What the Doctor Ordered

Will Indonesia's medicine-makers get better?

By Steven K.C. Poh

INDONESIAN DRUGMAKERS ARE ON the verge of catching cold. A new patent law and a grassroots revolt against costly medicine threaten profits. But don't reach for the aspirin yet. Analysts predict sales of pharmaceuticals will double in Indonesia to $2.6 billion by 2002. But along with growth will come market-share turf wars.

Under a law passed last year, locals have to cough up royalties for medication patented to foreigners. But implementation will be phased in over five years. Companies already making copycat drugs will likely continue while paying fees.

A more immediate concern, consumer groups want rapidly rising drug costs frozen. In February, the pharmaceuticals association asked members to hold prices down until after the March 1998 presidential election. It is not yet clear whether profits would suffer severely. "Nobody is expected to implement the price freeze across all products, if at all," says Alhakim Warsito of BDNI Securities. Like most analysts, he believes Indonesian pharmaceuticals stocks are healthy investments as long as buyers stick to companies with established distribution networks, efficient operations, sound strategic tie-ups and reasonable growth prospects.

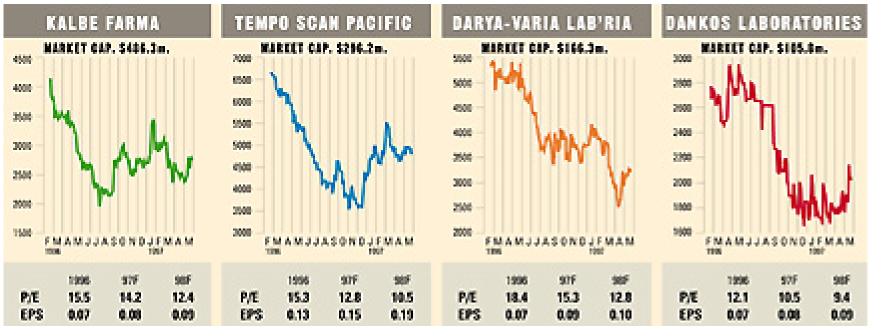
Darya-Varia Laboratoria, Indonesia's fastest-growing pharmaceuticals company, deserves attention. Earnings are forecast to rise 18% a year over the next two. DVL has been diversifying its products and expanding aggressively through acquisitions. It is well-positioned for the patent law changes, says Alhakim, with key licenses from global companies like Boehringer Ingelheim Switzerland and 3M Pharmaceuticals Australia. The analyst has been waiting for the share price to fall to about 15 times forecast 1997 earnings per share (price-earnings ratio or p/e), the current consensus (see chart below). But Richard Eary of Deutsche Morgan Grenfell considers DVL a sell, because a medicine price freeze would hurt earnings growth.

Kalbe Farma, Indonesia's largest medicine manufacturer, suffered inventory and distribution problems over the last 18 months, but Susan Baker of brokerage firm Jardine Fleming Nusantara says Kalbe is recovering, helped by a renewed focus on core businesses. First-quarter net profits were up 38% to $8.9 million. With 14 p/e, Baker sees lots of upside, up to 18.

A favorite of Eary's is Tempo Scan Pacific, Indonesia's second-largest listed pharmaceuticals company and the sales leader in non-prescription remedies. Its Bordrex line has 45% of the market for over-the-counter painkillers, while its Hemaviton brand has 40% of nationwide vitamin sales. Alhakim has a hold recommendation on Tempo Scan due to its share's poor 1996 performance. But Felix D'Souza of Peregrine Sewu Securities says Tempo's upcoming purchase of medicine distributor Supra Usadhatama and its manufacturing unit justify a positive view.

Bargain-hunters should look at Dankos Laboratories and Enseval Putra Megatrading (EPM). Dankos got $37 million cash for a money-losing stake in the maker of Lipovitan energy drink. It is "well-placed to outperform rivals in an industry facing lower price increases and consolidation," Baker says. She finds Dankos cheap at about 10 times 1997 earnings.

Shares of pharmaceuticals distributor EPM lagged the market badly last year. At 7.5 times 1997 earnings, it is trading at a 31% discount to the sector average. D'Souza notes that EPM owns two profitable Mitra Keluarga hospitals. Its parent may list other companies, including a hospital chain, through EPM. "We expect a turnaround," the Peregrine analyst says. But watch those patents.



All money values in U.S. dollars except share prices, which are in Indonesian rupiah. Sources: Asiaweek Research, Datastream, First Call/World Equities