

MERISTEM EQUITY RESEARCH

Performance Updates on Neimeth International Pharmaceuticals Plc

EXECUTIVE SUMMARY & INVESTMENT RATIONALE

- Neimeth's recent strategic repositioning has started to pay off, translating to appreciable returns as evident by its recent performance indicators. The company is poised to leverage on its notable brands, robust business models/technical prowess of its foreign partners firms/business associates and management resilience to exploit new business frontiers with a view to aggressively growing earnings and multiplying shareholders value beyond its core business enclaves.
- The Company has crafted lofty strategic plans aimed at accelerating a broad-based growth as encapsulated in its '**Vision 2010**'. Management has set ambitious revenue targets of N2bn & N10bn in 2008 & 2010 respectively. As a fall out of this, two additional subsidiaries have also evolved- **Neimeth Integrated Services Limited and Worldwide Healthcare Limited**. This initiative is focused at exploiting virgin and profitable businesses with a view to leap-frog performance through steady inventory, sustainable revenue and appreciable market size, products innovation and diversification.
- In a swift attempt to meet its aggressive growth targets in 2008, 2009 and 2010, Neimeth International Pharmaceutical Plc recently commissioned over N120m worth **General Manufacturing Practice Complainant (GMP)** equipment with view to enhancing the

production capacity and efficiency of the company to meet and surpass product demands for the growing healthcare needs of the consumers.

- Our forecast turnover and earnings growth for the financial year ending March 31, 2008 are 29.4 per cent and 32 per cent respectively. In other words, we projected turnover and Profit After Tax (PAT) of N1.95bn and N153.09m respectively for the company for the FYE March 31, 2008. This implies Earnings Per Share (EPS) of N0.23k, representing a 27.7 per cent growth over previous year's. We assume a pay out of 75 per cent **(FYE: 2007=83 per cent)** which translates to a dividend of 16k/share.
- Our fair value for the stock is N8.02. We believe Neimeth has good potentials to break the old resistance level of N7 and perhaps establish a new support level at about N5 price mark based on the renewed management drives for aggressive growth (organic and inorganic) in revenues and improved efficiency. However, key to this is the sustainability of the current growth momentum throughout the FYE March 31, 2007 and beyond. The stock is a good pick for fund managers especially PFAs having maintained a consistent dividend payment for over 5years till date.

Challenges of the Nigerian Pharmaceutical Industry

The pharmaceutical industry in Nigeria has passed through a number of tortuous periods in the history of the country starting from the pre-independence era when the pharmaceutical business involved the distribution of imported drugs by the representatives of different offshore manufacturers such as Beecham, May and Baker, Pfizer, Glaxo and J. L. Morrison, to the present moment when appreciable indigenous growth has seen 5 indigenous companies controlling 58 percent of manufacturing of pharmaceutical products. All through these circuitous periods, the industry has had to combat serious internal, macroeconomic, social, regulatory and global

challenges that further led to the failure of the rapidly expanding population to act as a fulcrum to the development of the sector.

A subterranean look at developments in the Nigeria's economic landscape and history reveals decades of policy formulations that have adversely affected an industry that is critical to life expectancy as well as longevity, and visibly impacts economic productivity in all its ramifications. Shortage of pharmaceutical products first became a phenomenon in Nigeria when the excessive unmanaged dependence on imported finished products up to the late 80's in the era of the Structural Adjustment programme (SAP) resulting from the oil boom era had a severely damaging effect on the economy. The government introduced the infamous import license for all imported goods, including drugs, and with it, the course of the history and development of the pharmaceutical industry was altered.

The present socio-economic environment presents fresh challenges that seem to be multifaceted with global industry spill-overs. **For multinational companies, competition and pricing pressures in the healthcare market continue to create pressures for reduction in costs in all parts of the pharmaceutical value chain throughout the world.** Outsourcing to lower cost but highly effective companies in Asia has become a common response to these pressures. This underscores the importance of improving infrastructural conditions in the country.

Industry Outlook, Prospects and Potentials

The Business Monitor International (BMI) has forecasted that growth in the Nigerian pharmaceutical industry is expected to be sluggish over the next five years, with market value reaching only US\$298mn in 2010, representing per capita expenditure of approximately US\$2. However, in recent times, government policies such as the abolition of import license system and exemption of pharmaceutical products from Value-Added Tax (VAT), the introduction of National Health Insurance Scheme (NHIS) as well as the laudable sanitary efforts of the National Agency for Food Drugs Administration and Control (NAFDAC) has brought profound succor to the pharmaceutical Industry.

Nigeria is the dominant economy in western Africa, with a strong entrepreneurial ethic. The country's exponentially-growing population confers enormous opportunities and challenges on the Pharmaceutical industry whose products seem to be basic necessities of life. Nigeria's basic health indicators have become worse in recent times. With the life expectancy at 46 years, infant mortality at 95.52 deaths per 1000 live births, and the population growing at an estimated annual rate of 2.379% per annum, the pharmaceutical industry needs to rise to the challenge of the nation's poor health system.

The key challenge for Nigeria still remains the scourge of counterfeit drugs, which are endemic in the market, accounting for more than half of all drug sales. Unsafe medicines kill thousands of people each year, undermine the local manufacturing sector and deter multinationals.

Another problem facing the industry is its inability to locally source input materials as a greater percentage of its raw materials is obtained outside the country. Meanwhile, the country's disease burden is also a reason for concern. Conservative estimates place the number of HIV/AIDS sufferers at more than 3mn, while only an estimated 13,000 are receiving antiretroviral drugs (ARDs). **The development of these drugs at low cost remains a challenge for the industry.**

Looking ahead, there seems to be a ray of hope for the Nigerian pharmaceutical industry as the entire continent aspires to attain the Millennium Development Goals (MDGs). Just like most pharmaceutical industries in Asia and emerging markets, capital expansion seems to be the right path to tread for sustainable long term growth. Currently, there is a dearth of innovation in the industry and more resources need to be committed to vigorous R&D even as long term strategic partnerships among firms can yield positive growth results.

Business Module:

Neimeth International Pharmaceuticals operates a highly diversified portfolio of healthcare products, strategically structured into operational business units which are meant to enhance market share, achieve operational efficiency and profitability as well as add superior values to all stakeholders.

The company's products portfolio mix consists of 15 different major products which are subdivided into four (4) Strategic Business Units (SBUs) viz: **Neimeth Products Group (NPG)**, **Pfizer Products Group (PPG)**, **Veterinary Products Group (VPG)** and **ECOWAS Business Group (EBG)**. Each business unit is saddled with the responsibility of marketing and distribution of newly developed products as well as the company's branded generics and alliance products.

The **NPG** business group represents the future operational direction of Neimeth's business development strategy. It is responsible for marketing and sales of Neimeth branded products such as sedatives, anti-ulcer drugs, Analgesics and its flagship home grown product- **Ciklavit** for the management of Sickle cell disease among others while the **PPG** is the key driver and distributor of Neimeth's 24 branded major products categorized into antiseptic, antibiotics, anti-asthmatics etc. The third operational unit, the **VPG** is a fledgling Strategic Business Unit that was recently introduced to recapture a sizeable portion of the domestic veterinary drug market. Its products line includes vitamins, antibiotics, and anthelministics. Due to its string presence in Anglophone West African countries such as Ghana, Sierra Leone and Gambia, the EBG was established to market and distribute its products such as Ciklavit, Histamines G; TCP, Antimal and Normoretic which have successfully made inroads into the West African sub region.

Recent Developments/Operational Highlights

- Effect of the fresh equity funds raised from its February 2006 Public Offering is clearly manifest in the company's operational efficiency and profitability indices. The recapitalisation drives has impacted favourably on both top-line and bottom-line growths. Its financial results for FYE March 31, 2007 show a 25.7 per cent leap in sales revenue (as against 3 per cent decline in prior year). Profit Before (PBT) and Profit After Tax (PAT) rose by 38.4 per cent and 41.6 per cent respectively from previous year's dip of 19 per cent and 16 per cent. There was also a moderate growth in margin by 2 percentage points to 12 per cent from 10 per cent achieved in 2005/2006 fiscal year.

- The most recent quarterly results for the FYE March 31, 2008 presuppose impressive consolidation on the feat achieved in the prior year. There were unprecedented quarter-on-quarter growths in turnover, earnings and margins. Sales revenue, PBT and PAT leapt by 36.2 per cent, 374.9 per cent and 358.8 per cent respectively just as net margin grew by over 5 percentage points to 7.3 percent. Similarly distributable earning per share (EPS) increased from 14k to 29k during same quarter Q-2 2007.
- All of the above is the resultant effect of its fresh investments in plant upgrades and R&D, modernization of distribution networks, enhancement of information communication technology (ICT) and management innovativeness in achieving the dual target of growing and sustaining earnings.
- Neimeth's aggressive Research and Development (R&D) effort is paying off with the introduction of the solid dosage of its ground-breaking sickle cell management drug, **Ciklavit** into the company's portfolio in 2007. More effort in this regard will definitely ensure sustainability of market share vis-à-vis earnings.
- The company has also entered into a new business agreement with **Johnson & Johnson Inc.** of **the U.S**, world's most comprehensive and broadly-based manufacturer of health care products, for the distribution of its major products. **Johnson & Johnson Inc.**, bought over Pfizer's Customer Health Care System unit in 2007. This offshore business partnership is very strategic to growing Neimeth's earnings and its share of the pharmaceutical industry in Nigeria.
- Towards the end of the second quarter 2007, the company commissioned a new set of equipment with a view to boosting its turnover growth. Amongst the new equipment commissioned are: two tableting machines with a combined 62 stations facility that can produce over 197,000 tablets per hour, oral liquid line that can produce 4,800 units of syrup presentation per hour while the new TCP liquid line can produce over 6,000 units of TCP x 100 per hour. Others are blistering machine with a production capacity of 11,500 blister cards per hour and copulating machine that can give over 40,000 capsules per hour. Expectedly, this had a considerable impact on its Q3-2007 results both in turnover growth and efficiency.

HIGHLIGHTS OF RECENT PERFORMANCE

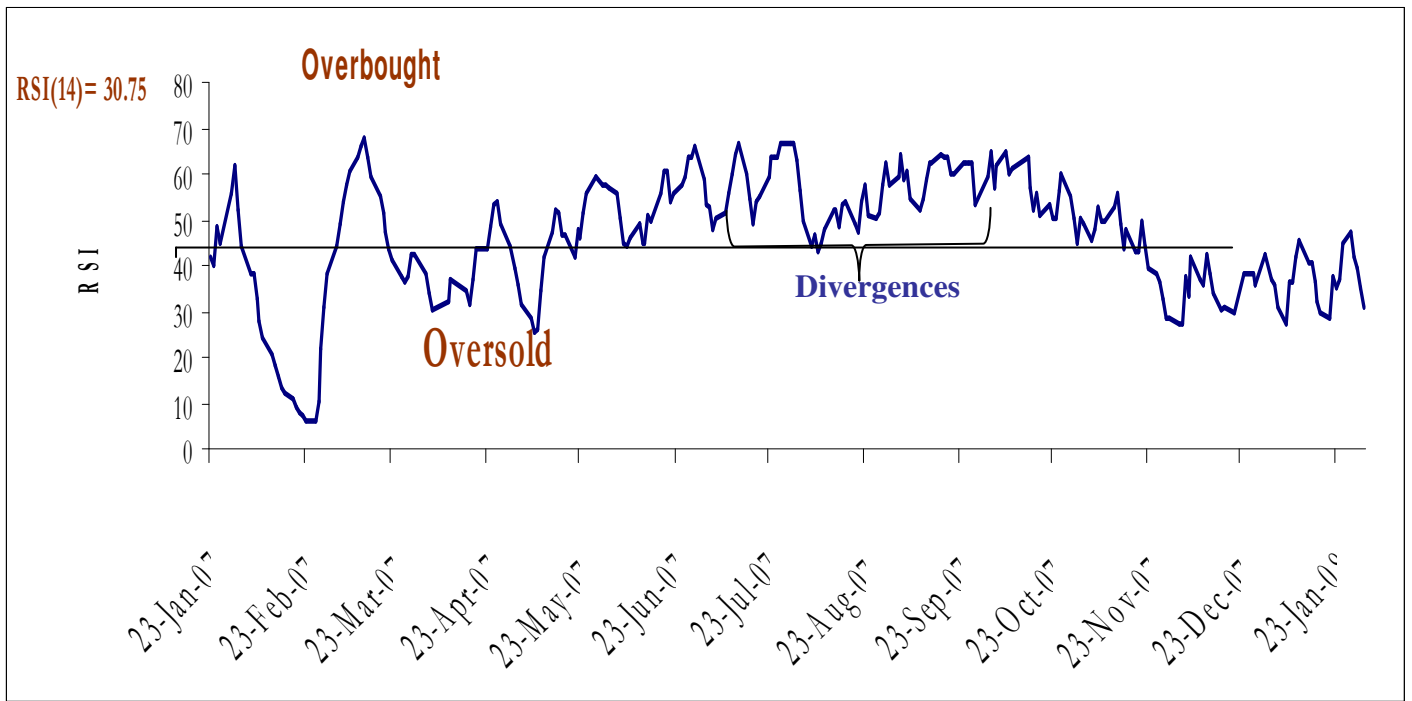
Growth Momentum, Efficiency and Profitability:

Neimeth's recent performance records suggest a surge in growth indices in the years ahead. The company has no established trend in top lines performance growth until recently with average quarter-on-quarter growth of 25 per cent in turnover. The company has achieved a compounded annual growth of 12.1 per cent over the past five years (2003-2007) much higher than 6 per cent growth in GDP. Recent quarterly results for the Q3-2007/08 show a leap in growth momentum courtesy of the new business strategies and strategic expansion of production capacity. Turnover leapt by 36.2 per cent while Profit After Tax and Profit Before Tax grew by 374.9 per cent and 358.7 per cent respectively.

Similarly, net margin rose by 5.3 percentage points to 7.6 per cent over the prior quarter, though lower than 9.95 per cent feat achieved in Q2-2006/07 while earnings per share (EPS) has significantly improved by almost 41 per cent to 29k from 21k reported in Q2-2007/08. Return on common shares (i.e. equity) rose from 5.22 per cent in 2005/06 to 7.17 per cent 2006/07. However, its books as at December 31, 2007 reveal that ROE was 5.4 per cent.

Technical Analysis of Neimeth Performance in the Stock Market:

Analysis of the technical behaviour exhibited by Neimeth shows a number of extreme readings and series of divergences that underscore the stock's high susceptibility to trend reversals and price swings. The early rally observed in the stock during the early trading period of 2007 could not be sustained as our momentum oscillator, the Relative Strength Index (RSI) dropped down to an abysmally low 6.04 causing the stock to linger in the **oversold region** for a major part of the first quarter of 2007. This sent a bullish signal and quite expectedly, the stock regained its rallying strength as the bulls stepped in to intersect the market trend thereby pushing the stock price to an early high of N6.60K



The increased buying pressure prevailed and caused the stock to inch towards the overbought region. Fortunately, it never quite got there. Again, the stock could not maintain this strength. After inching up to the center line of 50, the second quarter of the year saw the stock retreating to the oversold region albeit for a short period of time. Perhaps buoyed by exogenous factors, Neimeth woke up from its slumber to attain an All-time High of N7.23k on the August 5, 2007. Although frequent positive and negative divergences were observed in the stock's behaviour, the stock did well by maintaining its position on the centerline of 50 for the RSI in the third and fourth quarters of the year. This means that on the average, gains on the stocks are higher than losses. **However, we observe an imminent trend reversal as the stock is currently inching towards the oversold region.**

Neimeth Price Performance History Schedule : 2003-2007

	2007	2006	2005	2004	2003
On March 31st (Closing Price)	5.44	3.23	2.85	3.20	3.21
Annual change in Price (Capital Appreciation)	68.42%	13.33%	-10.94%	-0.31%	-40.99%
On March 31st					

(Closing Index)	43,456.14	23,336.60	20,682.37	22,896.37	13,531.08
Annual Change in All Share Index	86.21%	12.83%	-9.67%	69.21%	21.72%
All-Time Price bands					
High (Ngn)	7.23	4.41	3.99	4.43	4.45
Low (Ngn)	3.07	1.97	2.37	1.74	1.00

Valuation:

We used two different classes of methods in arriving at a fair value for Neimeth International Pharmaceuticals Plc. We employed trading multiples of industry average and Present Value of Neimeth future cash flows; measured by discounting our dividend payment projection. We our fair price for the stock is N8.02k implying its currently trading at slight premium to intrinsic value.

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