

Analyst: Kelvin Li

**Main Board H-share Listing – Research**

宜昌東陽光長江藥業股份有限公司

YiChang HEC ChangJiang Pharmaceutical Co., Ltd. (01558)

<b>Sole Sponsor</b>	:	CICC
<b>Joint Global Coordinators, Joint Bookrunners &amp; Joint Lead Managers</b>	:	CICC ICBC International CMB International
<b>Joint Bookrunners &amp; Joint Lead Managers</b>	:	Nomura ABC International CCB International

**Sector** : Pharmaceuticals, Biotechnology & Life Sciences

**Business** : Manufacture of pharmaceutical products in the PRC

<b>Total share offer:</b> <u>90,132,000</u> H shares (20.0% of the enlarged share capital)  <b>Public Offer:</b> 9,013,200 H shares (10%) <b>Placing:</b> 81,118,800 H shares (90%) <b>Greenshoe:</b> 13,519,800 H shares	<b><u>Business of HEC ('The Group')</u></b>  The Group is mainly engaged in the development, manufacturing and sale of pharmaceutical products in the therapeutic areas of anti-virus, endocrine and metabolic diseases and cardiovascular diseases.  In relation to anti-virus therapeutic area, the Group has Kewei (oseltamivir phosphate) products in capsule and granules form. Kewei is an anti-viral drug used for influenza treatment. In relation to endocrine and metabolic diseases therapeutic area, the Group's key product is Ertongshu (benzbromarone tablets). Ertongshu is a drug used for treatment of excess uric acid in blood (hyperuricemia). In relation to cardiovascular diseases therapeutic area, Oumeining (telmisartan tablets) and Xinhaining (amlodipine besylate tablets) are the Group's key products. Oumeining is an angiotensin II receptor antagonist used for treatment of hypertension, while Xinhaining is a calcium channel blocker that is used for treatment of hypertension and other related cardiovascular diseases.
<b>Price:</b> HK\$13.70 – HK\$18.50 per H share <b>Total Market Capitalisation:</b> HK\$6,174 million – HK\$8,337 million <b>Pro-forma fully diluted FY2014 P/E:</b> 37.4x-50.5x <b>Adjusted NTA per share:</b> HK\$5.10-HK\$6.02 <b>Staffing:</b> 857 (as of 30 <sup>th</sup> June 2015)	
<b>HK Public Offer period:</b> 15 <sup>th</sup> December 2015 - 18 <sup>th</sup> December 2015 noon  <b>Receiving banks:</b> Bank of China (Hong Kong) Wing Lung Bank ICBC (Asia)  <b>Share registrar:</b> Computershare Hong Kong Investor Services  <b>Listing date:</b> 29 <sup>th</sup> December 2015	

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### Shareholders after Listing:

• HEC Pharm Co., Ltd.* (Domestic share)	49.93%
• North & South Brother Pharma - 100% owned by non-executive Director MO kit (H share)	16.64%
• Six pre-IPO investors with interests ranging from 0.97% to 6.61% (H share)	13.43%
• Public shareholders (H share)	20.00%
	<u>100.00%</u>

Remark: (\*) a company controlled by the Group's Founder Mr. Zhang Zhongneng and his family members

### Use of Proceeds

Net proceeds from the offer are estimated to be HK\$1,351 million (based on an offer price of HK\$16.10).

	HK\$ million
For the construction of a new oral formulation production plant	606
For the construction of a new insulin formulation production plant	170
For marketing	440
For the general working capital	135

### Financial Highlights

	Year ended 31 <sup>st</sup> Dec			6 months ended	
	2013	2014	2015	30 <sup>th</sup> Jun 2014	30 <sup>th</sup> Jun 2015
	RMB million	RMB million	RMB million	RMB million	RMB million
Revenue	269.2	316.4	440.9	242.3	382.9
Gross profit	153.5	200.5	321.1	171.2	283.9
Operating profit	77.6	119.1	205.4	120.9	197.7
<b>Profit attributable to shareholders</b>	<b>23.0</b>	<b>57.8</b>	<b>135.3</b>	<b>82.1</b>	<b>153.2</b>
Gross profit margin	57.0%	63.4%	72.8%	70.6%	74.1%
Operating profit margin	28.8%	37.6%	46.6%	49.9%	51.6%
Net profit margin	8.5%	18.3%	30.7%	33.9%	40.0%
	31/12/2012	31/12/2013	31/12/2014	30/6/2014	30/6/2015
Net debt to shareholders' equity	151.2%	160.5%	118.5%	N/A	Net cash

### Breakdown of revenue of the Group in terms of products

(RMB million)	FY2012		FY2013		FY2014		1H2014		1H2015	
Anti-viral drugs	13.5	5.0%	75.4	23.8%	199.4	45.2%	128.2	52.9%	272.5	71.2%
Cardiovascular drugs	97.0	36.0%	98.3	31.1%	106.2	24.1%	49.7	20.5%	50.3	13.1%
Endocrine and Metabolic drugs	19.4	7.2%	25.5	8.1%	32.5	7.4%	13.5	5.6%	15.9	4.2%
Others	139.3	51.8%	117.2	37.0%	102.8	23.3%	50.9	21.0%	44.2	11.5%
<b>Total</b>	<b>269.2</b>	<b>100.0%</b>	<b>316.4</b>	<b>100.0%</b>	<b>440.9</b>	<b>100.0%</b>	<b>242.3</b>	<b>100.0%</b>	<b>382.9</b>	<b>100.0%</b>

### Peer valuation comparison

	HEC ChangJiang Pharmaceutical (01558)		China Medical System (00867)		CSPC Pharmaceutical (01093)	
	FY2014	FY2015E	FY2014	FY2015E	FY2014	FY2015E
Gross profit margin	72.8%	N/A	56.2%	56.7%	38.2%	44.2%
P/E ratio	37.4x-50.5x	19.8x-26.7x (Based on bookrunner's estimate)	19.3x	20.1x	36.0x	26.8x
Market capitalisation	HK\$6,174-8,337 million		HK\$24,922 million		HK\$45,278 million	

Sources: Reuters

**Strengths/Opportunities**

- ✓ The Group currently had 18 products in different stages of development. Such 18 products cover various therapeutic areas, including products for endocrine and metabolic diseases, digestive diseases, anti-viral products, cardiovascular diseases and diseases related to central nervous system.
- ✓ The Group reported strong sales growth of its core Kewei products amid more common use of oseltamivir phosphate in influenza treatment. In May 2013, health department of both Guangdong and Hubei provinces approved clinical use of oseltamivir phosphate for regular treatment of influenza, rather than only treatment for severe avian influenza. The relaxed guidelines for the use of oseltamivir phosphate had helped jump-start sales of the Group's Kewei products since 2013.
- ✓ The Group has entered into cornerstone placing agreements with four investors, namely Ally Bridge Sunshine (hedge fund), China Southern Dragon Dynamic Fund (managed by CSOP Asset Management), Pinpoint Asset Management and Sanxing Electric. The cornerstone investors will subscribe for an aggregate amount of HK\$620.3 million in the IPO, which will represent a combined 8.5% of the enlarged share capital (assuming the over-allotment option is not exercised and IPO price at HK\$16.10). The cornerstone subscriptions will be subject to six-month lock-up restriction.

**Weaknesses/Threats**

- × The Group registered strong business growth during the Track Record Period, which was mainly driven by sales of the Group's core Kewei (oseltamivir phosphate) product. However, the Group is only licensed from F. Hoffmann-La Roche (holder of patents relating to oseltamivir phosphate) to manufacture and sell such Kewei products, while some of the patents would expire in February 2016. Upon expiry of the patents, other pharmaceutical manufacturers could apply for commercial production of oseltamivir phosphate.
- × The Group's anti-viral Kewei products posted strong growth during the Track Record Period. However, it also led to a highly concentrated product mix, as revenue generated from sale of anti-viral products accounted for more than 70% of the Group's total revenue in 1H2015.
- × The Group does not appoint any CEO. General Manager Jiang Juncai (aged 33), who joined the Group in May 2015, is responsible for the Group's day-by-day management. Prior to joining the Group, Jiang was a director at Yichang Shancheng Cordyceps Sinensis (冬蟲夏草) Co., Ltd. and may be lack of concrete experience in running a Western pharmaceutical company.
- × The Group plans to price its IPO at 19.8x-26.7x FY2015E P/E (based on Bookrunner's estimate), in line with its sector peers. However, given its heavy reliance on Kewei products and the risk of rising competition in the production of oseltamivir phosphate amid expiry of the related patents in the next few years, we find such valuation unattractive.

**Recommendation:        Unattractive**

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