

HEC Pharm (1558.HK)

Oseltamivir May Become the Heavyweight Variety

Hong Kong | Healthcare | Company report

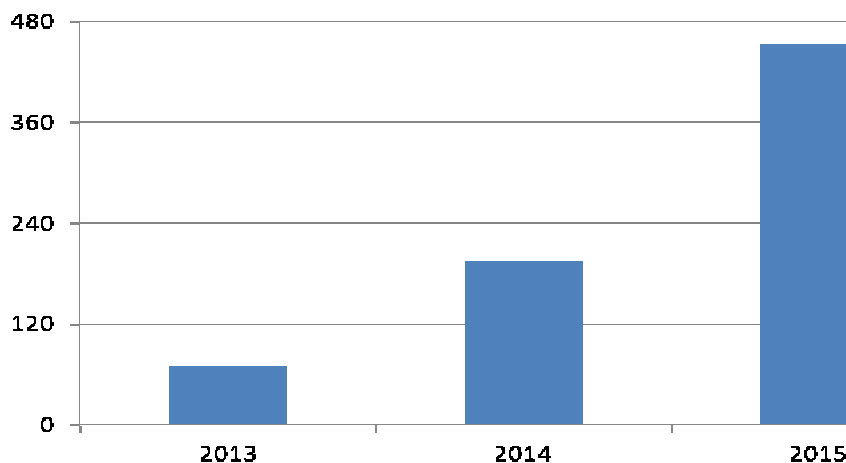
8 AUG 2016

Expecting a 35%+ Growth in 1H16

HEC Pharm (1558-HK) recently made a positive announcement. It is estimated that the company will see a no lower than 35% growth in net profit in the first half of the year mainly due to a surge of sales volume of the flagship product Oseltamivir Phosphate (Kewei) and the continuing improvement of marketing and promoting ability of the company on professional academics.

The company mainly engages in the drug production and sales of antiviral, endocrine and metabolic diseases and cardiovascular diseases. Among them, the star is Kewei that, with double growth in each of previous years, contributes 65.5% of the business revenues in 2015. What's worth mentioning is that, HEC Pharm is currently the only licensed company to produce and sell active pharmaceutical ingredients (API), granules and capsules of Oseltamivir. Specifically, Oseltamivir Phosphate Granules is the exclusive product in Chinese pediatric drug market. This exclusive license has made the company the leading enterprise in selling Oseltamivir since 2013. In 2016, the academic promotion and sales team of the company was enlarged to more than 300 people, comparing 196 people in 2015, which supported Oseltamivir to enter the markets of more provinces.

Revenue of Kewei (oseltamivir phosphate) (CNY: mn)



Source: Company reports, Phillip Securities (HK) Research

Oseltamivir May Become the Heavyweight Variety

We maintain a positive attitude towards the growth of Kewei, expecting it to be a one-billion class brand. First of all, the capacity of the market of anti-influenza virus drug is approximately RMB4 billion at present, with Amantadine occupying the major part. However, more than 90% of the population will have drug tolerance while Oseltamivir will bring about lower drug tolerance. Thus we expect it to dominate the market gradually. Secondly, there is little side effect of Oseltamivir Phosphate and it could fit in the pediatric drug market and suitable for pregnant women. Owing to its outstanding safety, FDA permitted its use to 2-week old babies. At present, the two-child policy is completely implemented in mainland China.

Buy (Initially)

CMP: HKD 17.06

(Closing price as at 4 Aug 2016)

TARGET: HKD 23.70 (+38.9%)

COMPANY DATA

O/S SHARES (MN) :	451
MARKET CAP (HKDMN) :	7,691
52 - WK HI/LO (HKD):	18.28/ 11.80

SHARE HOLDING PATTERN, %

Zhang Zhongneng:	49.93
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PRICE PERFORMANCE, %

	1M	3M	1Y
HEC Pharm	7.94	8.35	-
HSI	4.72	2.44	-

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	441	693	901	1137
Net Profit	135	266	368	472
EPS, CNY	-	0.79	0.82	1.05
PER, x	-	18.6	18.0	14.0
BVPS, CNY	-	4.75	5.42	6.31
P/BV, x	-	3.09	2.71	2.33
ROE, %	35.8	22.0	16.2	18.2
Debt/Equity (%)	242.5	20.3	25.0	25.0

Source: Company reports, Phillip Securities Est.

Research Analyst

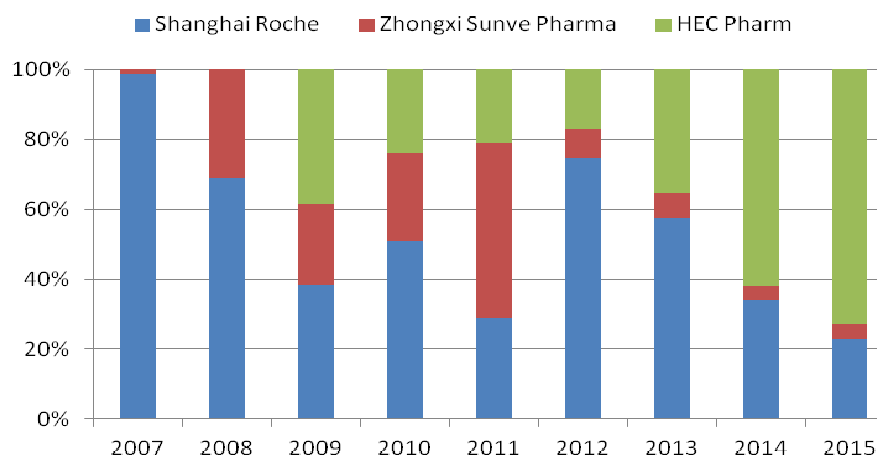
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The speed increase will be as high as 30% in pediatric drug market. What's more, there are only 3 manufacturers producing Oseltamivir in China, which indicates a bright future for the company in the competition landscape. In addition, except HEC Pharm, the other two manufacturers do not take Oseltamivir as their major brand. Therefore, it is likely that HEC Pharm will dominate the field and face a limited competition in the following 3 to 5 years.

Greatly increased market share of Oseltamivir phosphate by HEC Pharm



Source: Company reports, Phillip Securities (HK) Research

R&D Advantage Supports Medium and Long Term Development

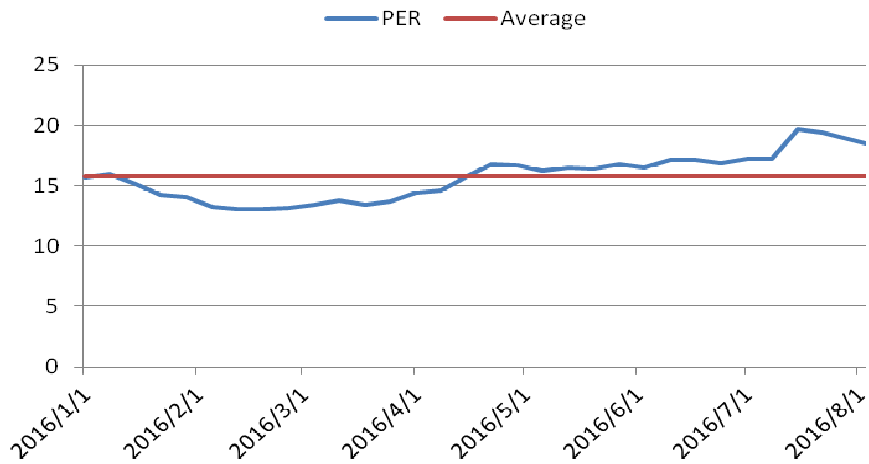
According to the strategic cooperation agreement with the controlling shareholder Shenzhen HEC Corporation, the company will gain the preemptive right of the products of HEC Pharm R&D Group. The research team of HEC consists of 1200 researchers, including 4 experts from the Thousand Talents Program of China. Therefore, the R&D system is outside the company but good brands could be brought in the listed company and provide support to the medium and long term development.

At present, there are two premier brands in research worthy of attention in HEC Pharm. First of all, insulin products are under clinical development. It is expected that Gen 2 insulin and recombinant human insulin will successively come to the market in the year 2017 to 2018 and Gen 3 insulin will be present in 2019 to 2020. Due to high technical barrier, there are fewer competitors in the insulin market. Except the traditional international Big Three, only Gan Lee Pharm is approved to produce Gen 3 insulin in China. Dongbao Pharm is the leading manufacturer of Gen 2 insulin. The overall competition landscape is positive. Additionally, the hepatitis C drugs of the company are expected to come to the market at the fastest speed compared to similar products in the year 2019 to 2020.

Valuation

The sales of Kewei increases in main provinces and is expected to be the major driver of the rapid growth in 2016 to 2018 of the company. It is hopeful to reach the scale of one billion in the future. The R&D support to the group and good product pipeline will support the medium and long term development of the company. We give an estimation of 25x EPS in 2016 and the target price is HKD23.7, with the "Buy" rating initially. (Closing price as at 4 Aug 2016)

Historical P/E Valuation



Source: Bloomberg, Phillip Securities (HK) Research

Risks

Risk of price drop in drugs;
Risk of R&D of new drugs.

Financials

FYE	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings	-	-	18.62	17.99	14.03
Price to Book	-	-	3.09	2.71	2.33
Dividend Yield	-	-	1.0%	1.1%	1.5%
Per share data(RMB))					
EPS Adjusted	-	-	0.79	0.82	1.05
Book Value Per Share	-	-	4.75	5.42	6.31
Dividends Per Share	-	-	0.15	0.16	0.22
Growth& Margin					
Revenue growth	-	39.3%	57.2%	30.0%	26.2%
Gross Profit growth	-	60.2%	60.3%	32.3%	27.9%
Net Profit growth	-	134.2%	96.4%	38.6%	28.2%
Profitability Ratios					
Gross Margin	63.4%	72.8%	74.3%	75.6%	76.6%
Net Profit Margin	18.3%	30.7%	38.4%	40.9%	41.6%
Dividend Payout Ratio %			25.4%	19.6%	21.0%
Key Ratios					
Return on Assets	3.7%	10.4%	15.1%	13.2%	14.6%
Return on Equity	12.8%	35.8%	22.0%	16.2%	18.2%
Effective Tax Rate	17.6%	17.0%	15.6%	15.6%	15.6%
Liability ratio	71.1%	70.8%	16.9%	20.0%	20.0%
Income Statement(RMB: mn)					
Revenue	316	441	693	901	1,137
- Cost of Goods Sold	116	120	178	220	266
Gross Income	200	321	515	681	871
- Selling, General & Admin Expense	148	170	199	250	316
Operating Income	97	184	329	449	577
- Interest Expense	49	42	25	15	20
Pretax Income	70	163	315	437	560
- Income Tax Expense	12	28	49	68	87
Net Profit	58	135	266	368	472

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 4 Aug 2016)

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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