

# Tasly Pharmaceutical Group (600535.CH)

## Internationalization of TCM enters the critical period

Shanghai | Pharmaceutical | Company report

14 April 2015

The annual report in 2014 of Tasly showed that the revenue was 12.57 billion Yuan, with a yearly growth of 13.24%. The net profit attributable to parent company increased by 24.61% up to 1.37 billion Yuan, and the profit excluding non-recurring item was 1.346 billion Yuan with a growth of 31.9%. The gross margin has grown by 0.94 pct. to 37.48%. Overall speaking, the company has maintained steadily growing trend and high dividend return. Seen from the categories of businesses, the revenue of pharmaceutical manufacturing was 6.05 billion Yuan, the revenue of pharmaceutical distribution and retail business was 6.47 billion Yuan and the growth dropped to 6.6%, caused by the company's adjustment of commercial channels.

The company holds prominent competitive advantages. It has a strong ability of vertical integration among traditional Chinese medicine(TCM) industry and established an end-to-end modern industry chain, which conforms to the standardized management including GAP, GEP, GMP, GLP, GCP, and GSP, in possession of leading control force and advantages of supply chain.

Tasly has established the new mode of TCM multi-fractions research and development and turn to a system of patent protection. Meanwhile, it has abundant product lines and most of them are at a fast growth. Moreover, Tasly has established integrated marketing network, the e-business channel will inject new vitality for its pharmaceutical distribution and retail business.

The company first carried forward the process of internationalization of TCM, and improved western medicine's recognition to TCM by establishing medicinal materials bases, improving production standard of TCM and boosting evidence-based research. Danshen's passing global phase III clinical trial is a big probability event, and it is expected to pass FDA certification in future, which may help it enter into the third rapid development period. Tasly has leading experience in the internationalization of TCM. Not only its own products will welcome the global market, but also the company is hopeful to hone into the platform for internationalization of domestic enterprises of TCM, so as to achieve further appreciation.

### "Buy" rating for the leading position in modernization and internationalization of TCM

The company holds leading position in the modernization of TCM, possessing creativity as well as international strategic perspectives. Its sufficient product lines and the worldwide expansion strategy will boost the growth, the denotation expansion is hopefully to accelerate. Meanwhile, the major shareholders and the management are heavily involved in the directional add-issuance, which also demonstrates their optimism and confidence. We grant it 38X 2015EPS, and the target price can be CNY 64.62, with "Buy" rating initially. (Closing price as at 10 April 2015)

### Buy (Initially)

CMP CNY49.81

(Closing price as at 10 April 2015)

TARGET CNY64.62 (+29.7%)

#### COMPANY DATA

O/S SHARES (MN) :	1,080
MARKET CAP (CNYMN) :	53,819
52 - WK HI/LO (CNY):	50.70/ 35.35

#### SHARE HOLDING PATTERN, %

Tasly Holdings Group:	45.18
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#### PRICE PERFORMANCE, %

	1M	3M	1Y
Tasly	10.00	13.03	18.86
SCI	-9.84	-7.43	-69.13

#### PRICE VS. SCI



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

CNY mn	FY13	FY14	FY15E	FY16E
Net Sales	11013	12476	14406	16634
Net Profit	1100	1368	1816	2240
EPS, CNY	1.07	1.32	1.70	2.07
PER, x	46.55	37.73	29.29	24.01
BVPS, CNY	3.74	4.68	7.35	8.80
P/BV, x	13.30	10.63	6.78	5.66
ROE, %	27.07	31.44	27.94	25.70
Debt/Equity (%)	148.87	154.94	129.89	129.89

Source: Company reports, Phillip Securities Est.

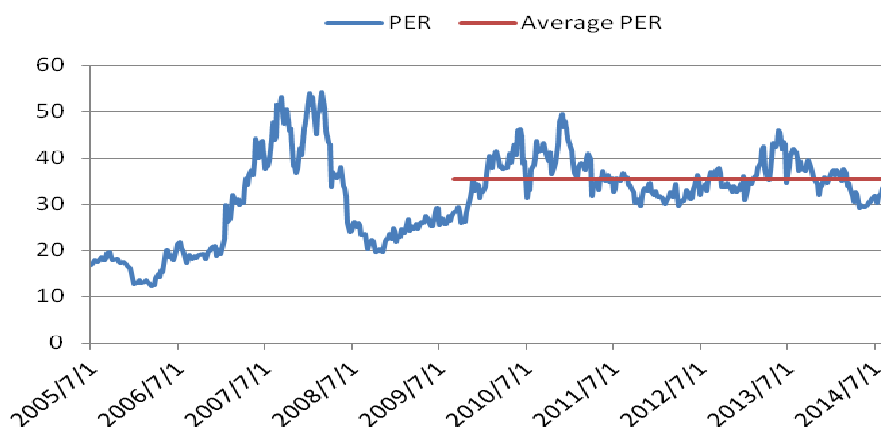
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### Historical P/E Valuation

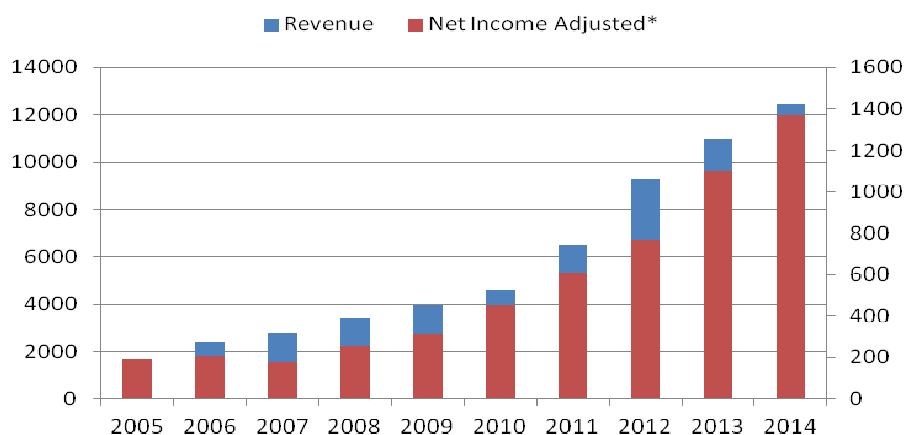


Source: Bloomberg, Phillip Securities (HK) Research

### Steadily growing performance in 2014

The annual report in 2014 of Tasly showed that the revenue was 12.57 billion Yuan, with a yearly growth of 13.24%. The net profit attributable to parent company increased by 24.61% up to 1.37 billion Yuan, and the profit excluding non-recurring item was 1.346 billion Yuan with a growth of 31.9%. Due to the rise in the percentage of pharmaceutical manufacturing, the gross margin has grown by 0.94 pct. to 37.48%. The company also has declared the profit distribution plan of 0.39 Yuan per share. Overall speaking, the company has maintained steadily growing trend and high dividend return.

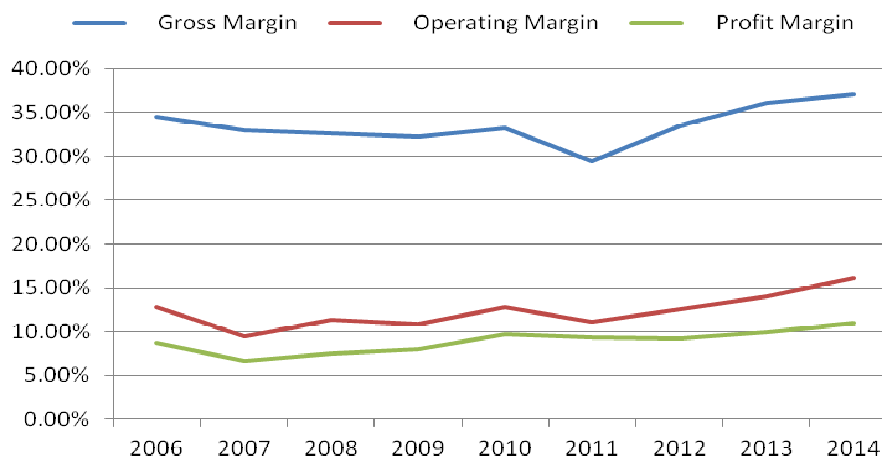
### Continually rapid growth trend (RMB:mn)



Source: Company report, Phillip Securities (HK) Research

Seen from the categories of businesses, the revenue of pharmaceutical manufacturing was 6.05 billion Yuan with a growth of 23%, among which the sale of Danshen Compound Dripping Pill(Danshen) was estimated to be more than 2.5 billion Yuan with a growth of 10% - 15%, accounting for 40%+ of total amount. The growth of the second variety Yangxue Qingnao Granule was about 20% and key varieties such as silibinin capsules, Qishen Yiqi Dripping Pill, Chuanxinlian Lactone Dripping Pill, Yiqi Fumai Injection kept the growth at over 30%. Although the gross margin went down somewhat, it was still up to 71%.

### Higher earning capabilities



Source: SFDA, Phillip Securities (HK) Research

The revenue of pharmaceutical distribution and retail business was 6.47 billion Yuan and the growth dropped to 6.6%, caused by the company's adjustment of commercial channels; however, the gross margin increased by almost 1 pct. up to 6.13% for the reason that the company increased the business of direct selling to hospitals.

In addition, the expense ratio were 23.24% with a growth of 0.6 pct., mainly caused by the increase in borrowing due to the denotation expansion, and the financial expense ratio went up by nearly 1 pct.. Nevertheless, recently the company has completed the financing of 1.6 billion Yuan by directional add-issuance, which will, to some degree, relieve the financial pressure.

### Prominent competitive advantages

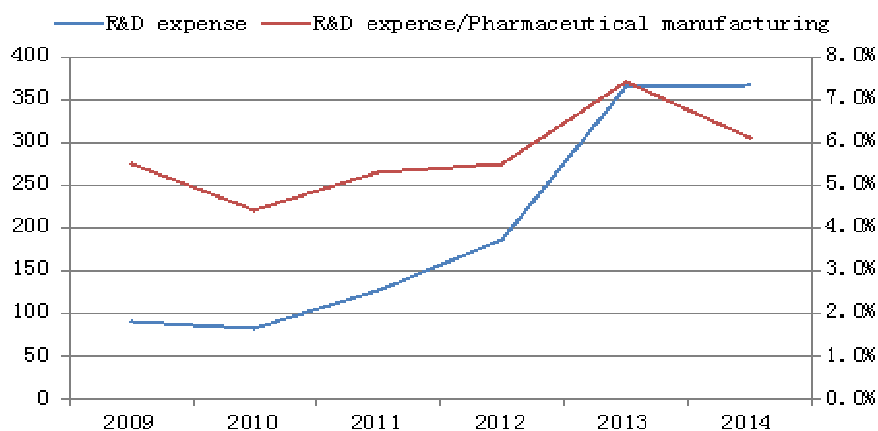
Tasly has established its leading role in modernization and internationalization of TCM industry in Mainland, and achieved the CAGR of 27% and 24.3% for its revenue and net profit from 2005 to 2014, which mainly rely on below competitive advantages:

First of all, the company has a strong ability of vertical integration among TCM industry and established an end-to-end modern industry chain, which conforms to the standardized management including GAP, GEP, GMP, GLP, GCP, and GSP, in possession of leading control force and advantages of supply chain. The company has set up standardized planting bases for dan-shen root and pseudo-ginseng in Shangluo of Shanxi, Yunnan and Xinhuang of Hunan, and the former is the first base of medicinal material resources in China which meets GAP standard and passes the EU certification.

Secondly, it has prominent advantages of research and development technology and patent system. Tasly has established the new mode of TCM multi-fractions research and development. It also first puts forward and formulates the new GEP standard for active composition of traditional Chinese medicine, and successfully applies the quality control technique of multiple chromatographic fingerprinting to quality control of traditional Chinese medicine. At the same time, the company turns to a system of patent protection, which is a change of patent protection from single industry to whole industrial chain, a change of patent protection from focus on China to internationalization and a change of focus on new drug protection to extension of term of protection for current products together with new drug protection. By the end of 2014, the company had 1,321 patents in total with

1,179 patents for invention, 436 patents for Danshen, and 94 patents for Yangxue Qingnao Granule.

#### Higher R&D expenditure of Tsley (RMB:mn)



Source: Company report, Phillip Securities (HK) Research

In addition, the company has abundant product lines and develops more than 10 varieties in the field including Cardiovascular and cerebrovascular, digestive system, antitumor, and anti-cold, which respectively has the output of over 100 million Yuan and most of which are at a fast growth. The Yiqi Fumai Injection has been added into the supplementary lists of medical insurance system in half of provinces in China, and if it is added into the national health insurance, it will promisingly become the product with an output of more than 1 billion. Salvianolic acid Injection is also added into health insurance in many provinces, and as the treatment guidelines drug for acute myocardial infarction in China, its capacity has been expanded three times. And at present, 95% of patients suffering from myocardial infarction cannot receive timely treatment, which shows the market space is quite wide.

Thirdly, the company has established integrated marketing network, formed acknowledged experts, consultants and prescription doctors group who are familiar with company products, and built long-term cooperation partner relationship with more than 200 first-grade business dealers and more than 2,000 second-grade business dealers, covering more than 60,000 drugstores, more than 60,000 basic level medical treatment organizations, and nearly 20,000 sales terminals of hospitals. And the company has set up a medical e-business platform, and the ranking of Tasly flagship store has ascended to No. 15 in Tmall OTC drug category. The company has launched "Door-to-Door service for diabetes mellitus" in Tianjin, collecting 5,800 service objects in 2014, with the repeat purchase rate as high as 97%, and it will continue to collect 30,000 service objects in 2015. We believe that the e-business channel will inject new vitality for pharmaceutical distribution and retail business.

### Internationalization of TCM enters the critical period

The company first carried forward the process of internationalization of TCM, and improved western medicine's recognition to TCM by establishing medicinal materials bases, improving production standard of TCM and boosting evidence-based research.

The main element of Danshen Compound Dripping Pills are danshen, pseudo-ginseng, and borneol, indication for coronary heart disease and angina, which has already gone through the two rapid development periods among 1994-

2002 and 2010 till now, with the CAGR as high as 75% and 18% respectively. At present, global multi-center clinical trial of Danshen has already come into the critical period, phase III clinical trial of North America has come into the ending phase. From the perspective of long term, we think, Danshen’s passing global phase III clinical trial is a big probability event, and it is expected to pass FDA certification in future, which may help it enter into the third rapid development period.

According to statistics, nearly 85 million American adults suffer from at least one kind of cardiovascular disease. Up to 2030, about 44 % of total population in America will suffer from one cardiovascular disease. In recent twenty years, there is only one new drug of chronic angina disease coming into market in America, and if Danshen could appear in the market as therapeutic drug in America, it will improve the temporary shortage plight of stranded against heart disease, and become the first global vegetable drug for preventing and curing for coronary heart disease and angina with huge international market.

**Cardiovascular disease death in the USA**

- Coronary heart disease    ■ Paralytic stroke    ■ Congestive heart failure
- High blood pressure    ■ Disease of artery    ■ Others



Source: National Center for Health Statistics, Phillip Securities (HK) Research

Moreover, the company is going to accelerate the application process of FDA-IND for Salvianolic acid Injection, Chuanxinlian Lactone Dripping Pill, Silibinin capsule and so on. We think Tasly has leading experience in the internationalization of TCM. Not only its own products will welcome the global market, but also the company is hopeful to hone into the platform for internationalization of domestic enterprises of traditional Chinese medicines, so as to achieve further appreciation.

**Catalyst**

- New products are put into market rapidly with more bidding in various provinces ;
- New national medical insurance catalog may launch and Tasly’s products can benefit from that;
- Accelerated denotative expansion;
- Danshen passed global phase III clinical trial.

**Risks**

- Drug price reduces;
- Adverse drug reaction;
- Price of raw materials increases;
- Uncertainty of approval for new drug.

## Financials

Periodicity:	2012	2013	2014	2015F	2016F
<b>Valuation Ratios</b>					
Price Earnings	66.86	46.55	37.73	29.29	24.01
Price to Book	12.12	13.30	10.63	6.78	5.66
Dividend Yield	0.20%	0.70%	0.78%	1.02%	1.24%
<b>Per share data(CNY)</b>					
EPS Adjusted	0.75	1.07	1.32	1.70	2.07
Book Value Per Share	4.11	3.74	4.68	7.35	8.80
Dividends Per Share	0.10	0.35	0.39	0.51	0.62
<b>Growth &amp; Margin</b>					
Revenue growth	-	18.79%	13.29%	15.47%	15.46%
Gross profit growth	-	27.69%	16.35%	22.04%	18.62%
Net profit growth	-	43.04%	24.36%	32.73%	23.36%
Gross Margin	33.54%	36.05%	37.02%	39.13%	40.20%
Operating Margin	12.56%	14.01%	16.18%	17.63%	18.70%
Net Profit Margin	8.30%	9.99%	10.97%	12.61%	13.47%
Dividend Payout Ratio %	13.42%	32.71%	29.55%	29.99%	29.89%
<b>Key ratios</b>					
Return on Assets	11.51%	11.85%	11.73%	11.66%	11.18%
Return on Equity	21.66%	27.07%	31.44%	27.94%	25.70%
Liability ratio	44.73%	59.82%	60.77%	56.50%	56.50%
Effective Tax Rate	17.24%	17.77%	16.31%	16.80%	16.80%
<b>Income Statement(CNY: mn)</b>					
<b>Revenue</b>	<b>9,271</b>	<b>11,013</b>	<b>12,476</b>	<b>14,406</b>	<b>16,634</b>
- Cost of Goods Sold	6,162	7,043	7,857	8,769	9,947
<b>Gross Income</b>	<b>3,109</b>	<b>3,970</b>	<b>4,619</b>	<b>5,637</b>	<b>6,687</b>
- Selling, General & Admin E	1,945	2,427	2,600	3,097	3,576
<b>Operating Income</b>	<b>1,164</b>	<b>1,543</b>	<b>2,019</b>	<b>2,540</b>	<b>3,111</b>
- Interest Expense	127	163	305	250	280
- Net Non-Operating Losses	-43	-35	-19	-25	-25
Pretax Income	1,080	1,416	1,733	2,315	2,856
- Income Tax Expense	186	252	283	389	480
Income Before XO Items	894	1,164	1,450	1,926	2,376
- Minority Interests	44	66	82	110	135
<b>Net Profit</b>	<b>769</b>	<b>1,100</b>	<b>1,368</b>	<b>1,816</b>	<b>2,240</b>

Source: Company, Phillip Securities (HK) Research Estimates  
(Financial figures as at 10 April 2015)

**PHILLIP RESEARCH STOCK SELECTION SYSTEMS**

<b>Total Return</b>	<b>Recommendation</b>	<b>Rating</b>	<b>Remarks</b>
<b>&gt;+20%</b>	<b>Buy</b>	<b>1</b>	<b>&gt;20% upside from the current price</b>
<b>+5% to +20%</b>	<b>Accumulate</b>	<b>2</b>	<b>+5% to +20% upside from the current price</b>
<b>-5% to +5%</b>	<b>Neutral</b>	<b>3</b>	<b>Trade within <math>\pm 5%</math> from the current price</b>
<b>-5% to -20%</b>	<b>Reduce</b>	<b>4</b>	<b>-5% to -20% downside from the current price</b>
<b>&lt;-20%</b>	<b>Sell</b>	<b>5</b>	<b>&gt;20% downside from the current price</b>

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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