

Kangmei Pharma (600518.SH)

Comments on 18H1 Results: Booming TCM Decoction and Instrument Businesses

Mainland China | Pharmaceutical | Company report

27 September 2018

Investment Summary

In 18H1, the company realized revenue/profit attributable to shareholders growth of 27.88%/21% yoy. In future, the company will increase investment in smart city pharmacy and build an complete mobile healthcare system involving online and off-line medical institutions and patients, which is expected to continuously promote TCM decoction pieces sales. Meanwhile, the distribution business of medical instruments will keep notable growth given intensifying sales channel. We predict the 18E/19E EPS to be RMB1.04/1.24 and adjust TP to RMB25.97, “Buy” rating. (Closing price at 24 Sep 2018)

Business Overview

18H1 Results. The company achieved revenue/ profit attributable to shareholders/ attributable profit excluding non-recurring items of RMB16,959mn /2,604.6mn /2,581.96mn, implying yoy growth of 27.88%/21%/20.3%, respectively. We see financial costs dramatically increased by 68.5% due to rising interest expenses for bank loan and bonds. Selling expenses rose given selling expenses to revenue ratio up from 2.35% in 17H1 to 2.92% in 18H1, while administration fees to revenue ratio dropped by 0.46ppt to 3.94% due to improving management efficiency.

TCM decoction pieces benefiting from smart pharmacy business. TCM decoction pieces recorded revenue of RMB3826.8mn, up by 41.88% due to rapid expansion of smart pharmacy network, with GPM up by 3.53ppt to 36.4%. The company announced in July that it will invest RMB7.7bn to build 15 city pharmacy centers, 48 central pharmacies and 5 satellite pharmacies within three years. It aims to build a business model of smart pharmacies (“移動醫療+城市中央藥房”), which serves patients` hospital visiting and medicines, combines the medical institutions online and offline, thus forms a complete commercial system. On one hand, the platform directly accesses to the hospital information system to collect and transfer patients` prescriptions. On the other hand, the mobile healthcare platform provides patients with services including appointment registration, visiting guidance, online payment, drug distribution and other ancillary services. Also the smart pharmacies provide one-stop service involving prescription examination, dispensing, TCM decoction production, home delivery and so on. In near future, the company will implement the smart pharmacy project in Guangzhou, Shenzhen, Beijing, Shanghai, Chengdu, Puning, Kunming, Chongqing, Guiyang, and actively start the construction of more central pharmacies in Xiamen, Meihokou and other cities. In 18H1, the company acquired Hubei Yikangjia Pharma and Guangdong Huayuan Shitiande Pharma to quickly enter into blank area of distribution business, and further boost sales and profitability of TCM decoction pieces business.

Medical apparatus and instruments kept high growth. This sector achieved sales of RMB1345mn with notable yoy growth of 67.76%. It mainly focuses on high-value consumables and small & medium-sized equipment, covering areas such as orthopaedics, surgery, five sense organs, diagnosis, etc. After acquiring two medical instrument companies, Kangmei established new distribution institutions in Nanjing, Anhui and Shanghai and consolidated the local market shares. At present, the company has covered about 90% of China market. In the future, it will add investment in the development of smart distribution, intelligent cold chain distribution, large data samples and other aspects, to strengthen related industry integration and profitability of its business.

BUY

CMP RMB20.83

(Closing price at 24 Sep 2018)

TARGET RMB25.97 (+25%)

COMPANY DATA

O/S SHARES (MN) :	4,946.74
MARKET CAP (RMBMN) :	103,606
52 - WK HI/LO (RMB):	27.96 / 19.1

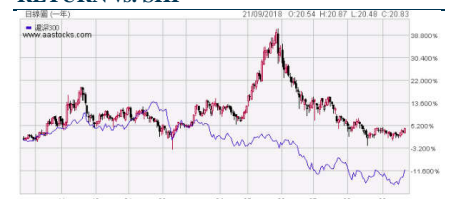
SHARE HOLDING PATTERN , %

Kangmei Investment Holdings Ltd.	32.98
CSF	4.79
Minmetals Trust	4.66

PRICE PERFORMANCE , %

	1M	3M	1Y
Kangmei	2.36	-6.62	4.60
SHI	2.50	-1.65	-16.56

RETURN vs. SHI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY15	FY16	FY17E	FY18E
Net Sales	21,642	26,477	33,477	40,214
Net Profit	3,340	4,101	5,167	6,189
EPS, RMB	0.67	0.78	1.04	1.24
PER, x	31.23	26.57	20.05	16.74
BVPS, RMB	5.29	5.84	7.28	7.90
P/BV, x	3.94	3.56	2.86	2.64
ROE, %	13.95	13.41	14.27	15.74

Source: Company reports, Phillip Securities Est.

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

Continuing hospital investment. After investing in Meihkou central hospital, Kaiyuan central hospital and Tongcheng people's hospital, the company will invest in medical service institutions in Liuzhou Guangxi and Tongliao Inner Mongolia. It is expected to invest RMB1.3bn (taking 67% of shares) in Tongliao city to build a new hospital and RMB192.7mn in Liuhe county to build a central hospital to further integrate local medical resources, which will further expand the company's hospital business network.

Figure: Interim results

	17H1	18H1	Change
Revenue/ mn	13,262.36	16,959.34	27.88%
TCM decoction pieces	2,697.22	3,826.82	41.88%
<i>GPM</i>	32.87%	36.40%	+3.53ppt
TCM distribution	3,805.59	4,802.66	26.20%
<i>GPM</i>	24.67%	25.72%	+1.05ppt
Western medicine distribution	4,452.91	4,904.43	10.14%
<i>GPM</i>	29.64%	28.96%	-0.68ppt
Medical instruments	801.76	1,345.04	67.76%
<i>GPM</i>	30.65%	29.19%	-1.46ppt
Others	1,504.87	2,080.39	38.24%

Source: Company, Phillip Securities (HK)

Investment Thesis, Valuation & Risk

We give target price of RMB25.97. We estimate 18E/19E net profit to be RMB5.16bn/6.19bn with EPS of RMB1.04/1.24. **Risks include:** smart pharmacy business fails expectations; rising raw material prices; hospital investment business fails expectations; policy risks.

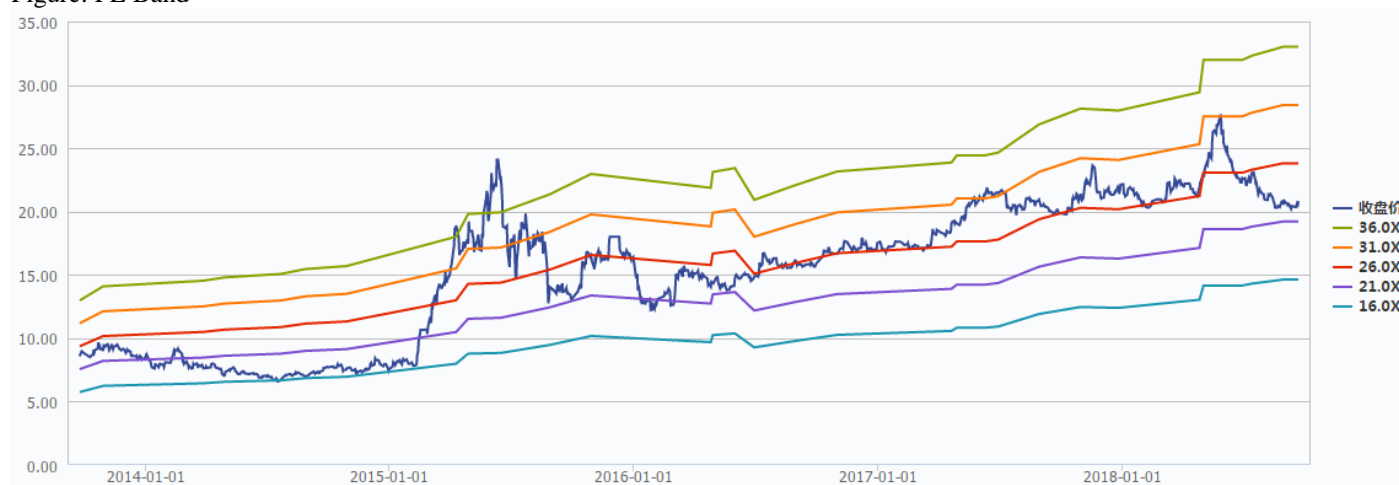
Figure: Key ratios of peers

Code	Mrt Cap/mn	Topline/mn	Net profit/mn	ROE%	PB(MRO)	17A	PE	
							18E	19E
600518.SH	103,605.54	26,239.06	4,100.93▼	13.41	3.11	25.26	20.76	16.99
A shares (10)								
Max	103,605.54	26,239.06	4,100.93	30.36	13.23	72.58	52.41	39.57
Median	38,168.89	12,079.10	1,339.11	17.6	3.71	24.97	20.84	17.64
Average	47,853.58	13,042.44	1,772.22	18.06	5.06	31.55	25.31	21.22
000538.SZ	73,137.50	24,144.96	3,144.98	18.63	3.72	23.26	20.92	18.49
600436.SH	58,570.03	3,674.32	807.02	21.16	13.23	72.58	52.41	39.57
600332.SH	54,895.75	20,750.14	2,061.65	11.39	2.76	27.92	17.52	16.88
600085.SH	42,378.43	13,232.19	1,017.38	12.55	4.86	41.65	37.74	33.67
600535.SH	33,959.36	15,905.01	1,376.54	16.57	3.7	24.67	21.23	18.3
000423.SZ	30,202.71	7,280.43	2,044.35	22.46	2.98	14.77	13.97	12.78
600566.SH	30,073.41	5,533.52	1,223.46	30.36	6.54	24.58	18.48	14.58
002773.SZ	26,907.72	2,738.71	644.2	19.98	7.31	41.77	33.27	26.22
000999.SZ	24,805.33	10,926.01	1,301.69	14.11	2.43	19.06	16.8	14.78
HK shares (10)								
Max	54,895.75	20,750.14	2,061.65	22.6	5.02	325.22	23.02	19.92
Median	9,649.48	1,924.36	451.55	11.39	1.64	18.56	14.29	12.71

Average	14,093.35	4,891.08	689.9	12.65	2.03	52.34	14.74	12.88
0874.HK	54,895.75	20,750.14	2,061.65	11.39	1.76	17.63	10.84	12.04
0570.HK	23,965.88	8,338.96	1,170.43	9.74	1.53	19.64	16.48	13.39
2186.HK	19,981.91	3,819.26	981.37	14.87	2.68	19.53	16.24	13.77
1666.HK	12,905.23	5,025.18	666.67	14.46	2.48	18.56	17.2	15.74
3613.HK	11,528.34	1,059.98	409.57	21.23	5.02	26.99	23.02	19.92
2877.HK	7,770.63	1,924.36	451.55	7.89	1.3	16.5	12.33	10.56
1681.HK	4,927.96	1,659.98	396.24	22.6	2.5	11.93	10.44	8.73
0587.HK	3,324.07	--	--	--	0.44	--	--	--
3737.HK	1,098.25	946.29	70.06	11.33	1.52	15.03	11.36	8.91
1498.HK	535.48	495.6	1.58	0.38	1.09	325.22	--	--

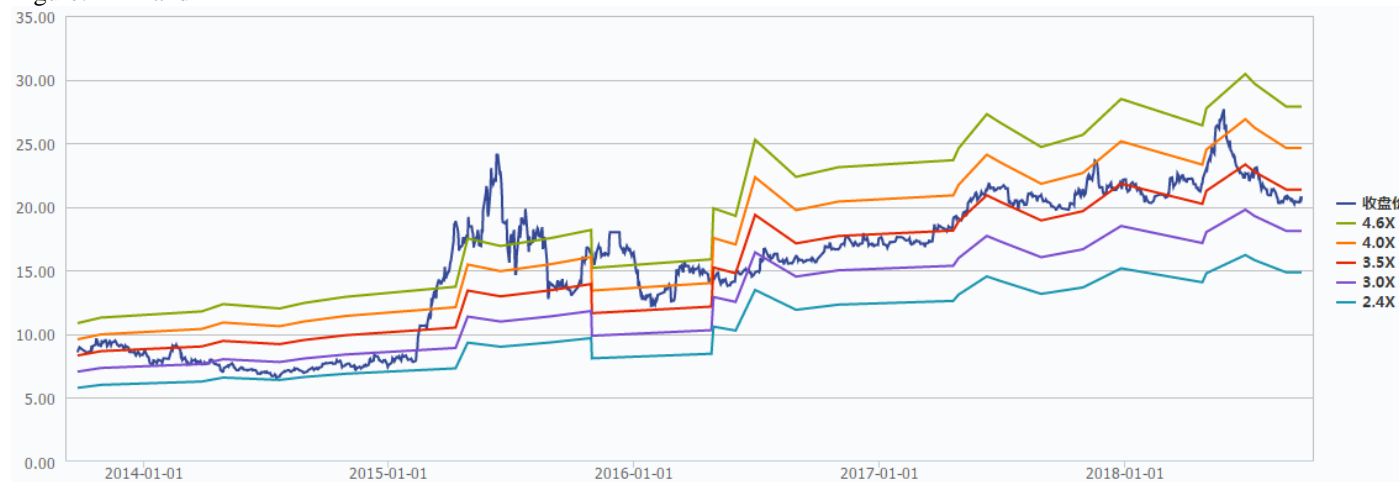
Source: Wind (as at Sep 21th), Phillip Securities

Figure: PE Band



Source: Wind (as at Sep 21th), Phillip Securities

Figure: PB Band



Source: Wind (as at Sep 21th), Phillip Securities

Financial Data

	2015	2016	2017	2018E	2019E
Valuation Ratios					
P/E	33.43	31.23	26.57	20.05	16.74
P/B	5.80	3.94	3.56	2.86	2.64
Per Share Data (RMB)					
EPS	0.62	0.67	0.78	1.04	1.24
Book Value Per Share	3.59	5.29	5.84	7.28	7.90
Dividend Per Share	0.19	0.21	0.24	0.31	0.37
Growth & Margin(%)					
Growth					
Revenue	13.28	19.79	22.34	26.44	20.13
Gross Profit	15.00	26.39	24.05	23.63	17.98
Operating Income	20.68	22.99	22.16	27.21	19.09
Net Profit	20.60	21.17	22.77	25.98	19.79
Margins					
Gross Profit Margin	28.34	29.90	30.32	29.64	29.11
Operating Profit Margin	17.81	18.29	18.26	18.37	18.21
Net Profit Margin	15.26	15.43	15.49	15.43	15.39
Key Ratios					
ROE (%)	15.54	13.95	13.41	14.27	15.74
ROA (%)	11.11	10.07	9.35	7.14	7.87
Income Statement (RMB Mn)					
Revenue	18,066.8	21,642.3	26,477.0	33,476.8	40,214.3
- Cost of Goods Sold	12,947.3	15,171.5	18,450.2	23,553.3	28,506.5
Gross Income	5,119.6	6,470.8	8,026.8	9,923.4	11,707.8
- Operating Expenses	1,928.6	2,587.2	3,365.2	3,572.0	4,182.3
Operating Income	3,217.9	3,957.7	4,834.8	6,150.6	7,324.5
Non-operating Gain/Loss	24.7	29.9	(8.1)	0.0	0.0
- Income Tax Expenses	486.2	650.8	732.1	984.1	1,135.3
Net Profit to Firm	2,756.5	3,336.8	4,094.7	5,166.5	6,189.2
-Minority Interest	(0.28)	(3.64)	(6.28)	0.00	0.00
Net Profit	2,756.8	3,340.4	4,100.9	5,166.5	6,189.2

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 24th Sep 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

GENERAL DISCLAIMER

This publication is prepared by Phillip Securities (Hong Kong) Ltd ("Phillip Securities"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively the "Research") contained in this publication are based on such information and are expressions of belief only. Phillip Securities has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities shall not have any responsibility to maintain the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the information or Research made available, even if it has been advised of the possibility of such damages.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a financial adviser regarding the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

Disclosure of Interest

Analyst Disclosure: Neither the analyst(s) preparing this report nor his associate has any financial interest in or serves as an officer of the listed corporation covered in this report.

Firm's Disclosure: Phillip Securities does not have any investment banking relationship with the listed corporation covered in this report nor any financial interest of 1% or more of the market capitalization in the listed corporation. In addition, no executive staff of Phillip Securities serves as an officer of the listed corporation.

Availability

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Information contained herein is based on sources that Phillip Securities (Hong Kong) Limited ("PSHK") believed to be accurate. PSHK does not bear responsibility for any loss occasioned by reliance placed upon the contents hereof. PSHK (or its affiliates or employees) may have positions in relevant investment products. For details of different product's risks, please visit the Risk Disclosures Statement on <http://www.phillip.com.hk>.

© 2018 Phillip Securities (Hong Kong) Limited

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