

Nov 8, 2016
Company Report
Rating: HOLD
TP: HK\$ 22.83

Share price (HK\$) 21.75
Est. share price return 4.97%
Est. dividend yield 0.00%
Est. total return 4.97%

Previous Rating HOLD
Previous TP 22.83

Analyst: Paul Pan
Tel: (852) 2147 8829
Email: paulpan@abci.com.hk

Key Data

52Wk H/L(HK\$) 31.8/12.48
Outstanding shares (mn) 630.41
Market cap (HK\$ mn) 13,711
3-mth avg daily turnover (HK\$ mn) 42.11
Major shareholder(s) (%):
Fei Luo 71.56

Source(s): Bloomberg, HKEX, ABCI Securities

Key data

	1H15	1H16
Revenue composition (%)	6.88	(3.95)
Infant milk formula	(5.02)	1.84
Adult nutrition products	1.87	13.92

Source(s): Company, ABCI Securities

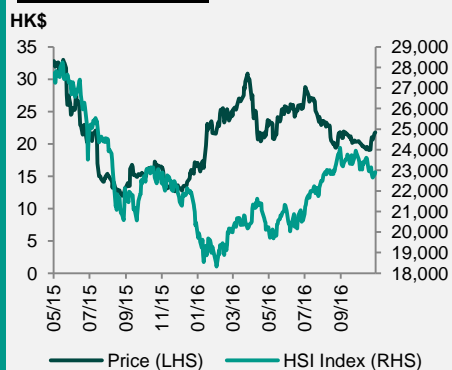
Share price performance (%)

	Absolute	Relative*
1-mth	5.65	(4.06)
3-mth	(6.11)	1.73
6-mth	0.70	13.79

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Stock performance



Source(s): Bloomberg, ABCI Securities

* All market data as of closing of Nov 8, 2016

Biostime International (1112 HK)

Cautiously optimistic on growth outlook

- Baby nutrition and care segment turned around in 3Q16, as the quarter's sales growth reached 16.23% YoY. In 9M16, YoY decline in sales narrowed to 3.29% from 12.16% in 1H16. We believe relaxation of one-child policy may have benefited the Group
- Adult nutrition segment disappoints, as 3Q16 revenue in AUD declined 15.7% due to policy overhangs and resellers' destocking
- Currency translation represents risk as the AUD/RMB exchange rate on by the global economy and the Fed's interest rate moves; adult nutrition segment would be the most affected
- Sales network has been contracting but improved sales in IMF indicates higher sales efficiency
- Maintain **HOLD** with TP of HK\$ 22.83 due to high leverage and our cautious stand on the outlook of related policies

Baby nutrition and care segment saved the day. The segment's performance was better than expected. Revenue reached RMB 2,760.35mn in 9M16 and RMB 1,036.05mn in 3Q16, up 16.23% YoY. Hence, 9M16 revenue was down only by 3.29% YoY as compared to 12.16% YoY in 1H16. We believe this turnaround was partially driven by the relaxation of one-child policy.

Adult nutrition sales disappointed. The total adult nutrition sales in 9M16 reached RMB 1,921.36 mn, up 17.36% YoY. 3Q16 sales (in AUD term) declined by 15.7% YoY due to the destocking by resellers. Revenue growth in 3Q16 was disappointing. In FY15, segmental revenue was RMB 2487.05mn and 4Q15 sales were estimated to be ~RMB 849.90mn. To achieve a flat annual sales growth, the segment's 4Q16 revenue would have to be RMB 565.70mn. In our opinion, such a sales target is hard to achieve as we expect the destocking period would be longer and the FDA's policy impact would be more negative on the Group's direct sales.

Currency translation represents risks. The Group's business now includes a large operation in Australia. Hence, the global economy and the Fed's interest rate moves would affect the AUD/RMB exchange rate and consequently, distort the Group's result reporting, which is stated in RMB. For 1H16, 9M16, and 9M15, the adult nutrition product segment used currency exchange rate of AUD1 = RMB4.7982, AUD1 = RMB4.8865, and AUD1 = RMB4.7175. Without the currency translation, the Group's revenue for 9M16 and 9M15 was AUD 393.20mn and AUD 347.04mn. YoY change for 9M16 sales would be +13.30% in AUD terms and +17.36% in RMB terms. Investors should caution the changing exchange rates and their impact on the Group's reported performance.

Shrinking sales network. According to the Group, the number of retail outlets decreased from 41,027 as of end-3Q15 to 38,025 as of end-3Q16. For the same period, the number of VIP baby stores, retail sales organization, and VIP pharmacies decreased from 28,649, 6,933, and 4,869 to 27,301, 5,727, and 4,997. The growing sales and shrinking sales network suggest the Group's sales and promotion strategies have turned effective.

Results and Valuation

FY ended Dec 31	FY14A	FY15A	FY16E	FY17E	FY18E
Revenue (RMB mn)	4,731.56	4,818.56	6,392.92	6,763.92	7,240.17
Chg (% YoY)	3.73	(16.12)	(3.20)	6.84	6.46
Net Profit (RMB mn)	806.79	251.46	428.49	505.44	594.67
Chg (% YoY)	(1.70)	(68.83)	70.40	17.96	17.65
Basic EPS (RMB)	1.34	0.41	0.79	0.94	1.10
Growth (%)	(69.40)	93.38	17.96	17.65	19.63
P/E (x)	12.81	41.55	26.27	22.26	18.90
BVPS (RMB)	4.85	5.91	6.83	8.08	9.41
P/B (x)	3.54	2.90	2.71	2.28	1.96
DPS(RMB)	0.67	0.00	0.00	0.00	0.00
Yield (%)	4.23	0.00	0.00	0.00	0.00
ROAA (%)	14.31	2.46	3.08	3.69	4.49
ROAE (%)	29.70	7.71	11.04	11.12	11.16

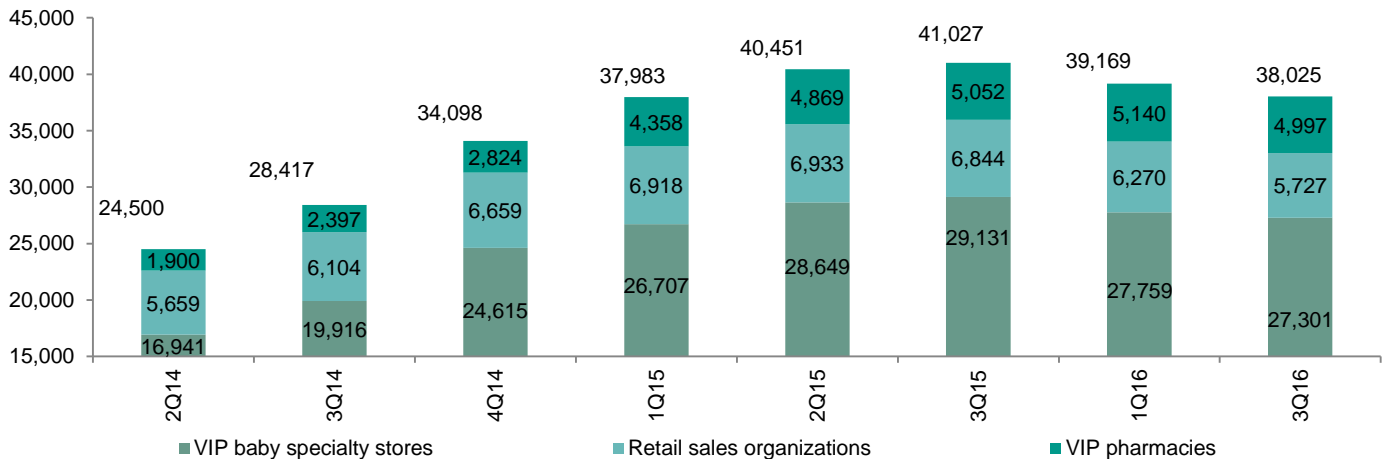
Source(s): The Group, Bloomberg, ABCI Securities estimates

We are cautious on the growth outlook. For the baby nutrition and care products, the prospect improves but we believe that the relaxation of the one-child policy would provide gentle nudges to the Group's growth momentum. We expect revenue growth of IMF products to be ~7% YoY in FY17E/18E after declining 4.14% YoY in FY16. Revenue of the entire baby nutrition and care segment would decline by 3.2% YoY in FY16E and grow at 6.84% YoY/6.46% YoY in FY17E/18E. For the adult nutrition segment, the main catalysts would be the increase in registered products to be sold in China and more importantly, the authority's clarification of related regulations. We expect comparative revenue growth to be 4.27% YoY in FY16 due to FDA policy headwinds.

Profitability outlook remains unchanged. We maintain our previous profitability projections for the Group. Overall GPM would improve from 62.35% in FY16E to 63.92% in FY18E; GPM of the adult nutrition segment would increase from 64.75% in FY16E to 65.46% in FY18E. High pressure on sales marketing however, would increase the selling and distribution expenses-to-sales ratio in the coming years to 37.42% in FY17E and 38.44% in FY18E. Our current NPM projections are 6.7%, 7.47% and 8.21% for FY16E-18E.

Reiterate HOLD with TP of HK\$ 22.83. We maintain our **HOLD** rating because of 1) the regulatory uncertainty faced by the adult nutrition segment; 2) the consistency and extent to which relaxation of the one-child policy would benefit sales; 3) impact of a high leverage on the Group's operation and finances. We maintain our previous **HOLD** rating and TP of HK\$ 22.83, which represents of 23.97x/23.69x FY16E/17E P/E and 2.88x/2.43x FY16E/17E P/B.

Exhibit 1: Sales network breakdown



Source(s): The Group, ABCI Securities

Appendix: Financial Statements of the Group

Consolidated income statement (FY14A - FY18E)

FY ends at Dec 31 (RMB mn, except per share data)	FY14A	FY15A	FY16E	FY17E	FY18E	1H15	1H16
Revenue	4,731.56	4,818.56	6,392.92	6,763.92	7,240.17	1,962.90	3,008.30
- Infant formula	3,981.58	3,355.85	3,217.02	3,462.83	3,706.21	1,697.84	1,460.49
- Adult nutrition products	0.00	849.90	2,551.27	2,659.41	2,870.49	951.82	1,284.01
- Others	425.09	389.38	396.14	406.55	417.31	265.06	263.80
COGS	(1,804.63)	(1,834.00)	(2,406.73)	(2,541.20)	(2,612.29)	(820)	(1,080)
Gross profit	2,926.93	2,984.57	3,986.19	4,222.72	4,627.88	1,142.90	1,928.11
- Infant formula	2,466.91	2,124.12	2,014.35	2,159.13	2,341.96	994.94	957.18
- Adult nutrition products	0.00	520.92	1,652.05	1,746.44	1,879.02	0.00	801.20
- Others	460.02	339.53	335.94	318.70	280.74	147.61	169.73
Other income, gains, and expenses	(64.52)	(178.76)	(50.66)	(44.80)	(48.59)	11.76	60.77
SG&A	(1,763.03)	(2,255.98)	(2,626.66)	(2,866.81)	(3,141.60)	(826.37)	(1,120.07)
Operating profit	1,099.38	549.83	1,308.87	1,311.11	1,437.69	271.07	868.82
Net interest income/(expense)	18.36	(45.50)	(462.90)	(391.68)	(350.64)	9.53	(204.21)
Share of profit of an associate	0.59	(0.39)	(0.46)	(0.56)	(0.67)	(0.48)	(2.86)
Profit before tax	1,118.34	503.94	845.51	918.87	1,086.39	280.12	661.75
Tax	(311.55)	(210.62)	(345.69)	(329.29)	(392.73)	(75.16)	(256.86)
Net profits	806.79	293.32	499.82	589.58	693.66	204.96	404.89
- Profit to owners of the Group	806.79	251.46	428.49	505.44	594.67	204.96	356.91
- Minority interest	0.00	41.86	71.33	84.14	98.99	0.00	47.98
Dividend	124.32	0.00	0.00	0.00	0.00	0.00	0.00
EPS (RMB)							
- Basic	1.34	0.41	0.79	0.94	1.10	0.34	0.57
- Dilute	1.31	0.45	0.63	0.74	0.88	0.33	0.56
DPS (RMB)	0.67	0.00	0.00	0.00	0.00	0	0

Source(s): The Group, ABCI Securities estimates

Consolidated balance sheet (FY14A - FY18E)

FY ends at Dec 31 (RMB mn)	FY14A	FY15A	FY16E	FY17E	FY18E	1H15	1H16
Cash and cash equivalents	3,347.16	1,198.24	1,839.60	985.72	1,177.12	3,998.20	1,559.96
Restricted bank deposit	0.00	1,677.00	1,494.12	1,166.74	1,078.33	0.00	1,102.50
Trade and bills receivable	12.04	622.84	591.81	639.49	600.03	22.40	415.31
Inventories	797.03	856.22	880.03	1,066.94	643.91	626.46	990.90
Others	179.49	243.69	244.97	255.04	214.13	196.71	184.95
Current assets	4,335.72	4,637.99	5,094.53	4,162.34	3,766.75	4,843.77	4,293.63
PP&E	478.03	547.00	639.33	693.36	750.71	518.77	532.74
Goodwill	76.00	4,937.30	4,937.30	4,937.30	4,937.30	76.00	5,164.18
Intangible assets	104.11	2,896.62	2,681.36	2,981.49	3,035.38	101.16	2,979.61
Others	1,637.30	825.50	597.43	649.03	592.32	830.39	327.19
Non-current assets	2,295.44	9,206.41	8,855.41	9,261.18	9,315.70	1,770.23	9,276.44
Total assets	6,631.16	13,844.40	13,949.94	13,423.52	13,082.45	6,614.00	13,570.07
Trade and bills payables	294.54	618.71	562.34	1,037.92	116.54	193.38	596.95
ST borrowings	0.00	4,740.45	807.50	765.87	666.22	134.61	654.02
Others	973.08	1,320.16	1,244.84	1,492.53	1,641.41	122.54	140.90
Current liabilities	1,267.62	6,679.32	2,614.68	3,296.32	2,424.17	1,161.24	3,691.20
LT borrowings	0.00	0.00	2,739.83	2,408.16	2,117.71	0.00	2,376.22
Convertible bonds	2,410.53	2,659.06	1,071.19	0.00	0.00	2,455.71	0.00
Other non-current liabilities	35.92	903.78	3,363.81	2,792.66	2,809.19	38.94	3,348.46
Non-current liabilities	2,446.45	3,562.84	7,174.82	5,200.82	4,926.90	2,494.65	5,724.68
Equity	2,917.09	3,602.24	4,160.44	4,926.38	5,731.38	2,958.11	4,154.20
Total liabilities and Equity	6,631.16	13,844.40	13,949.94	13,423.52	13,082.45	6,614.00	13,570.07

Source(s): The Group, ABCI Securities estimates

Consolidated cash flow statement (FY14A - FY18E)

FY ends at Dec 31 (RMB mn)	FY14A	FY15A	FY16E	FY17E	FY18E	1H15A	1H16A
Profit before tax	1,118.34	503.94	845.51	918.87	1,086.39	280.12	661.75
Depreciation and amortization	50.67	87.17	275.49	532.68	668.05	30.11	89.15
Change in working capital	150.98	4.62	(490.94)	891.39	(857.01)	43.13	(244.86)
Others	(347.81)	(230.00)	81.39	9.67	(115.68)	(205.93)	45.40
Cash flow from operating activities	972.17	365.73	711.44	2,352.61	781.75	147.43	551.44
Change in PP&E	(132.92)	(108.86)	(86.33)	(87.66)	(90.89)	(60.88)	(45.38)
Change in intangible assets	(13.82)	(3.71)	(215.25)	300.12	53.89	(0.69)	(8.08)
Others	(313.65)	(4,051.20)	(141.74)	(14.41)	253.71	3.40	(166.32)
Cash flow from investing activities	(460.39)	(4,163.77)	(443.32)	198.06	216.71	(58.17)	(219.78)
Change in bank loans	(750.61)	4,740.45	(806.95)	(1,444.48)	(390.10)	134.61	(1,710.21)
Net proceeds from convertible bonds	2,414.37	0.00	(1,587.87)	(1,071.19)	0.00	0.00	0.00
Dividends paid	(492.70)	(196.05)	0.00	0.00	0.00	(196.10)	0.00
Others	0.79	(1,973.90)	2,830.39	(859.47)	(387.37)	10.96	1,574.09
Cash flow from financing activities	1,171.85	2,570.50	435.57	(3,375.14)	(777.47)	(50.53)	(136.12)
Net change in Cash	1,683.63	(1,227.54)	703.69	(824.46)	220.98	38.73	195.53
Cash and equivalent at beg	764.84	2,447.16	1,115.24	1,793.58	936.16	2,447.16	1,115.24
Forex effect	(1.30)	(104.38)	(25.35)	(32.97)	(41.00)	(10.32)	46.31
Cash and equivalent at end	2,447.16	1,115.24	1,793.58	936.16	1,116.14	2,475.56	1,357.08

Source(s): The Group, ABCI Securities estimates

Key operating and financial ratios (FY14A - FY18E)

FY ended Dec 31	FY14A	FY15A	FY16E	FY17E	FY18E	1H15A	1H16A
Growth (YoY %)							
Revenue	3.73	(16.12)	(3.20)	6.84	6.46	(10.33)	53.26
Gross profit	(1.62)	1.97	33.56	5.93	9.59	(15.06)	68.70
Net profit	(1.70)	(68.83)	70.40	17.96	17.65	(34.36)	74.14
Revenue composition (%)							
- Infant formula	84.15	69.64	50.32	51.20	51.19	86.50	48.55
- Adult nutrition products	0.00	17.64	39.91	39.32	39.65	0.00	42.68
- Others	15.85	12.72	9.77	9.49	9.16	13.50	8.77
Profitability ratios (%)							
Gross margin	61.86	61.94	62.35	62.43	63.92	58.23	64.09
- Infant formula	61.96	63.30	62.62	62.35	63.19	58.60	65.54
- Adult nutrition products	0.00	61.29	64.75	65.67	65.46	0.00	62.40
- Others	61.34	55.41	53.78	49.67	42.31	66.51	64.34
EBIT margin	23.24	11.41	20.47	19.38	19.86	13.81	28.88
EBITDA margin	24.31	13.22	24.78	27.26	29.08	15.34	31.84
Pre-tax margin	23.64	10.46	13.23	13.58	15.01	14.27	22.00
Net margin	17.05	5.22	6.70	7.47	8.21	10.44	11.86
Return ratios (%)							
ROAA	14.31	2.46	3.08	3.69	4.49	3.09	2.95
ROAE	29.70	7.71	11.04	11.12	11.16	6.98	10.44
ROIC	10.15	6.72	4.98	5.61	6.66	7.56	3.39
Liquidity ratio (%)							
Current ratio	3.42	0.69	1.95	1.26	1.55	4.17	1.16
Quick ratio	2.79	0.57	1.61	0.94	1.29	3.63	0.89
Cash ratio	2.64	0.43	1.27	0.65	0.93	3.44	0.72
Cash conversion cycle (days)							
Days of outstanding receivable	1.05	29.20	57.70	54.75	51.77	1.6	54.9
Days of inventory on hand	178.89	200.48	210.19	218.23	192.64	158.4	156.0
Days of outstanding payable	73.48	88.04	88.68	107.05	96.24	64.3	59.4
CCC	106.46	141.64	179.21	165.92	148.17	95.7	151.6
Leverage ratios (%)							
Total debt/Equity	82.63	205.41	158.46	104.50	83.02	87.57	163.61
Total debt/Total assets	36.35	53.45	47.26	38.35	36.37	39.16	50.09

Source(s): The Group, ABCI Securities estimates

Disclosures

Analyst Certification

I, Hongxing (Paul) PAN, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

Disclosures of Interests

ABCI Securities Company Limited and/or its affiliates may pursue financial interests to the companies mentioned in the report.

Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return $- 6\% \leq$ Stock return $<$ Market return rate
Sell	Stock return $<$ Market return $- 6\%$

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 1.5
Low	180 day volatility/180 day benchmark index volatility $<$ 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

Disclaimers

This report is for our clients only and is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expresses or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. ABCI Securities Company Limited is under no obligation to update or keep current the information contained herein. ABCI Securities Company Limited relies on information barriers to control the flow of information contained in one or more areas within ABCI Securities Company Limited, into other areas, units, groups or affiliates of ABCI Securities Company Limited. The compensation of the analyst who prepared this report is



determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of ABCI Securities Company Limited as a whole, of which investment banking, sales and trading are a part. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither ABCI Securities Company Limited nor any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Additional information will be made available upon request.

Copyright 2016 ABCI Securities Company Limited

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of ABCI Securities Company Limited.

**Office address: ABCI Securities Company Limited, 13/F Fairmont House,
8 Cotton Tree Drive, Central, Hong Kong.**

Tel: (852) 2868 2183