

Luye Pharma (2186.HK)

Core Products Will Benefit from NDRL Revision

Hong Kong | Pharmaceutical | Company report

22 March 2017

Investment Summary

Varieties related to the company's core products, which have been removed from restriction conditions of medical insurance reimbursement or upgraded in National Drug Reimbursement List (NDRL), anticipates rapid growth. Previously the removal of channel inventories slackened growth, which is expected to recover gradually with NDRL revision. Also, consolidation of overseas acquisition in the financial statements and overseas products under research will drive mid- and long-term development of the company. We give an estimation of 18x EPS in 2017 and the target price of HK\$6.3, with the "Buy" rating initially. (Closing price as at 20 Mar 2017)

Buy (Initially)

CMP: HKD 4.95

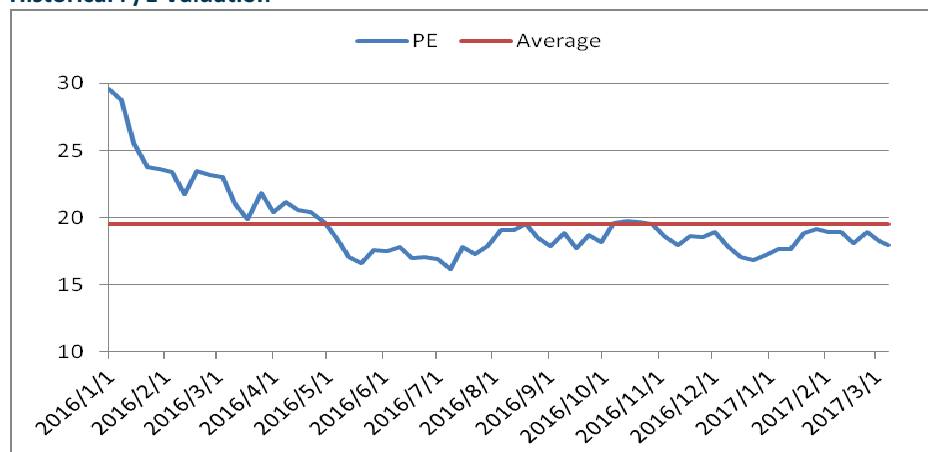
(Closing price as at 20 Mar 2017)

TARGET: HKD 6.30 (+27%)

COMPANY DATA

O/S SHARES (MN) :	3,321
MARKET CAP (HKDMN) :	16,439
52 - WK HI/LO (HKD):	6.1/4.37

Historical P/E Valuation



Source: Bloomberg, Phillip Securities (HK) Research

SHARE HOLDING PATTERN, %

Luye Pharma Investment Limited:	45.68
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PRICE PERFORMANCE, %

	1M	3M	1Y
Luye Pharma	-1.43	5.95	-8.50
HSI	-2.58	-4.45	-27.03

PRICE VS. HSI



Source: Phillip Securities (HK) Research

Historical P/E Valuation

Stock	Company	MV (HKD mn)	PE-TTM	PE-2016F	PE-2017F	PB
2196.HK	Fosun Pharma	73,748	21.20	22.23	19.89	2.97
1093.HK	CSPC Pharmaceutical	61,393	30.90	29.19	23.52	6.87
1177.HK	Sino Biopharmaceutical	49,062	25.69	24.13	22.68	5.53
1513.HK	Livzon Pharma	23,662	21.98	21.88	17.81	2.59
	Average		24.94	24.36	20.98	4.49
2186.HK	Luye Pharma	16,439	17.20	16.81	14.15	2.24

Source: Wind, Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	2544	2563	2883	3730
Net Profit	606	755	869	1033
EPS, CNY	0.20	0.23	0.26	0.31
PER, x	21.78	19.38	16.81	14.15
BVPS, CNY	1.48	1.71	1.97	2.28
P/BV, x	2.98	2.58	2.24	1.93
ROE, %	18.1	14.3	13.9	14.4
Debt/Equity (%)	21.7	21.6	25.0	25.0

Source: Company reports, Phillip Securities Est.

Core Products Will Benefit from NDRL Revision

Luye Pharma focuses on anti-tumor, cardiovascular, and digestive and metabolic products, which account for 97% of total revenues. According to the revised NDRL, three products, Calcitonin Injection, Sodium Aescinate Tablets and Smectite Dispersible Tablets, make their debut on the list; five are removed from restriction conditions of medical insurance reimbursement or have their restrictions loosened, including Xuezhikang Capsules, Sodium Glycididazole for Injection (sodium glycididazo) and Montmorillonite Powder, among others, and Acarbose Capsules (Beixi) is upgraded from B to A.

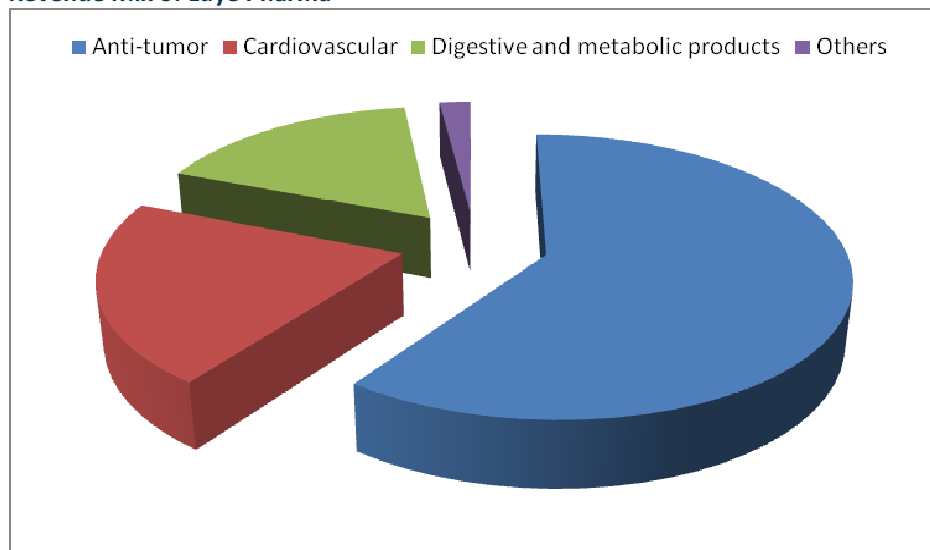
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Revenue Mix of Luye Pharma



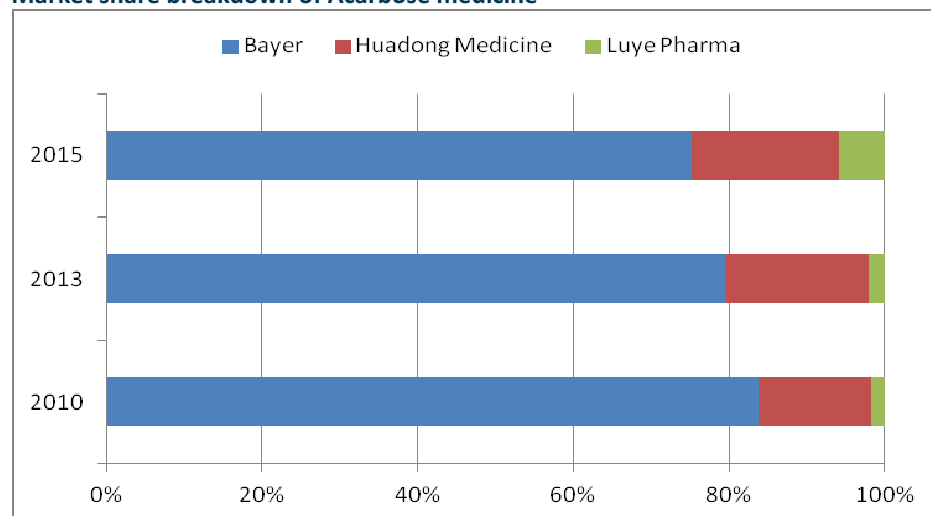
Source: Company reports, Phillip Securities (HK) Research

Besides the Paclitaxel Liposome for Injection, some core products have obtained policy support, which is expected to put the company on the fast-growth track again. First, the restriction of medical insurance reimbursement for occupational injury only is lifted for Sodium Glycididazo, the only domestic sensitizer for cancer radiation therapy approved by China Food and Drug Administration and a Category 1.1 new drug, sold only RMB34 million in 1H 2016. That the NDRL revision increases its applicable scope and market penetration will lead to a market size of over RMB100 million, a conservative estimation, and a premier variety worth RMB300 to 500 million by mid-term.

Second, the restriction of medical insurance reimbursement for occupational injury only is also lifted for Xuezhikang. The product, a pure, natural lipid-modulating proprietary Chinese medicine applicable to hypercholesteremia, is safer and has smaller side effects than statins. Its sales volume reached around RMB100 million in 1H 2016, making up a market share of under 3%, which grows at a roughly 20% annual rate. Notably, included in the low-price drugs, it anticipates a price raise. Coupled with the lifting of restriction conditions, we expect the product's continued high-speed growth.

Third, drugs for diabetes and oral hypoglycemic drugs constitute nearly 60% of domestic market, among which Acarbose makes up 34.6% of oral drugs, ranking first in sales volume. Among them, aside from Bayer original drugs, which accounts for a 75% market share, only domestic brands from Huadong Medicine and Luye Pharma have a finger in the pie, standing at around 19% and 6%, respectively. However, the market share of original drugs has dropped by 3-4 ppts annually due to its higher price, and the part has been shared equally by domestic brands. The upgrade of all domestic drugs on NDRL is likely to speed up their replacement of original drugs. The sales volume of Beixi in 1H 2016 is around RMB200 million and is expected to rise by 20% per year.

Market share breakdown of Acarbose medicine



Source: Company reports, Phillip Securities (HK) Research

Paclitaxel Liposome for Injection Anticipates Steady Growth

The company's premier product, Paclitaxel Liposome for Injection, reports an annual sales volume of over RMB1.5 billion, and is the only paclitaxel liposome product approved to be sold on the global market. It has been listed on 26 provincial drug reimbursement lists, though being kept outside of NDRL, and ranks first among domestic anti-tumor drugs. Although it only makes up around 20% of the taxol drug market due to its higher price over traditional taxol drugs, the latter may cause severe anaphylactic reactions, leading to further market changes. Its competitor, nanoparticle albumin-bound paclitaxel, roughly doubles its price and has entered only several provincial drug reimbursement lists, thereby gaining a limited edge.

Global Strategy Supports Mid- and Long-term Growth

In July 2016, the company entered into a purchase agreement with Acino, Switzerland, to acquire the entire issued share capital of its Acino AG and Acino Supply AG for EUR245 million, which was completed on November 30. The target revenue for the year 2015 is EUR67.3 million and the net profit is EUR16.2 million.

Acino AG, a world's leading transdermal delivery system (TDS) company, is strong in manufacturing and quality control with certification provided by the European Union's Good Manufacturing Practice (EU-GMP) and high-quality plant certification by the US Food and Drug Administration (USFDA). And it has many partners around the globe. We believe the acquisition will back up the company's strategy for development and globalization in many aspects.

In addition, the company's has seven products in research outside the country, of which the five in the US are in clinical trial, including Risperidone for Depot Suspension (LY03004), which is expected to be launched in 2H18. The product, mainly used for the treatment of schizophrenia and bipolar disorder by injection for once every two weeks, can effectively simplify the treatment of schizophrenia and improve medication compliance commonly seen among schizophrenia patients orally taking antipsychotic drugs. We expect that the launch of overseas products one after another will support the

company's mid- and long-term growth and contribute annual revenue of hundreds of millions of US dollars.

Risks

Drug promotion on the US market below expectations;
High pressure of Paclitaxel Liposome for Injection promotion brought by the launch of competitive products;
Results of the merged and acquired enterprises below expectations.

Financials

FYE	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings	-	21.78	19.38	16.81	14.15
Price to Book	-	2.98	2.58	2.24	1.93
Per share data(RMB)					
EPS Adjusted	-	0.20	0.23	0.26	0.31
Book Value Per Share	-	1.48	1.71	1.97	2.28
Growth& Margin					
Revenue growth	-	1.1%	0.8%	12.5%	29.4%
Gross Profit growth	-	-1.9%	1.3%	17.4%	27.6%
Net Profit growth	-	95.0%	24.6%	15.2%	18.8%
Profitability Ratios					
Gross Margin	83.6%	81.0%	81.4%	85.0%	83.8%
Net Profit Margin	12.3%	23.8%	29.4%	30.2%	27.7%
Dividend Payout Ratio %	30.3%	5.7%	30.9%	30.7%	29.8%
Key Ratios					
Return on Assets	10.2%	12.7%	11.4%	11.3%	11.5%
Return on Equity	19.2%	18.1%	14.3%	13.9%	14.4%
Effective Tax Rate	14.4%	15.3%	14.9%	15.0%	15.0%
Liability ratio	44.0%	17.8%	17.8%	20.0%	20.0%
Income Statement(RMB: mn)					
Revenue	2,515	2,544	2,563	2,883	3,730
- Cost of Goods Sold	414	483	476	432	604
Gross Income	2,102	2,061	2,087	2,451	3,126
- Selling, General & Admin Expense	1,728	1,391	1,323	1,540	2,033
Operating Income	405	719	831	989	1,183
- Interest Expense	24	40	16	27	30
- Net Non-Operating Losses (Gain)	-5	-37	-99	-110	-120
Pretax Income	383	726	898	1,037	1,233
- Income Tax Expense	55	111	133	156	185
Income Before XO Items	328	614	765	881	1,048
- Minority Interests	17	9	10	12	15
Net Profit	310	606	755	869	1,033

Source: Company, Phillip Securities (HK) Research Estimates

(Financial figures as at 20 Mar 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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