

Yunnan Baiyao (000538.SZ)

Composite Ownership Reform to Accelerate Development

Mainland China | Pharmaceutical | Company report

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Investment Summary

We highlight that: 1) stable growth in distribution business and notable hike in terms of health product segment; 2) rising selling expenses paving way for future growth; 3) composite ownership reform to accelerate development. We fine tune our model to factor into expenses hiking, therefore adjust EPS estimates to be RMB3.4 in 2018E. Given target PE 33x, we derive TP of RMB112. (Closing price at 13 Apr 2018)

Business Overview

Composite Ownership Reform to Accelerate Development

In 2017, Yunnan Baiyao Holdings Limited (YBH) introduced New Huadu and Jiangsu Yuyue (both private firms) as strategic investors, and three entities holds 45%/45%/10% of YBH respectively. Thus YBH and the listing company both transfer into enterprises without one actual controller. After adjustments in 2017, we expect that the reform will further motivate its staff and enhance company competitiveness.

Distribution Segment Achieving Stable Growth

YNSYY reported revenue of RMB14,494mn (+7.5%) in 2017. We expect that this segment will recover gradually in 18H2 after further digesting effects of two-invoice system. The distribution network has covered all county-level hospitals and some hospitals in part of developed towns, with expanding to combining pharma chains, drugstore trusteeship and online drug sales to achieve channel synergies. The company currently has entered into all mainstream e-commerce platforms and explores Wechat business to broaden distribution network.

Manufacturing Segment

This segment reported revenue growth of 9.7% YoY. (1) Medicine department: this part recorded revenue of RMB5,043.5 (+2.56%), weaker than we thought. The company continues to upgrade its distribution network to comply with two-invoice system requirements. On products, it is trying to integrate internal resources to enrich product mix to adapt to current increasing demand for medicinal consumer goods, including developing healthcare products like steam eye-masks. (2) Health product department: it reported revenue of RMB4,361.1mn with YoY growth of 16%. Health products` has covered the whole country market, even county level markets in some developed regions. Meanwhile, the company proactively to facilitate e-commerce growth, given it set up an e-commerce operation center in Hangzhou city and built flagship stores on mainstream platforms.

Efficient Promotion with Rising Selling Fee

Selling expenses rose by 30% YoY mainly due to more expenditure on market maintainance and promotion. The company focuses on new media channels, such as internet, building advertising and public events, to improve brand popularity among young generations. The company takes advantage of popular IP to develop related products, which helps to increase product exposure to the public. In 2017, the company launched two series of products under two popular TV series (‘三生三世十里桃花’, ‘春風十里不如你’). It also hosted sport event ‘雲南白藥愛跑 538’, which was also hosted in cities including Changsha, Chongqing, Wuhan, etc. We expect in future selling expenses to be in a climbing trajectory.

Accumulate

CMP RMB96.22

(Closing price at 13 Apr 2018)

TARGET RMB112.0 (+16.4%)

COMPANY DATA

O/S SHARES (MN) :	1,041.4
MARKET CAP (RMBMN) :	100,203
52 - WK HI/LO (RMB):	109.87/81.03

SHARE HOLDING PATTERN , %

Yunnan Baiyao Holdings	41.52
Yunnan Hehe	10.09
Pingan	9.36
HK Connect	6.51
New Huadu	3.39
CSF	2.56

PRICE PERFORMANCE , %

	1M	6M	1Y
Yunnan Baiyao	1.38	5.53	14.03
SHA	-3.50	-6.49	-2.68

RETURN VS. SHA



Source: Aastocks, Phillip Securities (HK) Research

KEY FINANCIALS

RMB/mn	FY16	FY17	FY18E	FY19E
Net Sales	22,411	24,315	26,911	29,263
Net Profit	2,931	3,133	3,536	4,005
EPS, RMB	2.80	3.02	3.40	3.85
PER, x	34.36	31.86	28.34	25.02
BVPS, RMB	15.10	17.32	19.97	22.85
P/BV, x	6.37	5.56	4.82	4.21
ROE, %	18.50	17.27	17.00	16.83

Source: Wind, Phillip Securities Est.

Eurus Zhou (2277 6515)
euruszhou@phillip.com.hk

Investment Thesis, Valuation & Risk

Our model indicates a target price of RMB112.0. Considering rising selling expenses, we estimate 2018E EPS to be RMB3.4 per share (vs. RMB3.55 previously). We see current PE of TCM sector is around 33.5x-37.6x. With target PE 33x, we give 2018E Target price of RMB112.0. **Risks include:** Effects from Two-invoice system; Fierce competition in health product industry; Composite ownership reform fail expectation.

Figure: Segments Performance (RMB`000)

	2014	2015	2016	2017	2018E	2019E
Revenue	18,814,366.37	20,738,126.21	22,410,654.40	24,314,614.04	26,910,549.80	29,263,000.50
YOY	18.97%	10.22%	8.06%	8.50%	10.68%	8.74%
Distribution	10,588,189.27	11,527,074.37	13,275,890.44	14,283,554.30	15,283,403.10	16,429,658.34
YOY	18.01%	8.87%	15.17%	7.59%	7.00%	7.50%
GPM	6.54%	6.36%	7.84%	7.29%		
Weight	56.28%	55.58%	59.24%	58.74%	56.79%	56.14%
Manufacturing	8,189,759.72	9,180,400.94	9,080,384.24	9,962,024.66	11,627,146.70	12,833,342.17
YOY	19.69%	12.10%	-1.09%	9.71%	16.71%	10.37%
GPM	60.65%	60.83%	62.10%	65.61%	63.86%	64.73%
--Medicin Section	4,977,240.00	5,095,940.00	4,917,690.00	5,043,510.00	5,144,380.20	5,272,989.71
YOY	12.58%	2.38%	-3.50%	2.56%	2.00%	2.50%
Weight	26.45%	24.57%	21.94%	20.74%	19.12%	18.02%
--Health Product Section	2,753,320.00	3,354,510.00	3,756,770.00	4,361,150.00	5,015,322.50	5,817,774.10
YOY	32.66%	21.84%	11.99%	16.09%	15.00%	16.00%
Weight	14.63%	16.18%	16.76%	17.94%	18.64%	19.88%
--TCM Section	450,520.00	651,400.00	943,950.00	1,162,870.00	1,395,444.00	1,660,578.36
YOY	30.19%	44.59%	44.91%	23.19%	20.00%	19.00%
Weight	2.39%	3.14%	4.21%	4.78%	5.19%	5.67%

Source: Company, Phillip Securities

Figure: Peers valuation

Code	Mkt.Cap/ mn	GPM(%)			NPM(%)			PE			ROE (%)
		2017	2016	2015	2017	2016	2015	TTM	18E	19E	
600518.SH	110,826.4	--	29.2	27.6	--	15.6	15.4	28.4	22.5	18.5	--
000538.SZ	101,515.6	30.7	29.4	30.2	13.0	13.2	13.4	32.3	27.0	23.3	18.6
600436.SH	53,852.1	--	48.3	46.4	--	22.2	24.8	68.1	53.6	41.1	--
600085.SH	51,471.3	45.7	45.4	45.5	13.2	13.1	13.7	50.6	45.6	40.2	12.6
600535.SH	47,919.1	35.5	35.8	38.2	8.8	8.8	11.6	34.8	29.9	25.8	16.6
600332.SH	44,995.7	37.1	32.4	35.6	10.2	7.9	7.1	22.8	19.3	17.0	11.4
600566.SH	40,724.1	--	85.0	84.1	--	20.4	18.4	35.0	26.2	21.1	--
002773.SZ	40,520.0	--	90.2	89.0	--	20.1	19.5	62.9	48.9	38.2	--
000423.SZ	40,503.6	64.6	66.6	64.2	28.1	29.7	30.4	19.8	17.5	15.5	22.5
603858.SH	34,321.8	--	82.8	82.5	--	14.7	30.9	20.9	--	--	--
Highest	110,826.4	64.6	90.2	89.0	28.1	29.7	30.9	68.1	53.6	41.1	22.5
Median	46,457.4	37.1	46.8	46.0	13.0	15.1	16.9	33.5	27.0	23.3	16.6
Average	56,665.0	42.7	54.5	54.3	14.6	16.6	18.5	37.6	32.3	26.7	16.3

Source: Wind as at Apr 12th, Phillip Securities

Financials

FYE	FY2015	FY2016	FY2017	FY2018E	FY2019E
Valuation Ratios					
Price to Earnings (P/E)	36.17	34.36	31.86	28.34	25.02
Price to Book (P/B)	7.46	6.37	5.56	4.82	4.21
Per Share Data (RMB)					
EPS	2.66	2.80	3.02	3.40	3.85
Book Value Per Share	12.90	15.10	17.32	19.97	22.85
Dividend Per Share	0.60	0.80	1.50	1.70	1.92
Growth (%)					
Revenue	10.22	8.06	8.50	10.68	8.74
Gross Profit	30.53	29.86	31.19	31.89	32.66
Operating Income	11.96	4.78	9.06	12.89	12.65
Net Profit	10.34	6.36	6.88	12.87	13.28
Margins (%)					
Gross Profit Margin	30.53	29.86	31.19	31.89	32.66
Operating Profit Margin	15.28	14.81	14.89	15.19	15.74
Net Profit Margin	13.29	13.08	12.88	13.14	13.69
Profitability					
ROE (%)	20.37	18.50	17.27	17.00	16.83
ROA (%)	14.28	11.92	11.31	11.22	11.11
FYE	FY2015	FY2016	FY2017	FY2018E	FY2019E
Income Statement (RMB Mn)					
Revenue	20,738.1	22,410.7	24,314.6	26,910.5	29,263.0
- Cost of Goods Sold	-14,405.9	-15,718.0	-16,731.6	-18,329.8	-19,707.0
Gross Income	6,332.2	6,692.7	7,583.0	8,580.7	9,556.0
- Operating Expenses	-3,164.0	-3,372.9	-4,100.4	-4,493.2	-4,951.3
Operating Income	3,168.2	3,319.8	3,620.7	4,087.5	4,604.7
+ Net Non-Operating Gain/Loss	47.1	77.7	1.1	0.0	0.0
Pretax Income	3,215.3	3,397.5	3,621.8	4,087.5	4,604.7
- Income Tax Expenses	-459.8	-466.6	-489.3	-551.7	-599.4
- Minority Interest	-15.3	11.0	-12.4	-13.8	-15.0
Net Profit	2,755.6	2,930.9	3,132.5	3,535.8	4,005.3

Source: Company, Wind, Phillip Securities (HK) Research Estimates
(Financial figures as at 13 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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Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website: www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96188238
Fax (613) 92002272
Website: www.phillipcapital.com.au

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005