

CR Pharmaceutical (3320.HK)

Acquiring New Drug Distribution Rights and Seeking to Enhance Competitiveness in Biopharmaceutical Field

Hong Kong | Pharmaceutical | Company report

30 January 2019

Investment Highlights

Currently the chemical products are affected by the centralized procurement policy, but this part accounts for a relatively low proportion in the company's topline, thus it is expected to have limited impact. In addition, the company actively acquires new drug distribution rights to underpin future growth. Besides it is going to enhance R&D strength and product reserve in the field of biological medicines. Meanwhile, it cooperates with banks to improve the financial services of its B2B platform, and the revenue of this platform is expected to exceed RMB10bn in 2018. We expect that the business will keep steady growth, and adjust the target price to HKD12.5 with Accumulate rating. (Closing price at 28 Jan 2019)

Business Overview

Chemical products price is affected by GPO. In 1H18, its manufacturing business accounted for 18% of total income, contributing more than 63% of gross profit. Specifically, the sales revenue of chemical drugs reached RMB8.04bn (48% of the manufacturing business revenue, and 8.6% in overall income). As the proportion is small, chemical drugs segment has relatively limited impact on total income, but may put pressure on profit margin.

Actively acquiring new drug distribution rights to underpin future growth. According to its official website, in November, CR Pharma signed a comprehensive strategic cooperation agreement with Gilead Sciences, Inc.. Gilead is a global leader in drug research and development in the field of viral infectious diseases. At present, Gilead's products have treated more than 12 million HIV patients and more than 1.7 million hepatitis C patients worldwide. CR Pharma takes over the distribution right of Gilead's product, Truvada (an anti-AIDS drug), and becomes Gilead's general agent for the import of anti-viral infectious drugs in China. CR Pharma is actively seeking to obtain more effective new drug products rights, in order to enrich product varieties and expand income scale. We anticipate that the sales increase of new drugs will offset some policy-affected sales reductions, and in the long run, the company's product mix is to be further optimized.

Enhancing R&D strength and pipeline in the field of biological medicines. The company integrates resources involving R&D, production and marketing to boost biopharmaceutical business. The company and CR biopharmaceutical 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. 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.

Accumulate

CMP HKD11.12

(Closing price at 28 Jan 2019)

TARGET HKD12.5 (+12.4%)

COMPANY DATA

O/S SHARES (MN) :	6,284.5
MARKET CAP (HKDMN) :	69,884
52 - WK HI/LO (HKD):	13.16 / 9.46

SHARE HOLDING PATTERN , %

CR Holdings	53.04
BSAMAC	20.63

PRICE PERFORMANCE , %

	1M	3M	1Y
CR Pharma	7.75	-3.30	6.78
HSI	8.13	12.17	-16.82

RETURN VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

HKD mn	FY16	FY17	FY18E	FY19E
Net Sales	156,705	172,532	194,084	215,405
Net Profit	2,821	3,483	4,417	4,882
EPS, HKD	0.57	0.55	0.70	0.78
PER, x	19.36	20.06	15.82	14.31
BVPS, HKD	11.05	10.05	10.04	10.86
P/BV, x	1.01	1.11	1.11	1.02
ROE, %	5.20	5.52	7.00	7.16

Source: Company reports, Phillip Securities Est.

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Launching an on-line healthcare platform in Beijing. In December, CR Pharma together with Beijing Aerospace General Hospital launched the first "intelligent hospital & prescription circulation platform" (智慧醫院+處方流轉平臺) project in Beijing. This platform provides comprehensive medical information, helps with appointment reservation, online payment and online pharmacy, and offers all-round medical services for patients before, during and after diagnosis. Through this platform, patients can access to the hospital service from WeChat or Alipay terminals, make appointment registrations, select the departments and doctors, pay the registration fee, and then receive the diagnosis and treatment service. Electronic prescriptions will be transmitted to patients' mobile phones synchronously, then patients can choose out-of-hospital pharmacies to purchase drugs. After electronic prescriptions are transferred to drug stores, drugstores check doctors' prescriptions, prepare drugs and invoices, and deliver them by professional pharmacy personnel.

Cooperating with banks to improve financial services on B2B platform. In 2015, CR Pharma established its online B2B medicine shop, which connects pharmaceutical producers, distributors and end customers, offering services like accurate marketing, online financing, product track, warehousing and logistics services. In October 2018, CR Pharma signed online supply chain financial cooperation agreements with China Merchants Bank (Beijing Branch) and WeBank respectively, which are going to support the construction of this B2B platform through providing relevant financial services for retail pharmacies, distribution companies and primary medical institutions. The turnover of this platform is estimated to exceed RMB10bn in 2018.

Figure: 18H1 results

(HKD mn)	18H1	17H1	Change
Revenue	93,741	82,738	+13.3%
--Pharmaceutical	16,874	12,692	--
--Distribution	77,601	70,413	--
--Retail	2,470	2,117	--
Gross profit	16,881	12,528	+34.7%
--Pharmaceutical	10,743	7,629	--
--Distribution	5,713	4,485	--
--Retail	365	402	--
GPM	18.0%	15.1%	+2.9ppt
Operating profit	6,296	5,137	+22.6%
OPM	6.7%	6.2%	+0.5ppt
Profit for the firm	4,063	3,453	+17.7%
Attributable profit	2,250	1,810	+24%
NPM	2.4%	2.2%	+0.2ppt
EPS HKD	0.36	0.29	+24%

Source: Company, Phillip Securities

Valuation and Risks

We adjust our target price to **HK\$12.5**, and mildly lower 18E/19E income forecast, which is based on the consideration of policy impact in the short term. CR Pharma is one of the top three distributors in terms of market scales, and it is expected to gain a larger market share through external expansion in future. At present, the average valuation of leading distribution enterprises in HK and A share markets is about 14-17 times PE. We give CR Pharma target PE 16x, with 19E EPS forecast of HKD0.78 (previously HKD0.79), to derive TP **HKD12.5**. **Downside risks** include: GPO may further drag down profitability; distribution business growth is less than expected; R&D failure risk; and policy risks.

Figure: PE band

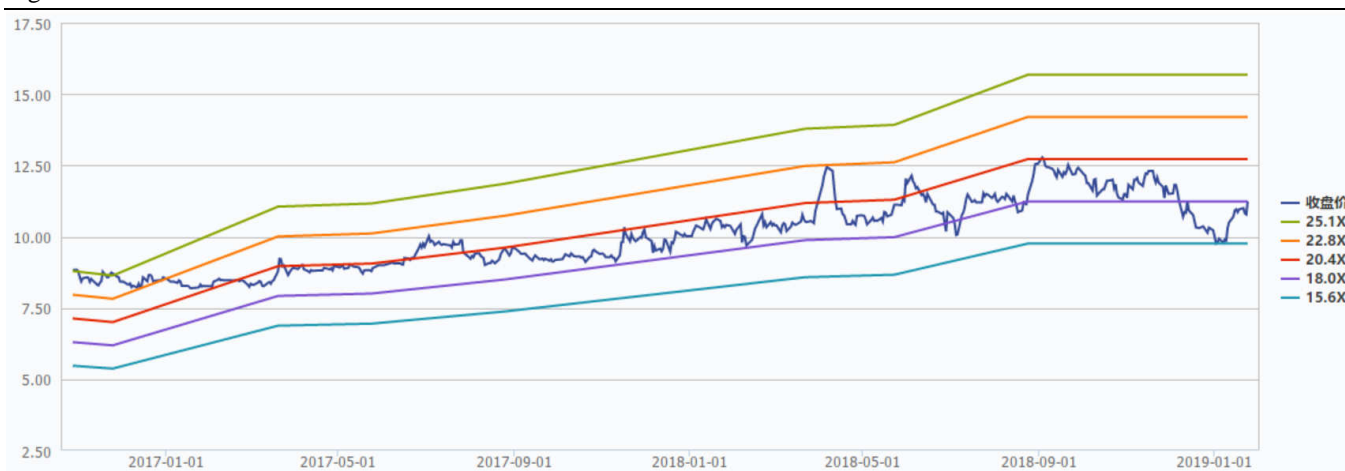
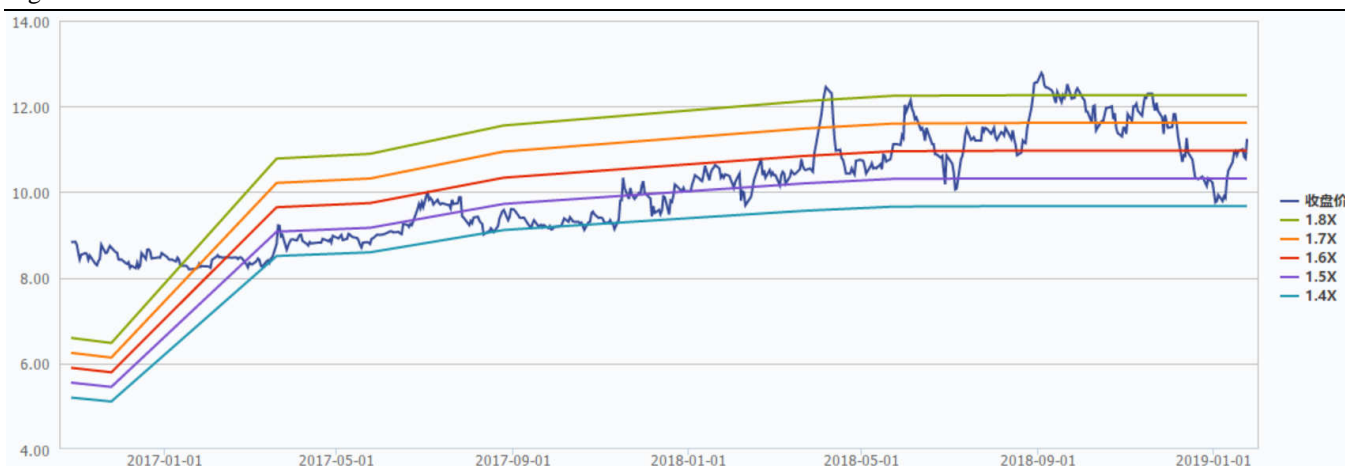


Figure: PB band



Source: Wind (as at Jan 24th), Phillip Securities

Figure: Peers valuation

Code	Mkt Cap	PE TTM	PE 19E	PE 20E	EPS 18E	EPS 19E
3320.HK	70,763.5	18.0	14.3	12.5	0.7	0.8
H share	HKD mn					
Max	104,453.7	23.7	17.7	14.1	2.5	2.9
Median	36,838.1	15.3	11.9	10.6	1.2	1.3
Average	46,018.4	15.5	11.9	10.1	1.2	1.4
1099.HK	104,453.7	16.6	14.1	12.3	2.2	2.5
1093.HK	81,945.5	23.7	17.7	14.1	0.6	0.7

2196.HK	67,172.1	18.9	14.2	11.8	1.4	1.7
2607.HK	52,606.5	10.0	9.0	8.1	1.7	1.9
1513.HK	21,069.8	14.1	12.2	11.2	1.8	2.1
0867.HK	19,297.6	8.9	7.5	6.6	0.9	1.0
0460.HK	15,343.2	9.4	7.9	7.2	0.2	0.2
1558.HK	14,962.0	12.9	11.6	10.0	2.5	2.9
0512.HK	12,570.7	22.0	10.7	7.6	0.2	0.4
A share	RMB mn					
Max	45,550.9	42.4	29.1	22.4	2.8	3.2
Median	13,563.4	14.2	12.2	10.6	1.4	1.7
Average	16,095.7	17.8	13.7	11.2	1.4	1.7
601607.SH	45,550.9	11.3	10.4	9.2	1.5	1.6
000963.SZ	39,064.5	18.6	14.3	11.6	1.5	1.9
600998.SH	27,151.0	21.5	15.9	12.7	0.7	0.9
600511.SH	17,825.9	14.2	12.1	10.8	1.7	1.9
603939.SH	17,031.6	42.4	29.1	22.4	1.1	1.6
603233.SH	16,176.4	31.0	23.7	19.5	1.4	1.7
000028.SZ	15,903.0	14.2	12.4	10.8	2.8	3.2
200028.SZ	15,903.0	8.5	7.4	6.4	2.8	3.2
603883.SH	13,563.4	32.2	23.9	19.3	1.6	2.0
600056.SH	13,537.7	8.7	7.3	6.1	1.5	1.7
002727.SZ	11,469.0	21.8	16.9	13.7	1.0	1.2
002589.SZ	9,359.3	8.4	6.1	4.9	0.8	1.0
000078.SZ	8,283.9	12.6	8.0	6.6	0.3	0.4
600090.SH	7,831.8	15.2				
603368.SH	6,883.6	13.7	10.4	8.4	2.0	2.6
600713.SH	4,478.9	17.0	12.4	10.3	0.3	0.3
002462.SZ	3,612.6	11.2	8.6	6.9	1.3	1.7

Source: Wind (as at Jan 25th), Phillip Securities

Financials

Key Ratios	2016	2017	2018E	2019E
Valuation Ratios				
Price to Earnings (P/E)	19.36	20.06	15.82	14.31
Price to Book (P/B)	1.01	1.11	1.11	1.02
Per Share Data (HKD)				
EPS	0.57	0.55	0.70	0.78
Book Value Per Share	11.05	10.05	10.04	10.86
Dividend Per Share	0.00	0.17	0.21	0.23
Growth (%)				
Revenue	6.92	10.10	12.49	10.99
Operating Income	-2.59	9.91	30.26	10.60
Net Profit	-1.01	23.45	26.82	10.53
Margins (%)				
Gross Profit Margin	15.39	16.39	16.50	16.50
Operating Profit Margin	6.28	6.27	7.26	7.23
Net Profit Margin	1.80	2.02	2.28	2.27
Profitability (%)				
ROE	5.20	5.52	7.00	7.16
ROA	2.11	2.17	2.70	2.77

Income Statement (HKD Mn)	2016	2017	2018E	2019E
Revenue	156,705.2	172,532.0	194,084.1	215,404.6
- Cost of Goods Sold	132,596.1	144,256.1	162,060.3	179,862.9
Gross Income	24,109.1	28,276.1	32,023.9	35,541.8
- Operating Expenses	14,270.4	17,462.9	17,938.0	19,963.4
Operating Income	9,838.7	10,813.3	14,085.9	15,578.3
- Financing Cost	1,796.1	2,230.9	2,134.9	2,369.5
Pretax Income	8,042.7	8,582.3	11,951.0	13,208.9
- Income Tax Expenses	2,074.6	1,715.5	2,748.7	3,038.0
- Minority Interest	3,146.7	3,383.8	4,785.2	5,288.8
Profit Attributable to Shareholders	2,821.4	3,483.0	4,417.1	4,882.0

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 28 Jan 2019)

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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