Outperform

(Maintained)

Pharmaceutical

Target Price: HKD 50.21

Yichang Hec Changjiang Pharmaceutical (1558.HK)

Register over-expected earnings performance for 2017

02/09/2018

Key Data

Feb. 05, 2018

Closing Price (HKD)	39.50
Total Shares (Mn)	452.02
Shares Outstanding (Mn)	225.82
Market Cap(HKD/Mn)	17854.79
Market Float(HKD/Mn)	8919.89
Net Assets (CNY/Mn)	2643.40
Total Assets (CNY/Mn)	3491.09
BVPS (CNY)	5.85

Revenue Breakdown (CNY, Mn) Jun. 30, 2017

Operating Revenue	700.00	
Revenue by Product:	700.00	
1.Anti-Virus Products	600.00	85.71%
2.Cadiovascular Drugs	100.00	14.29%
3.Endocrine and Metabolic Diseases Therapeutic Products	0.00	0.00%
4.Other Products	0.00	0.00%

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Key Financial Indicators

FY	2016A	2017E	2018E	2019E
Revenue (Mn/CNY)	942	1501	1883	2307
YoY (%)	35.9%	59.4%	25.5%	22.5%
Net Profit (Mn/CNY)	381	658	826	1003
YoY (%)	43.2%	72.9%	25.5%	21.5%
Gross Margin (%)	77.2%	83.4%	84.0%	84.1%
Net Profit Margin (%)	40.4%	43.8%	43.9%	43.5%
ROE (%)	15.5%	22.4%	23.5%	23.8%
EPS (CNY)	0.84	1.46	1.83	2.22
OCFPS (CNY)	37.7	21.8	17.4	14.3

Company Profile

Yichang Hec Changjiang Pharmaceutical (the Company, abbreviated as HEC later) is a PRC pharmaceutical manufacturing company that focuses on the development, manufacturing and sale of pharmaceutical products in the therapeutic areas of anti-virus, endocrine and metabolic diseases and cardiovascular diseases. The Company currently manufactures, markets and sells a total of 33 pharmaceutical products in the PRC. The Company also manufactures 11 types of APIs, most of which are manufactured for self-use.*(Source: Wind)*

Comments

HEC reported significant earnings growth for H217.

Company's net profit attributable to shareholders shall increase by no less than 70% for whole 2017. Given the 40.4% profit growth of H117, we expect company's profit growth to exceed 110% for the second half of 2017. We believe the booming earnings growth mainly attributed to three factors: 1) the influenza outbreak in H217 boosted sales of its main product, Kewei (Oseltamivir Phosphate Granules); 2) more sales staff were recruited and the efficiency of promotion activities kept improving; 3) economies of scale and falling costs of raw materials drove up company's gross margin.

HEC Pharmaceutical's core product, Kewei, posted surging sales.

We attribute HEC's explosive earnings growth of 2017 to surging sales of Kewei. The annual sales growth may clock in higher than 70% for 2017. Moderate growth in H117 was due to structural reform of sales team and company quitting bid in several provinces.

The influenza outbreak of 2017 became much more severe in H217, fueling surging demand for Kewei (since Kewei was the main chemical drug for treatment). At the same time, fallout of company's sales team reform mitigated gradually and company's sales team continued expanding. The two factors brought company's sales volume back to a fast upward track in H217.

Weaving distribution network across China is gradually gaining HEC access to markets other than Guangdong Province and building new headroom for Kewei. Considering that the current flu may last until H118, and that company's nationwide distribution channel shall bring new momentum, we expect the sales of *Kewei-series* to grow by over 25% in 2018, and by over 20% in 2019

Earnings forecast and investment grading

The company is developing in line with our expectation that stated in our in-depth report 'The quickly growing poster-boy in Influenza-Antiviral-Drug industry'. Its prime product, Oseltamivir Phosphate Granules (Kewei), as a prevailed chemical drug used to treat influenza, had achieved rapid growth in 2017 (we expect the revenue it contributed to notch an annual growth of over 70%) and is expected to report over 25% growth for 2018 and a growth of over 20% for 2019.

Company's research and development of other drugs are proceeding steadily at the same time: core products under research, such as the full series of insulin and *Yimitasvir-Phosphate*, are expected to become the company's new growth driver after their debut. The strong R&D capability of the conglomerate that HEC belongs to paves broad way for the company's future development.

Given such, we revise up company's estimated sales revenue of year 2017/2018/2019 to CNY 146mn/183mn/222mn, which implies a P/E ratio of 21.8x/17.4x/14.3x respectively for the three years (calculation is based on closing price of Feb. 05, 2018). We also revise up company's target price to HKD 50.21 and maintain 'Outperform' rating for the company.

Potential risks: the sales of *Kewei* may fail to meet expectation; influenza morbidity may be volatile; products under research may be promoted to market later than expected.

Introduction of Share Investment Rating

Industry Investment Rating

When measuring the difference between the markup of the industry index and that of the market's benchmarks (Shanghai Composite Index/Shenzhen Component Index) within twelve months after the release of the report, we define the terms as follows:

- **Overweight：** Industry performs better than that of the whole market；
- **Neutral：** Industry performs about the same as that of the whole market；
- **Underweight：** Industry performs worse than that of the whole market

Company Investment Rating

When measuring the difference between the markup of the company stock price and that of the market's benchmarks (Shanghai Composite Index/Shenzhen Component Index) within twelve months after the release of this report, we define the terms as follows:

- **Buy：** With a markup more than 15% better than that of the market；
- **Outperform：** With a markup 5% to 15% better than that of the market；
- **Neutral：** With a markup less than 5% better or worse than that of the market；
- **Underperform：** With a markup more than 5% worse than that of the market.

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