

# Haohai Biological Technology (6826.HK)

## Epitaxial Acquisition Leads New Impetus to the Development of Ophthalmic Business

10 July 2017

Hong Kong | Pharmaceutical | Company report

### Investment Summary

Overall speaking, Haohai's core products take leading positions in the market. Relying on broad market in medical cosmetology, ophthalmology and other fields, the company is expected to maintain fast growth. With R & D strengths, the company gains a momentum of sustainable development. With over RMB2 billion in cash, it also enjoys a promising prospect for the expansion and M&A. We offer the company an estimation of 18x EPS in 2017, with a target price of HKD51.2, to maintain "Buy" rating. (Closing price as at 6 July 2017)

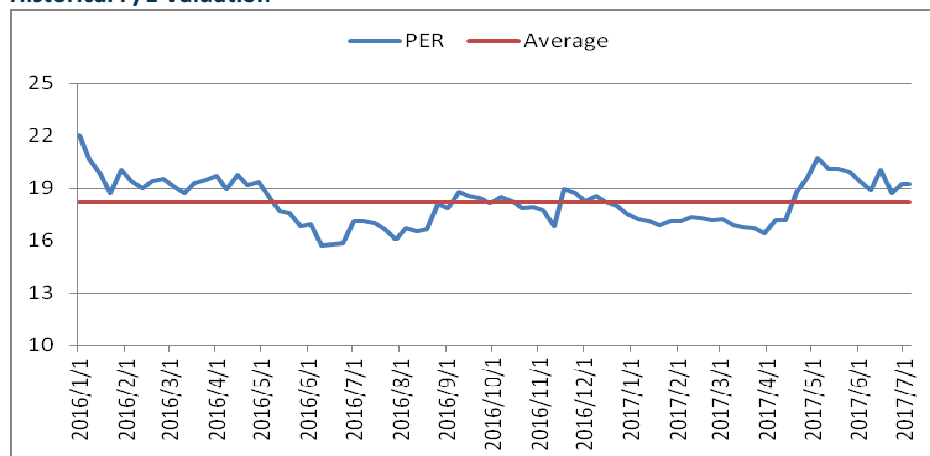
### Buy (Maintain)

CMP: HKD 41.60  
(Closing price as at 6 July 2017)  
TARGET: HKD 51.20 (+23%)

#### COMPANY DATA

O/S SHARES (MN) : 160  
MARKET CAP (HKDMN) : 6,658  
52 - WK HI/LO (HKD): 45.87/33.05

### Historical P/E Valuation



Source: Bloomberg, Phillip Securities (HK) Research

#### SHARE HOLDING PATTERN, %

Jiang Wei: 47.23

#### PRICE PERFORMANCE, %

	1M	3M	1Y
Haohai Biological	-1.86	15.93	17.22
HSI	-0.03	10.79	-7.30

#### PRICE VS. HSI



Source: Phillip Securities (HK) Research

### Peer Comparison

Ticker	Company	MV (HKD: mn)	PE-TTM	PE-2017F	PE-2018F	PB
1530.HK	3SBio	26,083	-	24.73	19.22	3.58
0867.HK	China Medical System	32,415	21.09	17.57	15.07	4.67
1513.HK	Livzon Pharmaceutical	29,773	22.10	10.13	16.20	2.70
0963.HK	Bloomage Biotechnology	5,515	21.64	17.62	14.80	3.18
	<b>Average</b>		<b>21.61</b>	<b>17.51</b>	<b>16.32</b>	<b>3.53</b>
6826.HK	Haohai	6,750	19.11	14.63	12.74	2.01

Source: Wind, Phillip Securities (HK) Research

#### KEY FINANCIALS

CNY mn	FY15	FY16	FY17E	FY18E
Net Sales	664	851	1338	1628
Net Profit	273	311	406	467
EPS, CNY	1.86	1.91	2.49	2.87
PER, x	19.62	19.11	14.63	12.74
BVPS, CNY	16.63	18.14	20.64	22.91
P/BV, x	2.19	2.01	1.77	1.59
ROE, %	16.8	10.8	12.7	13.2
Debt/Equity (%)	5.9	23.7	25.0	25.0

Source: Company reports, Phillip Securities Est.

### Rapid Development of Major Business in 2016

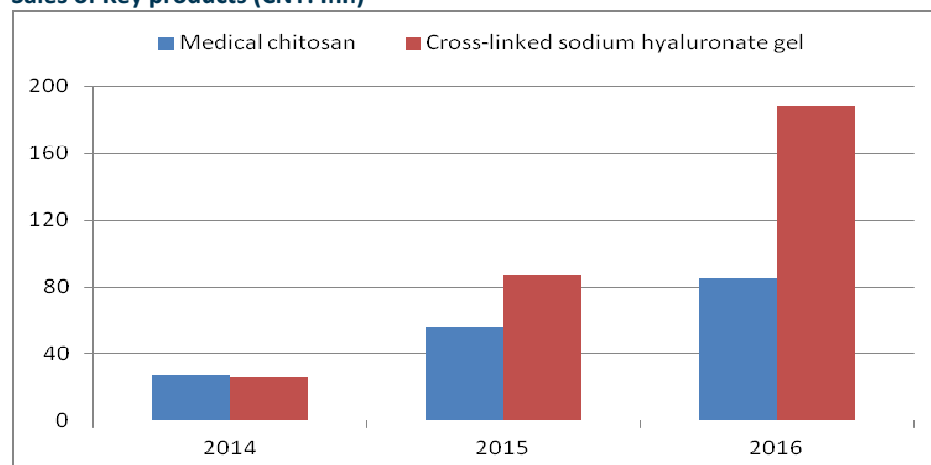
The revenue and net profit of Haohai Biological Technologies in 2016 reached RMB850 million and RMB310 million, respectively, representing year-on-year increase of 28.2% and 11.5%, respectively. Although the company's performance growth is slower than that of revenue, mainly due to a year-on-year drop of approximately RMB20 million in exchange gains, the major business still has achieved a rapid growth as a whole. In terms of orthopaedic products, sodium

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hyaluronate injection accounts for the largest proportion of the total revenue, whose revenue fell 11.2%, with the proportion decreasing from 34.3% in 2015 to 23.8%, mainly because the fall in the bidding price led to a decline of more than 10% in average selling prices. Besides, the tendering work has not finished yet in many cities and provinces and dealers show inert interest in purchase. However, at present suppliers are in low inventory, and future shipments are expected to rise by single digit. On the contrary, the revenue of another orthopaedic product called medical chitosan increased by 50.9% to RMB84.88 million. As a unique product of the company, with prominent competitive advantage, it has entered into Beijing, Shanghai, Guangdong and Shandong Province, etc. Almost unaffected by tender, the current 10% proportion of the total revenue now is estimated to rise considerably in the medium term.

In terms of medical aesthetics and wound care products, as of 2016, fifteen hyaluronic acid (HA) dermal fillers had been on the market. The revenue of the star product "Haiwei" rose by 115% to RMB190 million, taking up 22% of total from 13.1% in 2015. Moreover, developed independently by the company, the second-generation Janlane has earned the Machinery Registration Certificate of CFDA in September 2016 and came into the market at the end of 2016. Haiwei applies to facial wrinkles and folds while Janlane goes for lips and cheeks. The product mix, complementary and differentiated, is hopeful to help achieve a high-speed development by over 50%.

#### Sales of Key products (CNY: mn)



Source: Company reports, Phillip Securities (HK) Research

### Epitaxial Acquisition Leads New Impetus to the Development of Ophthalmic Business

In 2016, the revenue of ophthalmic products also increased by 65.9% to RMB120 million, accounting for 14.1%, up from 10.9% previously, which was attributed to the ongoing acquisitions of ophthalmic enterprises. The company successively completed the acquisition of a 60% stake in Shenzhen New Industries, Henan Universe, 100%, Zhuhai Etam, 98%, etc. and gradually moved into high-valued ophthalmic consumables business.

In April 2017, the company continued to announce a 70% stake acquisition of Contamac, a contact lens and IOL(intraocular lens) material manufacturing company in UK, with a purchase consideration of approx. HKD240 million, corresponding to 12.8x EPS in 2017. And with earlier acquisitions, the company has developed the capability of producing three types of ophthalmic viscoelastics, five intraocular lens, one eye drops as well as raw material of

IOL and has basically finished the industrial chain layout of the cataract surgery industry. Cataracts are the leading cause of blindness of the public in China. At present, only 1,500 people per million people have received cataract surgery in China, falling far behind America and India, with the number of 9000 and 6000, respectively. This industry, therefore, enjoys an enormous potential for development. We expect ophthalmic business will be a new impetus to the development of the company.

### **New NDRL is beneficial to expand product market**

In late February 2017, RHEGF (Recombinant Human Epidermal Growth Factor) was adjusted into category B drug in terms of the new NDRL(national drug reimbursement list) from the restrictions for the use of medicines in work-related injury insurance. It is the only EGF product with the same structure as natural amino acid in human body in the country. Registered as a kind of new drug in 2001, rhEGF won the second prize of National Scientific and Technological Progress Award in 2002 and with a market share of 16.2% in 2015. In the past two years, rhEGF contributed approx. RMB36 million to the company's total revenue, accounting for about 5%. We believe that the adjustment of the restrictions for the use of medicines is beneficial to expand the new market for this product. From the beginning of 2018, its contribution is expected to increase faster.

### **Risks**

The price reduction on products exceeds expectations;  
The promotion of the new products fails to meet expectations;  
The performance of M&A enterprises falls short of expectations.

## Financials

FYE	2014	2015	2016	2017F	2018F
<b>Valuation Ratios</b>					
Price Earnings	23.85	19.62	19.11	14.63	12.74
Price to Book	7.37	2.19	2.01	1.77	1.59
Dividend Yield	0.0%	1.1%	1.4%	1.6%	1.9%
<b>Per share data(CNY)</b>					
EPS Adjusted	1.53	1.86	1.91	2.49	2.87
Book Value Per Share	4.95	16.63	18.14	20.64	22.91
Dividend Per Share	0.00	0.40	0.51	0.60	0.70
<b>Growth&amp; Margin</b>					
Revenue growth	28.6%	28.7%	28.2%	57.2%	21.7%
Gross Profit growth	30.0%	24.2%	27.0%	51.7%	19.7%
Net Profit growth	30.4%	48.9%	13.8%	30.6%	14.9%
<b>Profitability Ratios</b>					
Gross Margin	87.2%	84.2%	83.4%	80.5%	79.2%
Net Profit Margin	35.6%	41.2%	36.5%	30.4%	28.7%
<b>Key Ratios</b>					
Return on Assets	26.7%	15.3%	9.4%	10.2%	10.5%
Return on Equity	32.6%	16.8%	10.8%	12.7%	13.2%
Effective Tax Rate	14.9%	14.8%	15.0%	20.0%	20.0%
Liability ratio	21.0%	5.5%	19.1%	20.0%	20.0%
<b>Income Statement(CNY: mn)</b>					
<b>Revenue</b>	<b>516</b>	<b>664</b>	<b>851</b>	<b>1,338</b>	<b>1,628</b>
- Cost of Goods Sold	66	105	142	261	339
<b>Gross Income</b>	<b>450</b>	<b>559</b>	<b>710</b>	<b>1,077</b>	<b>1,290</b>
- Selling, General & Admin Exp	265	337	433	682	830
<b>Operating Income</b>	<b>212</b>	<b>253</b>	<b>305</b>	<b>438</b>	<b>513</b>
- Net Non-Operating Losses (G	-4	-39	-59	-60	-60
<b>Pretax Income</b>	<b>216</b>	<b>321</b>	<b>366</b>	<b>508</b>	<b>583</b>
- Income Tax Expense	32	47	55	102	117
<b>Income Before XO Items</b>	<b>184</b>	<b>273</b>	<b>311</b>	<b>406</b>	<b>467</b>
- Minority Interests	0	0	6	7	8
<b>Net Profit</b>	<b>184</b>	<b>273</b>	<b>311</b>	<b>406</b>	<b>467</b>

Source: Company, Phillip Securities (HK) Research Estimates  
 (Financial figures as at 6 July 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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