

# China Medical System (867.HK)

## Solid 2017 Results with Potential Catalyst from Pipeline

Hong Kong | Pharmaceutical | Company report

9 April 2018

### Investment Summary

CMS reported strong 2017 results with decreasing expense ratios. Going forward, we highlight that current core products will grow stably in addition that expected progresses in pipeline may become possible explosive catalyst for stock price. We fine tune financial data to derive 18E/19E EPS of RMB0.77/0.86, and with target PE 23.45x (par to 2-year historical average plus 1x SD) we increase TP to HKD21.97, BUY recommendation. (Closing price as at 4 Apr 2018)

### Robust 2017 Results

The company reported revenue of RMB5348.8mn (+9.1% YoY), mainly attributable to sales hike in 2017 (excluding Two-invoice System effect, topline RMB5578.6mn, +21.2% YoY). GPM rose from 59.4% to 65%, however, excluding TIS effect there is 1% decrease in GPM, given ASP down by 1.9pp. We see efficient cost control measures, given EBITDA margin increased by 0.7pp, with percentage of selling/administrative expenses in revenue dropping by 0.8pp, as well as stable NPM. We see climbing inventory days and A/R days, mainly due to TIS effect (lower COGS) according to the management, which drew down turnover and added turnover days. Meanwhile, ROE rose by 0.9pp to 24.6% with stable payout ratio 40%.

### Products Updates

**Plendil**, included in NDRL, is for the treatment of hypertension and stable angina pectoris. On comparable basis, Plendil sales recorded ~8% YoY growth covering 26,000 hospitals and medical institutions (2016: 20,000). Since CMS took over Plendil asset, the company changed the down revenue trend when it belonged to AstraZeneca. Given much bigger market size of current comparable drugs, we highlight the great potential of Plendil to grow in future.

**Xinhuosu**, Class I biological agent used to treat acute heart failure, is the only rhBNP currently in China market. It entered NDRL through negotiation in Jul 2017, thus its ASP dropped by 40% while sales volume surged. Management indicated that Xinhuosu was estimated to grow by 36% YoY excluding the price cut effect. Resulting from price cut with TIS effect, the product reported negative growth in 2017 (-23.4% YoY). We highlight there will be a tradeoff between price cut and sales volume hike. We expect notable and positive growth in 2018E.

**Deanxit**, introduced in 1997 and ranked NO.1 in market share of antidepressant drugs in China, reported sluggish sales growth (+3.4%) in 2017. Given the company will strengthen promotion and management, we expect high-digital to low-teen growth for Deanxit in 2018E.

**TCM products** (Danshentong, Nuodikang, Ganfule) grew slowly or negatively in 2017. The management attributed this to policies and lack of medial evidences for promotion. After adjustments for compliance requirements, CMS is going to boost TCM products sales through further localizing its distribution network.

**Others.** Main products (including Ursofalk, Salofalk, Bioflor, Stulln, etc.) reported notable YoY growth higher than 20%. New products introduced during recent years, also grew dramatically, though insignificant sales volume currently. We expect them to contribute more to revenue in future.

### BUY

CMP HKD17.82

(Closing price at 4 Apr 2018)

TARGET HKD21.97 (+23%)

#### COMPANY DATA

O/S SHARES (MN) :	2,487
MARKET CAP (HKDMN) :	44,670
52 - WK HI/LO (HKD):	19.96 / 12.22

#### SHARE HOLDING PATTERN • %

Director Lam Kong	43.53
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#### PRICE PERFORMANCE • %

	1M	6M	1Y
CMS	9.33	23.75	26.92
HIS	-4.39	3.73	21.64

#### RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

#### KEY FINANCIALS

RMB mn	FY16	FY17	FY18E	FY19E
Net Sales	4,900.8	5,348.8	6,039.8	6,794.2
Net Profit	1,375.9	1,674.8	1,903.6	2,141.3
EPS, RMB	0.55	0.67	0.77	0.86
PER, x	26.27	21.67	19.01	16.90
BVPS, RMB	2.50	2.95	3.41	3.92
P/BV, x	5.82	4.94	4.27	3.71
ROE, %	22.16	22.79	22.47	21.95

Source: Company, Phillip Securities Est.

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Figure: CMS Product Mix under Direct Academic Promotion Network

Drugs	Function	Year of Introduction	Hospital Coverage	% in Sales	NDRL
Plendil	Hypertension and stable angina pectoris	2016	26,000	24.1%	Yes
Deanxit	Mild to moderate depression and anxiety	1997	21,000	17.7%	Yes
Ursofalk	Cholesterol gallstones in the gallbladder, cholestatic liver disease and biliary reflux gastritis	1998	9,400	17.9%	Yes
XinHuoSu	Acute heart failure	2008	1,900	7.7%	Yes
Salofalk	Ulcerative Colitis and Crohn's disease	2008	3,900	5.5%	Yes
Bioflor	Diarrhea in adults and children	2010	3,000	4.9%	-
Stulln	Senile macula degeneration and asthenopia	2007	7,000	4.1%	-
DanShen-Tong	Antisepsis and anti-inflammation	2015	4,000	2.8%	Yes
Hirudoid	Blunt traumata	2015	6,000	2.4%	PDRL
NuoDiKang	Activating blood circulation, freeing blood vessels, alleviating pain, Coronary heart disease and angina	2015	3,700	1.9%	Yes
Combizym	Dyspepsia	2015	1,300	1.3%	Yes
GanFuLe	Liver cancer, cirrhosis and liver fibrosis	2008	-	0.8%	Yes
Imdur	Anti-ischemic	2016	8,000	0.7%	Yes
Parlodel	Hyperprolactinaemia	2014	1,300	-	Yes
Lamisil	Superficial fungal infection	-	-	-	Yes
Movicol	Constipation	-	-	-	-
Total	-	-	-	92.4%	-

Source: Company, Phillip Securities

## Pipeline Progresses

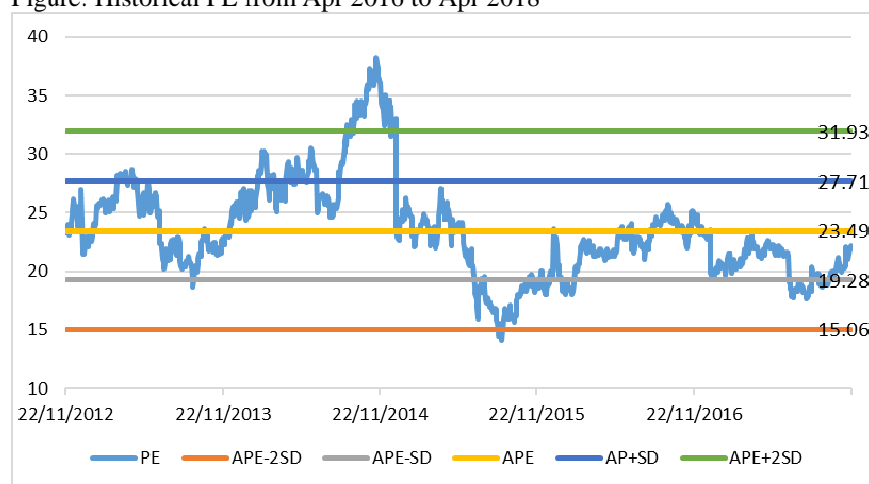
There are three main series in pipeline. 1) **CMS024**: it is for treatment of liver cancer, national Class I new drug. Currently, the research company is conducting phase III extended clinical-trial and it is in the patient recruitment stage. The listed firm will pay loyalty fee (13% of sales) to the research firm without bearing R&D risks. 2) **Traumakine**: for ARDS with huge market potential, developed by Faron, a Finland firm. The listed firm owns its rights in China. The patient data for phase I/II will be unblinded in Apr 2018. If the result is positive, we expect it to be commercialized in two years. 3) **Destiny Pharma portfolio**: Product XF-73, a kind of nasal gel with numerous potential target patients, has accomplished phase I/IIa clinical-trial in Europe and US; other two products (XF-70 & DFD-207) are in pre-clinical stage and to be developed to treat skin infections and ocular microbial infections.

## Investment Thesis, Valuation & Risk

**Our valuation model gives target price of HK\$21.97.** We highlight future growth momentum coming from increasing penetration of current hospital coverage and possible explosive contributor from pipeline. Comparing with HK listed peers, the company enjoys advanced ROE and NPM, thus we appreciate its stock valuation. Excluding possible pipeline contribution, we assume efficient expenses control and predict 18E/19E EPS to be RMB0.77/0.86, based on current product mix potential. Given target PE 23.45x (par to 2-y historical average plus 1\* SD), we given target price of HKD21.97, BUY recommendation. (Exchange rate= 0.8166 RMB/HKD)

**Risks include:** R&D fail expectations; Policy risks; Foreign currency risk; Fierce competition.

Figure: Historical PE from Apr 2016 to Apr 2018



Source: Bloomberg, Phillip Securities

Figure: Comparable firms

Code	Firm	Mkt Cap /HKD mn	PE (TTM)	PB (MRQ)	2017 NPM %	2017 ROE%
0867.HK	康哲藥業	44,670.97	22.30	5.13	<b>31.22</b>	<b>24.84</b>
	Average		20.34	3.33	17.03	21.14
	Median		18.44	2.76	13.00	15.75
1513.HK	麗珠醫藥	44,914.20	6.75	2.77	52.83	51.26
1093.HK	石藥集團	133,288.44	48.11	8.70	17.84	21.79
2186.HK	綠葉製藥	26,527.22	22.60	3.28	25.67	14.87
1345.HK	中國先鋒醫藥	3,416.49	10.24	2.50	13.00	24.78
1099.HK	國藥控股	116,494.70	18.44	2.76	2.83	15.75
2607.HK	上海醫藥	78,815.53	14.68	1.52	3.10	10.72
3320.HK	華潤醫藥	75,037.01	21.54	1.79	3.95	8.76

Source: Wind (as at Apr 3<sup>rd</sup>), Phillip Securities

## Financials

FYE	FY2015	FY2016	FY2017	FY2018 E	FY2019 E
<b>Valuation Ratios</b>					
Price to Earnings	36.04	26.27	21.67	19.01	16.90
Price to Book	6.83	5.82	4.94	4.27	3.71
<b>Per Share Data</b>					
EPS (RMB Cents)	40.37	55.40	67.14	76.53	86.09
Book Value Per Share (RMB)	2.13	2.50	2.95	3.41	3.92
Dividend Per Share (RMB Cents)	16.16	22.43	26.86	30.61	34.44
<b>Growth (%)</b>					
Revenue	20.65	37.92	9.14	12.92	12.49
Operating Income	21.32	48.11	24.72	9.85	12.49
Net Profit	-4.46	38.28	21.19	13.99	12.49
<b>Margins (%)</b>					
Gross Profit Margin	57.58	59.42	65.03	64.50	64.00
Operating Profit Margin	29.74	31.93	36.49	35.50	35.50
Net Profit Margin	28.04	28.12	31.22	31.52	31.52
<b>Key Ratios</b>					
ROE (%)	18.95	22.16	22.79	22.47	21.95
ROA (%)	17.62	16.99	16.45	15.73	15.36
<b>Income Statement (RMB Mn)</b>					
Revenue	3,553.4	4,900.8	5,348.8	6,039.8	6,794.2
- Cost of Goods Sold	1,507.3	1,988.9	1,870.5	2,144.1	2,445.9
Gross Income	2,046.1	2,911.9	3,478.3	3,895.7	4,348.3
- Operating Expenses	989.4	1,346.9	1,604.1	1,751.5	1,936.3
Operating Income	1,056.7	1,565.0	1,951.9	2,144.1	2,411.9
+ Net Non-Operating Gain/Loss	7.4	(64.6)	82.3	75.0	84.4
Pretax Income	1,064.1	1,500.4	1,808.4	2,069.1	2,327.5
- Income Tax Expenses	(67.6)	(122.5)	(138.5)	(165.5)	(186.2)
Net Profit	995.9	1,375.9	1,674.8	1,903.6	2,141.3

Source: Wind, Phillip Securities (HK) Research Estimates

Exchange rate is 0.8166 RMB/HKD (1YHKDRMB future price on Apr 4).

(Financial figures as at 4 Apr 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

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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