

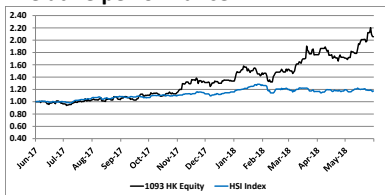
CSPC (1093.HK)

Healthcare Sector

Rating	Buy
Target Price	HKD32.00 (12/18)
Close Price	HKD24.55
52 weeks high/low	HKD10.94-26.75
Market cap	HKD153.00 bil

Source: HKEX, Bloomberg, CASH

Relative performance



Source: Bloomberg, CASH

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Investment Insights

1QFY18 results were another surprise to us: On 25th May, CSPC released its first quarter results ended 31st March 2018. Revenue grew 55.21% YoY to HKD5,387 mn with innovative drugs sales increased 66% YoY to HKD2,357 mn, common generic drugs sales increased 49.2% YoY to HKD1,696 mn, and bulk drugs increased 45.99% YoY to HKD1,335 mn. Gross profit was up 74.98% YoY with GPM at 64.27% due to a favorable shift in product mix towards higher GPM innovative drugs. Both the top line and GPM also surprised the market. Profit attributable to shareholders was up 42.6% YoY to HKD910 mn with EPS at HKD 0.15.

NBP revenue growth momentum remains strong: According to company statistics, NBP sales recorded a high yearly growth of 45%YoY in 1Q18. This is a surprise to the market. Besides, in March 2018, NBP capsule form was granted orphan drug designation for the treatment of amyotrophic lateral sclerosis (ALS) by the U.S. FDA. The indication has also been undergoing a clinical study in China since July 2015. We believe that new indication may help extend NBP patent period in China and bring new market potentials and opportunities. Going forward, we believe that the growth will persist given that the NBP penetration in county-level hospitals is still low.

Oncology drugs another growth engine: We see a very fast revenue growth in CSPC's oncology portfolio. In 1Q18, CSPC's revenue from Duomeisu sales soared 78%YoY to HKD196 mn, revenue from Jinyouli increased 119%YoY to HKD151 mn and revenue from other oncology drugs increased 110%YoY to HKD56 mn. Besides, in February, CSPC announced that the "Albumin-bound PTX" developed by the group has been granted drug registration approval by the CFDA. The drug generated HKD15 mn revenue in March 2018 and HKD55 mn revenue by 23th May 2018. Management guided that Albumin-bound PTX sales in FY18 will reach HKD200-300 mn. It is expected that the revenue growth in CSPC's existing oncology portfolio will persist given the robust demand in China.

Reiterate "Buy" with Dec-18 TP of HKD32: CSPC's EPS is expected to climb to HKD0.61/0.83 in FY18E/FY19E. We reiterate "BUY" rating for CSPC and raise our Dec-18 TP to HKD32 (Previous: HKD22), based on 1.2X PEG with FY18E-20E CAGR of 32%. Key downside risks include 1) an unexpected sales growth slowdown for CSPC's key products such as NBP, 2) delay or failure of R&D pipeline drugs, 3) unexpected restriction posted by the China government towards the use of drugs, and 4) increasing competition from domestic and international players.

Figure 1. Key financial data

	FY16	FY17	FY18E	FY19E	FY20E
Revenue	12,369	15,463	21,380	27,060	33,585
Gross profit	6,309	9,346	13,857	18,393	23,876
Operating profit	2,649	3,482	4,774	6,525	8,293
EBITDA	3,237	4,198	5,542	7,411	9,334
Net profit After tax	2,113	2,780	3,807	5,217	6,636
Income attr. to shareholders	2,101	2,771	3,797	5,207	6,626
EPS	0.35	0.45	0.61	0.83	1.06

Source: Bloomberg, CASH estimate

Figure 2. Update in our forecast

	FY18E		FY19E		% Change	
	Old	New	Old	New	FY18E	FY19E
Revenue	16,669	21,380	19,044	27,060	28.3%	42.1%
Gross profit	9,980	13,857	11,711	18,393	38.8%	57.1%
Operating profit	4,566	4,774	5,491	6,525	4.6%	18.8%
EBITDA	5,311	5,542	6,324	7,411	4.4%	17.2%
Net profit After tax	3,652	3,807	4,382	5,217	4.2%	19.1%
Income attr. to shareholders	3,639	3,797	4,369	5,207	4.3%	19.2%
EPS	0.59	0.61	0.70	0.83	3.1%	19.1%

Source: Bloomberg, CASH estimate

Figure 3. Major assumption in CSPC's top line and GPM forecast

Sales Breakdown (In million HKD)					
	2016	2017	Forecast		
	2016	2017	2018E	2019E	2020E
Revenue					
Finished Drugs					
Innovative Drugs	4,774	6,582	10,662	15,443	21,141
NBP	2,648	3,567	5,200	7,122	9,716
Capsules	1,403	1,794	2,550	3,468	4,767
Injections	1,245	1,773	2,650	3,654	4,949
Oulaining	1,073	1,310	2,200	2,942	3,319
Capsules	286	395	553	636	668
Injections	787	915	1,647	2,306	2,652
Xuanning	456	672	1,142	1,782	2,581
Duomeisu	356	523	863	1,312	1,857
Jinyouli	153	375	810	1,468	2,183
Albumin-bound PTX			250	539	1,102
Other oncology drugs	88	134	196	278	383
Common generic drugs	4,193	4,793	5,410	6,037	6,666
Total Finished Drugs	8,967	11,375	16,072	21,480	27,807
Bulk Drugs					
Antibiotics	1,334	1,215	1,458	1,632	1,728
Vitamin C	1,309	1,854	2,781	2,837	2,893
Caffeine and others	760	1,019	1,070	1,113	1,157
Total Bulk Drugs	3,402	4,088	5,309	5,581	5,779
Revenue (excluding pipeline)	12,369	15,463	21,381	27,061	33,586
YoY%		25.0%	38.3%	26.6%	24.1%
Finished drugs as a % of total revenue	72.5%	73.6%	75.2%	79.4%	82.8%
Bulk Drugs as a % of total revenue	27.5%	26.4%	24.8%	20.6%	17.2%
Gross Profit					
Finished drugs	5,815	8,129	12,107	16,632	22,116
Antibiotics	123	172	233	275	307
Vitamin C	126	754	1,209	1,150	1,088
Caffeine and others	245	291	308	336	366
Gross Profit Margin					
Finished drugs	64.85%	71.46%	75.33%	77.43%	79.53%
Antibiotics	9.22%	14.16%	15.96%	16.86%	17.76%
Vitamin C	9.63%	40.67%	43.48%	40.54%	37.60%
Caffeine and others	32.24%	28.56%	28.79%	30.21%	31.62%
Gross Profit	6,309	9,346	13,857	18,393	23,876
Gross margin	51.01%	60.44%	64.81%	67.97%	71.09%

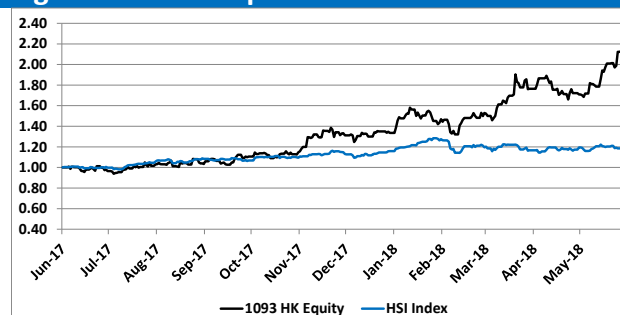
Source: Bloomberg, CASH estimate

Valuation: CSPC's EPS is expected to climb to HKD0.61/0.83 in FY18E/FY19E. We also introduce our earnings forecast for FY20E and expect FY20E EPS to reach HKD1.06. We reiterate "BUY" rating for CSPC and raise our Dec-18 TP to HKD32 (Previous: HKD22), based on 1.2X PEG with FY18E-20E CAGR of 32%. Again, we do not factor in any pipeline drugs in our model in order to make our estimate conservative. Key downside risks include 1) an unexpected sales growth slowdown for CSPC's key products such as NBP, 2) delay or failure of R&D pipeline drugs, 3) unexpected restriction posted by the China government towards the use of drugs, and 4) increasing competition from domestic and international players.

Figure 4. Forward PE



Figure 5. Relative price



Source: Bloomberg, CASH

CSPC Pharmaceutical Group**1093.HK, BUY, TargetPrice: HK\$32****Income Statement (In million HK\$)**

Year-end Dec 31	FY17	FY18E	FY19E	FY20E
Revenue	15,463	21,380	27,060	33,585
Cost of goods sold	(6,117)	(7,523)	(8,667)	(9,709)
Gross profit	9,346	13,857	18,393	23,876
SG&A	(5,057)	(8,179)	(10,722)	(14,158)
R&D	(815)	(912)	(1,154)	(1,433)
Other expense	8	8	8	8
Employee share expense	0	0	0	0
Operating profit	3,482	4,774	6,525	8,293
EBITDA	4,198	5,542	7,411	9,334
Depreciation	(613)	(718)	(832)	(979)
Amortisation	(104)	(51)	(54)	(62)
EBIT	3,482	4,774	6,525	8,293
Net interest expense	(27)	(60)	(64)	(75)
Associates & JCEs	10	32	44	55
Other income	0	0	0	0
Earnings before tax	3,465	4,746	6,504	8,274
Income tax	(685)	(939)	(1,287)	(1,638)
Net profit After tax	2,780	3,807	5,217	6,636
Minority interests	(10)	(10)	(10)	(10)
Other items	0	0	0	0
Preferred dividends	0	0	0	0
Normalised NPAT	2,780	3,807	5,217	6,636
Extraordinary items	0	0	0	0
Income attr. to shareholders	2,771	3,797	5,207	6,626
Dividends	(726)	(1,139)	(1,562)	(1,988)
Transfer to reserves	2,044	2,658	3,645	4,638
EPS	0.45	0.61	0.83	1.06
DPS	0.15	0.18	0.25	0.32

Cashflow statement (In million HK\$)

Year-end Dec 31	FY17	FY18E	FY19E	FY20E
Income attr. to shareholders	2,780	3,807	5,217	6,636
Non-cash item	717	768	886	1,041
Change in working capital	(1,633)	(1,528)	(759)	(901)
Cashflow from operations	3,288	3,047	5,345	6,776
Capital expenditure	(1,164)	(1,609)	(2,036)	(2,527)
Free cashflow	2,124	1,438	3,308	4,248
Dec in other LT assets	(39)	(12)	(12)	(12)
Inc in other LT liabilities	72	6	6	7
Adjustment	(300)	(57)	(70)	(86)
CF from investing acts	(3,287)	(1,672)	(2,113)	(2,619)
Cash dividend	(726)	(1,139)	(1,562)	(1,988)
Equity issue	2,353	0	0	0
Debt issue	(151)	720	(110)	63
Convertible debt issue	0	0	0	0
Others	1,094	0	0	0
CF from financial acts	1,631	(419)	(1,672)	(1,925)
Net cashflow	1,632	956	1,560	2,232
Beginning cash	3,235	5,163	6,119	7,679
Adjustments	296	0	0	0
Ending cash	5,163	6,119	7,679	9,911
Ending net debt	(4,176)	(4,413)	(6,082)	(8,252)

Source: Company data, CASH

Balance Sheet (In million HK\$)

Year-end Dec 31	FY17	FY18E	FY19E	FY20E
Cash & equivalents	5,163	6,119	7,679	9,911
Marketable securities	1,395	1,423	1,451	1,480
Accounts receivable	2,334	3,222	4,078	5,061
Inventories	2,901	3,092	3,562	3,990
Other current assets	1,842	1,878	1,916	1,954
Total current assets	13,635	15,734	18,686	22,397
LT investments	427	435	444	453
Fixed assets	6,663	7,554	8,758	10,307
Goodwill	122	122	122	122
Other intangible assets	103	101	109	124
Other LT assets	594	606	618	630
Total assets	21,543	24,552	28,736	34,032
ST debt	927	1,647	1,537	1,600
Accounts payable	4,513	4,122	4,749	5,320
Other current liabilities	319	326	332	339
Total current liabilities	5,760	6,095	6,618	7,259
LT debt	60	60	60	60
Convertible debt	0	0	0	0
Other LT liabilities	316	322	328	335
Total liabilities	6,135	6,477	7,006	7,654
Minority interest	85	95	105	115
Preferred interest	0	0	0	0
Common stock	12,922	12,922	12,922	12,922
Retained earnings	7,042	9,700	13,344	17,983
Proposed dividend	726	1,139	1,562	1,988
Other equity and reserves	(4,642)	(4,642)	(4,642)	(4,642)
Total shareholders' equity	15,407	18,075	21,730	26,378
Total equity & liabilities	21,543	24,552	28,736	34,032

Key Ratios

	FY17	FY18E	FY19E	FY20E
Growth (%)				
Revenue	25.0%	38.3%	26.6%	24.1%
Gross profit	48.1%	48.3%	32.7%	29.8%
Operating profit	31.4%	37.1%	36.7%	27.1%
Income attr. to shareholders	31.9%	37.0%	37.1%	27.3%
Profitability (%)				
Gross margin	60.4%	64.8%	68.0%	71.1%
Operating margin	22.5%	22.3%	24.1%	24.7%
Net Margin	18.0%	17.8%	19.3%	19.8%
Dividend payout	26.2%	30.0%	30.0%	30.0%
ROAE	23.7%	29.5%	40.4%	51.4%
ROAA	15.3%	16.5%	19.6%	21.1%
Liquidity (x)				
Current ratio	2.4	2.6	2.8	3.1
Interest coverage	130.7	79.9	102.0	110.8
Leverage				
Net Debt/EBITDA (x)	0.9	0.7	0.8	0.8
Net Debt/Equity (%)	24.7%	22.3%	26.2%	29.8%

Source: Company data, CASH