

Yunnan Baiyao (000538.CH)

Implementation of Composite-Ownership Reform Helps Enter New Stage of Development

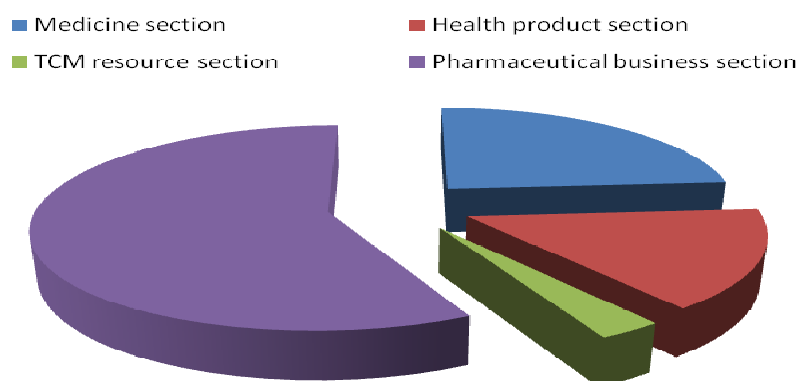
China | Pharmaceutical | Company report

6 January 2017

Strong Brand Extension Ability

Yunnan Baiyao started from producing and selling an anti-infective, hematostatic traditional Chinese medicine (TCM) "Baiyao". The Baiyao formula, a state-level secret, has no direct competitor and strong pricing ability. In recent years, the company has actively implemented the "medicine-centered" strategy of developing "New Baiyao, Great Health", focusing on boosting four major business sectors: in the medicine section, Yunnan Baiyao core/transdermal series are mature cash cow varieties, and the generic drugs are promoted steadily by a series of new products, such as Qixuekang oral solution and Xuesaitong capsule; the health product section focuses on promoting Yangyuanqing hair wash & care series and Qingyitang sanitary towel series, while ensuring the rapid growth of Baiyao toothpaste; the TCM resource section, in light of the resource edge of natural, genuine vegetable drugs from Yunnan, has built a complete industrial chain of raw materials; in addition, the company's pharmaceutical business section has made stable revenue contribution to the company via continuous channel improvement.

Sales Breakdown in 2015



Source: Company reports, Phillip Securities (HK) Research

It is worth mentioning that the company brand extension ability has been prominent in the new strategy promotion, and Yunnan Baiyao toothpaste has become a well-known brand, ranking among the top three in terms of market share and being the only homegrown brand in the top five taking the largest market shares. Therefore, the company has been a long-term champion among the pharmaceutical stocks over the past 10-odd years.

Implementation of Composite-Ownership Reform Helps Enter New Stage of Development

According to the announcement, New Hua Du intends to issue a capital increase of around RMB25.4 billion to the company's controlling shareholder Yunnan Baiyao Holdings Limited. When completed, Baiyao Holdings' ownership will be equally held by the SASAC of Yunnan Province and New Hua Du, each with a 50% equity, instead of being held by the SASAC of Yunnan Province exclusively. Meanwhile, Baiyao Holdings still holds 41.52% share of the company. This transaction also triggered a tender offer at the listed company.

BUY (Initially)

CMP: CNY 73.90
(Closing price as at 4 Jan 2017)
TARGET: CNY 90.60 (+22.6%)

COMPANY DATA

O/S SHARES (MN) :	1,041
MARKET CAP (CNYMN) :	76,930
52 - WK HI/LO (CNY):	76.15/53.50

SHARE HOLDING PATTERN, %

Yunnan Baiyao Holdings Limited :	41.52
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PRICE PERFORMANCE, %

	1M	3M	1Y
Yunnan Baiyao	6.41	6.41	1.45
HS300	9.74	2.05	12.84

PRICE VS. HS300



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	18722	20634	23158	25372
Net Profit	2506	2771	3077	3430
EPS, CNY	2.41	2.66	2.95	3.29
PER, x	30.66	27.78	25.01	22.44
BVPS, CNY	10.74	12.90	15.25	17.95
P/BV, x	6.88	5.73	4.84	4.12
ROE, %	24.80	22.51	20.86	19.73
Debt/Equity (%)	44.68	42.60	42.86	42.86

Source: Company reports, Phillip Securities Est.

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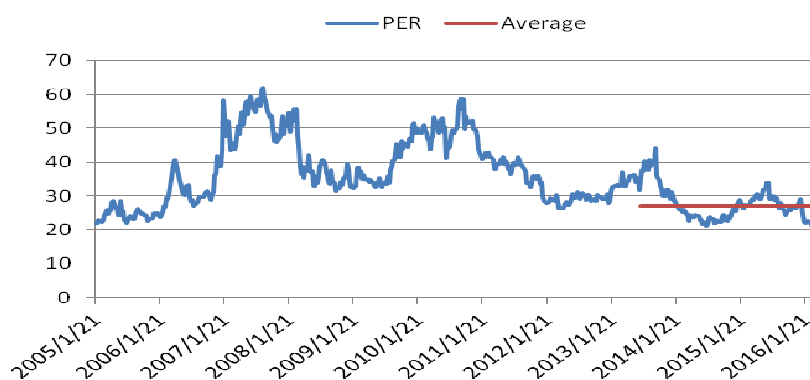
After the completion of the composite-ownership reform, the group will be state-owned and private-owned rather than solely state-owned, and the private owner has sufficient right of speech as a shareholder, which will contribute to Yunnan Baiyao's more flexible and market-oriented management (Baiyao Holdings' directors, supervisors and senior management will be recruited under the market-oriented principle) and lay the foundation for the listed company's future promotion of stock ownership incentive. At the same time, the company's external M&A is also expected to accelerate and new business development to step into a new stage. In the future, the company is expected to speed up businesses in precise medical care, pension & health care, medical services and other major health areas, thus promoting the company's entering a new stage of development.

It is notable that the reform has fully triggered a tender offer of Yunnan Baiyao, not at the cost of terminating the listing status of the company. The purchase price of up to RMB64.98, only 6.1% lower than that before the suspension, will provide strong support for the stock price.

Valuation Lower Than Counterparts

Yunnan Baiyao, a leading TCM enterprise in Mainland China, has attained significant results in implementing the Great Health strategy over the recent years. And the fast implementing speed and high efficiency of approval of the composite-ownership reform are rarely seen in the industry and expected to become the industry's benchmarking event. In light of the company's steady development of the original major businesses and profound resource value of brand, coupled with the development opportunity brought by the composite-ownership reform, we grant it an estimation of 27.5x EPS in 2017 and a target price of RMB90.6, with the "Buy" rating initially. (Closing price as at 4 Jan 2017)

Historical P/E Valuation



Source: Bloomberg, Phillip Securities (HK) Research

Peer Comparison

Ticker	Company Name	Mcap (M)	Performance(6M Ret)	P/E(2015)	P/E(2016F)	P/E(2017F)
600085 CH	BEIJING TONGRENTANG CO-A	42,378	5.32%	47.91	43.22	37.55
600436 CH	ZHANGZHOU PIENZEHUANG PHA-A	27,421	2.00%	58.77	46.14	36.65
600557 CH	JIANGSU KANION PHARMACEUTI-A	10,806	7.21%	29.63	27.61	23.63
600518 CH	KANGMEI PHARMACEUTICAL CO-A	87,467	16.52%	28.38	25.81	21.10
600329 CH	TIANJIN ZHONG XIN PHARM CO-A	11,246	4.23%	29.38	28.44	20.99
000423 CH	DONG-E-E-JIAOCO LTD-A	35,618	6.19%	21.92	19.61	16.85
002275 CH	GUILIN SANJIN PHARMACEUTI-A	10,948	1.59%	29.08	-	-
600535 CH	TASLY PHARMACEUTICAL GROUP-A	44,289	15.53%	29.70	29.55	25.60
600252 CH	GUANGXI WUZHOU ZHONGHENG G-A	15,985	6.22%	30.67	-	-
Average		31,795	7.20%	33.94	31.48	26.05
000538 CH	YUNNAN BAIYAO GROUP CO LTD-A	77,314	16.69%	26.77	25.00	21.80

Source: Bloomberg, Phillip Securities (HK) Research

Risks

The growth rate of everyday chemicals below expectations;
 Rising price of major raw materials;
 Results of the reform of state-owned enterprises below expectations.

Financials

Periodicity:	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings	33.19	30.66	27.78	25.01	22.44
Price to Book	8.52	6.88	5.73	4.84	4.12
Dividend Yield	0.45%	0.68%	0.81%	0.81%	0.89%
Per share data(CNY)					
EPS Adjusted	2.23	2.41	2.66	2.95	3.29
Book Value Per Share	8.67	10.74	12.90	15.25	17.95
Dividends Per Share	0.33	0.50	0.60	0.60	0.66
Growth & Margin					
Revenue growth	14.51%	18.96%	10.21%	12.23%	9.56%
Gross profit growth	11.29%	20.84%	11.55%	11.55%	9.25%
Net profit growth	46.71%	7.95%	10.56%	11.06%	10.29%
Gross Margin	29.36%	29.82%	30.18%	30.00%	30.20%
Operating Margin	12.47%	14.63%	14.57%	14.40%	14.60%
Net Profit Margin	14.75%	13.39%	13.43%	13.29%	13.52%
Dividend Payout Ratio %	14.97%	20.75%	22.56%	20.31%	20.04%
Key ratios					
Return on Assets	19.72%	17.15%	15.55%	14.61%	13.81%
Return on Equity	28.92%	24.80%	22.51%	20.86%	19.73%
Liability ratio	29.91%	30.88%	29.87%	30.00%	30.00%
Effective Tax Rate	14.06%	14.19%	14.30%	14.20%	14.20%
Income Statement(CNY: mn)					
Revenue	15,738	18,722	20,634	23,158	25,372
- Cost of Goods Sold	11,118	13,139	14,406	16,210	17,710
Gross Income	4,620	5,583	6,228	6,947	7,662
- Selling, General & Admin Expenses	2,658	2,844	3,221	3,613	3,958
Operating Income	1,962	2,739	3,006	3,335	3,704
- Interest Expense	21	46	79	70	60
- Net Non-Operating Losses (Gains)	-764	-217	-284	-300	-330
Pretax Income	2,701	2,910	3,215	3,567	3,974
- Income Tax Expense	380	413	460	506	564
Income Before XO Items	2,321	2,497	2,756	3,060	3,410
- Minority Interests	0	-9	-15	-17	-20
Net Profit	2,321	2,506	2,771	3,077	3,430

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 4 Jan 2017)

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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