

# Kangmei Pharmaceutical (600518.CH)

## Internet medical strategy is pushed forward rapidly

Shanghai | Pharmaceutical | Company report

16 Jun 2015

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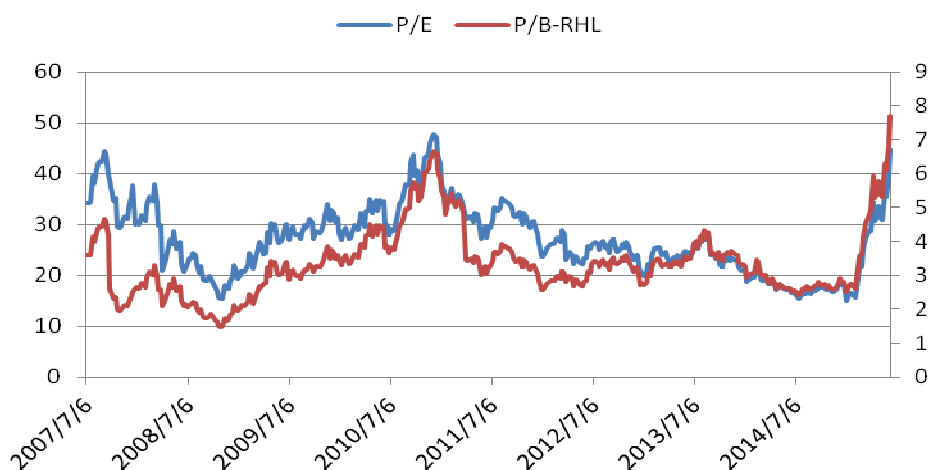
In the previous few years, Kangmei focused on the whole-industrial-chain strategy of Chinese traditional medicines and has operations in the upstream, middle-stream and downstream industry, thus gradually controlling the Chinese medicine resources and distribution market. In 2015, the Company's strategy of building the nationwide internet medicine became more evident. The internet medical platform has taken the initial form. In the future, the complete ecosphere of virtual hospitals is expected to be realized, placing the Company again in the leading position of the industry.

Recently, Qinghai Provincial Office of Financial Affairs approved Kangmei to invest RMB 100 million to build the Chinese Medicine Exchange. We believe that, after Chinese Medicine Exchange is established, the market space of e Medicine Valley will be opened. The future commission and financing service may bring more than RMB 1 billion gross margin for the Company.

### Internet medicine improves valuation

The Company has advantages in whole-industrial-chain of Chinese medicine. It has gradually eliminated the bottleneck of decoction pieces. The multiple marketing provides the channel support and the future sustainable growth is expectable. In particular, since 2015 the Company has been working to accelerate internet+ tactics. The internet medical platform has taken the initial form. In the future, the complete ecosphere of virtual hospitals is expected to be realized, placing the Company again in the leading position of the industry. The building of the platform will greatly improve the market recognition and valuation. We grant it 45X 2015EPS, and the target price can be CNY62.44, with "Buy" rating. (Closing price at 12 June 2015)

### Historical Valuation of Kangmei



Source: Bloomberg, Phillip Securities (HK) Research

### BUY (Maintain)

CMP: CNY 49.98  
(Closing price at 12 June 2015)  
TARGET: CNY 62.44 (+25%)

#### COMPANY DATA

O/S SHARES (MN) :	2,199
MARKET CAP (CNYMN) :	109,892
52 - WK HI/LO (CNY):	51.77/ 13.54

#### SHARE HOLDING PATTERN , %

Kang Mei Industrial Co. Ltd.	30.42
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#### PRICE PERFORMANCE , %

	1M	3M	1Y
Kangmei	36.20	84.24	225.07
SCI	18.01	28.61	75.83

#### PRICE VS. HS300



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

CNY mn	FY13	FY14	FY15E	FY16E
Net Sales	13263	15846	20564	25953
Net Profit	1880	2286	3051	3857
EPS, CNY	0.86	1.04	1.39	1.75
PER, x	58.46	48.06	36.02	28.49
BVPS, CNY	5.47	7.60	8.57	9.80
P/BV, x	9.14	6.58	5.83	5.10
ROE, %	16.63	17.74	17.15	19.09
Debt/Equity (%)	84.96	66.75	73.91	73.91

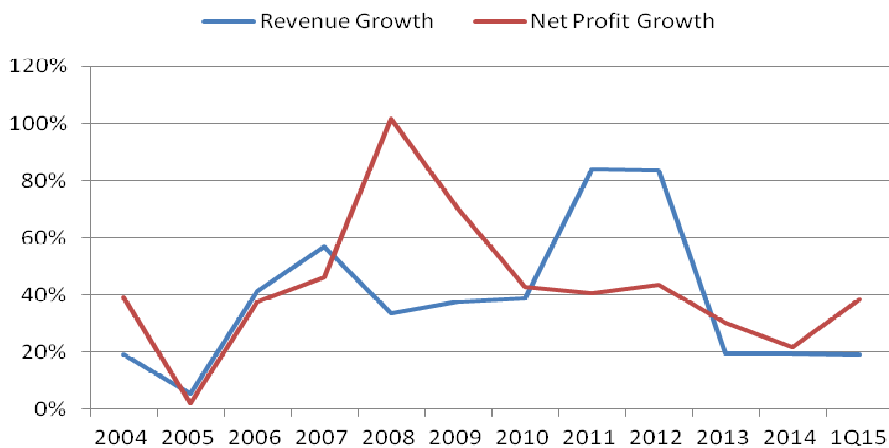
Source: Company reports, Phillip Securities Est.

Research Analyst  
**Fan Guohe**  
(+ 86 21 51699400-110)  
fanguohe@phillip.com.cn

## Rapid growth of results in 1Q15

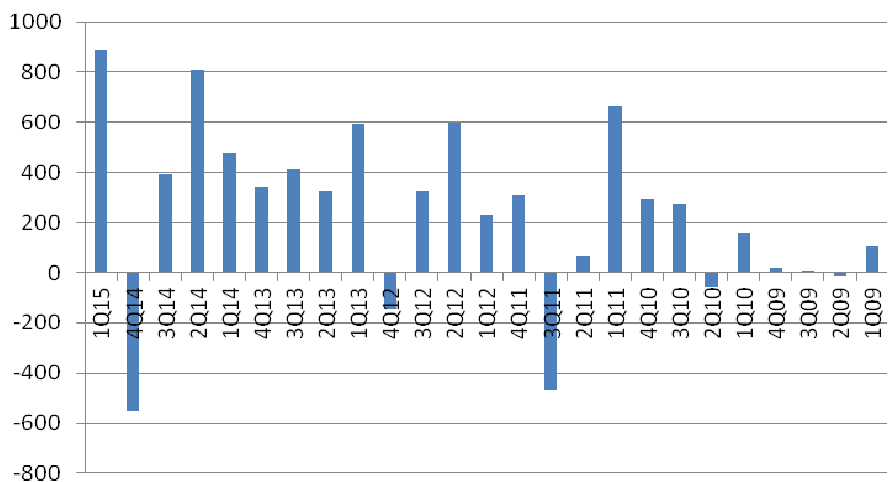
According to the financial statement for Q1, the revenues of the Company rose by 19.2% YOY to RMB 5 billion and the net profits rose by 38% to RMB 820 million. Even if the 25% tax rate of the same period of last year was adopted, the net-profit growth rate still reached 21.5%, maintaining the rapid growth trend. At the same time, the Company recorded the net increase of RMB 890 million in the operating cash flow, rising by 86% YOY, which was the highest level since the financial crisis, revealing the excellent quality of operation.

### Continually grown performance



Source: Company reports, Phillip Securities (HK) Research

### The highest CFO since 2009 (CNY: mn)



Source: Company reports, Phillip Securities (HK) Research

The result growth was mainly contributed by the income growth of traditional Chinese medicinal decoction pieces, which could rise by more than 40%. At present, the decoction pieces industry is in the booming stage. In next 3 years, the capacity of decoction pieces in the Company is expected to rise to more than 60,000 tons, which will support the continuous growth of decoction pieces business. Besides, the price of medicinal materials has rose stably, the exploitation of in-forest ginseng in the reserve has also gradually contributed to the revenues, which help the medicine trade business continue growing steadily. The direct-sales team now has more than 230,000 people. In 2015, probably 20 new direct-sales products will be launched into the market and high-speed growth is expected, we estimate the business's revenue

can exceed RMB 1 billion. What's more, the rise of profitability also contributed to the result growth. In Q1, the integrated gross margins rose by 0.39 percentage points to 27.7%.

### **Internet medical strategy is pushed forward rapidly**

In the previous few years, Kangmei focused on the whole-industrial-chain strategy of Chinese traditional medicines and has taken the leading position in the industry. In the upstream, the Company worked hard to build more than 50,000 Chinese mu of GAP and standard farm of pseudo-ginseng and Panax ginseng. At the same time, it has built 9 factories of traditional Chinese medicinal decoction pieces, thus basically finalizing the national layout. Besides, the Company has also built Kangmei (Bozhou) Huatuo International Chinese Medicine Town and put it into operation while managing the traditional Chinese medicine markets that account for more than 75% of the national trading volume in China. Meanwhile, it has integrated the hospitals and pharmacy resources by means of new-building, M&A or entrusting. Overall speaking, the Company has operations in the upstream, middle-stream and downstream industry along the traditional Chinese medicine industrial chain, thus gradually controlling the Chinese medicine resources and distribution market.

In 2015, the Company's strategy of building the nationwide internet medicine became more evident. Regarding data and platform, the Company, together with the former team of Microsoft, has established Kangmei Health Cloud Service Co., Ltd., which will develop the cloud computing system. It has also collaborated with xinhua.com to establish Kangmei Health Think Tank to build the big data platform of health, revealing the Company is actively working to establish the underlying data support for internet medical platform. Before that, the Company had announced the collaborative programs with Yulin of Guangxi, Qinghai Province and Guangzhou city, etc. It provides mobile medical construction service for public hospitals, and participates in hospital operations and management. At the same time, as the sole platform in Qinghai, it is responsible for providing online inquiry, appointment and registration, hospital guide and report query service, etc., thus offering online and offline service systems. In terms of medicine purchase, the Company is working together with professional e-commerce businesses to pilot test the Virtual Pharmacies in Guangzhou, Shenzhen and Beijing, etc. A few provincial-level Chinese medicine hospitals have had access to Kangmei Network Platform. These companies can read the e-prescriptions of these hospitals, prepare traditional Chinese medicines and distribute them to the homes of patients, thus establishing foundation for online sales of prescription medicines. In terms of upstream industry, the Company has signed agreement with Zhongheng Group and Youbo Pharmaceutical about supply chain of traditional Chinese medicines and channel collaboration, revealing the Company's channel building has been recognized by the market and its product lines will be richer. In general, the Company's internet medical platform has taken the initial form. In the future, the complete ecosphere of virtual hospitals is expected to be realized, placing the Company again in the leading position of the industry.

### **Internet finance will probably accelerate profits**

Recently, Qinghai Provincial Office of Financial Affairs approved Kangmei to invest RMB 100 million to build the Chinese Medicine Exchange. We believe the Company has core advantages in this field. At first, Kangmei Pharmaceutical is the maker of Chinese medicine price index and delivery standards. In short term, no companies will receive the approval. Second, the Company controls major Chinese medicine markets in Bozhou, Puning, Yulin and Qinghai, thus having the delivery ability that is difficult to be duplicated.

The Company operates the e Medicine Valley, a large trading platform. Since 2015, the transactions have risen rapidly. At present the daily transaction value is about

RMB 2 billion, with 10% of them are spot goods deliveries. We believe that, after Chinese Medicine Exchange is established, the market space of e Medicine Valley will be opened. At present, most of the investors in e Medicine Valley are financial investors. The nature of investment target of Chinese medicines is increasing. In the future, it is likely the Exchange will become a futures exchange. It is worth pointing out that, the future commission and financing service may bring more than RMB 1 billion gross margin for the Company.

### Catalysts

The newly-added capacity of traditional Chinese medicinal decoction pieces is released rapidly;

The expansion of direct-sales channels is faster than expected;

The agreements of internet medical platforms are signed and implemented.

### Risks

The internet medical health service platform promotion will probably stay lower than expectations:

Insufficient talent reserve will influence on the business layout.

## Financials

<b>Periodicity:</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015F</b>	<b>2016F</b>
<b>Valuation Ratios</b>					
Price Earnings	76.31	58.46	48.06	36.02	28.49
Price to Book	10.39	9.14	6.58	5.83	5.10
Dividend Yield	0.40%	0.52%	0.64%	0.83%	1.05%
<b>Per share data(CNY)</b>					
EPS Adjusted	0.66	0.86	1.04	1.39	1.75
Book Value Per Share	4.81	5.47	7.60	8.57	9.80
Dividends Per Share	0.20	0.26	0.32	0.42	0.53
<b>Growth &amp; Margin</b>					
Revenue growth	83.49%	19.41%	19.47%	29.78%	26.20%
Gross profit growth	51.92%	23.44%	20.27%	33.13%	27.46%
Net profit growth	43.40%	30.43%	21.61%	33.46%	26.41%
Gross Margin	24.73%	25.56%	25.74%	26.40%	26.66%
Operating Margin	17.67%	18.75%	19.24%	19.50%	19.46%
Net Profit Margin	12.98%	14.17%	14.43%	14.84%	14.86%
Dividend Payout Ratio %	30.53%	30.41%	30.77%	30.00%	30.00%
<b>Key ratios</b>					
Return on Assets	8.68%	9.35%	9.12%	10.06%	10.98%
Return on Equity	14.54%	16.63%	17.74%	17.15%	19.09%
Liability ratio	41.07%	45.93%	40.03%	42.50%	42.50%
Effective Tax Rate	14.84%	15.07%	15.55%	15.00%	14.84%
<b>Income Statement(CNY: mn)</b>					
<b>Revenue</b>	<b>11,107</b>	<b>13,263</b>	<b>15,846</b>	<b>20,564</b>	<b>25,953</b>
- Cost of Goods Sold	8,361	9,873	11,768	15,135	19,033
<b>Gross Income</b>	<b>2,747</b>	<b>3,391</b>	<b>4,078</b>	<b>5,429</b>	<b>6,920</b>
- Selling, General & Admin Expenses	784	904	1,030	1,419	1,869
<b>Operating Income</b>	<b>1,963</b>	<b>2,486</b>	<b>3,048</b>	<b>4,010</b>	<b>5,051</b>
- Interest Expense	360	406	491	579	684
- Net Non-Operating Losses (Gains)	-91	-134	-150	-160	-170
Pretax Income	1,693	2,214	2,707	3,591	4,537
- Income Tax Expense	251	334	421	539	681
<b>Net Profit</b>	<b>1,441</b>	<b>1,880</b>	<b>2,286</b>	<b>3,051</b>	<b>3,857</b>

Source: Company, Phillip Securities (HK) Research Estimates  
(Financial figures as at 12 June 2015)

**PHILLIP RESEARCH STOCK SELECTION SYSTEMS**

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

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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**Contact Information (Regional Member Companies)**

**SINGAPORE**

**Phillip Securities Pte Ltd**  
Raffles City Tower  
250, North Bridge Road #06-00  
Singapore 179101  
Tel : (65) 6533 6001  
Fax : (65) 6535 6631  
Website: [www.poems.com.sg](http://www.poems.com.sg)

**HONG KONG**

**Phillip Securities (HK) Ltd**  
Exchange Participant of the Stock Exchange of Hong Kong  
11/F United Centre 95 Queensway  
Hong Kong  
Tel (852) 22776600  
Fax (852) 28685307  
Websites: [www.phillip.com.hk](http://www.phillip.com.hk)

**INDONESIA**

**PT Phillip Securities Indonesia**  
ANZ Tower Level 23B,  
Jl Jend Sudirman Kav 33A  
Jakarta 10220 – Indonesia  
Tel (62-21) 57900800  
Fax (62-21) 57900809  
Website: [www.phillip.co.id](http://www.phillip.co.id)

**THAILAND**

**Phillip Securities (Thailand) Public Co. Ltd**  
15th Floor, Vorawat Building,  
849 Silom Road, Silom, Bangrak,  
Bangkok 10500 Thailand  
Tel (66-2) 6351700 / 22680999  
Fax (66-2) 22680921  
Website: [www.phillip.co.th](http://www.phillip.co.th)

**UNITED KINGDOM**

**King & Shaxson Capital Limited**  
6th Floor, Candlewick House,  
120 Cannon Street,  
London, EC4N 6AS  
Tel (44-20) 7426 5950  
Fax (44-20) 7626 1757  
Website: [www.kingandshaxson.com](http://www.kingandshaxson.com)

**AUSTRALIA**

**PhillipCapital Australia**  
Level 12, 15 William Street,  
Melbourne, Victoria 3000, Australia  
Tel (613) 96188238  
Fax (613) 92002272  
Website: [www.phillipcapital.com.au](http://www.phillipcapital.com.au)

**MALAYSIA**

**Phillip Capital Management Sdn Bhd**  
B-3-6 Block B Level 3 Megan Avenue II,  
No. 12, Jalan Yap Kwan Seng, 50450  
Kuala Lumpur  
Tel (603) 21628841  
Fax (603) 21665099  
Website: [www.poems.com.my](http://www.poems.com.my)

**JAPAN**

**PhillipCapital Japan K.K.**  
Nagata-cho Bldg.,  
8F, 2-4-3 Nagata-cho,  
Chiyoda-ku, Tokyo 100-0014  
Tel (81-3) 35953631  
Fax (81-3) 35953630  
Website: [www.phillip.co.jp](http://www.phillip.co.jp)

**CHINA**

**Phillip Financial Advisory (Shanghai) Co. Ltd**  
No 436 Hengfeng Road,  
Greentech Unit 604,  
Postal code 200070  
Tel (86-21) 51699400  
Fax (86-21) 63532643  
Website: [www.phillip.com.cn](http://www.phillip.com.cn)

**FRANCE**

**King & Shaxson Capital Limited**  
3rd Floor, 35 Rue de la Bienfaisance 75008  
Paris France  
Tel (33-1) 45633100  
Fax (33-1) 45636017  
Website: [www.kingandshaxson.com](http://www.kingandshaxson.com)

**UNITED STATES**

**Phillip Futures Inc**  
141 W Jackson Blvd Ste 3050  
The Chicago Board of Trade Building  
Chicago, IL 60604 USA  
Tel +1.312.356.9000  
Fax +1.312.356.9005