

Analyst: Vincent Leung

Main Board Listing – Research

Wuyi International Pharmaceutical Co. Ltd. [Stock Code: 1889] (武夷國際藥業有限公司)

Joint global coordinators, joint bookrunners and joint lead managers	: Credit Suisse (Hong Kong) Limited	UBS	
Joint sponsors	: Credit Suisse (Hong Kong) Limited	UBS	Sun Hung Kai International Limited

Sector : Pharmaceuticals

Business : Manufacture, marketing & selling of western and modern Chinese medicine products

Total share offer: <u>445,150,000</u> shares (27% of the enlarged share capital) Public Offer: 44,515,000 shares (10%) Placing: 400,635,000 shares (90%) Greenshoe: 66,772,500 shares Price: HK\$1.20 – HK\$1.80 per share Market Cap: HK\$1,972– HK\$2,957 million Pro-forma FY06 PER: 17.0X – 26.0X Adjusted NTA per share: HK\$0.29- HK\$0.42 Staffing: 310	<u>Business of Wuyi International (Wuyi)</u> Wuyi engages in the manufacturing, marketing and selling of prescription and over-the-counter western pharmaceuticals and modern Chinese medicine products. Founded by 12 shareholders, Wuyi currently has a principal product portfolio of 19 western pharmaceuticals and 5 modern Chinese medicine products out of a total product portfolio of 123 SFDA (State Food & Drug Administration) approved products. The principal products mainly target respiratory, cardiovascular, gastrointestinal, infectious disease and cancer. Wuyi markets the products through its own brand “3A”. Wuyi develops a range of SFDA approved products through R&D of new drugs and selection of generic drugs. It plans to launch 3 new products in 2007, 2 in 2008, and 3 in 2009, including cardiovascular, antibiotics, and pain products. A new product, Perilla oil for high lipid level in bloodstream, is expected to receive SFDA approval in 1H07.
HK Public Offer period: 22 nd January 07 – 25 th January 07 noon Receiving bank: Bank of Communications Bank of China (HK) Share registrar: Computershare Hong Kong Investor Services Limited Listing date: 1 st February 2007	

Major Shareholders after Listing (Assuming the over-allotment option is not exercised)

Bright Elite Management Ltd – wholly owned by Lin Qing Ping, General Manager, COO and a founding shareholder	20.18%
Thousand Space Holdings Ltd – wholly owned by Lin Ou Wen, Chairman, CEO and a founding shareholder	15.14%
Orient Day Management Ltd – owned by 3 of the 12 founding shareholders	7.53%
Orchid Asia*	7.18%
Loyal More Group Limited – owned by 3 of the 12 founding shareholders	6.40%
Pope Investments*	6.23%
Good East Management Ltd – owned by 3 of the 12 founding shareholders	4.59%
NAP*	4.28%
	<u>71.53%</u>

* These investors are independent third parties

Use of Proceeds

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Net proceeds from the offer are estimated to be HK\$391 million – HK\$600 million. (Assuming the over-allotment option is not exercised)

	HK\$ million
For the capital expenditure for construction of phase 2 manufacturing plants for Perilla Oil capsule in Fuzhou	248
For the enhancement of sales and distribution efforts	79
For research and development	69
For the replacement of an interest-free shareholder's loan extended by Lin Ou Wen (the Chairman, CEO and executive Director)	64
For the enhancement of informational systems and electronic commerce platform	10
For working capital and general corporate purposes	25

Financial Highlights

	Year ended 31 st December			Nine months ended 30th Sep
(RMB million)	2003	2004	2005	2006
Turnover	213.83	316.17	417.35	372.56
Gross profit	91.60	139.75	198.87	183.84
Operating profit	71.65	117.71	174.67	88.65
Net profit attributable to shareholders	48.26	78.91	117.29	54.33
Gross margin	42.8%	44.2%	47.7%	49.3%
Operating margin	33.5%	37.2%	41.9%	23.8%
Net margin	22.6%	25.0%	28.1%	14.6%

Turnover Breakdown (% of Total Turnover)

	Year ended 31 st December			Nine months ended 30th Sep
	2003	2004	2005	2006
Western Pharmaceuticals				
Prescription drugs	13.8%	42.4%	51.40%	57.40%
Over-the-counter drugs	-	-	-	0.40%
Modern Chinese medicine				
Prescription drugs	77.8%	46.6%	40.3%	33.2%
Over-the-counter drugs	8.4%	11.0%	8.3%	9.0%
Total	100.0%	100.0%	100.0%	100.0%

Strengths/Opportunities

- ✓ **Well-positioned product portfolio to capture key market trends** Wuyi's product portfolio targets key segments of the pharmaceutical markets – respiratory, cardiovascular, cancer and infectious diseases. Amid rising demand among the aging population and positive regulatory reform to streamline the national healthcare system and insurance coverage, the Chinese pharmaceutical industry is expected to grow and consolidate rapidly.
- ✓ **Product development track record** Wuyi has demonstrated the capability in developing new products in-house or acquired through collaboration with research institutes, universities and hospitals. Perilla Oil Capsule, a new product expecting SFDA approval in 1H07, has demonstrated promising results during clinical trials.
- ✓ **A solid regional player with established brand** The fragmented but competitive Chinese pharmaceutical industry has been consolidating amid a series of regulatory reforms. Larger players with strong brand recognition and solid distribution network with a regional focus should continue to benefit from the consolidation. Wuyi has strong foothold in Fujian and nearby affluent coastal provinces and leverage on the rising awareness on health and the demand for pharmaceutical products.

Weaknesses/Threats



- × **Pricing of products:** In effort to clamp down irregularities in pricing medicinal products in China and to make health expenses more affordable to the public, the government has recently slashed the maximum selling prices of many drug products. There have been 20 price adjustments since 1997. The average price cuts ranged from 10% to 40% targeting commonly prescribed drugs in antibiotics, cardiovascular, anticancer and respiratory categories. During the track record period, sales of Wuyi's products subject to price control accounted for 64% to 82% of total turnover. Manufacturers are passive and can only choose to absorb the margin erosion or modify the product portfolio (Wuyi discontinued one of its principal products that was affected in 2005). This poses high risk in increasing the volatility in revenue.
- × **Generic drugs product portfolio** Most of Wuyi's products are generic drugs based on known chemical entities, formulae and production methods. Although several licenses and certificates are needed before other rivals can start the production of those products, Wuyi does not have substantial competitive edge in R&D and technical know-how over other competitors.
- × **Valuation on the high side** The pro-forma FY06E PER of 17.0X – 26.0X is on the high-end. Pharmaceutical companies listed in Hong Kong trade at FY06E PER of 11.5X to 22.9X with an outlier at 67.5X. Several close peers in terms of product portfolio and regional focus, Hua Han (0587.HK) and Guangzhou Pharmaceutical (0874.HK), trade at 13.1X and 22.9X FY06E PER respectively. Tong Ren Tong (8069.HK), a national player with higher brand equity justifying for a premium valuation, only trades at 13.6X FY06E PER.

Recommendation: Neutral



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