August 22, 2013
Equity Focus
Rating: HOLD
TP: HK$ 49.2

H-Share price (HK$)	45.6
Est. share price return	7.9%
Est. dividend yield	2.3%
Est. total return	10.2%

Previous Rating &TP	HOLD; HK$ 43.8
Previous Report Date	May 16, 2013

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Key Data

52Wk H/L(HK$)	48.40/17.69
Issued shares (mn)	602
Market cap (HK$ mn)	27,465
3-mth avg daily turnover (HK$ mn)	83.2
Major shareholder(s) (%):	
Biostime Pharm	74.7

Source(s): Company, Bloomberg, ABCI Securities

1H13 Revenue breakdown (%)

Probiotic supplements	11.1
Infant formulas	81.6
Dried baby food products	3.0
Baby care products	3.1
Nutrition supplements	1.3

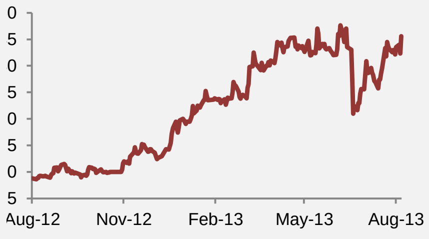
Source(s): Company, ABCI Securities

Share performance (%)

	Absolute	Relative*
1-mth	15.2	13.0
3-mth	8.6	12.8
6-mth	35.3	44.6

*Relative to HSI
Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK$)



Source(s): Bloomberg

Biostime (1112 HK)

Product lines and sales channels to drive growth

- 1H13 pre-ex net profit increased by 68.1% to RMB 460.4mn
- We lower FY13E/14E GP margins as Biostime adjusted down prices of some products by 5%-10% in July
- Expansion in sales volume and sales channel will be the major growth drivers
- Integrating into upstream business may lower Biostime's ROAA and ROAE.
- We roll over our valuation to FY14 and revise TP up to HK$ 49.2 from HK$ 43.8. Maintain HOLD.

Results in line with expectation. Biostime reported 1H13 sales increased by 51.3% YoY to RMB 2,061mn. Net profit for 1H13 increased by 8.6% YoY to RMB 297mn. Excluding the one-off anti-monopoly fine of RMB 162.9mn, net profit increased by 68.1% YoY to RMB 460mn which was 2.1% below market consensus of RMB 470mn.

Volume growth to offset narrowing GP margin in 2H13. Infant formula segment which accounted for 81.6% of Biostime's 1H13 revenue increased 53.7% YoY to RMB 1,682mn. In terms of product mix, proportion of high- and supreme-tier infant formulas changed from 55.4% and 44.6% in 1H12 to 59.3% and 40.7% in 1H13. We believe the change in product mix will not lower Biostime's GP margin based on the Group's track record. However, as Biostime announced in July that it would lower prices of some infant formula products by 5%-10% and offer its members 50% more accumulation points, we expect the FY13E GP margin will drop to 63%.

Expanding product line and sales channel to boost growth. Biostime has not raised ASP in the past five years and sales volume has been its major growth driver. Going forward, growth will be achieved through expansion of product line and sales channel. Biostime will launch a new infant formula brand, Adimil, in Sep 2013 for the premium market segment. In terms of sales channel, Biostime targets to increase 2,894 POS in 2H13. We believe the target is achievable given POS has increased by 4,346 in 1H13. In addition, the Group is developing an online ordering app to capture more online shoppers and help lower S&D costs.

Upstream business may lower ROAA/ROAE. In July, Biostime acquired 20% stakes in one of its major infant formulas products suppliers, ISM. Integrating into the upstream segment might lower Biostime ROAA and ROAE. However, the investment was small (net assets of ISM as of Dec 31, 2012 was EUR 36mn) and Biostime has no plans to further acquire other upstream business in the short term.

Maintain HOLD. We lower FY13E GP margin from 66% to 63%, and FY14E GP margin from 65% to 61%. After incorporating the penalty of RMB 162.9mn and lower GP margin, we lower our FY13/14E FD EPS by 21/11% to RMB 1.13/1.55. As we roll over our valuation to FY14E, TP is revised up to HK$ 49.2 from HK$ 43.8. Maintain **HOLD**.

Risk factors: 1) Further extension to upstream business; 2) Food safety; 3) Expansion pace of POS and possible over-stocking in POS; 4) Possible price war among POS; 5) High supplier concentration.

Results and Valuation

FY ended Dec 31	2010A	2011A	2012A	2013E	2014E
Revenue (RMB mn)	1,234	2,189	3,382	4,419	5,749
Chg (%,YoY)	*120.7*	*77.5*	*54.5*	*30.7*	*30.1*
Net Income (RMB mn)	266	527	743	713	977
EPS (RMB)	0.58	0.86	1.22	1.13	1.55
Chg (%,YoY)	-	*48.3*	*41.9*	*-7.0*	*37.0*
BVPS (RMB)	2.77	3.28	3.86	4.17	4.96
Chg (%,YoY)	-	*18.7*	*17.5*	*8.0*	*19.0*
P/E (x)	-	-	29.5	31.7	23.2
P/B (x)	-	-	9.3	8.6	7.3
ROE (%)	29.03	29.00	34.56	29.51	35.54
ROA (%)	24.31	24.30	24.89	18.83	21.97
DPS(RMB)	0.17	0.62	0.87	0.83	1.14
Yield (%)	1.81	3.14	2.57	2.30	3.03
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

*Net gearing=Net debt/Total equity
Source(s): Bloomberg, ABCI estimates

Exhibit 1: Biostime's 1H13 results

P&L	1H13	2H12	1H12	*HoH Chg*	*YoY Chg*	Remarks
	Rmb mn	Rmb mn	Rmb mn	(%)	(%)	
Turnover	**2,061**	**2,019**	**1,363**	***2.1***	***51.3***	**Driven by sales volume; ASP has remained flat for the past 5 years.**
Cost of Sales	(692)	**(684)**	**(469)**	*1.2*	*47.5*	
Gross Profit	**1,370**	**1,335**	**894**	***2.6***	***53.3***	
Gross Margin (%)	***66.4***	***66.1***	***65.6***	***0.3***	***0.9***	**Improved because i) more milk sourcing from ISM and Arla food who offer 4% discount compare to Montaigu; ii) lower transportation costs.**
Other income and gains	62	35	22	*75.0*	*185.6*	
Selling and distribution costs	(667)	(602)	(475)	*10.8*	*40.4*	
Administrative expenses	(79)	(67)	(50)	*17.5*	*58.1*	
Other expenses	(25)	(22)	(17)	*15.0*	*46.9*	
Fine on violation of Anti-Monopoly Law	(163)	0	0	-	-	
EBIT	**498**	**680**	**373**	***(26.8)***	***33.4***	
EBIT Margin (%)	***24.1***	***33.7***	***27.4***	***(9.5)***	***(3.2)***	
Finance costs	(4)	(2)	(0)	*85.0*	*1941.7*	
Profit before tax	494	678	373	***(27.1)***	*32.5*	
Tax	**(196)**	**(209)**	**(99)**	***(5.8)***	***98.5***	**Effective tax rate increased by 13.3ppt to 39.8% as one-off fine is subjected to income tax.**
Net profit	**298**	**469**	**274**	***(36.6)***	*8.6*	
Core profit	**460**	**469**	**274**	***(1.9)***	*68.1*	
Net profit margin (%)	***14.4***	***23.2***	***20.1***	***(8.8)***	***(5.7)***	
Core net profit margin (%)	***22.3***	***23.2***	***20.1***	***(0.9)***	***2.2***	
Sales breakdown						
Probiotic supplements	228	215	164	*6.3*	*38.8*	
Infant formulas	1,682	1,621	1,095	*3.8*	*53.7*	
Dried baby food products	61	80	54	*(23.6)*	*12.9*	
Baby care products	63	73	33	*(13.4)*	*93.7*	
Nutrition supplements	26	30	16	*(13.5)*	*59.2*	
Total	**2,061**	**2,019**	**1,363**	***2.1***	***51.3***	
%						
Probiotic supplements	11.1	10.6	12.1			
Infant formulas	81.6	80.3	80.3			
Dried baby food products	3.0	4.0	4.0			
Baby care products	3.1	3.6	2.4			
Nutrition supplements	1.3	1.5	1.2			
Total	**100.0**	**100.0**	**100.0**			

Balance sheet	Jun-13	Dec-12	Jun-12	*HoH %*	*YoY %*	Remarks
	Rmb mn	Rmb mn	Rmb mn			
Gross debt	405	271	82	*49.8*	*397.0*	
Cash	1,574	1,669	1,464	*(5.7)*	*7.5*	
Net debt	**(1,169)**	**(1,399)**	**(1,382)**	*(16.4)*	*(15.5)*	**Maintained a net cash position**
Key indicators						
Current ratio	1.6	2.0	3.0			
Inventory turnover days	148	130	101			
Trade receivable turnover days	1	1	1			
Trade payable turnover days	93	63	65			

Source(S): Company, ABCI Securities

Consolidated income statement (2010A-2014E)

FY Ended Dec 31 (RMB mn)	2010A	2011A	2012A	2013E	2014E
Revenue	1,233.6	2,189.0	3,381.9	4,419.4	5,748.6
Cost of sales	(356.4)	(732.9)	(1,153.0)	(1,621.6)	(2,235.8)
Gross profit	**877.2**	**1,456.1**	**2,228.9**	**2,797.8**	**3,512.8**
Other income and gains	4.4	71.8	56.9	0.0	0.0
S&D	(449.5)	(708.6)	(1,077.7)	(1,414.2)	(1,839.5)
Admin expenses	(87.6)	(82.0)	(116.9)	(154.7)	(218.4)
Other expenses	(10.4)	(23.3)	(38.6)	(48.6)	(63.2)
Fine on violation of Anti-Monopoly Law				(162.9)	
EBIT	**334.1**	**713.9**	**1,052.7**	**1,017.4**	**1,391.5**
Finance costs	0.0	0.0	(2.1)	(6.2)	(6.2)
EBT	**334.1**	**713.9**	**1,050.6**	**1,011.1**	**1,385.3**
Tax	(68.4)	(186.6)	(307.5)	(298.3)	(408.7)
Net profit attributable to owners	**265.7**	**527.4**	**743.1**	**712.9**	**976.6**
D&A	**7.1**	**13.0**	**22.6**	**49.8**	1.622
EBITDA	**341.1**	**726.9**	**1,075.3**	**1,067.2**	1.554
Dividends	**101.4**	**372.5**	**526.6**	**499.0**	**683.7**
No. of issued shares at end of period (mn)	**600**	**602.3**	**602.3**	**602.3**	**602.3**
Issuable shares:					
Share options	11.2	12.7	14.0	13.1	13.1
Total issued & issuable shares	**622.3**	**627.7**	**630.3**	**628.4**	**628.4**
Per share value (Rmb)					
FD EPS (RMB)	0.58	0.86	1.22	1.13	1.55
NBV (RMB)	2.77	3.28	3.86	4.17	4.96
DPS (RMB)	0.17	0.62	0.87	0.83	1.14

Source(s): Company, ABCI Securities estimates

Key Ratio (2010A-2014E)

FY ended Dec 31	2010A	2011A	2012A	2013E	2014E
Profitability ratio (%)					
Gross profit margin	71.1	66.5	65.9	63.3	61.1
EBIT margin	27.1	32.6	31.1	23.0	24.2
EBITDA margin	27.7	33.2	31.8	24.1	25.4
Net profit margin	21.5	24.1	22.0	16.1	17.0
ROAA	24.3	24.3	24.9	18.8	22.0
ROAE	29.0	29.0	34.6	29.5	35.5
Cost ratio (%)					
S&D/revenue	-36.4	-32.4	-31.9	-32.0	-32.0
Admin expenses/revenue	-7.1	-3.7	-3.5	-3.5	-3.8
Effective tax rate	-0.8	-1.1	-1.1	-1.1	-1.1
Leverage (x)					
Current ratio	7.88	5.18	2.02	1.86	1.94
Quick ratio	7.43	4.46	1.56	1.42	1.41
Net debt/total equity	Net cash	Net cash	Net cash	Net cash	Net cash
Working capital cycle (days)					
Inventory turnover days	95.8	100.5	129.9	130.0	130.0
Receivables turnover days	1.3	1.2	0.5	0.5	0.5
Payables turnover days	74.3	49.5	62.9	65.0	65.0

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2010A-2014E)

As of Dec 31 (RMB mn)	2010A	2011A	2012A	2013E	2014E
PPE	31.3	59.4	77.1	177.3	209.5
Others	8.6	228.3	1,165.3	1,165.3	1,165.3
Non-current assets	**39.9**	**287.7**	**1,242.4**	**1,342.6**	**1,374.8**
Inventories	106.1	297.4	523.3	631.9	960.8
Trade and bills receivables	5.2	9.7	0.4	11.7	4.0
Prepayments, deposits and other receivables	22.6	29.2	85.7	83.8	105.2
Loans receivable	0.0	0.0	12.6	12.6	12.6
Cash and bank balances	1,728.2	1,814.1	1,669.1	1,956.0	2,396.3
Current assets	**1,862.1**	**2,150.4**	**2,291.0**	**2,696.0**	**3,478.8**
Trade payables	65.8	67.2	263.1	314.5	481.9
Other payables and accruals	142.3	265.1	443.8	711.3	881.3
Interest-bearing bank loan	0.0	0.0	270.5	270.5	270.5
Others	28.2	82.7	155.8	155.8	155.8
Current liabilities	**236.3**	**415.1**	**1,133.3**	**1,452.1**	**1,789.5**
Deferred tax liabilities	5.8	45.5	77.5	77.5	77.5
Non-current liabilities	**5.8**	**45.5**	**77.5**	**77.5**	**77.5**
Total assets	**1,902.0**	**2,438.1**	**3,533.4**	**4,038.6**	**4,853.6**
Net assets	**1,659.9**	**1,977.6**	**2,322.7**	**2,509.0**	**2,986.7**
Issued capital	5.1	5.2	5.2	5.2	5.2
Reserves	1,553.4	1,679.0	1,903.5	2,089.8	2,567.5
Others	101.4	293.4	414.0	414.0	414.0
Equity attributable to owners	**1,659.9**	**1,977.6**	**2,322.7**	**2,509.0**	**2,986.6**

Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (2010A-2014E)

FY ended Dec 31 (RMB mn)	2010A	2011A	2012A	2013E	2014E
EBITDA	341.1	726.9	1,075.3	1,067.2	1,459.3
Change in working capital	74.6	(71.8)	114.6	200.7	(5.1)
Others	9.0	(16.0)	2.0	0.0	0.0
Cash (used in)/generated from operations	**424.7**	**639.2**	**1,191.8**	**1,267.9**	**1,454.2**
Interest paid					
Income tax paid	(43.7)	(123.0)	(244.6)	(298.3)	(408.7)
CF from operating activities	**381.0**	**516.2**	**947.2**	**969.6**	**1,045.5**
CAPEX	(17.4)	(38.8)	(39.3)	(150.0)	(100.0)
Others	8.0	(490.5)	(1,811.2)	0.0	0.0
Cash flows from investing activities	**(9.4)**	**(529.2)**	**(1,850.5)**	**(150.0)**	**(100.0)**
Net borrowing	-1	0	1	2	3
Proceeds from issue of shares	1,371.6	11.6	0.0	0.0	0.0
Dividends paid	(146.0)	(180.5)	(404.0)	(526.6)	(499.0)
Interest paid					
Others	6.3	0.0	211.3	(8.2)	(9.2)
Cash flows from financing activities	**1,230.9**	**(168.8)**	**(191.7)**	**(532.8)**	**(505.2)**
Net (decrease)/increase in cash and cash equivalents	1,602.6	(181.9)	(1,095.0)	286.8	440.3
Cash and cash equivalents at beginning of year/period	133.8	1,728.2	1,490.5	400.6	687.4
Effect of foreign exchange rates, net	(8.2)	(55.9)	5.1	0.0	0.0
Cash and cash equivalents at end of year/period	1,728.2	1,490.5	400.6	687.4	1,127.8

Source(s): Company, ABCI Securities estimates

Disclosures

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Definition of equity rating

Rating	Definition
Buy	Stock return ≥ Market return rate
Hold	Market return – 6% ≤ 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 from 2007-2011
Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	2.6 ≤180 day volatility/180 day benchmark index volatility
High	1.5 ≤ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	1.0 ≤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

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