

1H18 result in-line; eyeing opportunities in the Oncology segment

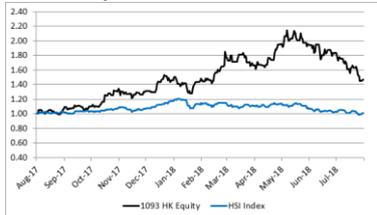
CSPC (1093.HK)

Healthcare Sector

Rating	Buy
Target Price	HKD28.00 (12/18)
Close Price	HKD17.82
52 weeks high/low	HKD11.98-26.75
Market cap	HKD111.25bn

Source: HKEX, Bloomberg, CASH

Relative performance



Source: Bloomberg, CASH

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Investment Insights

1H18 results in-line: CSPC released its interim result yesterday. Revenue grew 49.8% YoY to HKD10.8bn, with innovative drugs sales increased 65.3% YoY to HKD4,874mn, common generic drugs sales increased 42.3% YoY and bulk drugs sales increased 35.1%YoY. The gross profit rose 67.1% YoY, with the GPM climbed 6.6pp from 57.3% in 1H17 to 63.9% in 1H18, due to the favorable shift in product mix towards the innovative drugs. The innovative drugs accounts for 45.2% of the total sales, up 4.2pp compared to the corresponding period. Both the top line and GPM is impressive, yet, the OPM has fell from 23.3% to 21.5%, in which the OPM of finished drugs dropped 6pp. The increase of R&D expense (up 112% YoY), and the increase of selling & distribution expenses (up 93.6% YoY) explains the fall, with the latter caused by the increased promotion and expanded sales forces. Overall NPM has fell slightly from 18.3% to 17.1% in 1H18. We find the interim result to be fine, as the increase in current operating expense will be beneficial to the future growth, especially for the oncology segment.

Strong momentum of existing products: According to company statistics, NBP sales recorded a high yearly growth of 42.6%YoY in 1H18. The satisfactory result was explained by the inclusion of NBP injection in the 2017 NDRL. NBP injection recorded a 57.5% YoY increase in sales. Oulaining/Xuanning sales climbed 78.1%/105.2 YoY, thanks to the company's self- promotion strategy. Apart from the innovative drugs, CSPC's generic drugs segment also delivered nice result. Revenue from common generic drugs increased 42.3% YoY to HKD3.3bn in 1H2018. With more drugs passing the BE test, both the ASP and sales volume went up.

Oncology drugs to be another growth engine: We see a very fast revenue growth in CSPC's oncology portfolio. In 1Q18, CSPC's revenue from oncology portfolio increased by 109.2% YoY to HKD907mn in 1H18. Duomeisu sales soared 80.6%YoY to HKD407mn, revenue from Jinyouli increased 113.8%YoY to HKD329mn and revenue from Keaili "Albumin-bound PTX", which was launched in March 2018, achieved sales of HKD86mn, with the hospital coverage at cc. 290 units. Looking forward, the penetration rate of Keaili will increase in different provinces and its sales team will also enlarge in scale. Despite the fact that there is a new competing drug from Hengrui, the management is extremely confident towards the sales prospect of Albumin-bound PTX given the strong replacement demand in the mainland market and therefore a huge potential for the entire industry. Management guided that Albumin-bound PTX sales in FY18/19 will exceed HKD0.3bn/1bn. Meanwhile, the sales team of oncology portfolio will reach 1,800 people by the end of this year (v. 1,100 people in June and 1,200 people in July).

Increasing R&D to enhance future growth: There were approximately 200 drugs in the pipeline, in which 25 in the areas of new target macromolecule biologics or cell- based immunotherapy; and 30 new small molecule drugs, including DBPR108, SKLB1028, etc. For small molecule drugs, there are 3 drugs undergoing clinical trials in USA, namely Levamlodipine, Butylphthalide soft capsules and CSPCHA115 capsules.

Management believes that the future trend will be the application of macromolecule biologics, combined usage of macromolecule biologics and small molecule drugs, and immunotherapy. In our view, the strategic collaboration between CSPC and Junshi shows the company's determination to expand its oncology business. The launch of PD1 after year 2020 will help CSPC to secure a better position in the oncology area.

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

Sales Breakdown (In million HKD)					
	2016	2017	Forecast	Forecast	Forecast
	Revenue				
Finished Drugs					
Innovative Drugs	4,774	6,582	11,245	16,492	25,181
NBP	2,648	3,567	5,149	6,592	9,620
Capsules	1,403	1,794	2,434	3,150	4,550
Injections	1,245	1,773	2,715	3,442	5,070
Oulaining	1,073	1,310	2,333	3,086	3,466
Capsules	286	395	722	830	871
Injections	787	915	1,611	2,256	2,595
Xuanning	456	672	1,377	1,956	2,531
Duomeisu	356	523	945	1,399	1,936
Jinyouli	153	375	802	1,235	1,635
Albumin-bound PTX			306	1,003	2,665
Other oncology drugs	88	134	419	1,222	3,329
Common generic drugs	4,193	4,793	6,819	8,250	9,463
Total Finished Drugs	8,967	11,375	18,063	24,742	34,644
Bulk Drugs					
Antibiotics	1,334	1,215	1,486	1,665	1,763
Vitamin C	1,309	1,854	2,935	2,994	3,054
Caffeine and others	760	1,019	1,035	1,076	1,119
Total Bulk Drugs	3,402	4,088	5,456	5,734	5,935
Revenue (excluding pipeline)	12,369	15,463	23,520	30,477	40,579
YoY%		25.0%	52.1%	29.6%	33.1%
Finished drugs as a % of total revenue	72.5%	73.6%	76.8%	81.2%	85.4%
Bulk Drugs as a % of total revenue	27.5%	26.4%	23.2%	18.8%	14.6%
	Gross Profit				
Finished drugs	5,815	8,129	13,473	18,972	27,292
Antibiotics	123	172	252	297	330
Vitamin C	126	754	1,260	1,127	989
Caffeine and others	245	291	254	272	292
	Gross Profit Margin				
Finished drugs	64.85%	71.46%	74.59%	76.68%	78.78%
Antibiotics	9.22%	14.16%	16.93%	17.83%	18.73%
Vitamin C	9.63%	40.67%	42.93%	37.66%	32.38%
Caffeine and others	32.24%	28.56%	24.58%	25.32%	26.07%
Gross Profit	6,309	9,346	15,239	20,669	28,903
Gross margin	51.01%	60.44%	64.79%	67.82%	71.23%

Source: Bloomberg, CASH estimate

Reiterate “Buy” with Dec-18 TP of HKD28: We fine tune CSPC’s EPS to HKD0.84/1.17 in FY19E/FY20E (Previous: HKD 0.83/1.06), to reflect the higher expected growth driven by oncology segment. However, given the recent weak market sentiment triggered by the vaccine scandal, we adjust the Dec-18 TP to HKD28 (Previous: HKD32), implying a 33x 2019E PE, or 24x 2020E PE. Key downside risks include 1) an unexpected sales growth slowdown for CSPC’s key products, 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. Forward PE

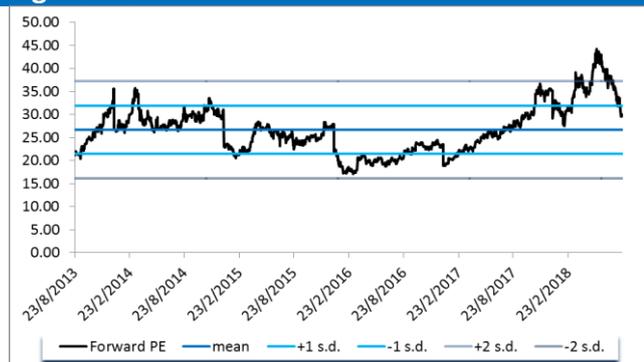


Figure. Relative price



Source: Bloomberg, CASH

CSPC Pharmaceutical Group

Income Statement (In million HK\$)				
Year-end Dec 31	FY17	FY18E	FY19E	FY20E
Revenue	15,463	23,519	30,476	40,578
Cost of goods sold	(6,117)	(8,281)	(9,807)	(11,676)
Gross profit	9,346	15,238	20,668	28,902
SG&A	(5,057)	(8,927)	(11,986)	(16,955)
R&D	(815)	(1,646)	(2,133)	(2,840)
Other expense	8	8	8	8
Employee share expense	0	0	0	0
Operating profit	3,482	4,672	6,557	9,115
EBITDA	4,198	5,357	7,351	10,064
Depreciation	(613)	(633)	(741)	(888)
Amortisation	(104)	(52)	(53)	(61)
EBIT	3,482	4,672	6,557	9,115
Net interest expense	(27)	(35)	(51)	(44)
Associates & JCEs	10	31	44	61
Other income	0	0	0	0
Earnings before tax	3,465	4,669	6,550	9,132
Income tax	(685)	(924)	(1,296)	(1,808)
Net profit After tax	2,780	3,745	5,254	7,325
Minority interests	(10)	(10)	(10)	(10)
Other items	0	0	0	0
Preferred dividends	0	0	0	0
Normalised NPAT	2,780	3,745	5,254	7,325
Extraordinary items	0	0	0	0
Income attr. to shareholders	2,771	3,735	5,244	7,314
Dividends	(726)	(1,121)	(1,573)	(2,194)
Transfer to reserves	2,044	2,615	3,671	5,120
EPS	0.45	0.60	0.84	1.17
DPS	0.15	0.18	0.25	0.35

Cashflow statement (In million HK\$)

Year-end Dec 31	FY17	FY18E	FY19E	FY20E
Income attr. to shareholders	2,780	3,745	5,254	7,325
Non-cash item	717	685	794	950
Change in working capital	(1,633)	(1,746)	(899)	(1,327)
Cashflow from operations	3,288	2,683	5,149	6,947
Capital expenditure	(1,164)	(1,770)	(2,293)	(3,054)
Free cashflow	2,124	913	2,855	3,893
Dec in other LT assets	(39)	(12)	(12)	(12)
Inc in other LT liabilities	72	6	6	7
Adjustment	(300)	(62)	(78)	(102)
CF from investing acts	(3,287)	(1,838)	(2,377)	(3,161)
Cash dividend	(726)	(1,121)	(1,573)	(2,194)
Equity issue	2,353	0	0	0
Debt issue	(151)	289	(310)	(249)
Convertible debt issue	0	0	0	0
Others	1,094	0	0	0
CF from financial acts	1,631	(831)	(1,883)	(2,444)
Net cashflow	1,632	14	888	1,342
Beginning cash	3,235	5,163	5,177	6,065
Adjustments	296	0	0	0
Ending cash	5,163	5,177	6,065	7,408
Ending net debt	(4,176)	(3,901)	(5,099)	(6,691)

Source: Company data, CASH

1093.HK, BUY, TargetPrice: HK\$28

Balance Sheet (In million HK\$)				
Year-end Dec 31	FY17	FY18E	FY19E	FY20E
Cash & equivalents	5,163	5,177	6,065	7,408
Marketable securities	1,395	1,423	1,451	1,480
Accounts receivable	2,334	3,544	4,592	6,115
Inventories	2,901	3,403	4,030	4,798
Other current assets	1,842	1,878	1,916	1,954
Total current assets	13,635	15,425	18,055	21,755
LT investments	427	435	444	453
Fixed assets	6,663	7,800	9,352	11,517
Goodwill	122	122	122	122
Other intangible assets	103	105	122	154
Other LT assets	594	606	618	630
Total assets	21,543	24,493	28,713	34,631
ST debt	927	1,216	907	657
Accounts payable	4,513	4,537	5,374	6,398
Other current liabilities	319	326	332	339
Total current liabilities	5,760	6,079	6,613	7,394
LT debt	60	60	60	60
Convertible debt	0	0	0	0
Other LT liabilities	316	322	328	335
Total liabilities	6,135	6,461	7,001	7,788
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	9,656	13,327	18,447
Proposed dividend	726	1,121	1,573	2,194
Other equity and reserves	(4,642)	(4,642)	(4,642)	(4,642)
Total shareholders' equity	15,407	18,032	21,712	26,842
Total equity & liabilities	21,543	24,493	28,713	34,631

Key Ratios

	FY17	FY18E	FY19E	FY20E
Growth (%)				
Revenue	25.0%	52.1%	29.6%	33.1%
Gross profit	48.1%	63.0%	35.6%	39.8%
Operating profit	31.4%	34.2%	40.3%	39.0%
Income attr. to shareholders	31.9%	34.8%	40.4%	39.5%
Profitability (%)				
Gross margin	60.4%	64.8%	67.8%	71.2%
Operating margin	22.5%	19.9%	21.5%	22.5%
Net Margin	18.0%	15.9%	17.2%	18.1%
Dividend payout	26.2%	30.0%	30.0%	30.0%
ROAE	23.7%	29.0%	40.7%	56.7%
ROAA	15.3%	16.3%	19.7%	23.1%
Liquidity (x)				
Current ratio	2.4	2.5	2.7	2.9
Interest coverage	130.7	135.2	128.3	209.1
Leverage				
Net Debt/EBITDA (x)	0.9	0.7	0.6	0.6
Net Debt/Equity (%)	24.7%	19.6%	21.7%	23.5%

Source: Company data, CASH