

CMS (867.HK)

Leading Pharmaceutical Marketing and Promotion Company

Hong Kong | Pharmaceuticals | Company Update

October 22, 2019

Result Update

For the six months ended June 30, 2019, the company recorded operating income of RMB 2.964 billion, an increase of 11.7% YoY; if excluding the effect of the “two-invoice system” revenue was RMB 3.402 billion, an increase of 14.4% YoY, mainly because of an increase in sales volume. Gross profit was RMB 2.218 billion, a YoY increase of 17.7%; excluding the effect of the “two-invoice system”, gross profit was RMB 2.023 billion, a YoY increase of 16.0%, mainly reflecting the increase in turnover. Gross profit margin was 74.8%, up 3.9ppt YoY; excluding the effect of the “two-invoice system”, gross profit margin was 59.5%, an increase of 0.8ppt YoY, mainly due to decreases in import duty rate and value-added tax rate. The selling expenses were RMB 883 million, up 20.1% YoY; selling expenses accounted for 29.8% of turnover, an increase of 2.1ppt YoY; excluding the effect of the “two-invoice system”, selling expenses accounted for 20.2% of turnover, with an increase of 0.2ppt YoY, mainly reflecting increases in academic promotion activities and human costs. The administrative expenses of the company was RMB 110.3 million, an increase of 12.0% YoY; the administrative expenses accounted for 3.7% of the turnover, which was the same as that of the same period of 2018; excluding the effect of the “two-invoice system”, administrative expenses accounted for 3.2, a YoY decrease of 0.1ppt, mainly due to the effective control over expenses and the benefit from economies of scale. Finance costs were RMB 29.1 million, a decrease of 31.3% YoY, mainly due to a decrease in utilization of loans. The profit for the period was RMB 1.168 billion, a YoY increase of 22.2%, mainly due to the continuous growth in turnover and an increase in other gains.

Accelerate the development of innovative product development

The company mainly invests in innovative products of different innovation levels and development stages by making equity investment in overseas R&D companies or achieving strategic collaboration with them. As of June 30, 2019, the company acquired four innovative products with sufficient competitive advantages to meet the clinical needs in Chinese market. Among them, two have been launched in the United States, the European Union and other regions, and the other two are in the clinical stage. The company's innovative products have expanded to 13 products in various fields, including ophthalmology, dermatology, nervous system, anti-tumor, immune system, digestive system, anti-infection and endocrine system.

In-licensing

Cyclosporine A, 0.09% Eye Drops

Cyclosporin A, 0.09% Eye Drops is a nanotechnology enabled-formulation in a clear, preservative-free, aqueous solution. It is the globally first patent protected innovative 0.09% cyclosporin ophthalmic solution using nanotechnology for the treatment of increasing tear production in patients with dry eye. The drug was marketed in the United States in August 2018. In June 2019, the company through its wholly-owned subsidiary signed a Licensing Agreement with a wholly-owned subsidiary of Sun Pharma, a global pharmaceutical company focusing on branded innovative products and complex generics, and gained an exclusive license with the right to grant sublicenses under Sun Pharma's intellectual property rights and regulatory documentation to develop and commercialize its product Cyclosporin A, 0.09% Eye Drops in greater China (including Hong Kong, Macao and Taiwan).

Accumulate

CMP HKD 10.06

(Closing price at 18 October 2019)

TARGET HKD 11.34 (+12.74%)

COMPANY DATA

O/S SHARES (MN)	2,480.4
MARKET CAP (HKDMN)	24,953
52 - WK HI/LO (HKD):	10.92/6.14

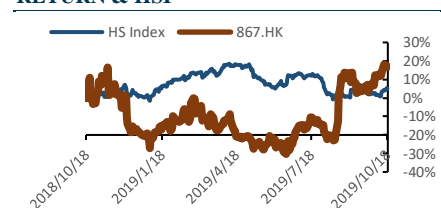
SHARE HOLDING PATTERN

Treasure Sea Limited	43.92%
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PRICE PERFORMANCE

	1M	3M	1Y
CMS	11.90%	30.59%	16.71%
HSI	-0.13%	-6.12%	4.97%

RETURN & HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

mn RMB	FY17 A	FY18 A	FY19 E	FY20 E	FY21 E
Revenue	5,349	5,433	5,983	6,304	6,742
Net Profit to owner	1,675	1,850	2,187	2,298	2,451
EPS RMB	0.67	0.74	0.88	0.93	0.98
P/E	14.94	13.52	11.41	10.86	10.24
BVPS RMB	2.92	3.36	3.90	4.45	5.02
P/B	3.44	2.99	2.58	2.26	2.00
ROE	24.84 %	23.67 %	24.27 %	22.18 %	20.80 %

Source: Company, Phillip Securities (HK) Research

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Tildrakizumab (A Monoclonal Antibody Specifically Targeting Interleukin-23 (IL-23))
 Tildrakizumab-asmn is a humanized IgG1/k monoclonal antibody that specifically target IL-23 to treat adults with moderate-to-severe plaque psoriasis that meets systemic or phototherapy indications. The drug was marketed in the United States in March 2018. In June 2019, the company through its wholly-owned subsidiary signed a Licensing Agreement with a wholly-owned subsidiary of Sun Pharma, and gained an exclusive, royalty-bearing license with the right to grant sublicenses under Sun Pharma’s intellectual property rights to develop, use, sell, offer to sell and import Tildrakizumab in Greater China (including Hong Kong, Macao and Taiwan).

Equity Investment

MTD201 (A Q-Sphera™ Polymer Microsphere Formulation of Octreotide), MTX110 (Panobinostat)

In January 2019, the company through its wholly-owned subsidiary made an equity investment in a UK-based international specialty pharmaceutical company, Midatech Pharma, which specializes in R&D of a pipeline of medicines for oncology and immunotherapy, and gained exclusive, perpetual, transferable, sub-licensable rights to develop and commercialize its current products mainly including MTD201 and MTX110, and certain new pharmaceutical products or line extension in China (including Hong Kong, Macao and Taiwan) and specific Southeast Asian countries. MTD201 is a Q-Sphera™ polymer microsphere formulation of Octreotide developed for the treatment of neuroendocrine tumors (NETs) and acromegaly. MTX110 is primarily developed for the treatment of diffuse intrinsic pontine glioma (DIPG).

Figure-1: Progress of innovative products

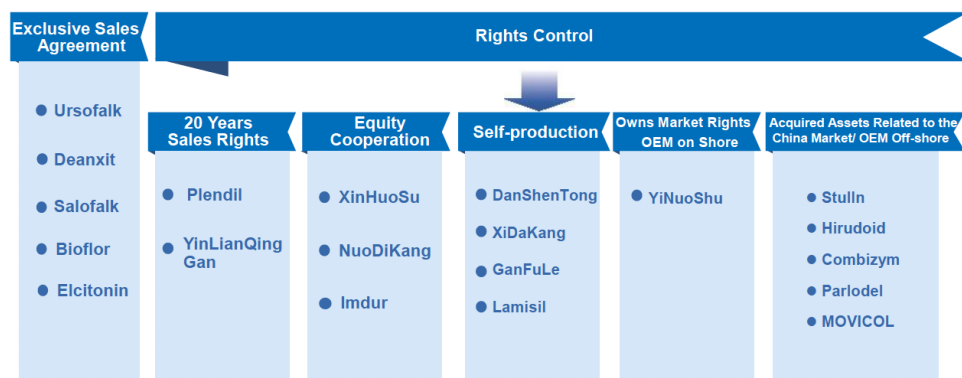
Product	Indication	Innovativeness	Phase I	Phase II	Phase III	FDA/EMA* Marketing Approval Application	Launched into Market	
Cyclosporine A, 0.09% Eye Drops	Increasing Tear Production in Patients with Keratoconjunctivitis Sicca (Dry Eye)	Global nanotechnology patent	→				Approved for marketing by the U.S. FDA	→
TILDRAKIZUMAB (Biological Agent)	Moderate-to-severe Plaque Psoriasis	Innovative biological agent; substance and formulation patents	→				Approved for marketing by the U.S. FDA, the Europe EMA and the Australia TGA**	→
PoS (Medical Device)	Physical Adjuvant Therapy for Balance Disorders Related Symptoms due to mild-to-moderate Traumatic Brain Injury (TBI)	Invention and design patents	→				Received License Clearance from Health Canada to market in Canada FDA noted that Helius could generate additional data and resubmit its application	→
NRL-1	Acute Repetitive Seizures	Innovative pharmaceutical composition with overseas patent technology	→					
CMS024	Primary Liver Cancer	New lead compound; substance, compound, use and application patents	→					
CF101	Rheumatoid Arthritis (RA)	New lead compound	→					
	Psoriasis		→					
CF102	Hepatocellular Carcinoma (HCC)	New lead compound	→					
	Non-Alcoholic Fatty Liver Disease (NAFLD) / Non-Alcoholic Steatohepatitis (NASH)		→					
XF-73	Prevention of Post-surgical Staphylococcal Infections	New lead compound; compound and use patents	→					
BB2603	Onychomycosis and Tinea Pedis	Formulation patents	→					
ACT017 (Biological Agent)	Acute Phase of Ischemic Stroke	Innovative biological agent; substance patent	→					
VXM01 (Biological Agent)	Recurrent Glioblastoma (GBM)	Innovative biological agent; production process and use patents	→					
MTX110	Diffuse Intrinsic Pontine Glioma (DIPG)	Increases available routes of administration for a drug	→					
MTD201	Acromegaly and Neuroendocrine Tumors (NETs)	Production process patents	→					

*European Medicines Agency ("EMA")
 ** Therapeutic Goods Administration ("TGA")

Continuous optimization of existing product portfolio

The company divides its existing products into cardio-cerebrovascular line, digestion line, ophthalmology line and dermatology line. The main products of cardio-cerebrovascular line include Xinhuosu, Plendil and Deanxit. As of 1H2019, the cardio-cerebrovascular line realized revenue of RMB 1.341 billion, a year-on-year increase of 3.7%. If excluding the effect of "two-invoice system", the income from the cardio-cerebrovascular line will reach RMB 1.940 billion, showing a year-on-year increase of 14.7%, accounting for 57% of the company's turnover excluding the effect of "two-invoice system". The main products of the digestion line include Ursolfalk, Salofalk, Bioflor and Combizym. As of 1H2019, the digestion line realized revenue of RMB 1.027 billion, representing a year-on-year increase of 19.6%, accounting for 30.2% of the company's turnover excluding the effect of "two-invoice system". The main product of the ophthalmology line is Augentropfen Stullen Mono Eye Drops. As of 1H2019, the ophthalmology line realized revenue of RMB 115.2 million, a year-on-year increase of 9.5%, accounting for 3.4% of the company's turnover excluding the effect of "two-invoice system". The main product of dermatology line is Hirudoid. As of 1H2019, the dermatology line realized revenue of RMB 86 million, a year-on-year increase of 16.5%, accounting for 2.5% of the company's turnover excluding the effect of "two-invoice system". As of 1H2019, the company's other sales and promotion products realized revenue of RMB 395 million, an increase of 21.8% year-on-year; if excluding the effect of "two-invoice system", the realized revenue was RMB 233 million, a decrease of 5.1% year-on-year, accounting for 6.8% of the company's turnover excluding the effect of "two-invoice system".

Figure-2: The cooperation methods of existing products



Source: Phillip Securities (HK) Research, Company Report

Figure-3: Products line-divided revenue of existing products

No.		2015		2016		2017		2018		1H2018		1H2019	
		RMB'000	Y-o-Y Change	RMB'000	Y-o-Y Change	RMB'000	Y-o-Y Change	RMB'000	Y-o-Y Change	RMB'000	Y-o-Y Change	RMB'000	Y-o-Y Change
1	Cardio-cerebrovascular Line	1,333,733	14.8%	2,427,190	82.0%	3,020,092	24.4%	3,392,531	12.3%	1,691,331	11.4%	1,940,386	14.7%
	Weight	41.1%		52.7%		54.1%		55.3%		56.9%		57.0%	
2	Digestion Line	1,040,491	18.1%	1,221,797	17.4%	1,586,939	29.9%	1,837,048	15.8%	858,807	16.9%	1,027,218	19.6%
	Weight	32.0%		26.5%		28.4%		29.9%		28.9%		30.2%	
3	Ophthalmology Line	159,103	20.0%	181,112	13.8%	217,478	20.1%	225,402	3.6%	105,201	0.1%	115,210	9.5%
	Weight	4.9%		3.9%		3.9%		3.7%		3.5%		3.4%	
4	Dermatology Line	56,990	-	111,546	95.7%	137,286	23.1%	157,479	14.7%	73,869	15.3%	86,026	16.5%
	Weight	1.8%		2.4%		2.5%		2.6%		2.5%		2.5%	
5	Other Products	656,576	34.7%	661,427	0.7%	616,808	-6.7%	522,075	-15.4%	245,105	-10.6%	232,646	-5.1%
	Weight	20.2%		14.4%		11.1%		8.5%		8.2%		6.8%	
	Total	3,246,893	21.9%	4,603,072	41.8%	5,578,603	21.2%	6,134,535	10.0%	2,974,313	10.3%	3,401,486	14.4%

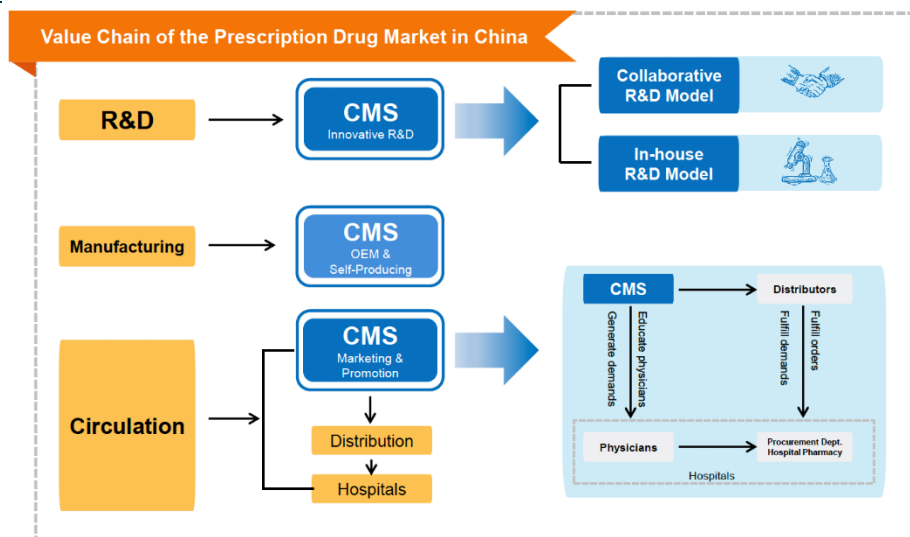
Remark: Above data was calculated after excl. the effect of "two-invoice system"

Source: Phillip Securities (HK) Research, Company Report

Continue to promote network development

In 1H2019, the company used digital marketing tools and digital internal management systems to implement a new academic promotion model, making business data easy to analyze, traceable, and employee behavior management more standardized. At the same time, the company optimized the personnel and compensation system and upgraded the training system to improve employee execution efficiency. The company also steadily promoted the construction and development of the retail team, maintaining and expanding the coverage and channel layout of the retail business. For 1H2019, the company's promotion network covers more than 57,000 hospitals and medical institutions across the country, covering all provincial administrative regions and most prefecture-level administrative regions, and also China's tertiary hospitals, secondary hospitals and the main departments of the tertiary hospital.

Figure-4: Business model of the prescription drug market in China



Source: Phillip Securities (HK) Research, Company Report

Financial Forecast and Valuation

We forecast that the company's FY19/FY20/FY21 income will be RMB 5.98/6.30/6.74 billion, representing an increase of 10.12%/5.36%/6.95% YoY; net profit attributable to shareholders will be RMB 2.19/2.30/2.45 billion, increasing 18.23%/5.07%/6.65% YoY; corresponding EPS will be RMB 0.88/0.93/0.98. We use DCF model and residual income model to value the company. Assuming equity cost is 10.65%, debt cost is 5%, and WACC is 10.14%. We get PT of HKD 11.34 and HKD 11.31 respectively. The higher valuation result corresponds to FY19/FY20/FY21 12.86x/12.24x/11.55x PE, which has an increase of +12.74% compared to the current price (HKD 10.06 as of October 18, 2019), giving an "Accumulate" rating.

Figure-5: Profit margin keep increasing

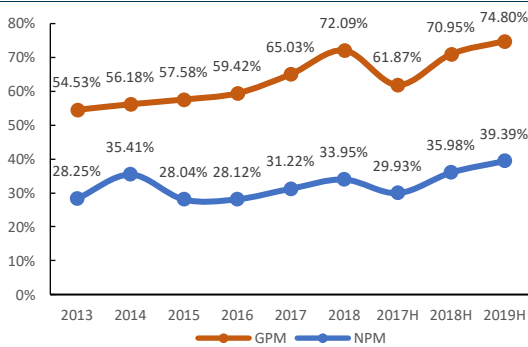
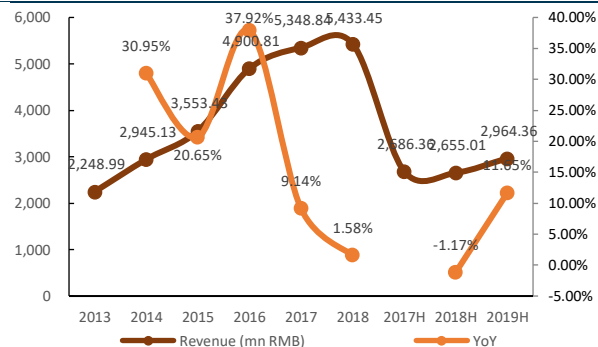


Figure-6: Growth rate of revenue rebounded slightly



Source: Phillip Securities (HK) Research, Company Report

Figure-7: Liability to asset ratio

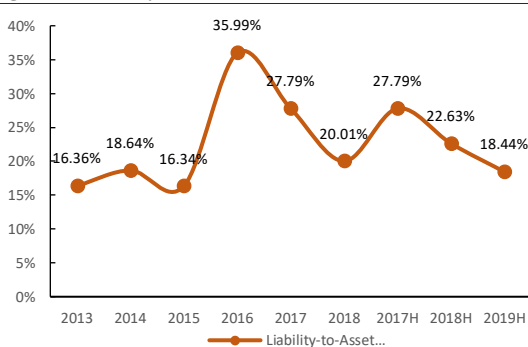
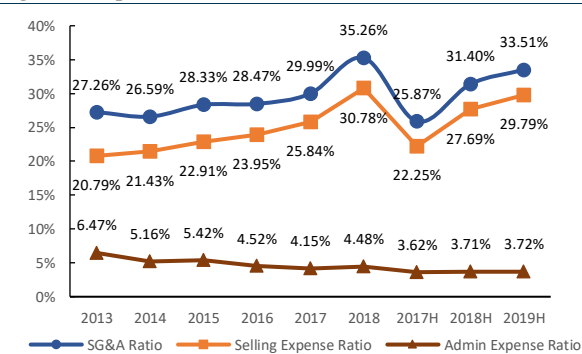


Figure-8: Expense rate



Source: Phillip Securities (HK) Research, Company Report

Table-1: Financial forecast

RMB in million	FY2016A	FY2017A	FY2018A	FY2018H	FY2019H	FY2019E	FY2020E	FY2021E
Revenue	4,900.8	5,348.8	5,433.4	2,655.0	2,964.4	5,983.3	6,304.1	6,742.1
COS	-1,988.9	-1,870.5	-1,516.6	-771.3	-746.9	-1,670.1	-1,759.6	-1,881.9
GP	2,911.9	3,478.3	3,916.9	1,883.7	2,217.5	4,313.3	4,544.5	4,860.3
Operating Profit	1,516.43	1,874.18	2,001.01	1,050.02	1,224.17	2,356.26	2,482.60	2,655.09
EBIT	1,542.96	1,890.68	2,078.26	1,087.44	1,327.62	2,423.42	2,549.75	2,722.24
EBT	1,500.44	1,808.43	2,006.37	1,045.13	1,298.55	2,365.29	2,485.09	2,650.31
NP	1,377.92	1,669.94	1,844.60	955.14	1,167.52	2,184.32	2,294.96	2,447.54
NP attributable to shareholders	1,375.94	1,674.81	1,849.88	957.54	1,169.90	2,187.18	2,297.96	2,450.74
YoY	38.16%	21.72%	10.45%	18.96%	22.18%	18.23%	5.07%	6.65%
EPS (Basic)	0.55	0.67	0.74	0.38	0.47	0.88	0.93	0.98

Source: Phillip Securities (HK) Research, Company Report

Table-2: DCF model

RMB in million	FY2019	FY2020	FY2021	FY2022	FY2023
FCFF	1,509.09	1,848.78	1,972.10	2,028.26	2,296.04
Terminal Value					28,441.28
Discount factor	0.91	0.82	0.75	0.68	0.62
NPV	1,370.15	1,524.02	1,476.01	1,378.27	18,964.09
EV	24,712.55				
Debt value	1,443.27				
Cash	2,049.82				
Equity value	25,319.09				

Equity value in RMB	25,319,094,332.48
Number of shares	2,480,408,512.00
Value per share RMB	10.21
Currency rate	0.90
Value per share HKD	11.34
Cost of debt	5.00%
Debt weights	8.5%
Adjusted beta	0.9
Risk-free rate	3.19%
Market return	11.48%
Cost of equity	10.65%
Equity weights	91.5%
Tax	-7.65%
WACC	10.14%
Terminal growth rate	1%

Source: Phillip Securities (HK) Research, Company Report

Table-3: RI model

RMB	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028
EPS	0.88	0.93	0.98	1.05	1.18	1.33	1.65	2.07	2.62	3.36
DPR	39.97%	39.97%	39.97%	39.97%	39.97%	39.97%	39.97%	39.97%	39.97%	39.97%
DPS	0.35	0.37	0.39	0.42	0.47	0.53	0.66	0.83	1.05	1.34
Add R/E PS	0.53	0.56	0.59	0.63	0.71	0.80	0.99	1.24	1.57	2.02
BPSt	3.90	4.45	5.02	5.65	6.36	7.16	8.15	9.39	10.96	12.98
BPS0	3.36	3.90	4.45	5.02	5.65	6.36	7.16	8.15	9.39	10.96
ROEO	26.24%	23.77%	22.05%	20.95%	20.95%	20.95%	23.05%	25.35%	27.88%	30.67%
Re	10.65%	10.65%	10.65%	10.65%	10.65%	10.65%	10.65%	10.65%	10.65%	10.65%
RI	0.52	0.51	0.51	0.52	0.58	0.66	0.89	1.20	1.62	2.19
Persistent factor	0.80									
Terminal Vaue	5.73									
PV	0.47	0.42	0.37	0.34	0.35	0.36	0.44	0.53	0.65	2.88
BPS0	3.36									
TP	10.18									
Currency rate	0.9									
TP in HKD	11.31									

Source: Phillip Securities (HK) Research, Company Report

Figure-9: Forward P/E Band

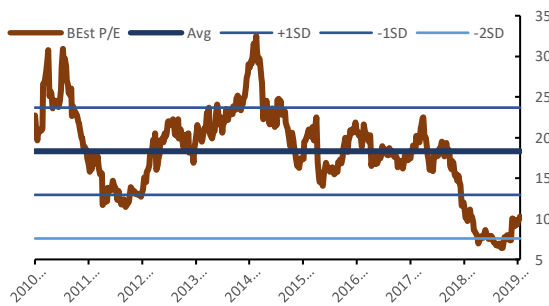
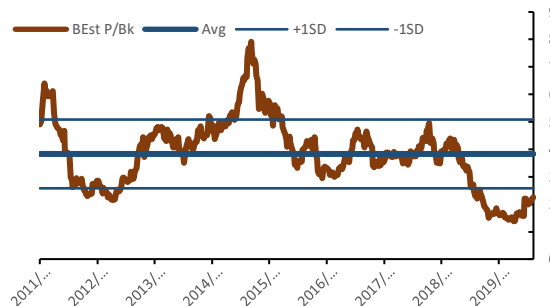


Figure-10: Forward P/B Band



Source: Phillip Securities (HK) Research, Bloomberg

Table-4: Comparable peers

Ticker	Mkt Cap	EV	EV/TTM EBITDA	EV/EBITDA FY1	EV/EBITDA FY2	P/E	P/E FY1	P/E FY2	P/FCF	Dividend
CNY (17 securities)										
Median	22.98B	21.30B	12.21	10.72	8.99	15.47	13.73	11.07	32.25	1.45%
Average	26.89B	33.64B	16.51	15.99	13.03	22.44	19.87	15.93	142.36	1.86%
300122	90.13B	91.81B	34.32	26.57	18.71	42.48	32.59	23.2	395.18	0.98%
600196	68.57B	92.90B	20.7	19.89	16.66	24.53	20.37	17.43	--	1.26%
601607	52.75B	78.59B	9.59	8.48	8.01	12.67	12.14	10.86	69.47	2.22%
603939	37.17B	38.80B	42.78	38.83	30.18	66.08	58.39	43.96	100.22	0.34%
600998	29.73B	62.66B	15.9	16.13	13.37	17.25	16.01	13.07	32.25	0.70%
000513	25.70B	18.88B	10.76	10.03	8.81	21.86	20.38	17.62	17.2	3.31%
600566	24.95B	23.87B	9.98	8.28	6.65	12.46	10.84	8.83	17.75	4.45%
603883	23.66B	26.66B	28.78	26.7	22.06	43.99	40.1	32.61	--	0.67%
600511	22.98B	21.30B	9	8.27	7.5	13.77	2.02	1.8	21.07	1.45%
002424	15.61B	17.19B	21.08	--	--	27.15	--	--	822.8	0.80%
600056	15.38B	18.25B	7.81	7.84	7.1	9.97	9.89	9.12	59.57	3.34%
002589	12.88B	29.42B	7.17	9.4	8.13	20.17	11.12	9.26	8.75	0.67%
000950	11.83B	20.50B	15.22	--	--	12.55	--	--	--	--
603368	10.52B	13.14B	12.55	11.41	9.18	15	13.73	11.07	--	1.69%
600090	6.92B	7.11B	6.64	--	--	10.87	--	--	21.73	4.61%
600829	4.48B	5.35B	11.87	--	--	15.25	--	--	--	--
000756	3.91B	5.38B	--	--	--	15.47	10.76	8.27	--	1.47%

HKD (17 securities)											
Median	18.47B	18.66B	8.54	9	7.84	11.8	12.41	10.02	12.88		2.41%
Average	33.19B	36.97B	10.08	9.95	8.32	14.58	17.25	12.52	22.95		2.87%
1177	140.49B	142.85B	19.7	18.93	16.38	13.61	38.17	32.51	--		0.72%
1093	108.51B	103.86B	19.15	16.02	13.38	28.35	24.17	19.69	62.34		1.03%
1099	78.30B	155.44B	7.23	7.39	6.57	11.93	11.1	9.8	--		2.54%
874	61.57B	58.52B	11.59	12.36	9.5	11.65	11.77	10.02	55.25		1.80%
1530	35.34B	37.54B	23.42	17.95	13.99	29.27	25.38	18.79	--		--
867	24.95B	24.78B	9.65	8.79	8.16	10.93	10.25	9.29	10.83		3.71%
2186	19.88B	20.99B	8.54	8.51	7.8	11.68	11.34	10.13	--		2.13%
2005	18.60B	19.75B	12.83	11.64	9.85	18.22	16.39	13.81	--		1.63%
1558	18.47B	18.66B	9.71	9.21	7.87	13.12	12.41	10.88	27.38		4.35%
570	18.18B	18.15B	5.98	5.18	4.49	10.68	9.62	7.99	--		3.11%
460	10.03B	4.84B	2.04	--	--	--	47.86	5.17	5.02		1.81%
1666	9.48B	8.81B	6.25	6.27	5.98	13.59	12.54	11.83	9.82		2.75%
2877	5.81B	1.79B	227%	2.52	2.16	9.51	9.03	7.91	13.73		5.11%
1349	5.61B	5.23B	20.85	--	--	26.93	28.9	24.96	23.74		1.34%
1681	4.01B	3.60B	4.31	4.37	3.93	7.2	7.03	6.21	12.03		6.48%
950	2.64B	2.20B	4.11	10.11	6.46	7.98	12.82	9.85	--		2.29%
2348	2.29B	1.55B	3.71	--	--	8.63	4.55	4	9.34		5.14%

Source: Phillip Securities (HK) Research, Bloomberg

Risk

The launch of new products fails expectations; Industry policy risk.

Financials

Table-5: Financial data

FYE DEC	FY17A	FY18A	FY19E	FY20E	FY21E
Valuation Ratios					
P/E	14.94	13.52	11.41	10.86	10.24
P/B	3.44	2.99	2.58	2.26	2.00
Dividend Yield	2.67%	2.95%	3.50%	3.68%	3.90%
Per Share Data in RMB					
EPS	0.67	0.74	0.88	0.93	0.98
DPS	0.27	0.30	0.35	0.37	0.39
BVPS	2.92	3.36	3.90	4.45	5.02
Growth & Margins (%)					
Growth					
Revenue	9.14%	1.58%	10.12%	5.36%	6.95%
Operating Profit	23.59%	6.77%	17.75%	5.36%	6.95%
Net Profit	21.19%	10.46%	18.42%	5.07%	6.65%
Margins					
Gross Margin	65.03%	72.09%	72.09%	72.09%	72.09%
Operating Profit Margin	35.04%	36.83%	39.38%	39.38%	39.38%
Net Profit Margin	31.22%	33.95%	36.51%	36.40%	36.30%
Key Ratios					
ROA	16.80%	17.91%	19.30%	17.70%	16.67%
ROE	24.84%	23.67%	24.27%	22.18%	20.80%
Income Statement in mn RMB					
Revenue	5,348.84	5,433.45	5,983.32	6,304.14	6,742.15
Gross Profit	3,478.30	3,916.87	4,313.27	4,544.54	4,860.29
EBIT	1,890.68	2,078.26	2,423.42	2,549.75	2,722.24
EBT	1,808.43	2,006.37	2,365.29	2,485.09	2,650.31
Net Profit	1,669.94	1,844.60	2,184.32	2,294.96	2,447.54
Net Profit for Owners	-4.87	-5.29	-2.86	-3.00	-3.20

Source: Company, Phillip Securities (HK) Research
(Financial data as of October 18)

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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