

CSPC Pharmaceutical (1093.HK)

Acquiring Biotechnology Company Wuhan YZY

Hong Kong | Pharmaceutical | Company report

5 February 2018

Investment Summary

- Acquiring a biotechnology company;
- Proposed spin-off and listing of XNW on Mainland GEM;
- One product was recognized as orphan-drug in US.

Business Overview

Strong growth expectation. We highlight that the company recorded notable revenue growth in 17Q3 (+24.9% YoY in RMB terms) beyond our expectation. We attribute this to 1) sales hike and rising share of innovative drugs; 2) Caffeine segment reported fast growth and newly-acquired glucose business made more contribution; 3) Vitamin C sales continued to climb. GPM increased by 8.3ppts (17Q3 58.46%, 16Q3 50.17%) due to share of innovative drugs rose which enjoyed higher profit margin. The management expect bottom line to maintain 20%-30% growth in 17E/18E.

Figure: 17Q3 sales breakdown

HKD mn	17Q3	16Q3	Change	Change in RMB terms
Revenue	11,208	9,250	21.2%	24.9%
Finished Drug	8,176	7,012	16.6%	-
-Innovative drugs	4,655	3,506	32.8%	36.8%
-Common generic drugs	3,521	3,126	12.6%	16.2%
Bulk drug segment	3,032	2,618	15.8%	-
-Antibiotics API	914	1,020	-10.4%	-7.5%
-Vitamin C API	1,334	1,021	30.7%	34.3%
-Caffeine API and others	783	577	35.7%	40.1%
GPM	58.46%	50.17%	+8.3ppts	-
OPM	23.20%	21.47%	+1.7ppts	-
NPM	18.23%	16.95%	+1.3ppts	-

Source: Company, Phillip Securities

Innovative drugs developing quickly. We are positive on bright outlook of innovative drug business. On NBP, both capsules and injection have entered NDRL in 2017 while we still see quite growth potential of NBP injection in future. Oulaining capsule has entered 12 PDRLs while lyophilized powder injection is included in 21 PDRLs. Xuanning, for the treatment of hypertension and angina pectoris, is expected to maintain stable growth as the roll-out of chronic disease management and national tiered medical system. Meanwhile, we highlight that oncology portfolio may serve as a key momentum given Duomeisu and Jinyouli both reported obvious growth in 2017. During first three quarters in 2017, Duomeisu achieved HKD0.36bn sales growing by 44%. It is a drug for treatment of lymphoma, multiple myeloma, ovarian cancer and breast cancer, with less side effects than traditional medicines. Now Duomeisu entered into only three PDRLs. We expect Duomeisu sales to exceed one billion HKD in future with expanding coverage and inclusion into more PDRLs. On Jinyouli, it reported HKD0.26bn (+168% YoY) in 17Q3 and was just selected into new NDRL in 2017. We highlight Jinyouli's potential to achieve high growth in future with further implementation of NDRL.

Accumulate

CMP HKD17.06

(Closing price at 1 Feb 2018)

TARGET HKD19.4 (+14%)

COMPANY DATA

O/S SHARES (MN) :	6,243
MARKET CAP (HKDMN) :	108,378
52 - WK HI/LO (HKD):	18.7 / 8.51

SHARE HOLDING PATTERN, %

Director Cai Dong Chen	22.89
Common Success	6.78

PRICE PERFORMANCE, %

	1M	3M	1Y
CSPC	8.11	24.71	92.77
HIS	9.14	14.19	42.68

RETURN VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

HKD mn	FY15	FY16	FY17E	FY18E
Net Sales	11,394	12,369	14,959	17,663
Net Profit	1,665	2,101	2,783	3,383
EPS, HKD	0.28	0.35	0.46	0.56
PER, x	60.93	48.74	37.11	30.52
BVPS, HKD	1.48	1.67	2.01	2.40
P/BV, x	11.53	10.22	8.51	7.12
ROE, %	19.80	22.30	22.93	23.32

Source: Company reports, Phillip Securities Est.

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Acquiring YZY, a biotechnology company. CSPC proactively explores biologic field. Its subsidiary CSPC NBP entered an agreement to acquire 39.56% shares of Wuhan YZY at a consideration of HKD203.57mn. And CSPC will make additional payment up to RMB55mn once milestone events happen. YZY is a biotechnology company engaged in the development of innovative biopharmaceutical drugs, including anti-tumor bispecific antibodies. One bispecific antibody in its product pipeline has obtained clinical trial approval, and another bispecific antibody for clinical trial has been submitted in PRC.

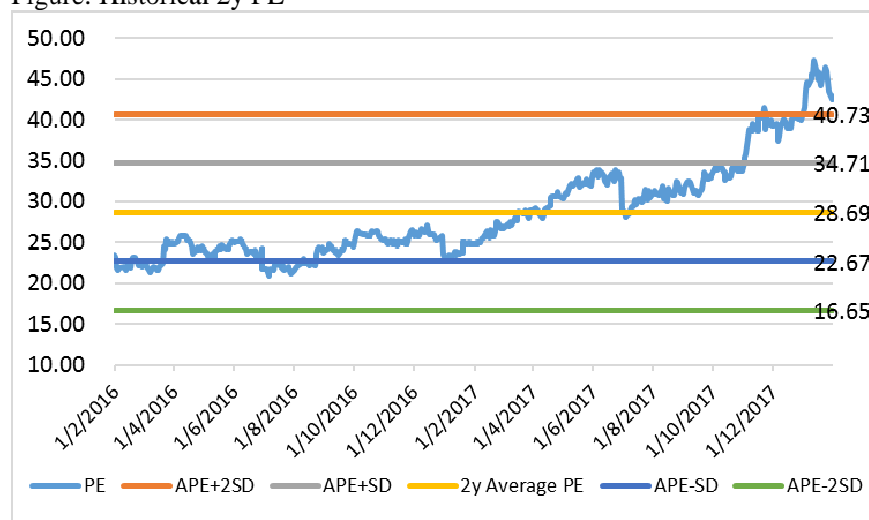
Proposed spin-off and listing of XNW on Mainland GEM. XNW is engaged in manufacture and sales of caffeine and vitamin C health supplement and beverage products. CSPC is going to separate XNW (one of indirect subsidiaries) to list on PRC GEM. XNW has already submitted an application to CSRC for proposed A share listing on GEM. After fulfillment of listing, the equity interest of CSPC in XNW will decrease to 75%.

One product was recognized as orphan-drug in US. Orphan-drug is the medicine for treatment of rare disease. In Sep 2017, one product MHL (鹽酸米托蒽醌脂質體) was granted orphan-drug designation by US FDA. This liposome formulation has better efficacy and safety with less side effects. The designation implies that more guidance may be given by US FDA and even part of clinical trials could be waived to speed up product launch. Meanwhile, orphan drugs enjoy exclusive marketing rights for 7 years and tax credits of up to 50% of R&D expenses. The clinical research of MHL is processing in US and we expect the simultaneous application for production approval in China and US by 2020.

Valuation Thesis & Risks

We conservatively predict the topline growth to be 21%/18% in 17E/18E. Assuming relatively stable profit margin, we estimate 17E EPS to be HKD0.46 and 18E HKD0.56. We select 36 pharmaceutical firms listed in HK and Mainland with market cap over HKD30bn, and get industry average PE to be 31x in HK and 39x in Mainland market (excluding outliers). Thus we see average PE range for pharmaceutical firms should be 31x-39x currently. We also highlight that CSPC has higher ROE than HK and Mainland peers (CSPC 23.8%, HK peers 16.5%, Mainland peers 17.34%). We conservatively assume PE 34.7x (par to 2-y historical average PE + 1*SD) and derive 2018E TP 19.4HKD. **Risks:** 1) Sales growth and R&D fail expectation; 2) Spin-off effect; 3) Policy risks.

Figure: Historical 2y PE



Source: Company, Phillip Securities

Figure: H&A share pharmaceutical firms (H share: HKD; A share: RMB)

Ticker		Mkt Cap/mn @Jan 30	P/E @Jan 30	1H17 Revenue Growth	1H17 NI Growth	1H17 EPS /Cents	1H17 ROE%
1093	HK	104,758.00	42.98	17.18	27.12	24.16	23.81
H Share							
Average		63,251.32	30.99	15.25	24.10	14.62	16.50
Median		60,701.14	30.25	16.98	24.41	16.82	13.42
Highest		110,738.00	287.23	59.47	39.23	45.45	24.49
1177	HK	110,738.00	43.43	10.56	25.70	25.74	22.19
2269	HK	66,138.26	287.23	59.47	9.95	0.00	-
3320	HK	65,861.63	20.03	9.42	10.66	-17.14	9.59
874	HK	55,540.65	15.67	2.11	39.23	10.56	13.42
867	HK	42,233.46	22.22	23.39	23.12	23.09	24.49
1530	HK	38,995.92	38.27	30.80	36.92	45.45	12.82
A Share							
Average		43,415.43	39.51	15.45	23.14	23.18	17.34
Median		38,046.80	32.33	14.64	15.32	13.60	16.39
Highest		104,509.00	148.52	139.99	1,326.96	1,000.00	31.81
600518	CH	104,509.00	26.06	18.45	21.83	8.98	14.40
000538	CH	103,338.00	32.79	14.22	12.75	12.78	19.67
600196	CH	99,232.33	31.77	20.34	12.58	7.69	13.76
002252	CH	98,858.05	73.99	-16.94	9.30	7.23	14.25
000963	CH	52,999.79	30.72	15.06	26.53	24.27	23.26
002001	CH	49,242.28	34.59	12.52	13.62	128.05	16.59
300122	CH	48,176.00	148.52	139.99	1326.96	1000.00	7.43
600085	CH	46,506.56	46.79	9.54	6.49	6.33	12.58
600436	CH	44,289.52	60.30	82.75	41.83	41.18	19.02
000423	CH	42,504.86	22.82	9.67	8.75	8.74	24.10
002411	CH	40,728.10	45.79	-5.86	-5.91	-11.62	11.22
002294	CH	40,334.38	27.99	7.14	5.19	6.06	28.62
600867	CH	39,770.53	48.45	32.07	30.21	25.22	22.29
600535	CH	39,491.39	29.83	13.21	10.43	11.10	15.81
000513	CH	36,602.20	9.16	13.07	23.21	14.42	15.26
002773	CH	36,312.95	58.01	17.34	30.84	31.00	19.41
603858	CH	34,069.55	17.50	11.74	12.03	0.57	18.48
600566	CH	33,769.42	29.06	19.16	32.10	28.39	31.81
300142	CH	30,010.77	102.19	-12.97	73.43	75.00	7.13
000661	CH	29,652.27	50.92	28.41	32.25	12.08	14.43
600521	CH	27,615.57	45.82	17.71	14.12	16.00	12.79
600201	CH	26,920.65	30.64	20.99	36.46	26.00	24.84
000623	CH	26,801.85	15.22	0.05	8.70	7.87	9.54
000999	CH	25,774.44	20.27	16.37	16.52	16.92	15.03
002007	CH	25,716.92	32.57	17.53	5.07	5.05	19.73
002019	CH	25,443.02	22.13	6.73	32.04	33.33	23.28
300146	CH	24,639.69	32.09	20.52	62.29	60.00	16.19
300558	CH	24,428.92	59.02	-4.14	-35.45	-42.37	18.97

Financials

Key Ratios	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation Ratios					
Price to Earnings (P/E)	81.24	60.93	48.74	37.11	30.52
Price to Book (P/B)	12.45	11.53	10.22	8.51	7.12
Per Share Data (HKD)					
EPS	0.21	0.28	0.35	0.46	0.56
Book Value Per Share	1.37	1.48	1.67	2.01	2.40
Dividend Per Share	0.1	0.11	0.12	0.14	0.17
Growth & Margins (%)					
Growth					
Revenue	10.11	4.00	8.56	20.94	18.08
Operating Income	33.65	24.68	20.84	35.15	20.15
Net Profit	30.39	31.29	26.15	32.48	21.56
Margins					
Gross Profit Margin	38.22	45.82	51.00	58.00	58.00
Operating Profit Margin	15.25	18.96	21.40	23.58	24.58
Net Profit Margin	11.58	14.62	16.98	18.61	19.15
Returns					
ROE (%)	16.33	19.8	22.3	22.93	23.32
ROA (%)	10.27	12.79	14.85	15.82	16.09
Income Statement (HKD Mn)					
Revenue	10,955	11,394	12,369	14,959	17,663
- Cost of Goods Sold	(6,768)	(6,173)	(6,060)	(6,432)	(7,419)
Gross Income	4,187	5,221	6,309	8,526	10,245
- Operating Expenses	(2,516)	(3,061)	(3,662)	(4,998)	(5,903)
Operating Income	1,671	2,160	2,647	3,528	4,341
- Net Non-Operating Gain	(50)	(48)	(11)	(35)	(43)
Pretax Income	1,622	2,112	2,635	3,493	4,298
- Income Tax Expenses	(337)	(432)	(522)	(699)	(903)
- Minority Interest	(16)	(14)	(12)	(11)	(12)
Net Profit	1,268	1,665	2,101	2,783	3,383

Source: Bloomberg, Phillip Securities (HK) Research Estimates

(Financial figures as at 1 Feb 2018)

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

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