajawali Nusantara Indonesia. Post the consolidation of these two pharmaceutical companies, it is estimated that the combined market share will reach 4-5% in the prescription drugs market.
- **Greater economies of scale.** Phapros has three factories in Semarang and Bandung for 14 OTC, 91 Ethical and 122 generic products. Combined with Kimia Farma, which has 11 plants and 233 SKU in branded and generic drugs, the company will enjoy larger economies of scale to tap the increasing demand from BPJS Kesehatan considering the e-catalog tender that is held every 2 years. In addition, greater bargaining power should secure the prices of its raw materials in the future.
- **Extensive distribution network**
 From its consolidation with KAEF, Phapros has extended coverage to 34 provinces and 511 cities across Indonesia – through KAEF’s subsidiaries’ National Distribution Center (NDC) and Kimia Farma Trading and Distribution (KFTD). In addition, the company also stands to benefit from Kimia Farma Apotek (KFA), the largest pharmacy chain in the country

b) Additional new products development in the pipeline

Phapros plans to launch 12 new products/drugs on an annual basis. For 2019, the company plans to launch 8 new medicines in Ethical category, while the other 4 are generic drugs. In 1H19, 3 products were launched for the treatment of allergic reactions, for diabetes treatment, and the treatment of gastric pains. These new products are expected to support revenues growth and margins in the future.

c) Development of new facilities

Phapros plans to develop several new facilities to support its business encompassing product innovation, the development of higher margin products and new products to meet the requirement for local content in the pharmaceutical industry, especially for medical devices.

d) Solid 2018-2020 earnings growth of 13.7% CAGR

With production capacity more-than-doubled to 4.6mn units in 2019, we estimate solid sales volume growth of 22% CAGR in 2018-2020. This will support the FY19-20 top line growth of 27.9% and 23.7% yoy, respectively. We expect the company to maintain the contribution from generic drugs at around 50% to total revenues. This will sustain margins ahead and support estimated earnings growth of 11.9% and 24.5% yoy in 2019-20F.

e) Attractively valued compared to its peers

At the current share price, PEHA is trading at FY20F PE of 12.8x, a 56% discount to the average FY20F PE of Kalbe Farma and Kimia Farma. With room to grow in the future and strong earnings growth compared to the sector, we see potential for a rerating in the valuation. As such, we initiate coverage with a BUY recommendation and TP of IDR1,800, implying FY20F PE of 16.6x with an implied 43% discount to the average pharmaceuticals’ FY20F PE of given the stock’s small capitalization and lower liquidity in the market.

Exhibit 5. Valuation

DCF			
Value of firm - IDR bn			3,288
Net cash/(debt) - IDR bn			(203)
Value of equity - IDR bn			3,085
# of shares (mn shares)			1,703
Target price - IDR			1,800
			*
			**
PE		2019F	2020F
At current price		16.0	12.8
At target price		20.7	16.6

Source: Company, Danareksa Sekuritas estimates *Fully dilutive

**WACC 10.4% and Terminal growth 3%

Exhibit 6. Peers' comparison

Company	Rec	TP	Market Cap	Avg daily TO	PE, x		Revenue g, %		Op Margin, %		Net profit g, %		ROE %	
		IDR	IDR bn	IDR bn	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
KLBF	BUY	1,800	78,047	37.9	30.4	28.1	7.7	8.2	15.7	14.6	2.2	4.4	16.6	16.3
KAEF	HOLD	3,120	16,329	5.1	34.5	29.9	23.2	20.2	7.3	7.1	13.9	15.3	13.9	14.3
PEHA	BUY	1,800	1,168	0.1	16.0	12.8	27.9	23.7	18.5	16.4	11.9	24.5	10.9	9.2

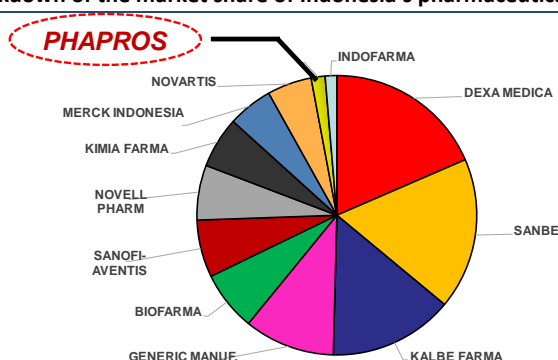
Source: Bloomberg, Danareksa Sekuritas estimates *Closing price 26 Sept 2019

Industry outlook

Indonesia' pharmaceutical market is highly fragmented

Indonesia's pharmaceutical market is highly fragmented. In total, there are around 200 pharmaceutical companies in the country, with around 40-50 of them accounting for 80% of the total market share. Domestic companies have around 70% market share in the country, making Indonesia one of the few countries in Asia to have such a strong domestic presence. Multinational companies have been more successful in the larger cities. In more rural areas, however, domestic companies drive the market. It is also the case that domestic companies dominate the market for over-the-counter (OTC) products. All in all, around 40% of the total Indonesia pharmaceuticals market constitutes OTC products, whereas in other countries the figure is typically 10-15% (source: Indo pharma 2015.pdf)

Exhibit 7. Breakdown of the market share of Indonesia's pharmaceutical sector - 2018

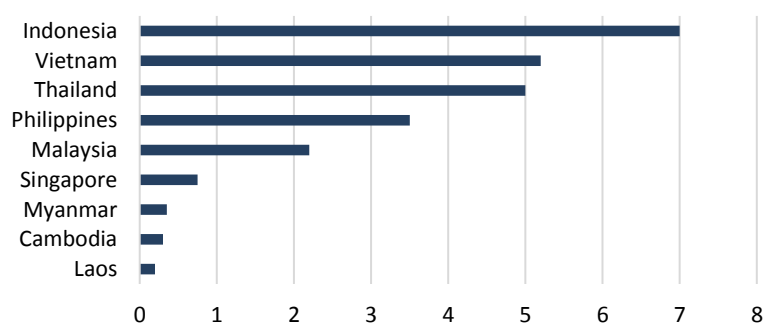


Source: Company, IPA+IHPA 4Q 2018, IQVA

Indonesia is also the largest medicine market in South East Asia

In 2017, Indonesia was the largest medicine market in South East Asia worth IDR94.2tn, larger in size than the markets in both Vietnam and Thailand. Fitch Solutions estimates that the country's drug sales may reach IDR300tn by 2027, driven by the imminent transformation of the healthcare system, which provides greater access for medical services.

Exhibit 8. South East Asia Pharmaceutical Sales, 2017 (USD Bn)

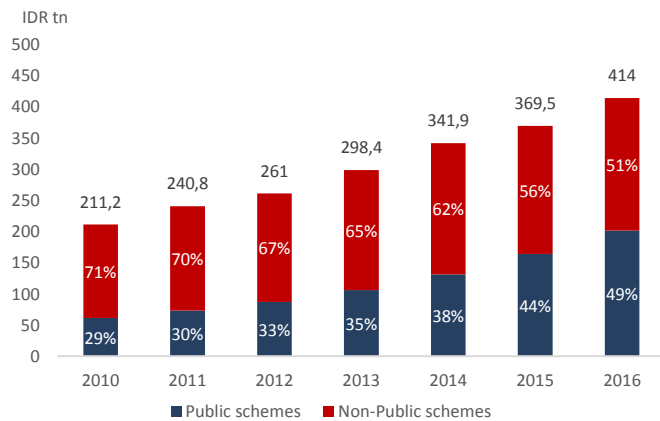


Source: Fitch Solutions

Continued government focus on healthcare

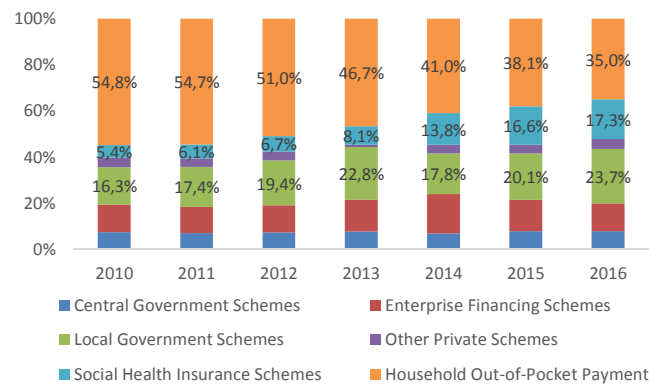
The government plans to maintain healthcare expenditure at 5% of GDP in 2019. In the past few years, the government’s focus on healthcare has supported increasing spending on healthcare in Indonesia. In previous years (1999-2009), Indonesia’s healthcare spending was only around 2.1% of GDP, or less than in other South East Asian countries. Since the implementation of the National Health Program (JKN) in 2014, higher spending on public healthcare has resulted in a rising contribution of public funding on total healthcare. Meanwhile, the percentage of out-of-pocket spending on healthcare declined in the 2010 to 2016 period.

Exhibit 9. Public Vs non- public to healthcare spending



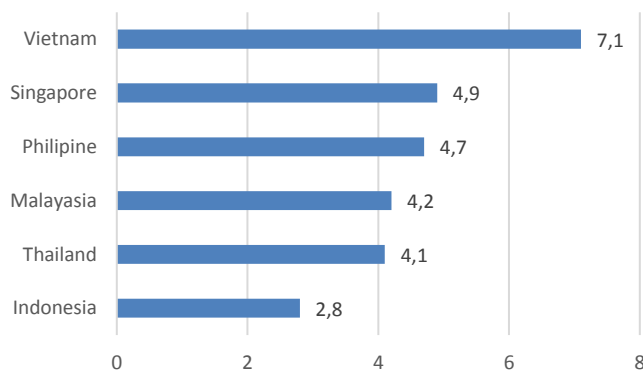
Source: Indonesia National Health Accounts, 2016

Exhibit 10. The out-of-pocket contribution declined



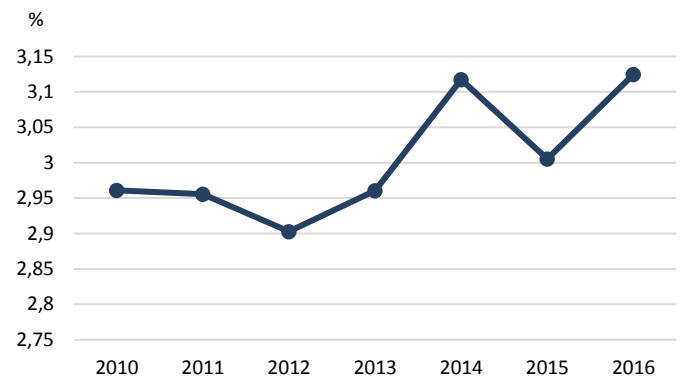
Source: Indonesia National Health Accounts, 2016

Exhibit 11. % Healthcare expenditure/GDP - 2017



Source: Asean Secretariat, ASEAN stats database

Exhibit 12. Indonesia’s healthcare to GDP, 2010-2016

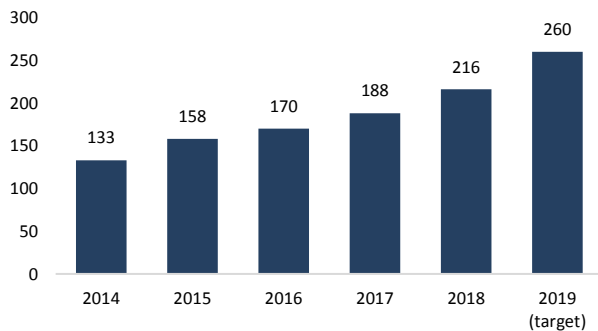


Source: WHO

Increasing number of participants in JKN, higher demand for medicine especially generic

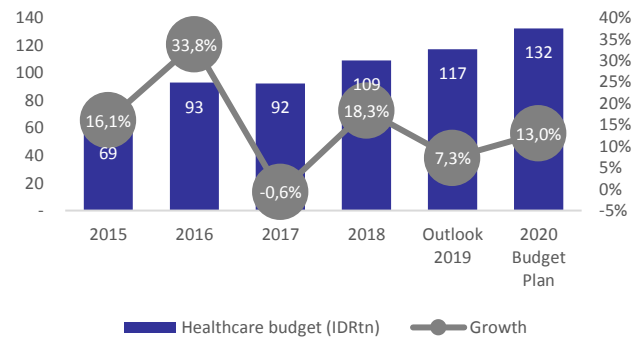
Since the national health insurance (JKN) program started to operate in 2014, the number of people covered in Indonesia has increased from around 133mn people (more than 50% of the total population). Coverage is expected to reach 260mn people by the end of the year. For 2020, the government has allocated IDR132tn on healthcare in the draft state budget, or translating into an increase of 12.9% yoy. The 2020 healthcare budget is 5.2% of the total state budget, or higher than 2019's 5%.

Exhibit 13. Coverage of National Health Program (mn people)



Source: Ministry of Health

Exhibit 14. Government healthcare allocation budget, 2015-2020



Source: Ministry of Finance

Supportive government regulations

In 2016, the government issued stimulus package number 10, which permits 100% foreign investment in the raw materials business for pharmaceuticals. Meanwhile, for pharmaceuticals finished goods, the regulation permits a maximum of 85% foreign investment. With the easing of the provisions in the Foreign Direct Investment (FDI) regulation combined with tax relief policies for pharmaceutical companies, members of the International Pharmaceutical Manufacturers Group (IPMG) in Indonesia, including Novartis, Merck, Bayer, Boehringer Ingelheim and Pfizer, have invested more than USD1bn in the sector over the past few years, especially for the construction of factories and on clinical research. In 2017, Bayer invested around USD9mn on the expansion of its factory in West Java.

Recently, the joint venture of CKD Pharma (South Korea) and Otto Pharmaceutical (Mensa Group) completed the construction of its new plant to produce oncology products involving a total investment of USD30mn. Another pharmaceuticals company, Kalbe Farma, is also set to produce new oncology products, while Kimia Farma will commence the operation of its two new factories: one in Banjarnegara (West Java) – as part of its expansion plans - while the other is its new plant for active pharmaceutical ingredients (API) – a JV with Shungwun Pharmacopia (South Korea). More investments in pharmaceuticals should improve the country's ability to provide greater public healthcare services.

Exhibit 15. Investment of pharmaceutical companies within the past few years

Years	Company	Products	Investment (USD mn)	Investment (IDR bn)
2013	Ethica (Soho Group) and Fresenius Kabi (Germany)	Injection / IV drugs (Intra Venous), generic, infusion therapy, nutritional products clinical and health equipment	60	
2017	KLBF & Genexine (South Korea)	new innovative biological drugs, which will be patented and marketed in the ASEAN region, the Middle East, Taiwan and Australia		130
2017	Ethica	More than 20 injection drugs (ampules and vials) using aseptic technology and final sterilization		1,000
2018	Novartis	annual investment to add capacity	1	
2019	Otto Pharmaceutical (Mensa group) & CKD (South Korea)	Oncology products	350	
2019	B Braun Indonesia	Infusion liquid (Infus)		1,000
2019	Bayer Indonesia	Various health products		1,600
2019	Pfizer Indonesia	Various health products	5	
2019	Phapros	Pehacain ampoule (carpoule) cartridges through technology transfer (ToT)		50

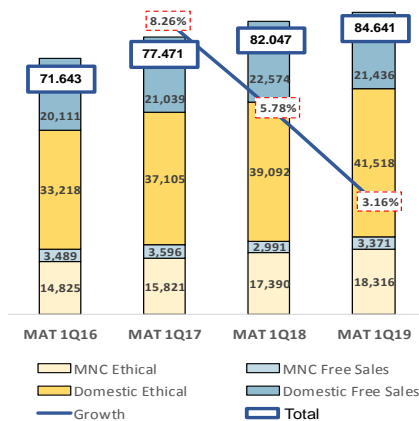
Source: Various sources

Generic: Potential growth from higher government spending

Based on data from IQVIA, the total Moving Annual Total (MAT) in the pharmaceuticals industry in 1Q19 reached IDR84.6tn, +3.2% yoy. Ethical products provided the biggest contribution of 51% in 1Q19, while the remainder came from Unbranded Generic products and Free Sales/OTC of 20% and 29%, respectively. Local companies still hold the majority market share with 74% market share, while multinationals account for the remainder.

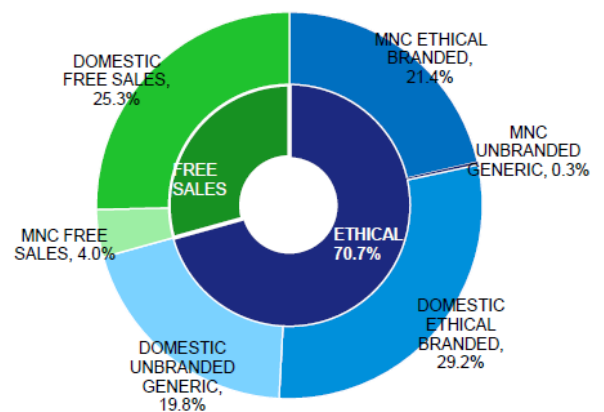
With an increasing number of participants in BPJS Kesehatan, sales of Unbranded Generic products are still the growth driver in the pharmaceuticals industry. In 1Q19, sales of Unbranded Generic products booked the highest growth of 14.5% yoy. Meanwhile, sales of Ethical products booked solid growth of 5.9% yoy, as demand for these products increased along with the better access to healthcare services for many people in the country.

Exhibit 16. Total MAT of Pharmaceutical sector – 1Q19 (IDR bn)



Source: PEHA, KAEF, IQVIA

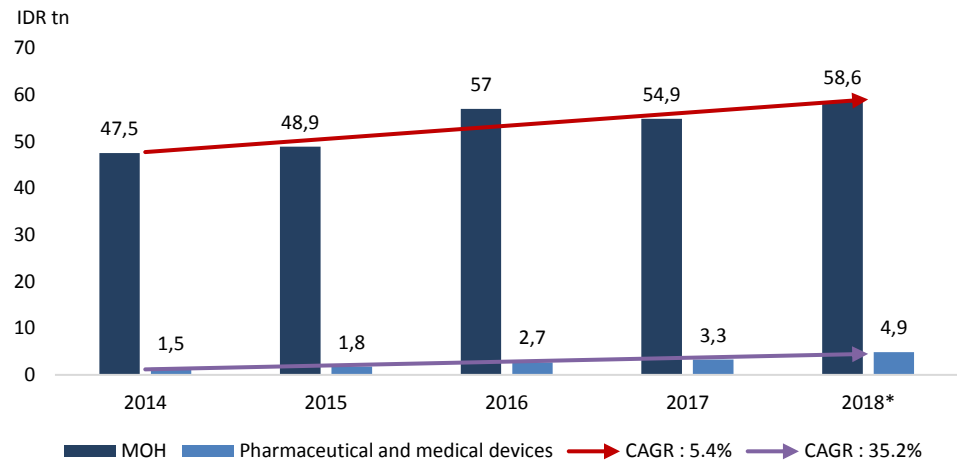
Exhibit 17. Market shares in Pharmaceutical industry



Source: PEHA, KAEF, IQVIA

To meet the increasing demand for generic drugs and medical devices, we expect the budget of the Ministry of Health (MOH) for pharmaceutical products and medical devices to increase. In 2014, pharmaceutical products and medical devices only accounted for 3.1% of the MOH budget. However, this more than doubled to 7.6% in the 2019 budget. Hence, the CAGR 2014-18 for the pharmaceutical products and medical devices budget reached 35.2%, or much higher than the overall CAGR for the MOH budget of 5.4% in the same period.

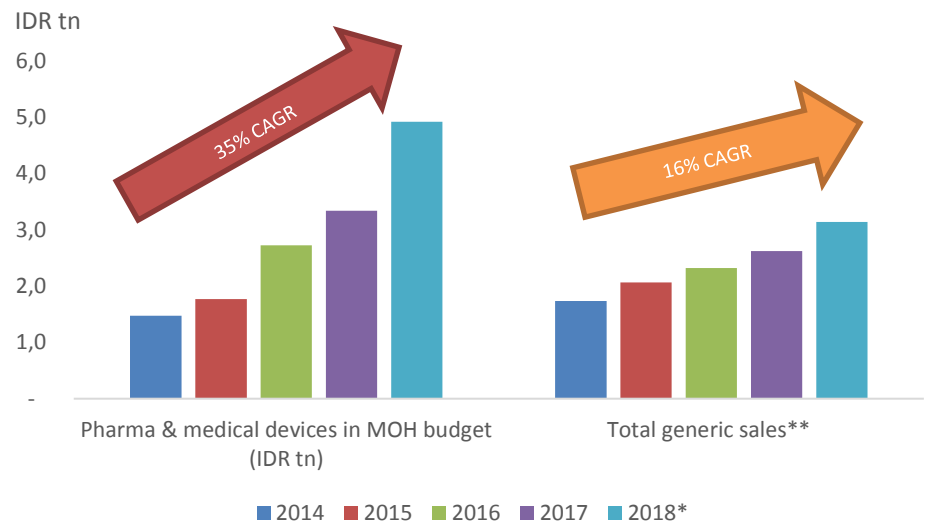
Exhibit 18. Ministry of Health budget – 2014-18



Source: Ministry of Health

We examined the revenues of generic/unbranded products produced by 3 major players: Kimia Farma (KAEF IJ), Kalbe Farma (KLBF IJ) and Phapros (PEHA). In the period 2014-18, generic products became the driver of the revenues growth of these companies’ prescription divisions (excluding OTC). The total sales of generic products produced by these companies has shown a similar trend to the increase in the government’s budget on pharmaceuticals and medical devices (16% and 35% CAGR in 2014-18, respectively). As such, we believe continued government support for JKN will provide ample room for sales of generic drugs to grow further in Indonesia.

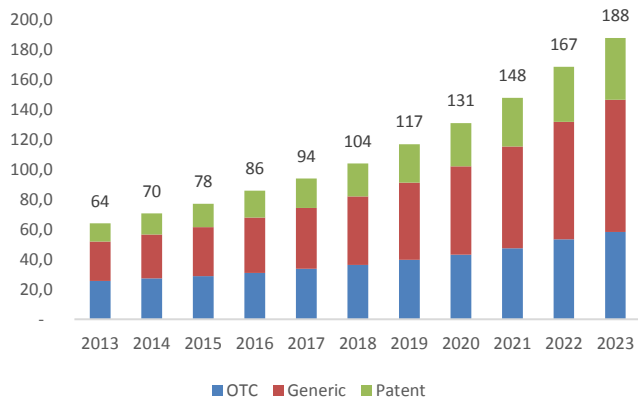
Exhibit 19. Generic sales versus Pharma & Medical devices’ budget in MOH



Source: Ministry of Health, Danareksa

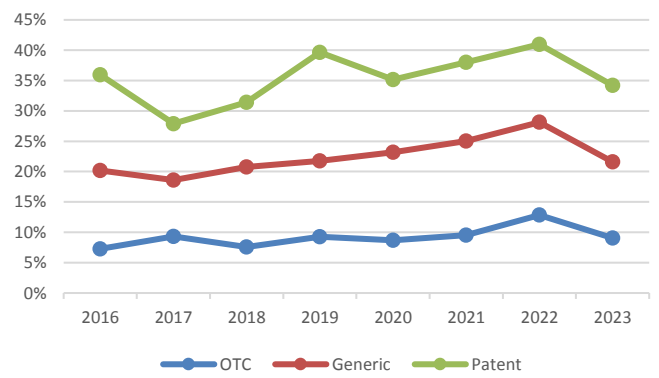
*Outlook **KLBF, KAEF and PEHA

Exhibit 20. Sales of Indonesia' pharmaceutical industry



Source: BMI research, strategic and analysis

Exhibit 21. Growth by segment



Source: BMI research, strategic and analysis

Investment thesis

Getting bigger from the recent consolidation with KAEF

By the end of March 2019, Kimia Farma (KAEF IJ) had completed the acquisition of a 56.77% stake in Phapros from Rajawali Nusantara Indonesia (RNI) in a deal worth IDR 1.36tn. As both companies are government owned, we see that the consolidation of KAEF and PEHA has the potential to tap the growing demand for medicines sold under the National Health Program (BPJS Kesehatan).

1. Greater economies of scale

Phapros' factories, which are located in Semarang and Bandung, produce 14 OTC products, 91 Ethical and 122 generic products. As for KAEF, it has 11 plants with 233 SKU for its Branded and Generic products, excluding OTC products. With the consolidation of both companies, greater economies of scale should be achieved to tap the e-catalog market.

It is worth noting that KAEF is the only pharmaceutical company in Indonesia which has a plant to produce Antiretroviral (ARV – for HIV treatment) and an Iodines plant in East Java (for producing the main material of blood booster). In 2020, Kimia Farma will commence the commercial production at Shungwun Pharmacopia (KFSP), which will manufacture the first Active Pharmaceutical Ingredients (API) in Indonesia. In the early stage, KFSP will produce 3 API for Cholesterol Drugs, Hypertension Drugs and Anti Retroviral Drugs. In the next step, KFSP will also develop API for TBC and Gastro Intestinal conditions. From KFSP's total production, around 25% will be sold locally, while the remainder will be exported. The government has also ruled that only KAEF can distribute narcotic products of any kind in Indonesia in order to ensure that such products are appropriately utilized.

In relation to the e-catalog tender, which will be done every 2 years, the consolidation of KAEF and PEHA will create a larger scale of operations to tap the increasing demand from BPJS Kesehatan as well as ensure greater bargaining power to secure the lowest possible raw material prices.

Exhibit 22. Phapros' business and pareto products

Division	Items
OTC	14
Ethical	91
Generic	122
Pareto products	
Antimo	
Pehacain	
Pro TB	
Methyl Prednisolone	
Dextamine	





Source: Phapros

Exhibit 23. Several plants under Kimia Farma

Location	Products/specialty
Medan, North Sumatera	Non Betalaktam, Tablet, cream and capsule
Semarang, Central Java	Focus on castor oil, edible oils and cosmetics
Jakarta	The only plant in Indonesia that has been assigned to produce antiretroviral drugs (ARV) For HIV patients
Bandung, West Java	Non Betalaktam, Contraceptive hormones, Intra-Uterine contraception (IUD) and herbal products
Banjaran, West Java	Pharmaceutical and herbal products
Watudakon, Jombang East Java	To process iodine mine. Producing raw materials i.e Ferrous Sulphate as the main material for blood booster
Denpasar, Bali	Medical equipment i.e test for HIV, Sifilis, Hepatitis C, Malaria, Narcotics and Pregnancy

Source: Kimia Farma

Exhibit 24. Kimia Farma's business portfolio

<p>Kimia Farma Holding</p>  <ul style="list-style-type: none"> Revenue contribution: 18% Manufacture of Pharmaceutical & Chemistry Product 	<p>Sinkona Indonesia Lestari</p>  <ul style="list-style-type: none"> Revenue contribution: 2% Quinine Manufacturing and Marketing as well as its product diversification 97% 30% Worldwide Quinine Market Share 	<p>Kimia Farma Sungwun Pharmacopia</p>  <ul style="list-style-type: none"> Revenue contribution: 0% Manufacture and marketing of raw materials and active pharmaceutical ingredients 	<p>Phapros Tbk</p>  <ul style="list-style-type: none"> Revenue contribution: 7% Manufacture of Pharmaceutical & Medical Equipment
<p>Kimia Farma Trading & Distribution</p>  <ul style="list-style-type: none"> Revenue contribution: 29% 48 branch Trading & Distribution of KF Product and 3rd party product 	<p>Kimia Farma Apotek</p>  <ul style="list-style-type: none"> Revenue contribution: 43% 1.234 Retail Pharmacy 564 Clinic 58 Diagnostic Lab 10 Optic 3 Marcks Venus Clinic 	<p>Kimia Farma Dawaa</p>  <ul style="list-style-type: none"> Revenue contribution: 1% Retail Pharmacy in Saudi Arabia 34 branch in Makkah, Jeddah, Madinah 	

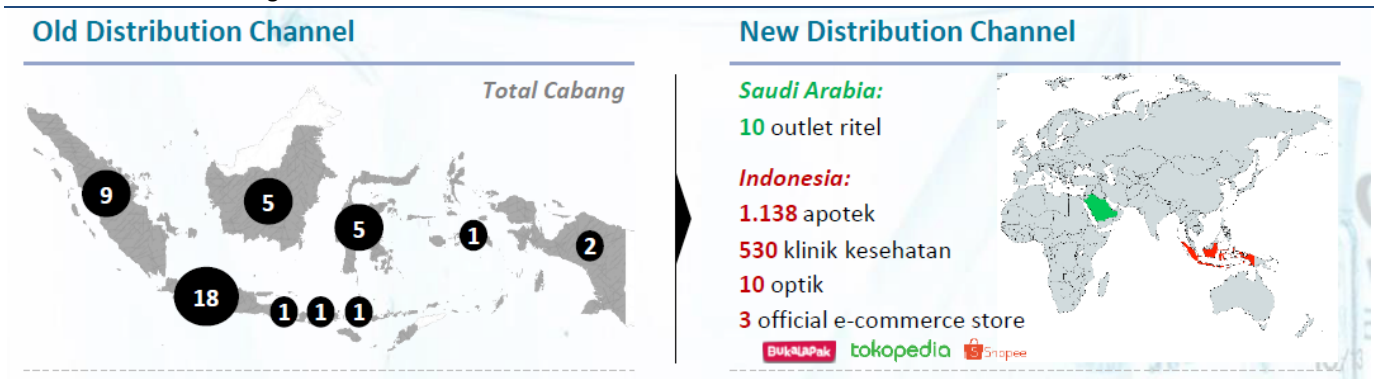
Source: Kimia Farma

2. Extensive distribution network

Phapros previously utilized the distribution network of RNI for the marketing and distribution of its products. Starting this year, since its acquisition by KAEF, Phapros is still undergoing a transitional process so as to better utilize KAEF's distribution network.

Under its distribution business, KAEF has the National Distribution Center (NDC) and Kimia Farma Trading and Distribution (KFTD). NDC is responsible for warehouses and also acts as a distributor of the company's and 3rd party products while KFTD - which was established in 2003 - manages the company's healthcare trade and distribution services. With extensive coverage across 34 provinces and 511 cities in Indonesia, the company distributes products to pharmacies, hospitals, dispensaries, supermarkets, restaurants and cafés.

Exhibit 25. Greater coverage in the distribution network



Source: Phapros

3. Direct downstream access through KFA, KFD and KF Dawaa

At present, Kimia Farma Apotek (KFA) is the largest pharmacy chain in the country, with 1,234 outlets, 564 health clinics, 10 opticians and 3 Mark's Venus clinics. KAEF also has 56 clinics in a network covering Medan to Makassar, under Kimia Farma Diagnostika (KFD). To tap the market in the Middle East, KAEF acquired a 60% stake in Dawaa to form a new subsidiary – Kimia Farma Dawaa in 2018. At present, KF Dawaa has 34 retail pharmaceutical and medical goods outlets in Saudi Arabia.

Several new products in the pipeline

This year, the company plans to add 12 new drugs to its portfolio. By the end of June 2019, the company had launched 3 new products:

- **Besaline Tab**
 In tablet or syrup form, this product contains Dexchlorpheniramine Maleate combined with Betamethasone. The medicine is categorized as an antihistamine to block histamine, a chemical produced in the human body that causes allergic reactions
- **Omeprazole 40mn SI**
 Omeprazole is included in a class of drugs called proton pump inhibitors (PPI) that block the production of acid by the stomach.
- **Diafac XR Tab**
 Comprised of metformin hydrochloride, to treat diabetes patients

In the following quarters, Phapros plans to launch another 9 new drugs:

- **Orabloc 1:100000**
Rapid onset of anesthesia within 1-9 minutes, utilized for dental treatment
- **Sesma Syrup**
Cough medicine for kids with asthma, contains procaterol hydrochloride as its active ingredient.
- **Acetosal 100 TSE**
The generic name is Aspirin. This product can be used as inhibition of platelet aggregation.
- **Bonefill Ortho**
For bone filler.
- **Implant HIP Revisi Long Stem Cemented & Cementless**
For revision of hip replacement
- **Implant ACS SC FB Revision Bearing Semi Constrained**
For revision of total knee replacement

- **Glimepiride 2mg tab**
Taken with a proper diet and exercise program to control high blood sugar in people with type 2 diabetes. Glimepiride belongs to the class of drugs known as sulfonylureas. It lowers blood sugar through the release of the body's natural insulin

- **Ramipril 5mg tab**
Ramipril (Altace) is an ACE inhibitor. ACE stands for angiotensin converting enzyme. Ramipril is used to treat high blood pressure (hypertension) or congestive heart failure, and to increase the chances of survival after a heart attack. Ramipril may also be used for purposes not listed in this medication guide

- **Mycophenolate Mofetil (Mycocell) 500 mg tablet**
Mycophenolate is used in combination with other medications to prevent the body from attacking and rejecting transplanted organs (such as the kidneys, liver, heart). It belongs to a class of medications called immunosuppressants

Development of new facilities

Going into 2020, we believe that pharmaceutical companies such as Phapros will have room to grow. As the government plans to increase the fees paid by BPJS Kes Participants, this should reduce the National Health program deficit and have a positive impact on all stakeholders (hospitals and pharmaceutical companies).

Going forward, Phapros has several innovative product developments in the pipeline which should help to sustain growth and maintain margins, namely:

1. *The development of small batch facilities*

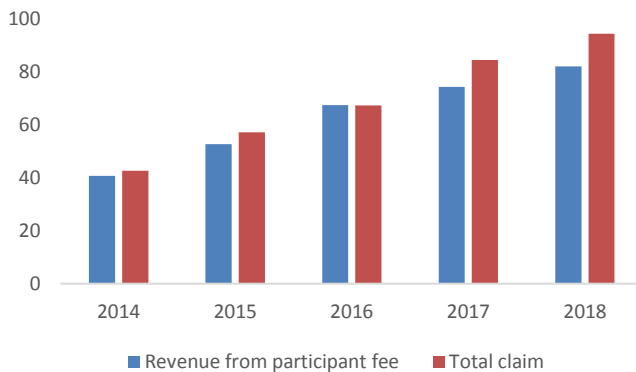
The development of small batch facilities will help the company to develop new product/life-saving products on a smaller scale (i.e. Phenytoin – an anti-seizure medication for epilepsy). This will not disturb the existing commercial production.

2. *Development of intravenously administered liquid and Continuous Ambulatory Peritoneal Dialysis (CAPD)*

The treatment of kidney failure is one of several major illnesses which contributes toward the large costs/deficit of BPJS Kesehatan. Under Lucas, the company has an existing facility for intravenously administered liquid that will be modified to support the liquid products for CAPD - a simple device for dialysis. The company has worked with local universities for the development of these new products.

The company also plans to establish other facilities to develop devices for coronary angioplasty, the production of cartridge ampoule (carpoule) pehacain for dental anesthesia and also to add new capacity for cephalosporin products (antibiotics for patients with penicillin allergy).

Exhibit 26. Total fee vs claim of BPJS Kesehatan (IDR tn)



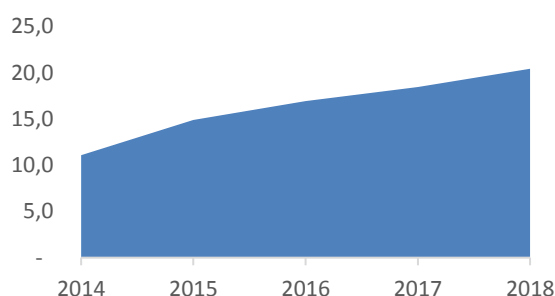
Source: BPJS Kesehatan

Exhibit 27. Current and proposed fee for BPJS Kesehatan

Class	Current (Rp)	Proposed by			
		DJSN	% increase	MOF	% increase
1	80,000	120,000	50%	160,000	100%
2	51,000	80,000	57%	110,000	116%
3	25,500	42,000	65%	42,000	65%

Source: Ministry of Finance (MOF) and National Social Security Council (DJSN)

Exhibit 28. Increasing claims from catastrophic diseases* to BPJS Kesehatan (IDR tn)



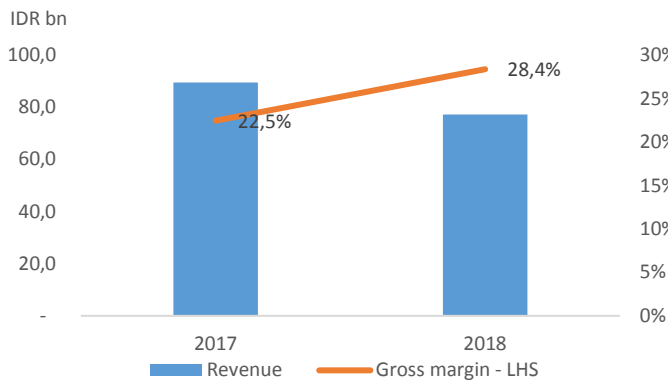
Source: BPJS Kesehatan *Including Dialysis/kidney failure, heart disease, hypertension, stroke

Tap export markets through its subsidiary – Lucas Djaja

In November 2018, Phapros acquired 99% of Lucas Djaja from its previous owner in a deal worth IDR 316bn. Around 80% of Lucas’ revenues were generated from sales of generic products. Lucas has successfully tapped export markets (Nigeria, Myanmar and Afghanistan), contributing around 30% of its total sales. Lucas also won the national project to provide Vitamin A and Antasida Doen in 2018.

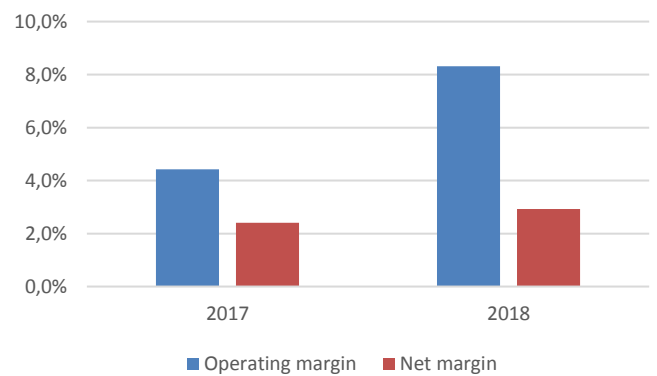
Following the acquisition, the management of PEHA expects its drugs portfolio to increase, especially in generic markets, whilst also providing greater opportunities to tap export markets. In terms of capacity, the consolidation of Lucas Djaja has increased Phapros’ production capacity by 9.5% to 4.6mn units by the end of 2018. For 2019, Lucas is expected to contribute IDR120-150bn of revenues to PEHA.

Exhibit 29. Revenue and gross margin



Source: Lucas Djaja

Exhibit 30. Operating and net margins



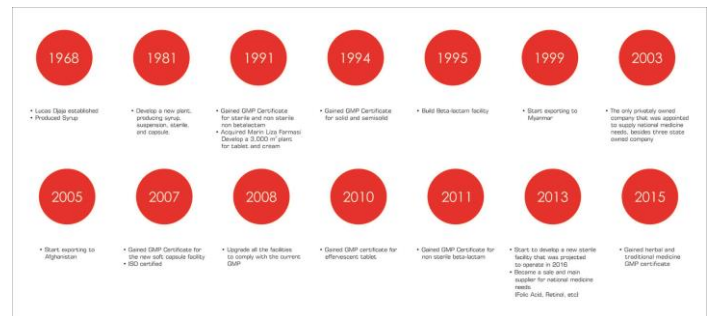
Source: Lucas Djaja

Exhibit 31. Lucas already taps the export market



Source: Lucas Djaja

Exhibit 32. Historical timeline



Source: Lucas Djaja

Financial

Sufficient production capacity to support top line growth

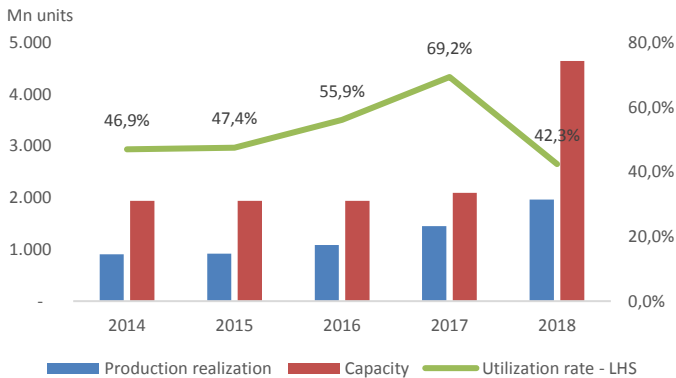
By the end of 2018, Phapros had increased its production capacity to 4.6mn units. This reflects an increase in internal production capacity from 2.1mn units in 2017 to 4.2mn units coupled with an additional 0.4mn units from the consolidation of Lucas Djaja. By the end of 2018, the utilization rate stood at 42%, providing plenty of room for further growth in the future.

We estimate 2018-2021 volume growth of 22% CAGR. For 2019, we estimate FY19 top line growth of 27.9% yoy, supported by growth in all divisions:

- Generic products, which provided the major contribution of 51% of total revenues, are expected to continue growing (+23.8% yoy) with increasing demand from BPJS Kesehatan and additional products in its portfolio from the recent acquisition of Lucas Djaja.
- For Ethical products - which carry higher margins - we estimate 30% yoy revenues growth stemming from sales of new products and continued demand from out-of-pocket spending in the healthcare market. Bear in mind that out-of-pocket spending still accounted for around 30% of the country's total spending on 2016.
- Meanwhile, for OTC products including its best-selling brand – Antimo, sales should benefit from its more extensive distribution network post consolidation with Kimia Farma.

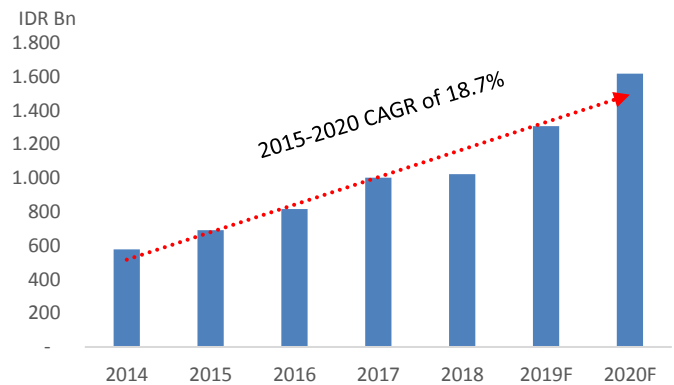
For 2020, we estimate solid top line growth of 23.7% yoy as we expect to see the full impact from the more extensive distribution network (KFA, KFTD) as well as the positive impact from sales of new products and the operation of new production facilities that will promote growth in all divisions.

Exhibit 33. Production and utilization rate



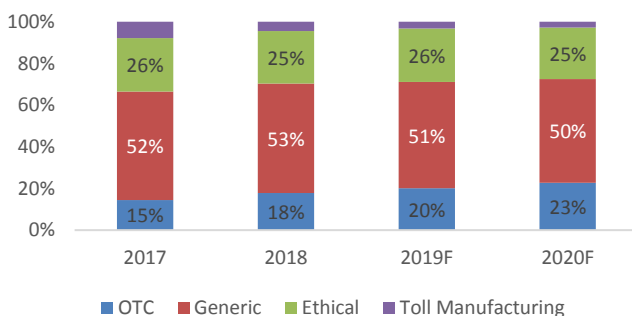
Source: Phapros

Exhibit 34. Revenue and CAGR



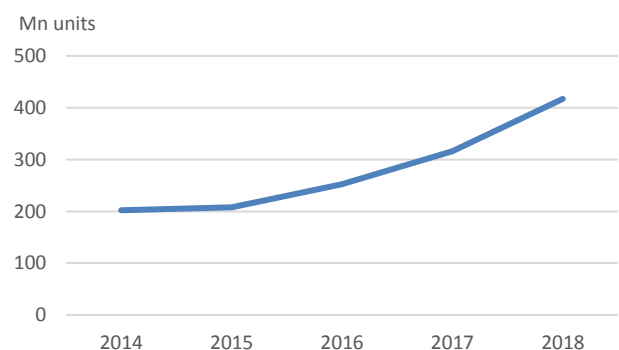
Source: Phapros, Danareksa

Exhibit 35. Contribution to top line



Source: Phapros, Danareksa

Exhibit 36. The sales volume of Antimo products



Source: Phapros

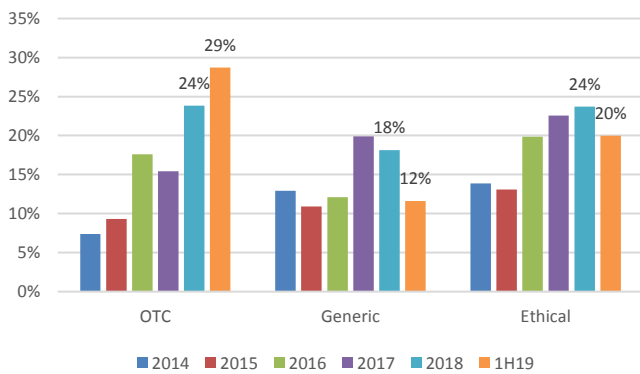
13.7% earnings CAGR in 2018-2020

The trend of an increasing contribution from sales of generic products to the revenues of pharmaceutical companies is unavoidable given the wider coverage of the National Health Program. To cushion the impact from the increasing contribution of sales of lower margin products, pharmaceutical companies need to focus on increasing the sales of higher margin products whilst tapping the demand for local content in the industry, especially for consumable medical devices.

For Phapros, sales of generic products already provide a significant revenues contribution to the company's revenues, ranging from 49-53% in 2014-18. Going forward, sales of OTC, Ethical and new products is expected to sustain the company's margins.

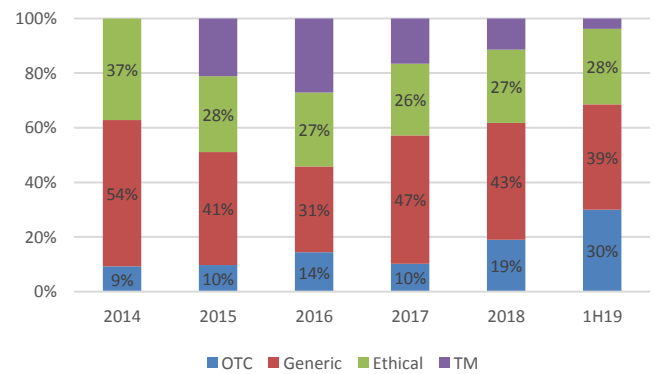
Following the consolidation of Lucas Djaja this year, we estimate lower 2019-20 gross margins 54.5% and 54.6%, respectively. We estimate higher 2020 opex/revenue to support new products, leading to 2020 operating margin at 16.4%. This will filter through to solid FY19-20 earnings growth of 11.9% and 24.5% yoy, or 13.7% CAGR in 2018-2020.

Exhibit 37. Operating margin by division



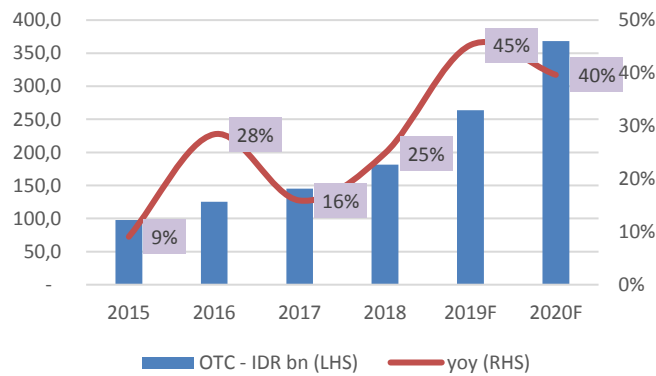
Source: Phapros

Exhibit 38. Contribution of operating profit



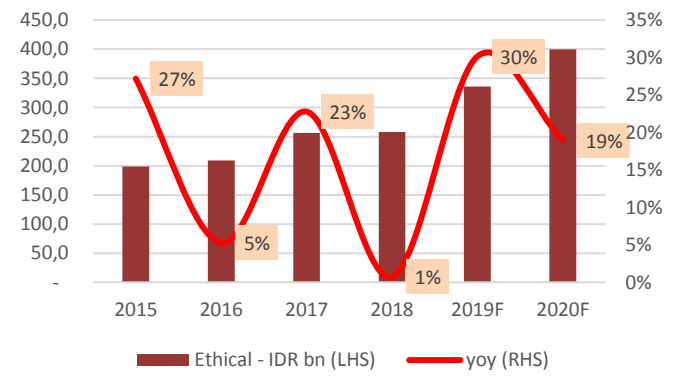
Source: Phapros

Exhibit 39. OTC – revenue and growth



Source: Phapros, Danareksa

Exhibit 40. Ethical – revenue and growth



Source: Phapros, Danareksa

1H19 result

Solid top line yet tepid earnings on lower margins & financing costs

In 1H19, PEHA reported solid top line growth of 35.5% yoy, supported by strong growth in all divisions. It is also worth noting that 1H19 already incorporated the new subsidiary, Lucas Djaja. In line with other SOE pharmaceutical companies, the company expects more revenues to come in 2H19 with increasing order realization from the government. With lower margins from Lucas, Phapros reported a lower 1H19 margin of 53.7%. On the operating front, the company maintained its opex/revenues at 37.6% in 1H19.

At the end of 2018, the company added more debt to finance the acquisition of Lucas Djaja as well as to support working capital. As a result, the company reported higher interest expenses of IDR34bn in 1H19. Lower margins with higher financing costs led to 1H19 net profits of IDR48bn, down 9.4% yoy.

Exhibit 41. 1H19 result

	2Q18	1Q19	2Q19	yoy	qoq	1H18	1H19	yoy	2019F	A/F
Revenue - IDR bn	267	178	374	40.0%	110.4%	407	552	35.5%	1,308	42.2%
Gross profit	147	99	197	34.0%	99.6%	232	296	27.5%	714	41.5%
Operating profit	59	17	72	21.7%	325.5%	76	89	17.6%	242	36.8%
Pretax profit	54	8	56	4.4%	590.8%	70	64	-8.7%	199	32.4%
Net profit	40	5	43	7.0%	818.2%	53	48	-9.4%	148	32.3%
<hr/>										
Gross margin	55.1%	55.6%	52.8%			57.1%	53.7%		54.6%	
Operating margin	22.1%	9.5%	19.2%			18.6%	16.1%		18.5%	
Pretax margin	20.1%	4.6%	15.0%			17.3%	11.7%		15.2%	
Net margin	15.1%	2.6%	11.5%			12.9%	8.6%		11.3%	

Source: Danareksa

Expect improved cash conversion days going forward

Payment delays from BPJS Kesehatan combined with the company's efforts to secure lower prices of raw materials with long term contracts led to a longer cash conversion cycle of 332days in 1H19. The structural changes in the pharmaceutical industry – through the implementation of National Health coverage - led pharmaceutical and healthcare companies to record longer CCC days. Government plans to increase the fees paid by BPJS Kesehatan participants should reduce the National Health Program deficit and have a positive impact on all stakeholders. For 2020-21, we estimate an improving cash conversion cycle to 260 and 235 days, respectively.

Rights issue

PEHA to issue new shares through rights issue

The company plans to issue new shares through rights issue with total target proceed of IDR1.1tn or maximum new shares of 862.7mn, translating to a minimum exercise price of IDR1,275 and 51% dilution. The estimated minimum exercise price is 8% discount to current share price of IDR IDR1,390 (26 Sept 2019).

Exhibit 42. Rights issue target proceed and new shares issuance – based on the company

Maximum target proceed	IDR bn	1,100
Maximum new shares issuance	mn	862.7
Minimum exercise price/share	IDR	1,275
<hr/>		
Existing shares - pre right Issue	mn shares	840
Total shares - post rights issue	mn shares	1,703
Dilution rate		51%

Source: Phapros

Based on the scenario of 10-20% discount or premium to the initial exercise price of IDR1,275/share, the dilution range will be around 46% to 56% (exhibit 43). Assuming 10-30% discount to the maximum 862.7mn new shares issuance, the dilution rate will be around 42-48% (exhibit 44).

Exhibit 43. PEHA's rights issue scenario – based on price

		Exercise price	Discount		Premium	
			10%	20%	10%	20%
Exercise price	IDR	1,275	1,148	1,020	1,403	1,530
New shares issued	mn shares	863	959	1,078	784	719
Ratio of new shares, %		103%	114%	128%	93%	86%
Dilution rate on equity, %		51%	53%	56%	48%	46%

Source: Danareksa

Exhibit 44. PEHA's rights issue scenario – based on number of new shares

Scenario		Base	Discount		
			10%	20%	30%
No of new shares, mn	mn shares	862.7	776.5	690.2	603.9
% new shares issuance		103%	92%	82%	72%
Estimated exercise price	IDR/share	1,275	1,417	1,594	1,821
Premium (discount) to current price		-8%	2%	15%	31%
Dilution rate on equity		51%	48%	45%	42%

Source: Danareksa

Rights issue proceed to support expansion ahead

The proceed from the rights issue will be utilized for capex (50%), working capital (30%) and refinancing (20%). By end of 2018, the company acquired Lucas Djaja financed by bank loans. As the result, the gearing ratio increase to 105% from 33% in 2017. The company plans refinance its interest bearing debt from right issue proceed. Post the right issue (with the assumption of total IDR1.1tn proceed), we estimate 2019' net cash position from 105% debt-to-equity ratio in 2018.

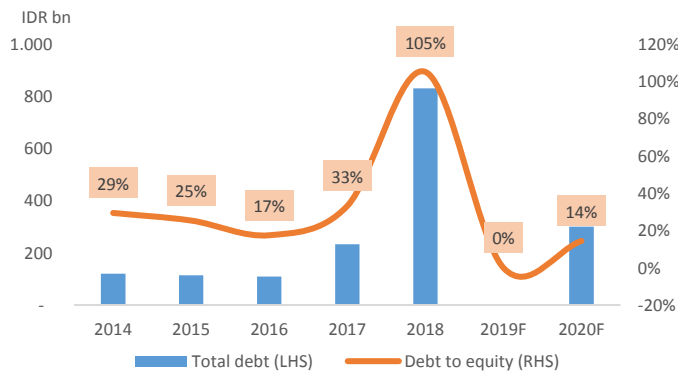
In 1H19, the company received an advance payment from its shareholder – Kimia Farma - for subscription to the upcoming rights issue amounting to IDR400bn. The funds were utilized to partially refinance its bank loan and support working capital.

Exhibit 45. Planned capex spending from rights issue proceed

	% to total capex	IDR bn	Timeline		
			2020	2021	2022
JV - to produce devices for coronary angioplasty	18%	97			
Capacity improvement	25%	139			
Small batch facility	10%	57			
Carpoule facility	15%	84			
Office building	10%	53			
Investment to subsidiary	5%	30			
Increase capacity in Cephalosporin facility	16%	84			
Total capex	100%	550			

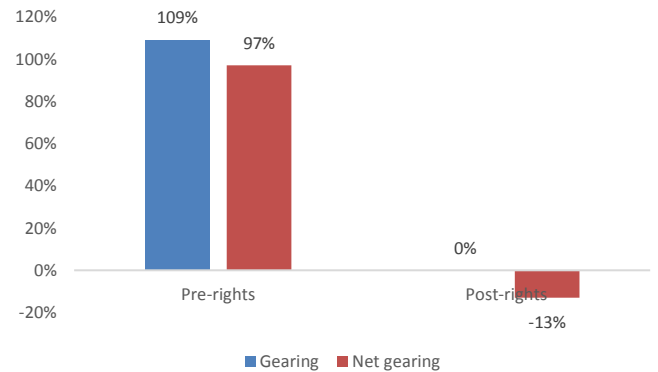
Source: Phapros

Exhibit 46. Debt to equity ratio



Source: Phapros, Danareksa

Exhibit 47. Phapros' leverage pre and post rights issue, 2019F



Source: Danareksa

Key risks

Currency volatility

Around 90% of the total raw materials required by the pharmaceutical industry are USD-linked. On the flip side, with increasing demand from generic products, the company will be required to meet the minimum selling prices (HET) set by the government. Forex fluctuations will negatively impact the company's costs and reduce margins.

Competition

In Indonesia, there are around 200 pharmaceutical companies, meaning stiff competition in the industry. The company's ability to offer the right prices, maintain product availability, as well as gauge the market demand will help the company to achieve its sales targets.

Delays in payment

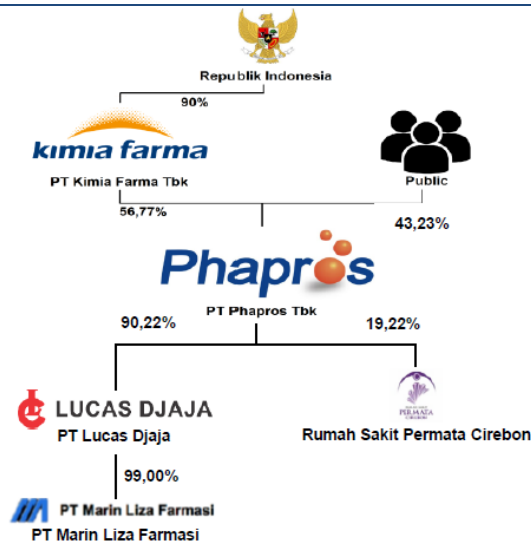
Post the purchase of Phapros' stake by Kimia Farma (from RNI), the company is gradually shifting from using single distribution (RNI) to multi distribution (using KAEF and RNI) until the end of 2019. From 2020 onward, Phapros will depend upon sole distribution from KFTD. Payment delays from customers and the national health program will negatively impact the company's cash flow.

Lower margins on increasing generic contribution

With an increasing contribution from lower margin generic products, pharmaceutical companies are seeking growth from sales of higher margin products and from creating a cost leadership strategy to sustain margins and earnings growth in the future. New product development, new resourcing and innovation will help the company to attain a more balanced product portfolio between low and high margin products to maintain the overall margins.

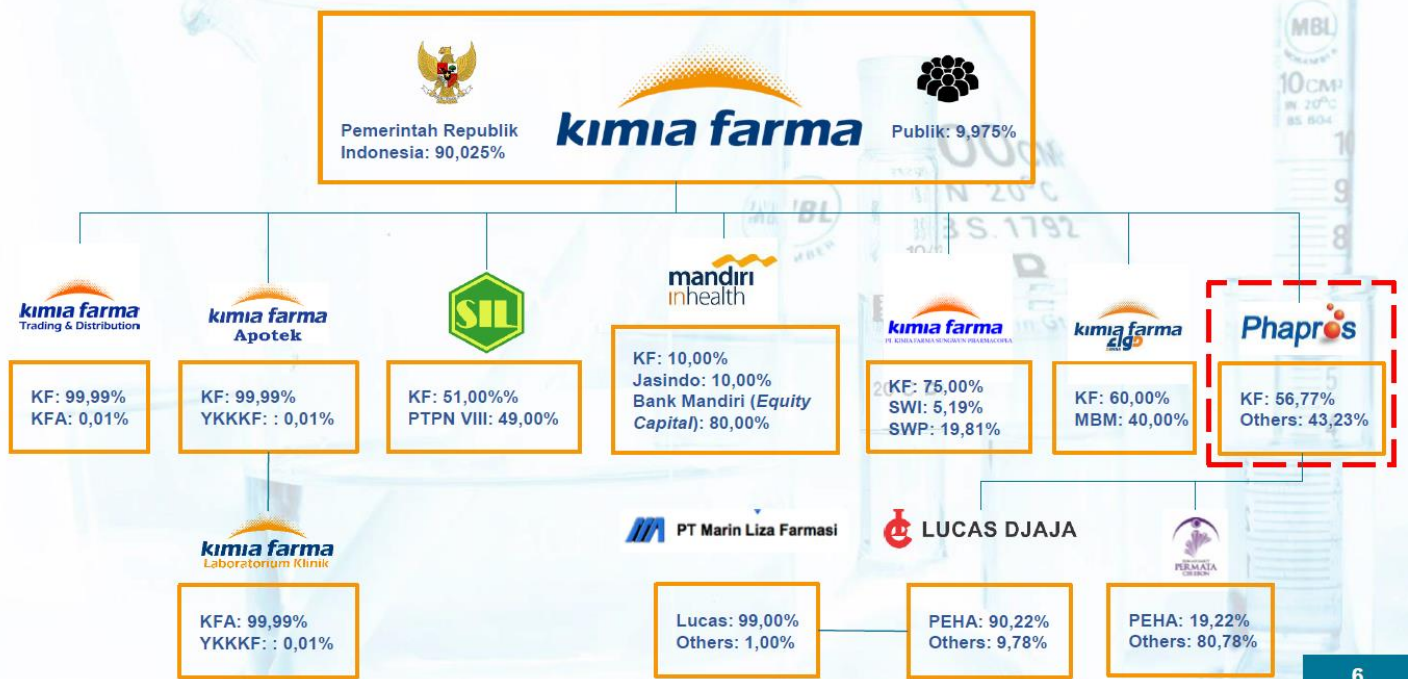
Appendix

Exhibit 48. Phapros ownership structure and subsidiaries



Source: Phapros

Exhibit 49. The group structure of Kimia Farma



Source: Kimia Farma

Exhibit 50. Phapros' pareto products



Source: Phapros

Exhibit 51. Phapros' production facilities



Source: Phapros

Exhibit 52. Income Statement

Year to 31 Dec (IDRbn)	2017A	2018A	2019F	2020F	2021F
Revenue	1,002	1,023	1,308	1,618	1,988
COGS	(437)	(440)	(594)	(735)	(903)
Gross profit	565	583	714	882	1,085
EBITDA	205	220	282	309	399
Oper. profit	187	194	242	266	347
Interest income	1	1	2	1	1
Interest expense	(17)	(40)	(58)	(19)	(56)
Forex Gain/(Loss)	0	0	0	0	0
Income From Assoc. Co's	0	0	0	0	0
Other Income (Expenses)	0	23	13	0	0
Pre-tax profit	171	178	199	248	292
Income tax	(46)	(44)	(50)	(62)	(73)
Minority interest	0	(1)	(1)	(2)	(2)
Net profit	125	132	148	184	217
Core Net Profit	125	132	148	184	217

Exhibit 53. Balance Sheet

Year to 31 Dec (IDRbn)	2017A	2018A	2019F	2020F	2021F
Cash & cash equivalent	147	109	253	97	104
Receivables	361	471	565	647	713
Inventory	159	320	412	409	477
Other Curr. Asset	98	108	138	171	210
Fixed assets - Net	367	621	690	1,225	1,487
Other non-curr.asset	43	239	245	253	262
Total asset	1,176	1,869	2,303	2,801	3,252
ST Debt	24	810	0	100	130
Payables	103	92	132	173	212
Other Curr. Liabilities	58	70	89	110	135
Long Term Debt	209	21	0	200	400
Other LT. Liabilities	81	86	111	137	168
Total Liabilities	475	1,079	332	719	1,045
Shareholder's Funds	701	770	1,952	2,062	2,187
Minority interests	0	20	20	20	20
Total Equity & Liabilities	1,176	1,869	2,303	2,801	3,252

Exhibit 54. Cash Flow

Year to 31 Dec (IDRbn)	2017A	2018A	2019F	2020F	2021F
Net income	125	132	148	184	217
Depreciation and Amort.	17	72	40	43	52
Change in Working Capital	(12)	(283)	(146)	(38)	(94)
Other Oper. Cash Flow	(16)	48	64	27	65
Operating Cash Flow	115	(31)	107	216	241
Capex	(101)	(388)	(110)	(580)	(317)
Others Inv. Cash Flow	1	(133)	2	1	1
Investing Cash Flow	(100)	(522)	(108)	(579)	(316)
Net change in debt	124	598	(831)	300	230
New Capital	(3)	43	1,100	0	0
Dividend payment	(44)	(88)	(66)	(74)	(92)
Other Fin. Cash Flow	(17)	(39)	(58)	(19)	(56)
Financing Cash Flow	61	514	145	207	82
Net Change in Cash	76	(38)	144	(156)	7
Cash - begin of the year	71	147	109	253	97
Cash - end of the year	147	109	253	97	104

Exhibit 55. Key Ratios

Year to 31 Dec	2017A	2018A	2019F	2020F	2021F
Growth (%)					
Sales	22.8	2.1	27.9	23.7	22.9
EBITDA	43.8	7.3	28.4	9.5	29.2
Operating profit	45.5	3.4	24.8	9.8	30.6
Net profit	44.0	5.6	11.9	24.5	17.9
Profitability (%)					
Gross margin	56.4	57.0	54.6	54.5	54.6
EBITDA margin	20.4	21.5	21.6	19.1	20.1
Operating margin	18.7	18.9	18.5	16.4	17.4
Net margin	12.5	12.9	11.3	11.4	10.9
ROAA	12.2	8.7	7.1	7.2	7.2
ROAE	18.9	18.0	10.9	9.2	10.2
Leverage					
Net Gearing (x)	0.1	0.9	(0.1)	0.1	0.2
Interest Coverage (x)	11.0	4.9	4.1	14.2	6.2

Source : PEHA, Danareksa Estimates

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