

# Kangmei Pharma (600518.SH)

## TCM Decoction Pieces Benefiting From Omni-Channel

Mainland China | Pharmaceutical | Company report

4 June 2018

### Investment Summary

The company realized revenue 22%/28% YoY growth in FY17/18Q1, slightly beyond our expectation. We see TCM decoction pieces benefiting from omni-channel advantage, while medicine and medical instrument distribution business grow dramatically. We are positive on Kangmei's integrated healthcare industry chain which is of great synergies and expected to consolidate its leading position. Given 18E/19E EPS estimation of RMB0.98/1.21 and target PE of 31x (roughly par to market consensus 26.69x + 15% premium), we increase target price to RMB30.5. (Closing price at 31 May 2018)

### Business Overview

**Financial updates.** In FY17/18Q1, the company achieved revenue of RMB2.5bn/9.1bn (+22.3%/27.7% YoY) beyond our expectation, and NP attributable to shareholders of RMB4.1bn/1.4bn (+22.8%/33.3% YoY). In terms of profit margin, GPM was up by 0.4pp, more specifically, GPM of TCM decoction pieces up by 1.37pp, self-produced medicine up by 3.32pp and medical instrument up by 5.8pp. By region, East China is still main market taking up 57% in topline and growing by 20% last year, while sales in North China and Southwest China also developed quickly with sales up by 55%/21% YoY.

**TCM decoction pieces benefiting from omni-channel advantage.** In 2017, TCM decoction pieces business generated revenue over RMB6.16bn with over 30.93% YoY growth. We highlight that favorable policies for TCM decoction pieces (maintaining 15% mark-up) will facilitate this industry's continued growth. Kangmei has set up factories in 11 cities (including Guangdong, Beijing, Jilin, Sichuan, Anhui, etc.) which produce over 1,000 types of TCM products and 20,000 formulas. As a leading company in this industry, Kangmei is going to boost this business leveraging on its strong distribution network, involving medical institutions, pharmacy trusteeship, smart pharmacy, OTC retail, pharma store chain, e-commerce platform, mobile healthcare app, and so on. We see that omni-channel advantage has formed to help digest newly-added capacity, enlarge business scale and take more market shares.

**Medicine transaction and medical instrument business to speed up.** Medicine transaction business generated income of RMB9.6bn rising by 31.44% YoY and medical instrument contributed to RMB1.99bn with 117.88% YoY growth. These two businesses mainly target hospitals and chain pharma stores. Resulting from powerful control over entire TCM value chain (from upstream to downstream), the company's business model helps to increase GPM of these two businesses. The company develops medical instrument business through self-construction and M&A and mainly focuses on consumptive materials and apparatus of orthopedics field. Its agency service has covered 90% Chinese districts, with proxy for Zimmer-Biomet, Smith&Nephew, etc. It will actively enhance integration of medical instrument value chain and strive for more agency rights of competitive products.

### Accumulate

CMP RMB26.76

(Closing price at 31 May 2018)

TARGET RMB30.5 (+14%)

#### COMPANY DATA

O/S SHARES (MN) :	4,946.74
MARKET CAP (RMBMN) :	116,508
52 - WK HI/LO (RMB):	28.25 / 19.30

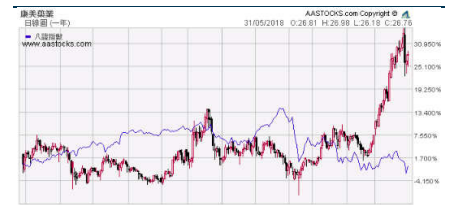
#### SHARE HOLDING PATTERN , %

Kangmei Investment Holdings Ltd.	33.16
Minmetals Trust	4.69
CSF	4.54

#### PRICE PERFORMANCE , %

	1M	3M	1Y
Kangmei	18.89	26.88	25.52
SSE 50	0.21	-7.18	6.48

#### RETURN VS. HSI



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

RMB mn	FY16	FY17	FY18E	FY19E
Net Sales	21,642	26,477	32,357	39,039
Net Profit	3,340	4,101	4,888	6,043
EPS, RMB	0.67	0.78	0.98	1.21
PER, x	40.12	34.13	27.23	22.03
BVPS, RMB	5.29	5.84	7.25	7.86
P/BV, x	5.06	4.58	3.69	3.40
ROE, %	13.95	13.41	13.56	15.46

Source: Company reports, Phillip Securities Est.

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**Bright outlook of healthcare value chain.** The company has cultivated an integrated TCM value chain with rich medical resources and great synergies. For upstream, the company effectively manages the supply of Chinese medicine materials (CMM) leveraging on well grasping terminal information. For mid-stream, Kangmei builds `康美 e 藥穀` as the online transaction platform of CMM and launches CMM price index as well as establishes distribution center in Beijing, Northeast China, Shanghai involving 30 regions. For downstream, its distribution network (involving medical institutions, pharmacy trusteeship, e-commerce platform, etc.) together with managed hospitals (Kangmai Hospital, Meihekou Center Hospital, Kaiyuan City Center Hospital, etc.) and launch of mart pharmacy projects will enrich medical services provided and further supplement its value chain.

## Investment Thesis, Valuation & Risk

**Our valuation model gives target price of RMB30.5**, based on assumption that revenue growth rate will be 22%/20.65% in 18E/19E. We estimate NP to be RMB4.89bn/6bn in 18E/19E, and EPS of RMB0.98/1.21. Given target PE 31x (roughly par to market consensus 26.69x + 15% premium), our TP is RMB30.5.

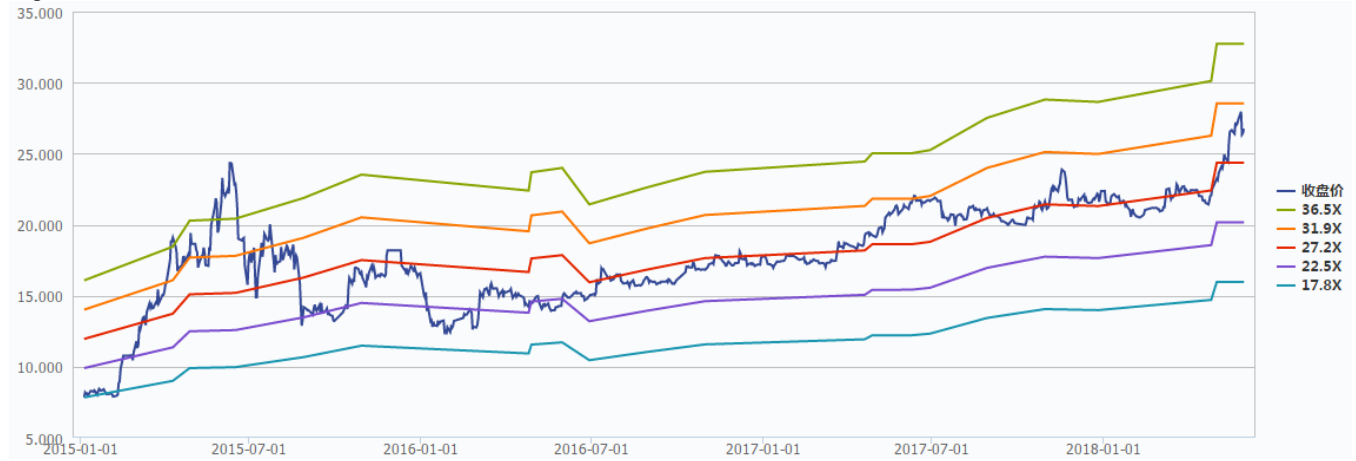
**Downside risks:** 1) Management inefficiency; 2) Business growth fail expectation; 3) Policy risks.

Figure: Key ratios of peers

Code	Firm	Mkt Cap/mn	Free Float Mkt Cap	PE			PB (MRQ)
				TTM	18E	19E	
600518.SH	康美藥業	133111.03	133111.03	29.87	26.69	22.03	3.97
<b>滬深(10)</b>							
	Max	133111.03	133111.03	74.09	62.64	47.43	15.14
	<b>Medium</b>	<b>50594.83</b>	<b>50594.83</b>	<b>31.32</b>	<b>28.62</b>	<b>24.69</b>	<b>5.68</b>
	Average	64905.08	64168.00	38.56	35.58	29.44	6.67
000538.SZ	雲南白藥	118823.71	118823.71	36.83	33.05	28.85	6.31
600332.SH	白雲山	69539.36	62168.50	28.96	27.63	23.99	3.64
600436.SH	片仔癀	67179.37	67179.37	74.09	62.64	47.43	15.14
600085.SH	同仁堂	55571.98	55571.98	53.42	49.23	44.02	6.39
600535.SH	天士力	45617.69	45617.69	31.90	28.62	24.69	5.05
600566.SH	濟川藥業	43021.19	43021.19	30.74	26.66	21.22	8.84
002773.SZ	康弘藥業	40769.48	40769.48	58.36	48.59	37.51	10.86
000423.SZ	東阿阿膠	39254.37	39254.37	19.16	17.12	15.24	3.75
603858.SH	步長製藥	36162.67	36162.67	22.30	--	--	2.71
<b>香港(10)</b>							
	Max	69539.36	29642.18	--	24.13	20.84	10.06
	<b>Medium</b>	<b>11467.84</b>	<b>7190.85</b>	<b>--</b>	<b>19.68</b>	<b>17.36</b>	<b>2.87</b>
	Average	17163.52	10219.52	--	18.58	15.92	3.50
0874.HK	白雲山	69539.36	7370.86	--	21.17	18.44	2.70
0570.HK	中國中藥	29642.18	29642.18	--	21.51	18.10	2.44
2186.HK	綠葉製藥	23052.54	23052.54	--	20.39	17.84	3.48
1666.HK	同仁堂科技	14282.34	7010.83	--	18.97	16.89	3.03
2877.HK	神威藥業	11547.88	11547.88	--	18.48	15.72	2.03
3613.HK	同仁堂國藥	11387.80	11387.80	--	24.13	20.84	5.59
1681.HK	康臣藥業	6292.68	6292.68	--	13.31	11.10	3.68
0587.HK	華瀚健康	3117.79	3117.79	--	--	--	0.44
0932.HK	順騰國際控股	1735.64	1735.64	--	--	--	10.06
3737.HK	中智藥業	1036.97	1036.97	--	10.73	8.42	1.59

Source: Wind (as at May 31), Phillip Securities

Figure: 2015-2018 PE Band



Source: Wind (as at May 31), Phillip Securities

## Financials

	2015	2016	2017	2018E	2019E
<b>Valuation Ratios</b>					
P/E	42.95	40.12	34.13	27.23	22.03
P/B	7.45	5.06	4.58	3.69	3.40
<b>Per Share Data (RMB)</b>					
EPS	0.62	0.67	0.78	0.98	1.21
Book Value Per Share	3.59	5.29	5.84	7.25	7.86
Dividend Per Share	0.19	0.21	0.24	0.29	0.36
<b>Growth &amp; Margin (%)</b>					
<b>Growth</b>					
Revenue	13.28	19.79	22.34	22.21	20.65
Gross Profit	15.00	26.39	24.05	18.39	18.02
Operating Income	20.68	22.99	22.16	18.26	22.90
Net Profit	20.60	21.17	22.77	19.20	23.62
<b>Margins</b>					
Gross Profit Margin	28.34	29.90	30.32	29.37	28.73
Operating Profit Margin	17.81	18.29	18.26	17.67	18.00
Net Profit Margin	15.26	15.43	15.49	15.11	15.48
<b>Key Ratios</b>					
ROE (%)	15.54	13.95	13.41	13.56	15.46
ROA (%)	11.11	10.07	9.35	6.78	7.73
<b>Income Statement (RMB mn)</b>					
Revenue	18,066.8	21,642.3	26,477.0	32,357.3	39,039.1
- Cost of Goods Sold	12,947.3	15,171.5	18,450.2	22,854.0	27,823.3
Gross Income	5,119.6	6,470.8	8,026.8	9,503.3	11,215.9
- Operating Expenses	1,928.6	2,587.2	3,365.2	3,688.7	4,079.6
Operating Income	3,217.9	3,957.7	4,834.8	5,717.5	7,027.0
Non-operating Gain/Loss	24.7	29.9	(8.1)	0.0	0.0
- Income Tax Expenses	486.2	650.8	732.1	829.0	983.8
Net Profit to Firm	2,756.5	3,336.8	4,094.7	4,888.5	6,043.2
-Minority Interest	(0.28)	(3.64)	(6.28)	0.00	0.00
Net Profit	2,756.8	3,340.4	4,100.9	4,888.5	6,043.2

Source: Bloomberg, Phillip Securities (HK) Research Estimates  
(Financial figures as at May 31 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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