

China / Hong Kong Company Guide

CSPC Pharmaceutical

Version 5 | Bloomberg: 1093 HK EQUITY | Reuters: 1093.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

20 Aug 2019

BUY

Last Traded Price (19 Aug 2019):HK\$12.96(HSI : 26,292)

Price Target 12-mth:HK\$22.00 (69.8% upside)

Analyst

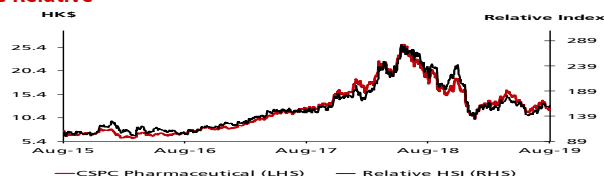
Mark KONG CFA, +852 36684187, mark_kong@db.com

Michael PAN PhD, +852 36684171, michaelpan@db.com

What's New

- **1H19 earnings 5% below consensus due to higher selling and R&D expenses**
- **Strong pipeline of over 29 innovative drugs to support long term earnings growth**
- **Penetration into lower tier medical institutes to drive 21% earnings CAGR in 2019F-21F**
- **Attractive entry point, stock is trading at 18x FY19F PE which is 30% below its 5-year average; Maintain BUY and HK\$22.00 TP**

Price Relative



Forecasts and Valuation

FY Dec (HK\$m)	2018A	2019F	2020F	2021F
Turnover	21,029	26,332	31,097	35,683
EBITDA	5,273	6,316	7,584	8,938
Pre-tax Profit	4,502	5,505	6,747	8,095
Net Profit	3,655	4,469	5,478	6,572
Net Pft (Pre Ex) (core profit)	3,655	4,469	5,478	6,572
Net Profit Gth (Pre-ex) (%)	31.9	22.3	22.6	20.0
EPS (HK\$)	0.59	0.72	0.88	1.05
EPS Gth (%)	28.7	22.3	22.6	20.0
Diluted EPS (HK\$)	0.59	0.72	0.88	1.05
DPS (HK\$)	0.18	0.22	0.27	0.32
BV Per Share (HK\$)	2.74	3.28	3.93	4.72
PE (X)	22.1	18.1	14.8	12.3
P/Cash Flow (X)	18.3	18.1	15.0	12.4
P/Free CF (X)	32.9	24.8	19.2	15.2
EV/EBITDA (X)	14.5	11.9	9.5	7.7
Net Div Yield (%)	1.4	1.7	2.1	2.5
P/Book Value (X)	4.7	4.0	3.3	2.7
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE(%)	22.5	23.8	24.3	24.3
Earnings Rev (%):	Nil	Nil	Nil	Nil
Consensus EPS (HK\$)		0.65	0.80	0.96
Other Broker Recs:		B:34	S:0	H:3

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Sustainable long-term growth on strong pipeline of innovative drugs

BUY for 21% EPS CAGR in 2019F-21F and strong pipeline of new products. We expect CSPC's EPS CAGR to be 21% in 2019F-21F driven by innovative drug segment. We estimate the segment to contribute >50% earnings and its sales CAGR in 2019F-21F to be >30% on: 1) sales network expansion into lower-tier hospitals; 2) product cross-selling in current network, e.g. promoting NBP injections (for treatment of stroke) to customers using NBP capsules; 3) sales volume growth for products being included in the new version of National Reimbursement Drug List issued in February 2017; and 4) launch of new products. To accelerate earnings growth, it has 25 innovative drugs under different stages of clinical trials, targeted to be launched in the next five years.

Where we differ: Other than new drugs in the pipeline, we highlight that cross-selling potential of current products can be an earnings driver in the next 2 years.

Critical factors driving share price: Potential acquisition of oncology drug maker to boost earnings growth, government's approval of new products in clinical trials to accelerate.

Valuation:

To reflect CSPC's stronger-than-peer R&D capability evidenced by its innovative drugs in the pipeline, we believe the stock should trade at a 10% premium above sector average 19F PE. With that, we derive a PE of 31x 19F and TP of HK\$22.00.

Key Risks to Our View:

Drop in ASP of bulk drugs (e.g. vitamin C) due to increased supply), price cuts on oncology drugs imposed by the government to lower the treatment cost of cancer.

At A Glance

Issued Capital (m shrs)	6,236
Mkt Cap (HK\$m/US\$m)	80,823 / 10,303
Major Shareholders (%)	
Cai (Dong Chen)	12.8
Massive Giant Group Ltd.	10.2
Common Success International Ltd.	6.8
Free Float (%)	70.3
3m Avg. Daily Val. (US\$m)	51.65
ICB Industry: Health Care / Pharmaceuticals & Biotechnology	

Bloomberg ESG disclosure score (2017)^	22.3
- Environmental / Social / Governance	9.3 / 22.8 / 51.8

^ refer to back page for more information



Live more, Bank less

CSPC Pharmaceutical**WHAT'S NEW****Sustainable long-term growth on strong pipeline of innovative drugs**

1H19 earnings 5% below consensus due to higher selling and R&D expenses: 1H19 earnings grew by 25% y-o-y to Rmb1.9bn, which was 5% below consensus. We believe this is due to: 1) selling expenses as a percentage of sales was up 5ppt y-o-y to 38% to expand sales force of innovative drugs; 2) R&D expenses as a percentage of sales was up 2ppt y-o-y to 8% as CSPC enlarged its R&D team to support over 300 R&D projects.

1H19 total revenue rose 28% y-o-y to Rmb11bn with gross margin improving by 6ppts to 70% driven by innovative drugs segment. This segment made up 55% of total revenue and sales growth was strong at 55% y-o-y.

With net cash of Rmb5.4bn as of Jun 2019, CSPC's balance sheet remains strong.

Maintain BUY for strong product pipeline, attractive valuation, penetration into lower tier medical institutes: We maintain BUY with TP of HK\$22.00 due to:

- 1) Strong pipeline of innovative drugs to support long term growth. CSPC has 25 class one drugs (drugs with innovative active ingredient) in different stages of clinical trials in 5 therapeutic areas. Of which, two are in phase three clinical trials (final phase, for treatment of lymphoma and diabetes), while one has completed all clinical trials and is pending government approval for launch (for treatment of non-Hodgkin's lymphoma). These would underpin CSPC's earnings growth in the long run;
- 2) Penetration into lower tier medical institutes to drive 21% earnings CAGR in 2019F-21F. For example, CSPC is promoting butylphthalide soft capsule and injection at the county level and community hospitals, and untapped cities. This product made up 23% of sales in 2018.
- 3) Attractive valuation. Trading at 18x FY19F PE which is 30% below 5-year average PE, we believe the current valuation is attractive for entry.

CSPC Pharmaceutical

CRITICAL FACTORS TO WATCH

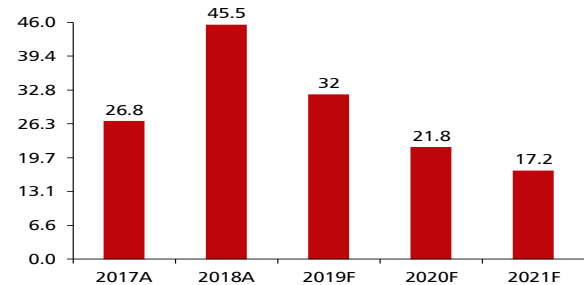
Critical Factors

Government approval of innovative drugs under clinical trials to accelerate. As of June 2019, CSPC had 25 class 1 new drugs (class 1 means the active ingredient is new) under different stages of clinical trials, targeted to be launched in the next five years to fuel earnings growth. Their therapeutic areas cover antithrombotic, oncology, metabolic diseases, psychiatry & neurology, anti-infectives. The accelerated approval of these products can boost CSPC's share price.

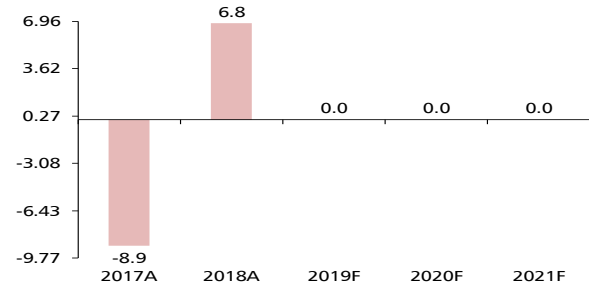
Product cross-selling to boost sales growth. There are two ways of cross-selling: 1) products with the same active ingredient in different forms can be cross-sold in each other's customer network. For example, CSPC is promoting NBP injections (for treatment of stroke) to customers using NBP capsules; 2) different products in the same category can be cross-sold in one another's network. For example, CSPC is building its portfolio of oncology drugs and they contributed 12% of CSPC's sales in 2018. We believe the company is looking for the opportunity to acquire oncology drug makers. The newly acquired products will be sold through CSPC's current oncology drug customers' network.

Penetration into lower tier medical institutes. Major products of the company have well penetrated in top tier hospitals. To drive the earnings growth further, the company is penetrating into lower tier medical institutes. For example, CSPC is promoting butylphthalide soft capsule and injection (for treatment of stroke) at the county level and community hospitals, and untapped cities. This product made up 23% of sales in 2018.

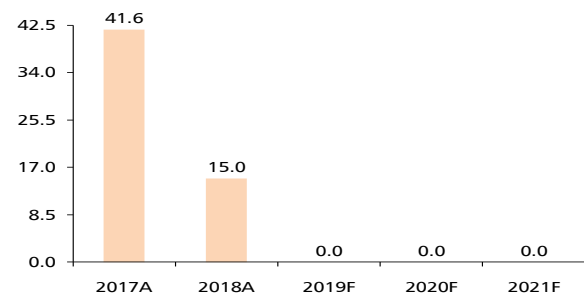
Finished drugs sales Gth %



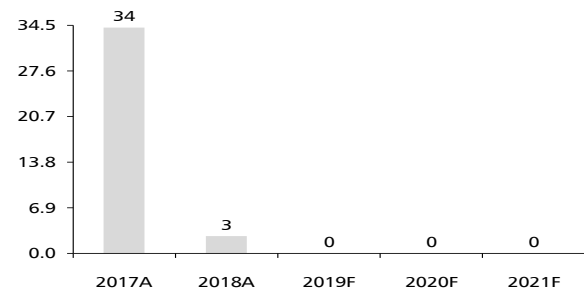
Antibiotics (API) sales Gth %



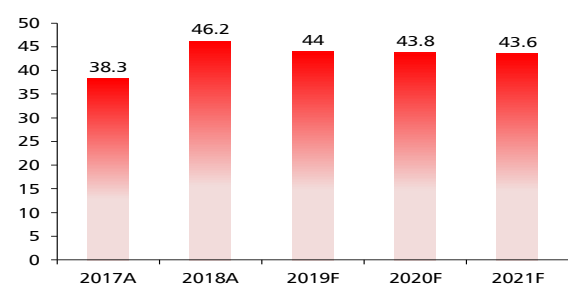
Vitamin (API) sales Gth %



Caffeine & others (API) sales Gth %



SG&A % in sales

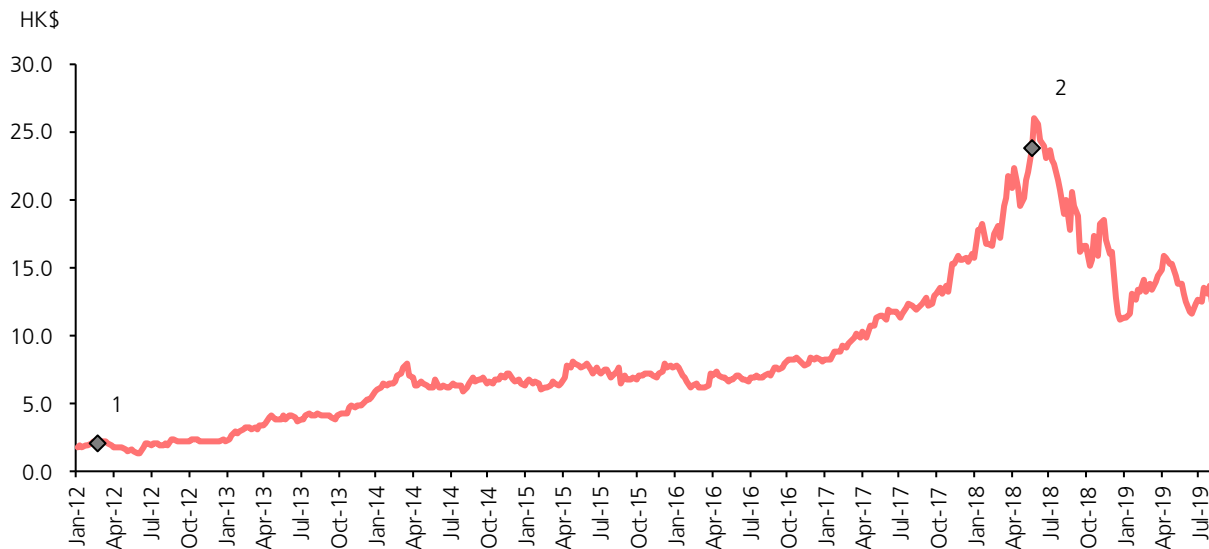


Source: Company, DBS HK

CSPC Pharmaceutical

Appendix 1: A look at Company's listed history – what drives its share price?

Share price chart (since Jan 2012 till now)



Date	Events
1 1-Mar-12	Since IPO in 1994, the production of bulk drugs including vitamin C and antibiotics was CSPC's major business until 2012, when it acquired the finished drug business from Hony Capital. This included innovative drugs like butylphthalide soft capsule and injection for treatment of strokes. The finished drug business contributes >50% of CSPC's earnings.
2 30-May-18	National Healthcare Bureau was established in May 2018. The bureau manages public medical insurance programmes (which finances over half of the drug expenses in China) and provincial tenders for drugs and sets the prices. This means that the party that pays the bill will have a say on the drug price. To save money for insurance programmes, it will exert stronger pressure on drug prices.

Source: Company, Thomson Reuters

CSPC Pharmaceutical

Balance Sheet:

Solid balance sheet since 2013. CSPC turned from a net debt position in 2013 to a net cash position from 2014 onwards. This is attributed to rising revenue contribution from the finished drug segment with profit margin that is c.20ppts higher than other segments on average. Therefore, an increasing contribution from this segment can improve both earnings and financials of the company. We believe CSPC would remain in a net cash position in the foreseeable future.

Share Price Drivers:

Government approval of innovative drugs under clinical trials to accelerate. As mentioned above, CSPC has 25 class 1 new drugs under different stages of clinical trials, targeted to be launched in the next five years to fuel earnings growth. The approval of these products can boost CSPC's share price.

Acquisition of oncology drug marker to fuel earnings growth.

CSPC is building a portfolio of oncology drugs. With ample net cash, the company is in a strong position to expand its product range in this area through M&A.

Key Risks:

Increasing ASP pressure due to pressure imposed by National Healthcare Bureau. The bureau manages public medical insurance programmes (which finance over half of the drug expenses in China) and provincial tenders for drugs which set the prices. This means that the party that pays the bill will have a say on the drug price. To save money for the insurance programmes, it will exert stronger pressure on drug prices.

Environment, Social, Governance:

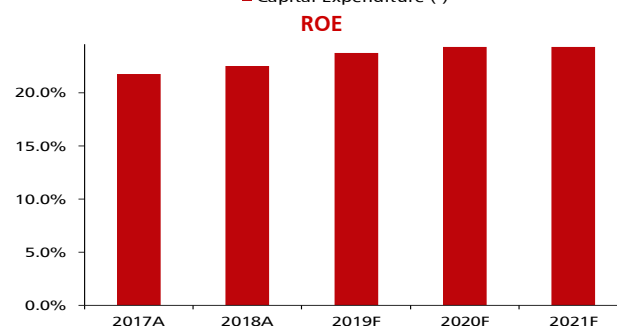
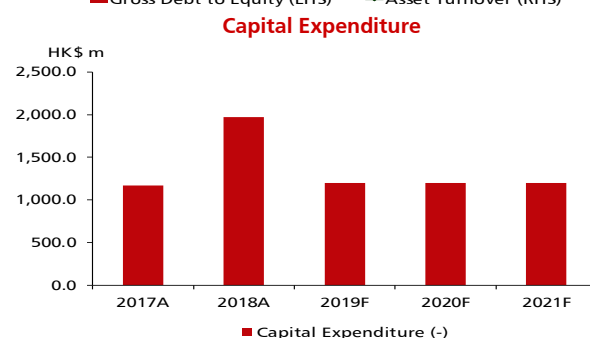
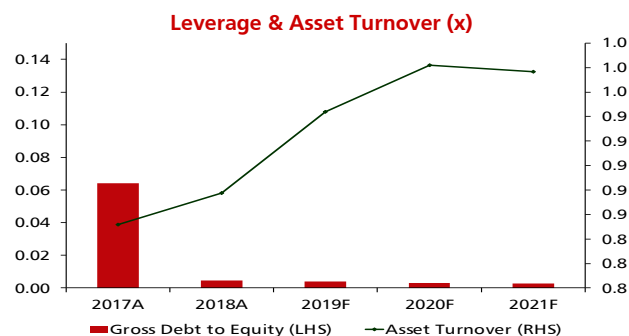
Environment: CSPC is taking steps in this area given that tons of solid waste per HK\$100m income and unit of electricity consumed per HK\$100m income dropped by 26% and 26% respectively in 2018.

Social: CSPC is making efforts to contribute to society through Hebei CSPC Pu'en Charity Foundation.

Governance: In terms of production, CSPC is in strict compliance with government regulations, as evidenced by 12 Good Manufacturing Practice certifications obtained from the China government, and two food & drug certifications from the US government.

Company Background

CSPC was listed on the Hong Kong stock market in 1994. The production of bulk drugs including vitamin C and antibiotics had always been its major business until 2012, when it acquired the finished-drug business from Hony Capital. The finished-drug business is contributing >50% of its earnings.



Source: Company, DBS HK

CSPC Pharmaceutical

Key Assumptions

FY Dec	2017A	2018A	2019F	2020F	2021F
Finished drugs sales Gth %	26.8	45.5	32.0	21.8	17.2
Antibiotics (API) sales Gth %	(8.9)	6.8	0.0	0.0	0.0
Vitamin (API) sales Gth %	41.6	15.0	0.0	0.0	0.0
Caffeine & others (API) sales Gth %	34.1	2.6	0.0	0.0	0.0
SG&A % in sales	38.3	46.2	44.0	43.8	43.6

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Revenues (HK\$ m)					
Finished drugs	11,374	16,553	21,857	26,621	31,207
Antibiotics (API)	1,215	1,298	1,298	1,298	1,298
Vitamin (API)	1,854	2,131	2,131	2,131	2,131
Caffeine & others (API)	1,019	1,046	1,046	1,046	1,046
Total	15,463	21,029	26,332	31,097	35,683
Gross margin (HK\$ m)					
Finished drugs	8,129	11,753	15,518	18,901	22,157
Antibiotics (API)	172	195	182	169	169
Vitamin (API)	754	853	746	639	639
Caffeine & others (API)	291	262	262	262	262
Total	9,346	13,913	16,707	19,971	23,227
Gross margin (%)					
Finished drugs	71.5	71.0	71.0	71.0	71.0
Antibiotics (API)	14.2	15.0	14.0	13.0	13.0
Vitamin (API)	40.7	40.0	35.0	30.0	30.0
Caffeine & others (API)	28.5	25.0	25.0	25.0	25.0
Total	60.4	66.2	63.4	64.2	65.1

Source: Company, DBS HK

CSPC Pharmaceutical
Income Statement (HK\$ m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Revenue	15,463	21,029	26,332	31,097	35,683
Cost of Goods Sold	(6,117)	(7,116)	(9,625)	(11,126)	(12,456)
Gross Profit	9,346	13,913	16,707	19,971	23,227
Other Opng (Exp)/Inc	(5,889)	(9,438)	(11,302)	(13,336)	(15,273)
Operating Profit	3,456	4,475	5,406	6,635	7,954
Other Non Opng (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	10	51	51	51	51
Net Interest (Exp)/Inc	(1)	(25)	47	61	90
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	3,465	4,502	5,505	6,747	8,095
Tax	(685)	(873)	(1,067)	(1,308)	(1,570)
Minority Interest	(10)	26	32	40	47
Preference Dividend	0	0	0	0	0
Net Profit	2,771	3,655	4,469	5,478	6,572
Net Profit before Except.	2,771	3,655	4,469	5,478	6,572
EBITDA	4,183	5,273	6,316	7,584	8,938
Growth					
Revenue Gth (%)	25.0	36.0	25.2	18.1	14.7
EBITDA Gth (%)	28.6	26.0	19.8	20.1	17.9
Opg Profit Gth (%)	31.1	29.5	20.8	22.7	19.9
Net Profit Gth (%)	31.9	31.9	22.3	22.6	20.0
Margins & Ratio					
Gross Margins (%)	60.4	66.2	63.4	64.2	65.1
Opg Profit Margin (%)	22.4	21.3	20.5	21.3	22.3
Net Profit Margin (%)	17.9	17.4	17.0	17.6	18.4
ROAE (%)	21.8	22.5	23.8	24.3	24.3
ROA (%)	15.3	15.3	16.0	17.3	18.0
ROCE (%)	19.6	20.7	21.9	22.7	22.9
Div Payout Ratio (%)	33.8	30.7	30.7	30.7	30.7
Net Interest Cover (x)	2,330.7	178.4	NM	NM	NM

Source: Company, DBS HK

CSPC Pharmaceutical

Quarterly Income Statement (HK\$ m)

FY Dec	2Q2018	3Q2018	4Q2018	1Q2019E	2Q2019E
Revenue	5,400	5,061	5,180	6,385	6,322
Cost of Goods Sold	(1,972)	(1,627)	(1,592)	(1,920)	(1,906)
Gross Profit	3,428	3,434	3,588	4,465	4,416
Other Oper. (Exp)/Inc	(2,241)	(2,322)	(2,548)	(3,121)	(3,100)
Operating Profit	1,187	1,112	1,040	1,344	1,316
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	14	12	16	18	10
Net Interest (Exp)/Inc	(25)	(24)	35	1	(32)
Exceptional Gain/(Loss)	0	0	0	(18)	18
Pre-tax Profit	1,175	1,100	1,091	1,347	1,313
Tax	(246)	(223)	(181)	(245)	(266)
Minority Interest	13	5	10	5	(16)
Net Profit	943	881	921	1,106	1,029
Net profit bef Except.	943	881	921	1,126	1,012
EBITDA	1,300	1,300	1,260	1,540	1,492

Growth (QoQ)

Revenue Gth (%)	0.2	(6.3)	2.3	23.3	(1.0)
EBITDA Gth (%)	4.5	(6.2)	(3.1)	22.2	(3.1)
Opg Profit Gth (%)	4.5	(6.3)	(6.5)	29.3	(2.1)
Net Profit Gth (%)	3.7	(6.6)	4.6	20.1	(7.0)

Growth (YoY)

Revenue Gth (%)	44.7	26.3	21.8	18.5	17.1
EBITDA Gth (%)	34.7	14.9	18.9	16.1	7.6
Opg Profit Gth (%)	36.6	20.3	21.4	18.3	10.8
Net Profit Gth (%)	39.7	20.5	26.7	21.6	9.1

Margins

Gross Margins (%)	63.5	67.8	69.3	69.9	69.8
Opg Profit Margins (%)	22.0	22.0	20.1	21.1	20.8
Net Profit Margins (%)	17.5	17.4	17.8	17.3	16.3

Source: Company, DBS HK

CSPC Pharmaceutical

Balance Sheet (HK\$ m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Net Fixed Assets	6,500	7,769	8,128	8,448	8,732
Invt in Associates & JVs	110	144	144	144	144
Other LT Assets	1,298	2,785	2,785	2,785	2,785
Cash & ST Invt	5,242	4,932	6,306	9,195	12,929
Inventory	2,901	3,461	4,213	4,975	5,709
Debtors	1,850	2,347	2,897	3,421	3,925
Other Current Assets	3,641	4,948	4,948	4,948	4,948
Total Assets	21,543	26,383	29,417	33,912	39,168
ST Debt	927	80	80	80	80
Creditors	1,485	1,840	2,370	2,799	3,211
Other Current Liab	3,347	6,315	5,505	5,505	5,505
LT Debt	60	0	0	0	0
Other LT Liabilities	316	500	500	500	500
Shareholder's Equity	15,322	17,105	20,452	24,557	29,447
Minority Interests	85	542	510	471	423
Total Cap. & Liab.	21,543	26,383	29,417	33,912	39,168
Non-Cash Wkg. Capital	3,560	2,600	4,183	5,040	5,866
Net Cash/(Debt)	4,255	4,851	6,226	9,115	12,849
Debtors Turn (avg days)	39.3	36.4	36.3	37.1	37.6
Creditors Turn (avg days)	87.8	95.3	87.6	92.2	95.2
Inventory Turn (avg days)	163.4	182.3	159.8	163.9	169.2
Asset Turnover (x)	0.9	0.9	0.9	1.0	1.0
Current Ratio (x)	2.4	1.9	2.3	2.7	3.1
Quick Ratio (x)	1.2	0.9	1.2	1.5	1.9
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	118.6	2,459.6	1,496.0	1,496.0	1,494.7
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

Cash Flow Statement (HK\$ m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Pre-Tax Profit	3,465	4,502	5,505	6,747	8,095
Dep. & Amort.	717	747	861	901	937
Tax Paid	(575)	(873)	(1,067)	(1,308)	(1,570)
Assoc. & JV Inc/(loss)	(10)	(51)	(51)	(51)	(51)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(270)	(701)	(773)	(858)	(825)
Other Operating CF	(39)	806	(13)	(27)	(57)
Net Operating CF	3,288	4,429	4,460	5,403	6,529
Capital Exp.(net)	(1,171)	(1,973)	(1,200)	(1,200)	(1,199)
Other Invt.(net)	(1,488)	(447)	0	0	0
Invt in Assoc. & JV	(380)	(34)	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(249)	62	49	63	92
Net Investing CF	(3,287)	(2,391)	(1,151)	(1,137)	(1,107)
Div Paid	(726)	(936)	(1,123)	(1,373)	(1,683)
Chg in Gross Debt	(193)	(907)	0	0	0
Capital Issues	2,351	0	0	0	0
Other Financing CF	274	(505)	(812)	(2)	(2)
Net Financing CF	1,706	(2,348)	(1,934)	(1,375)	(1,685)
Currency Adjustments	296	0	0	0	0
Chg in Cash	2,003	(310)	1,375	2,892	3,737
Opg CFPS (HK\$)	0.58	0.82	0.84	1.00	1.18
Free CFPS (HK\$)	0.35	0.39	0.52	0.67	0.85

Source: Company, DBS HK

CSPC Pharmaceutical
Target Price & Ratings History


S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	21-Aug-18	HK\$17.82	HK\$21.00	Buy
2:	20-Nov-18	HK\$17.10	HK\$20.00	Buy
3:	21-Mar-19	HK\$14.48	HK\$22.00	Buy

Source: DBS HK

Analyst: Mark KONG CFA,

[^] Bloomberg ESG Disclosure Scores rate companies annually based on their disclosure of quantitative and policy-related ESG data. It is based on a scoring scale of 0-100, and calculated using a subset of more than 100 raw data points it collects on ESG. It is designed to measure the robustness of companies' disclosure of ESG information in their reporting/the public domain. Based on Bloomberg disclosures, as of 25 Jan 2019, the global ESG disclosure average score is 24.92 and 22.14, 28.26, 49.97 for Environmental, Social and Governance, respectively.

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 20 Aug 2019 07:29:38 (HKT)

Dissemination Date: 20 Aug 2019 09:25:48 (HKT)

Sources for all charts and tables are DBS HK unless otherwise specified.

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DBS Bank (Hong Kong) Limited13th Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong

Tel: (852) 3668-4181, Fax: (852) 2521-1812

DBS Regional Research Offices

HONG KONG

DBS Bank (Hong Kong) Ltd
Contact: Carol Wu
 13th Floor One Island East,
 18 Westlands Road,
 Quarry Bay, Hong Kong
 Tel: 852 3668 4181
 Fax: 852 2521 1812
 e-mail: dbsvhk@db.com

MALAYSIA

AllianceDBS Research Sdn Bhd
Contact: Wong Ming Tek (128540 U)
 19th Floor, Menara Multi-Purpose,
 Capital Square,
 8 Jalan Munshi Abdullah 50100
 Kuala Lumpur, Malaysia.
 Tel.: 603 2604 3333
 Fax: 603 2604 3921
 e-mail: general@alliancedbs.com

SINGAPORE

DBS Bank Ltd
Contact: Janice Chua
 12 Marina Boulevard,
 Marina Bay Financial Centre Tower 3
 Singapore 018982
 Tel: 65 6878 8888
 Fax: 65 65353 418
 e-mail: equityresearch@db.com
 Company Regn. No. 196800306E

INDONESIA

PT DBS Vickers Sekuritas (Indonesia)
Contact: Maynard Priajaya Arif
 DBS Bank Tower
 Ciputra World 1, 32/F
 Jl. Prof. Dr. Satrio Kav. 3-5
 Jakarta 12940, Indonesia
 Tel: 62 21 3003 4900
 Fax: 6221 3003 4943
 e-mail: research@id.dbsvickers.com

THAILAND

DBS Vickers Securities (Thailand) Co Ltd
Contact: Chanpen Sirithanarattanukul
 989 Siam Piwat Tower Building,
 9th, 14th-15th Floor
 Rama 1 Road, Pathumwan,
 Bangkok Thailand 10330
 Tel. 66 2 857 7831
 Fax: 66 2 658 1269
 e-mail: research@th.dbs.com
 Company Regn. No 0105539127012
 Securities and Exchange Commission, Thailand