

Guangzhou Baiyunshan Pharma (874.HK)

Share of Wong Lo Kat Continued to Expand

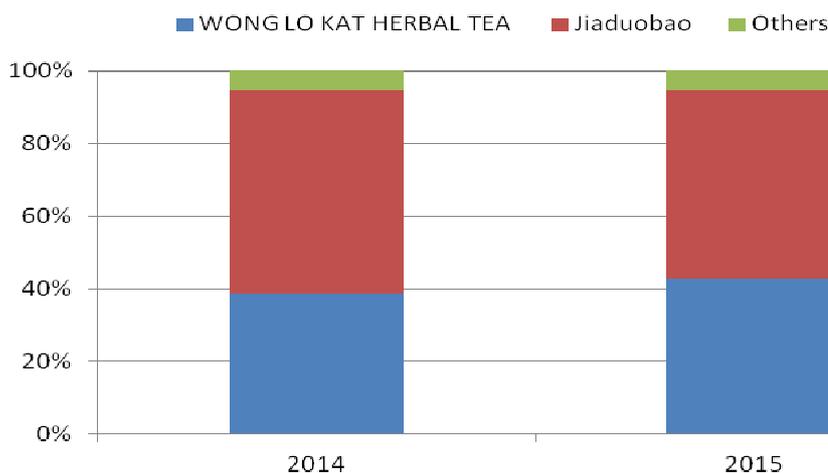
17 October 2016

Hong Kong | Pharmaceutical | Company report

Share of Wong Lo Kat Continued to Expand

In 1H16, the company's Great Health business focusing on Wong Lo Kat saw sound development, and its revenue increased by 7.6% to RMB4.7 billion. Specifically, the Q2 revenue witnessed a QoQ increase of nearly 20%. Overall, Wong Lo Kat has recovered the sole right to use the trademark, advertisement, red can packaging and formula assets, contributing to increasingly obvious competitive edge and continued expand in market share. Jiaduobao has changed red cans into gold cans, and hence may lose some of the festive market share. In the meantime, it significantly reduced marketing expenses and changed the management this year. By contrast, Wong Lo Kat will increase terminal investment by virtue of considerable funds, so it is expected to continue enhancing competitive advantage.

Market Pattern of Herbal Tea Industry



Source: Company reports, Phillip Securities (HK) Research

Additionally, we are optimistic about the improvements in profitability of Wong Lo Kat. Previously, the expense pressure on the two competitors was immense. Net profit margin of Wong Lo Kat plunged from about 20% to less than 5%, far lower the industry. Nevertheless, presently Jiaduobao emphasizes cost control and reduces advertising investment, so the expense pressure on the two parties was alleviated, and the profitability of Wong Lo Kat is projected to improve. In 2015, net profit margin of Wong Lo Kat rose by 0.23 percentage points to 5.03%.

Buy (Initially)

CMP: HKD 19.16

(Closing price as at 13 Oct 2016)

TARGET: HKD 24.48 (+28%)

COMPANY DATA

O/S SHARES (MN) :	1,626
MARKET CAP (HKDMN) :	44,746
52 - WK HI/LO (HKD):	22.6/15.6

SHARE HOLDING PATTERN, %

Guangzhou Pharmaceutical Group:	45.04
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PRICE PERFORMANCE, %

	1M	3M	1Y
Baiyunshan	-3.43	-3.72	-9.84
HSI	-2.74	-10.54	-12.47

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	18663	18955	20834	22581
Net Profit	1194	1300	1467	1830
EPS, CNY	0.92	1.01	1.06	1.13
PER, x	17.95	16.35	15.65	14.67
BVPS, CNY	5.99	6.55	11.10	12.22
P/BV, x	2.76	2.52	1.49	1.35
ROE, %	15.9	15.6	11.0	9.7
Debt/Equity (%)	78.6	82.8	42.9	42.9

Source: Company reports, Phillip Securities Est.

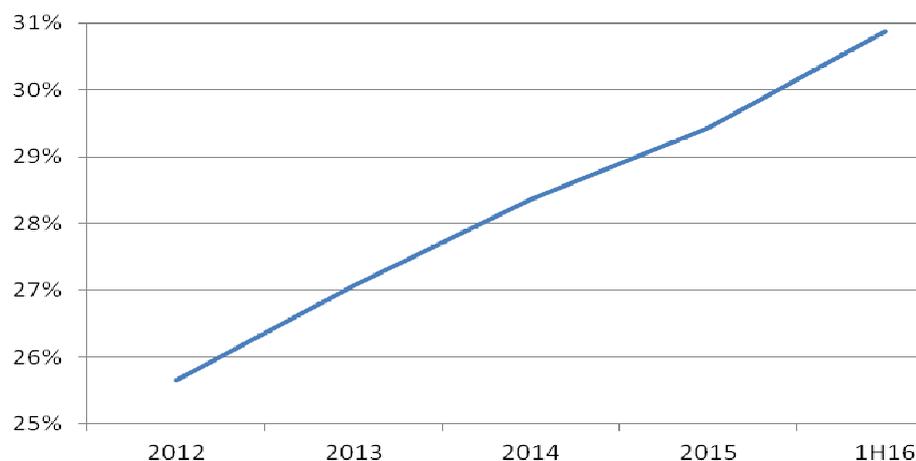
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Continually Increasing Expense Ratio



Source: Company reports, Phillip Securities (HK) Research

Grand Southern TCM Business is Expected to Recover

In spite of an increase of over 60% in the revenues of An Gong Niu Huang pill and Jin Ge, the revenue of the company's Grand Southern TCM segment dropped by 7.9% to RMB3.5 billion in 1H16, which was mainly because of the influence of de-stocking by distributors and relocation of such enterprises as Qi Xing Pharmaceutical Factory. However, the improvement in product structure resulted in an increase of 3 percentage points in gross profit margin of Grand Southern TCM to 45.4%. Furthermore, with the relocation and reconstruction of pharmaceutical factories and completion of de-stocking, better performance in the second half of 2016 is expected.

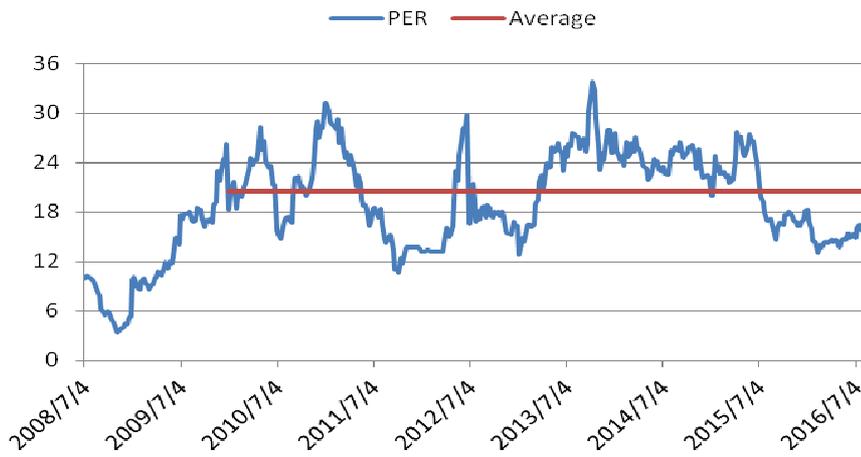
It is worth mentioning that Pfizer's patent protection on Viagra expired. Increase in the company's Jin Ge lived up to expectations. Jin Ge is RMB34.5/pill, 73% cheaper than Viagra, which is RMB128/pill. Besides, the company continues to build drug sales network after private placement. Therefore, we expect that the market share of Jin Ge will significantly increase, and the sales may exceed the original target of RM B300-400 million in 2016.

The Government Participated in Private Placement with Heavy Investment

The company completed the private placement, with the non-public offering price of RMB23.56/share and the total size of RMB7.9 billion. The Guangzhou Municipal Government invested RMB7.3 billion, showing its firm support to the company. The company, as the only pharmaceutical listed platform of Guangdong SASAC, is likely to gather pharmaceutical resources. Additionally, the shareholding by YF Capital would also introduce the resources of Alibaba, so the company may speed up the efforts to promote regional medicine integration in the future.

In conclusion, the company's Grand Southern TCM segment is projected to recover. The profitability of the Great Health segment will be improved, and the Great Commerce segment will witness constant and rapid growth due to policy changes. We grant it 20x EPS in 2016 and the target price of HK\$24.48, with the "Buy" rating initially. (Closing price as at 13 Oct 2016)

Historical P/E Valuation



Source: Bloomberg, Phillip Securities (HK) Research

Risks

Competition of consumer goods market is more intense;
 Integration of Grand Southern TCM segment fails to meet expectations.

Financials

Periodicity:	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings	21.45	17.95	16.35	15.65	14.67
Price to Book	3.12	2.76	2.52	1.49	1.35
Dividend Yield	1.39%	1.70%	0.00%	0.00%	0.00%
Per share data(CNY)					
EPS Adjusted	0.77	0.92	1.01	1.06	1.13
Book Value Per Share	5.29	5.99	6.55	11.10	12.22
Dividends Per Share	0.23	0.28	0.00	0.00	0.00
Growth & Margin					
Revenue growth	46.05%	6.89%	1.56%	9.91%	8.39%
Gross profit growth	51.88%	14.56%	4.29%	12.57%	11.06%
Net profit growth	119.90%	37.36%	8.88%	12.82%	24.80%
Gross Margin	32.38%	34.71%	35.64%	36.50%	37.40%
Operating Margin	5.32%	6.35%	6.20%	6.15%	7.25%
Net Profit Margin	4.98%	6.40%	6.86%	7.04%	8.11%
Dividend Payout Ratio %	29.87%	30.43%	0.00%	0.00%	0.00%
Key ratios					
Return on Assets	9.06%	9.02%	8.64%	7.04%	6.76%
Return on Equity	15.81%	15.94%	15.62%	10.98%	9.66%
Liability ratio	42.67%	43.99%	45.28%	30.00%	30.00%
Effective Tax Rate	18.08%	17.51%	17.39%	17.50%	17.50%
Income Statement(CNY: mn)					
Revenue	17,460	18,663	18,955	20,834	22,581
- Cost of Goods Sold	11,806	12,186	12,201	13,229	14,136
Gross Income	5,654	6,477	6,755	7,604	8,445
- Selling, General & Admin Expense	4,725	5,292	5,579	6,323	6,808
Operating Income	929	1,185	1,176	1,281	1,637
- Interest Expense	35	38	41	40	40
- Net Non-Operating Losses (Gains)	-336	-321	-492	-600	-700
Pretax Income	1,229	1,468	1,627	1,842	2,299
- Income Tax Expense	222	257	283	322	402
Income Before XO Items	1,007	1,212	1,345	1,520	1,897
- Minority Interests	27	17	45	53	66
Net Profit	869	1,194	1,300	1,467	1,830

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 13 Oct 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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