

CR Pharmaceutical (3320.HK)

Manufacturing business developed quickly and distribution segment consolidated leading position

Hong Kong | Pharmaceutical | Company report

6 September 2018

Investment Highlights

During 18H1, we see that revenue from three main segments, namely distribution, manufacturing and retail, increased by 10.2%/32.9%/16.7% yoy, respectively. We highlight that the company 1) continues to be optimize the distribution network, 2) integrates R&D capabilities on generics and innovative drugs, 3) places importance on biopharmaceuticals, and 4) boosts chemical and TCM drugs through external mergers and acquisitions. Considering impacts from two-invoice system will mitigate in 18H2 and lead to better operating results, we thus raise TP to HK\$15.2, implying 19x PE for FY18. (Closing price at 4 Sep 2018)

Business Overview

18H1 results. The company achieved revenue of HK\$93,741mn, up by 13.3% yoy. Gross profit climbed by 34.7% to HK\$16,881mn with GPM up by 2.9ppt to 18%. Operating profit increased by 22.6% to HK\$6,296mn, while OPM increased by 0.5ppt. Significantly increased expenses is resulting from the implementation of two-invoice system, given selling expenses as a percentage of revenue increased from 6.7% in 17H1 to 9% in 18H1. Net profit attributable to shareholders increased by 24.3% yoy with NPM up by 0.2ppt.

Manufacturing business. This segment reported income of HK\$16,874.5mn (+32.9% yoy). GPM was up by 3.6ppt to 63.7%, mainly due to the continuous improvement of product mix and production process. By product, 1) Chemicals recorded a revenue of HK\$8,039.1mn, a rapid yoy increase of 50.9%, mainly benefiting from the increase in income from anti-infectives, infusion products, and chronic diseases and specialist drugs; 2) TCM records sales of HK\$7,496.5mn, up by 19.9% yoy, attributable to the sales hike of OTC products and prescription TCM products for cardiovascular and cerebrovascular diseases, and TCM formula pellets; 3) Biopharmaceutical products generated sales of HK\$88.5mn, affected by selling model adjustment, increased by 39.1% yoy; 4) Nutrition and health products benefited from the continuous enrichment of product categories thus recorded revenue of HK\$306.9mn, up by 93.6% yoy.

Distribution business. In 18H1, distribution business achieved revenue of HK\$77,60mn, a yoy increase of 10.2%. GPM was 7.4% up by 1.0ppt, mainly due to the direct revenue from medical institutions taking a larger portion in distribution income. For the upstream, the company speeds up the introduction of quality products, expands the import of value-added services, and optimizes product structure, as well as vigorously promotes medical device distribution business. For downstream network, it enhances distribution network in blank provinces of western China and strengthens the downstream terminal control by further infiltrating the grassroots market. Its distribution network had covered 27 provinces and municipalities across the country, including 5,857 second- and third-level hospitals, 38,954 primary-level medical institutions, and 28,916 retail pharmacies.

Retail business. This segment recorded sales of HK\$2,470.4mn (+16.7% yoy), GPM was 16.3%, a drop of 0.9ppt from 17H1 level, mainly due to the rapid growth of the high-value drug direct delivery service (DTP) which has relatively low profit margin. The company further integrates retail resources in terms of brands, drug products and information systems, enriches product categories, and actively develops innovative business models such as DTP and chronic disease management. At present, the company has 812 retail pharmacies and 94 DTP pharmacies covering more than 50 cities in China.

BUY

CMP HKD12.72

(Closing price at 4 Sep 2018)

TARGET HKD15.2 (+20%)

COMPANY DATA

O/S SHARES (MN) :	6,284.5
MARKET CAP (HKDMN) :	79,939
52 - WK HI/LO (HKD):	13.04 / 9.02

SHARE HOLDING PATTERN , %

CR Holdings	53.04
BSAMAC	20.63

PRICE PERFORMANCE , %

	1M	3M	1Y
CR Pharma	13.36	7.25	34.41
HIS	1.08	-10.51	0.84

RETURN VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

HKD mn	FY16	FY17	FY18E	FY19E
Net Sales	156,705	172,532	196,921	220,085
Net Profit	2,821	3,483	4,479	4,984
EPS, HKD	0.57	0.55	0.71	0.79
PER, x	22.15	22.95	17.85	16.04
BVPS, HKD	11.05	10.05	10.04	10.86
P/BV, x	1.15	1.27	1.27	1.17
ROE, %	5.20	5.52	7.10	7.30

Source: Company reports, Phillip Securities Est.

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Figure: 18H1 Results

(HKD mn)	18H1	17H1	Change
Revenue	93741	82738	+13.3%
Gross profit	16881	12528	+34.7%
GPM	18.0%	15.1%	+2.9ppt
Operating	6296	5137	+22.6%
OPM	6.7%	6.2%	+0.5ppt
Profit for the firm	4063	3453	+17.7%
Net profit attributable to shareholders	2250	1810	+24%
NPM	2.4%	2.2%	+0.2ppt
EPS (HKD)	0.36	0.29	+24%

Source: Company, Phillip Securities

Pipeline. R&D efforts focus on fields like cardiovascular, anti-tumor, digestive tract and metabolism, central nervous system, immune system, etc. R&D expenditure reached HK\$649mn in 18H1, up by 63.5% yoy, accounting for 3.8% of manufacturing income. There are 37 existing innovative drugs in pipeline, among which one anti-tumor drug is in phase II of clinical stage. We highlight that one respiratory system drug has been initiated in China and US, and 19 projects are in registration and approval stage. Four products, including polyethylene glycol recombinant human erythropoietin injection, obtained clinical approvals. Meanwhile Baixiaoan injection and other three products obtained production approvals. These further enrich the product line for future growth. Besides, the company actively process the consistency evaluation work, given now more than 40 evaluation projects are undergoing and several projects have carried out bioequivalence clinical trials. In July, amlodipine besylate tablets (5 mg) passed the consistency evaluation.

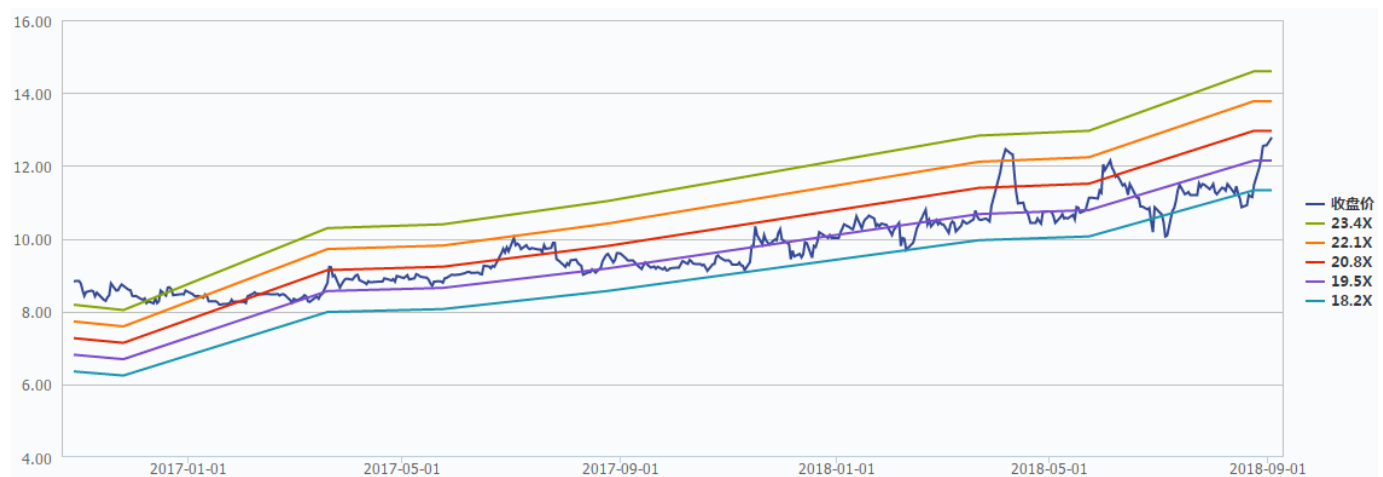
Boost biopharmaceuticals business. The company integrates resources involving R&D, production and marketing to boost biopharmaceutical business. In June, the company and CR biopharmaceutical firm jointly funded the reorganization of a biopharma subsidiary (Angde Biotech) and shared 51% of Angde's ownership, with injection of two products of their owns. Founded in 2001, Angde was originally a wholly-owned subsidiary of Dong'e Ejiao, and has a good foundation in R&D and production capacity of recombinant protein biopharmaceuticals. The two products injected belong to recombinant protein products for diabetes, which own great market potential. It is expected to form a complete product portfolio together with Angde's own pipeline product (one insulin), and enjoy synergies involving capital, tech and distribution channel, etc. At present, there are recombinant human erythropoietin and reteplase for injection in biopharma pipeline, focusing on anti-tumor, immune, cardiovascular and cerebrovascular fields. Meanwhile, the company is to accelerate the acquisition of high-quality drugs, introduction of bio-products as well as international cooperation, in order to enhance its overall strength in biopharmaceutical field.

External M&A underpin chemical and Chinese medicine sectors. The company implements a handful of M&A projects with respect to TCM and chemical medicine segments, to enrich product portfolio and expand business layout. 1) TCM. The company will reorganize Jiangzhong Group to acquire 51% of shares of Jiangzhong Group, which owns 43.03% of Jiangzhong Pharma shares. Jiangzhong Pharma is a leading OTC product manufacturer in China. It has a high brand awareness and market share in the gastrointestinal and oropharynx fields. It is expected to cooperate with CR Pharma in various aspects such as brands, products, productions, R&D and sales network. 2) Chemical sector. In May, CR Double Crane (its chemical product platform) announced the acquisition of a 45% stake in Xiangzhong Pharma, to enrich the psychiatric and neurological drug product lines, and strengthen sales capacity towards psychiatric hospitals. In Aug, CR Double Crane announced the further acquisition of 40.65% equity of Xiangzhong Pharmaceutical. When completed, CR Double Crane will hold a total of 85.65% equity of Xiangzhong Pharma. These M&A will enhance CR Pharma's control and integration of industry chain.

Valuation and Risks

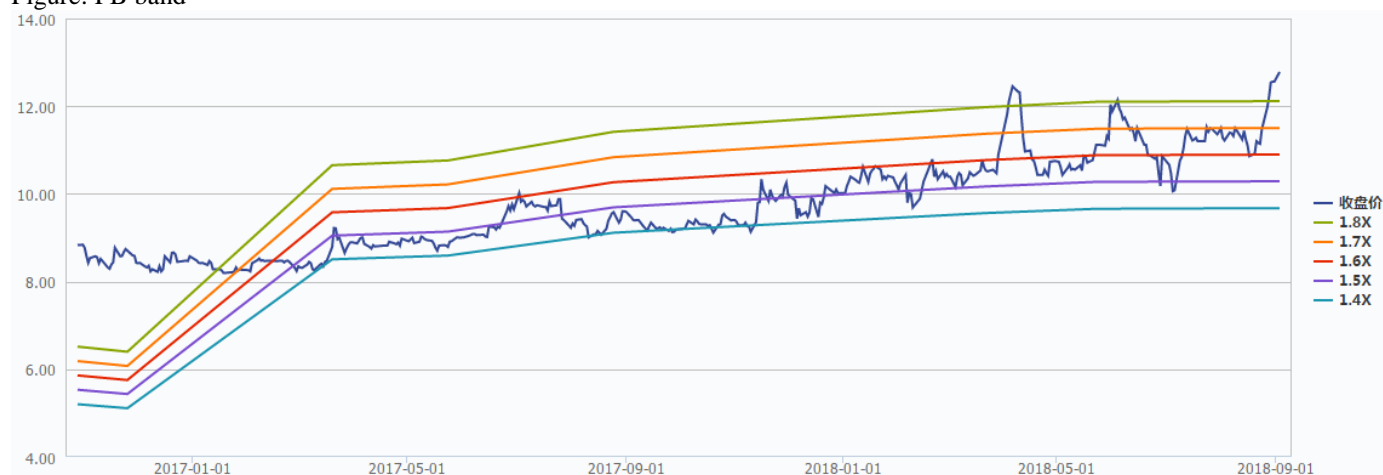
We raise our target price to HK\$15.2. We forecast revenue growth rates for 18E/19E to be 18%/12%, corresponding to EPS estimates of HK\$0.71/0.79 respectively. Based on a 19x target P/E, we get target price of HK\$15.2. **Downside risks** include: R&D failure risk; distribution business growth is less than expected; policy risk.

Figure: PE band



Source: Wind (as at Sep 4), Phillip Securities

Figure: PB band



Source: Wind (as at Sep 4), Phillip Securities

Figure: HK Peers

Code	Firm	Mrk. Cap HKD mn	Free Float HKD mn	PE		PB (MRQ)	EV/Rev	EV/EBITDA
				18E	19E			
3320.HK	華潤醫藥	79,938.92	79,938.92	18.96	16.50	1.91	0.68	9.42
	Max	126,125.16	126,125.16	37.59	30.07	7.73	6.51	28.78
	Median	32,135.24	22,484.63	18.96	15.98	3.43	5.37	15.45
	Average	59,562.12	45,199.44	21.33	17.61	3.84	4.29	17.83
1177.HK	中國生物製藥	126,125.16	126,125.16	37.59	30.07	5.24	6.40	28.78
1093.HK	石藥集團	124,485.79	124,485.79	34.21	26.69	7.73	6.51	28.69
1099.HK	國藥控股	107,916.71	46,519.62	17.12	14.98	2.51	0.49	9.17
2196.HK	復星醫藥	84,616.75	17,220.54	19.26	15.98	2.64	4.31	27.88
0867.HK	康哲藥業	32,135.24	32,135.24	14.13	12.25	3.43	5.43	13.32
1513.HK	麗珠醫藥	28,573.76	7,566.02	17.98	15.56	1.80	2.77	12.13
2005.HK	石四藥集團	22,484.63	22,484.63	24.95	19.36	5.52	6.12	20.75
0460.HK	四環醫藥	16,384.97	16,384.97	9.67	8.91	1.18	5.37	8.76
1558.HK	東陽光藥	16,363.23	8,174.79	15.82	13.46	4.17	5.70	15.45
0512.HK	遠大醫藥	16,158.19	16,158.19	24.98	19.95	6.09	3.43	21.79

Source: Wind (as at Sep 4), Phillip Securities

Financials

Key Ratios	2016	2017	2018E	2019E	2020E	2021E
Valuation Ratios						
Price to Earnings (P/E)	22.15	22.95	17.85	16.04	14.44	12.99
Price to Book (P/B)	1.15	1.27	1.27	1.17	1.09	1.01
Per Share Data (HKD)						
EPS	0.57	0.55	0.71	0.79	0.88	0.98
Book Value Per Share	11.05	10.05	10.04	10.86	11.70	12.62
Dividend Per Share	0.00	0.17	0.21	0.24	0.26	0.29
Growth (%)						
Revenue	6.92	10.10	14.14	11.76	11.50	11.56
Operating Income	-2.59	9.91	32.10	11.35	11.14	11.24
Net Profit	-1.01	23.45	28.59	11.28	11.08	11.18
Margins (%)						
Gross Profit Margin	15.39	16.39	16.50	16.50	16.50	16.50
Operating Profit Margin	6.28	6.27	7.25	7.23	7.20	7.18
Net Profit Margin	1.80	2.02	2.27	2.26	2.26	2.25
Profitability (%)						
ROE	5.20	5.52	7.10	7.30	7.53	7.76
ROA	2.11	2.17	2.73	2.80	2.88	2.96

Income Statement (HKD Mn)	2016	2017	2018E	2019E	2020E	2021E
Revenue	156,705.2	172,532.0	196,920.7	220,084.9	245,405.2	273,785.4
- Cost of Goods Sold	132,596.1	144,256.1	164,428.8	183,770.9	204,913.3	228,610.8
Gross Income	24,109.1	28,276.1	32,491.9	36,314.0	40,491.9	45,174.6
- Operating Expenses	14,270.4	17,462.9	18,207.5	20,408.1	22,813.5	25,509.6
Operating Income	9,838.7	10,813.3	14,284.4	15,905.9	17,678.4	19,665.0
- Financing Cost	1,796.1	2,230.9	2,166.1	2,420.9	2,699.5	3,011.6
Pretax Income	8,042.7	8,582.3	12,118.3	13,485.0	14,978.9	16,653.3
- Income Tax Expenses	2,074.6	1,715.5	2,787.2	3,101.6	3,445.1	3,830.3
- Minority Interest	3,146.7	3,383.8	4,852.2	5,399.4	5,997.6	6,668.0
Profit Attributable to Shareholders	2,821.4	3,483.0	4,478.9	4,984.1	5,536.2	6,155.1

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 4 Sep 2018)

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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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