by Ng Wai Mun

Hovid's tough task to regain trust

Generic drug maker faces issue of consumers ditching the brand after licence revocation, and further strain from upcoming audits

DD HOE/FocusM

Workers packing strips of tablets into boxes at Hovid's plant in Chemor, Perak

IPOH-BASED Hovid Bhd, which built a successful business as a generic drug maker over the last 20 years, will have to work harder to restore confidence in the company following the revocation of its manufacturing licences by the Health Ministry recently.

The revocation serves as a big blow for Hovid, which is already hit by slower sales and rising costs. The pharmaceutical firm was also recovering from its investment in Carotech Bhd's biodiesel plant some years ago, which was built to ride on the biodiesel play spurred by high crude oil prices and unsustainability of fossil fuels.

However, the palm oil-based biodiesel venture faces huge challenges, making it non-viable. Biodiesel players had to struggle with rising high crude palm oil feedstock prices and poor export market prospects.

Attempts to revive the loss-making Carotech, in which Hovid held a 58.2% stake, were unsuccessful. Hovid exited Practice Note 17 status in January 2012 after the sale of its stake in Carotech.

Since then, the company has been making good progress and garnered investor attention. But the latest issue with the manufacturing licences may have just wiped out its efforts to gain a stronger footing.

On Jan 9, the Pharmaceutical Services Division revoked Hovid's manufacturing licences for its plants in Chemor and Jalan Tunku Abdul Rahman in Ipoh following an audit by the National Pharmaceutical Regulatory Department. The company had to halt all its manufacturing activities.

According to the audit findings, Hovid's current good manufacturing practice (cGMP) is not acceptable, and that its pharmaceutical quality system does not comply with the latest cGMP requirements. The company expects to revert with the necessary corrective actions by the end of this month and hopes to resume production by April 1.

A matter of confidence

Trading in Hovid's shares was suspended on Jan 9. It recalled its Ternolol 50mg film-coated tablets on Jan 6 due to mislabelling.

Prior to the suspension, Hovid's shares were last traded at 34.5 sen, down 25% from a year ago. The counter closed at 30 sen on Jan 12. It fell to an intra-day low of 24 sen when it resumed trading on Jan 10 and closed at 30 sen.

The company's largest shareholder is its chairman and managing director David Ho Sue San, who controls 33.8% of the shares.

Ho declined to comment on how the company plans to restore investor confidence. "We want to focus on getting the licences back first," he tells ***FocusM***.

Equities Tracker International Sdn Bhd director Alvin Vong believes market confidence in Hovid will be affected following the licence revocation.

"The confidence will be weak. The trust element for the products is very important, not only for investors but also for consumers," Vong says, but he is optimistic that time will heal the company.

"People have no doubt the company will get back the licences. It is a matter of time. It is what happens after that," says an investor.

He believes that investors need assurances from the company. "There are so many questions which investors seek answers to. The first is what will be done to ensure this doesn't occur again ... what the company will be doing to regain consumers' confidence towards its products?

"The impact (from the loss of trust) is non-quantifiable. Consumers will surely play safe by switching to Hovid's competitors instead for their medication. The pharmaceutical industry is very competitive and substitutes are in abundance," he adds.

Many were caught by surprise by the licence revocation as Hovid has been operating for many years and has been exporting most of its products to markets which have very stringent quality checks.

The latest incident would inevitably dent Hovid's reputation among its overseas clientele as the audit may have exposed the company's less-than-adequate quality assurance.

"Licence is not the issue, it is the upcoming audits that will put a strain on Hovid," says an industry source.

The company has stated that its subsidiaries in Malaysia, Hong Kong and the Philippines will continue to market and sell their existing stocks.

An analyst projects Hovid's inventories to last up to two months and is unsure if the stocks can sustain until it resumes operations by April.

"Even if it (the stockpile) can hold out, will there be buyers?" the analyst asks.

As it is, analysts are mainly neutral with limited upside on Hovid following its results for its first quarter ended Sept 30, 2016.

"The market will probably scrutinise Hovid's sales after the licences are given back to see the impact of the revocation," he adds.

'Two-month production hiatus'

CIMB Research has downgraded its rating on Hovid from hold to reduce on assumption the company could suffer from loss of production and lower sales volume, following revocation of its manufacturing licences.

"This is expected to have a negative impact on the group's earnings in FY17. We forecast that the group could face a two-month manufacturing hiatus in view of the upcoming festive period," CIMB Research says in its note dated Jan 9.

The research house lowered its earnings estimates by 2% to 18.5% for FY17-19, taking into account two months' loss of production and lower sales due to the negative impact on the company's reputation.

"Our SOP (sum-of-parts)-based target price is also lowered to 32 sen, based on a lower P/E multiple of 13.3 times on its operations," CIMB Research adds.

"Our P/E multiple is based on a 10% discount to its five-year historical mean (14.8 times), to take into account the impact of reputation risk. Downside or upside risks to our view (would include) a prolonged or shorter-than-expected suspension of its manufacturing licences and indefinite suspension of licences," it says.

The suspension of licences will dampen Hovid's efforts to turn in better results.

Its net profit fell 33.3% to RM4.1 mil in Q1FY17 from RM6.15 mil a year ago despite a higher revenue of RM44.14 mil versus RM41.05 mil.

The lower net profit was due to a smaller foreign exchange gain of RM700,000 in the first quarter just ended compared with a RM6.7 mil forex gain in the corresponding quarter of FY16.

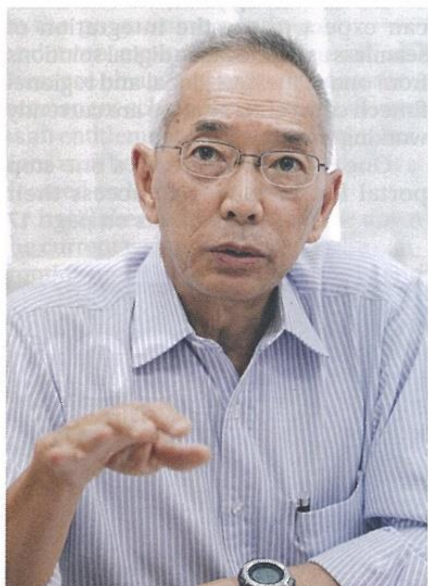
Quarter-on-quarter, Hovid's Q1FY17 revenue fell by 13.6% mainly because of the deferment of export shipments and lower local sales. In comparison, Q1FY16 revenue fell by only 4%, qoq.

Hovid's earnings are already on a decline. For the financial year ended June 2016, the company managed to record only a marginal 0.3% increase in revenue to RM189 mil while net profit fell by 14.8% to RM17.9 mil.

Hovid was formerly known as Ho Yan Hor. When it was first established some 70 years ago, its sole product was the Ho Yan Hor herbal tea. The drink, concocted by its founder Dr Ho Kai Cheong, became a household name.

During the 1980s, David Ho, a trained pharmacist, led Hovid into a new chapter of manufacturing excellence by venturing into mainstream medical approaches.

FocusM



Ho says Hovid is focusing on getting back its licences first

HOVID BHD

KEY BOARD MEMBERS AND MANAGEMENT
DAVID HO SUE SAN (chairman/MD)

MAJOR SHAREHOLDERS

David Ho Sue San	33.8%
Kumpulan Wang Persaraan (Diperbadankan)	5.1%

MARKET CAP (Jan 12)	RM246m
SHARE PRICE (Jan 12)	30 sen
52-WEEK HIGH (Jan 13, 2016)	48.5 sen
52-WEEK LOW (Jan 10)	24 sen

FINANCIAL RESULTS (Q1 ended Sept 30, 2016)

REVENUE	RM44.1m
NET PROFIT	RM4.1m