



Biostime (1112 HK)

Facing hurdles on all product fronts

- FY16 results show unexpected margin expansion, but growth momentum disappointed
- Sales from ANC (Adult nutrition care) segment was up 2.6% YoY in AUD terms, but declined in 4Q16; BNC (Baby nutrition care) segment sales also declined
- Favorable AUD/RMB exchange rate benefited the reported figures
- Expecting margin pressure from increasing S&D expense and higher financing costs
- Downgrade to SELL; current TP represents FY17E/18E P/E of 21.96x/18.82x, and FY16E/17E P/B of 3.31x/2.69x

Cost saving measures help boost margins. FY16 sales growth outpaced that of COGS, resulting in a surprising increase of GPM to 62.39%. The lower-than-expected SG&A spending also contributed to higher pretax margin of 22.39% and NPM of 14.67%, which exceed our expectation.

ANC sales growth was less than expected. FY16 total revenue was up 35% YoY because the ANC result was consolidated since Oct 1 2015. The full-year revenue (in AUD) of ANC products was only up 2.6%, lower than the 9M16 growth of 17.36% YoY. Based on our calculation, ANC sales decline extended from 3Q16 to 4Q16. We expect the negative impact from the new policy on cross-border e-commerce and the resulting destocking activities in sales channels would have residual impacts on the 1H17 performance.

Two-child policy was insufficient to support BNC sales. BNC revenue declined by 4.54% YoY, which is attributable to the increased competition in the Chinese IMF market, the policies regarding IMF product registration, and the decline in general economic growth. We believe the intense competition outweighed benefit from two-child policy implementation, and the situation would continue in 2017 as the grace period of the IMF product registration policy would only apply until end-2017.

Favorable currency translation led to better reported figures in RMB. Based on the figures reported by the Group, the AUD/RMB exchange rate used by the Group for FY16 was 4.9. Yet, the exchange rate adopted in each quarter throughout FY16 gradually increased from 4.7 to 5.0. The Group benefited from the appreciation of AUD against RMB in its reported financial results.

Margins may be pressured by the increasing S&D expense and potentially higher financing cost. We believe increasing marketing effort is on the Group's agenda to promote its BNC and ANC products. Therefore, S&D expense is expected to increase to 37.3%/38.4% of total sales in FY17/FY14, leading to EBITDA margin of 27.6%/29.1% in FY17/FY18. The increased leverage level would also increase cost of debt, which we project would bring NPM down to 8.4%/9.1% in FY17/FY18.

Downgrade to SELL; TP at HK\$23.2. Downgrade to SELL due to faltering growth momentum, residual impacts from the IMF registration policy, and less-than-expected effect of the two-child policy. The high leverage is also a concern. Our current TP represents FY17E/18E P/E of 21.96x/18.82x, and FY16E/17E P/B of 3.31x/2.69x.

Risk factors: 1) Regulatory risk; 2) M&A Execution risk; 3) Credit risk; 4) ForEx risk; 5) Interest rate risk; 6) High leverage risk

Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (RMB mn)	4,818.56	6,505.62	7,034.86	7,591.23	8123.13
Chg (% YoY)	(16.12)	(3.67)	7.36	6.46	3.45
Net Profit (RMB mn)	250.69	954.40	592.28	691.15	819.25
Chg (% YoY)	(68.93)	280.71	(37.94)	16.69	18.54
Basic EPS (RMB)	0.41	1.52	0.94	1.09	1.30
Chg (% YoY)	(69.40)	270.73	(38.34)	16.69	18.54
P/E (x)	49.52	14.82	24.04	20.60	17.38
BVPS (RMB)	5.91	5.07	6.21	7.65	9.42
P/B (x)	3.43	4.45	3.63	2.94	2.39
DPS (RMB)	0.00	0.00	0.00	0.00	0.00
Yield (%)	0.00	0.00	0.00	0.00	0.00
ROAA (%)	2.45	6.81	4.34	5.31	6.16
ROAE (%)	8.07	29.57	16.95	16.29	15.84

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Mar 30, 2017

Rating: SELL

TP: HK\$ 23.2

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Share price (HK\$)	25.4
Est. share price return	(8.66%)
Est. dividend yield	0.00%
Est. total return	(8.66%)
Previous Rating & TP	HOLD; HK\$22.83
Previous report date	Nov 8, 2016

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L (HK\$)	31.8/18.88
Issued shares (mn)	631.93
Mkt cap (HK\$mn)	16,050.91
3-month ADT (HK\$mn)	34.97
Major shareholder (%)	
Luo Fei	71.56
Source(s): Bloomberg, HKEX	

% of total revenue	FY17E
IMF products	49.22
Adult nutrition products	41.65
Other pediatric products	9.12

Source(s): ABCI Securities estimates

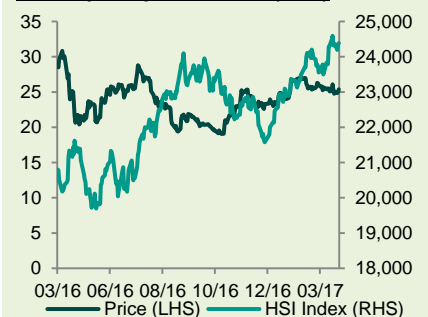
Sector Performance (%)

	Absolute	Relative*
1-mth	(1.36)	(4.10)
3-mth	7.86	(4.08)
6-mth	23.00	20.25

* Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year price performance (HK\$)



Source(s): Bloomberg, ABCI Securities

* All pricing and market data as of closing of Mar 29, 2017

Consolidated income statement (2015A-2019E)

FY ends at Dec 31 (RMB mn, except per share data)	2015A	2016A	2017E	2018E	2019E
Revenue	4,819	6,506	7,035	7,591	8,123
- Infant formula	3,356	3,204	3,463	3,706	3,834
- Adult nutrition products	850	2,683	2,930	3,222	3,603
- Others	389	396	407	417	431
COGS	(1,834)	(2,447)	(2,634)	(2,734)	(2,910)
Gross profit	2,985	4,059	4,401	4,858	5,213
- Infant formula	2,124	2,105	2,159	2,342	2,401
- Adult nutrition products	521	1,542	1,924	2,109	2,360
- Others	340	336	319	281	267
Other income, gains, and expenses	(179)	138	(47)	(51)	(52)
SG&A	(2,256)	(2,309)	(2,979)	(3,296)	(3,480)
Operating profit	550	1,888	1,375	1,511	1,681
Net interest income/(expense)	(46)	(426)	(344)	(301)	(238)
Share of profit of an associate	(0)	(5)	(6)	(7)	(9)
Profit before tax	504	1,457	1,026	1,203	1,434
Tax	(211)	(405)	(368)	(435)	(523)
Net profit	293	1,052	658	768	910
- Profit to owners of the Group	251	954	592	691	819
- Minority interest	42	98	66	77	91
EPS (RMB)					
- Basic	0.41	1.52	0.94	1.09	1.30
- Dilute	0.40	1.50	0.92	1.07	1.27

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2015A-2019E)

FY ends at Dec 31 (RMB mn, except per share data)	2015A	2016A	2017E	2018E	2019E
Cash and cash equivalents	1,198	1,506	1,033	1,188	1,557
Restricted bank deposit	1,677	995	589	482	395
Trade and bills receivable	623	517	764	536	784
Inventories	856	775	874	916	917
Others	284	639	306	215	275
Current assets	4,638	4,433	3,566	3,336	3,928
PP&E	547	531	571	573	584
Goodwill	4,937	5,304	5,304	5,304	5,304
Intangible assets	2,897	3,002	2,981	3,035	3,077
Others	826	936	691	694	779
Non-current assets	9,206	9,772	9,546	9,606	9,743
Total assets	13,844	14,205	13,113	12,943	13,671
Trade and bills payables	619	532	670	623	696
ST borrowing	4,740	1,974	2,058	1,757	1,505
Others	1,320	2,731	1,594	1,545	1,954
Current liabilities	6,679	5,237	4,322	3,925	4,154
LT borrowing	2,659	4,785	3,828	3,063	2,450
Others	904	986	1,036	1,119	1,114
Non-current liabilities	3,563	5,772	4,864	4,181	3,564
Shareholders' equity	3,293	3,162	3,826	4,660	5,685
Minority interest	309	35	100	177	268
Total equity	3,602	3,196	3,926	4,837	5,953
Total liabilities and equity	13,844	14,205	13,113	12,943	13,671

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2015A-2019E)

FY ends at Dec 31 (RMB mn, except per share data)	2015A	2016E	2017E	2018E	2019E
Profit before tax	504	1,457	1,026	1,203	1,434
Depreciation and amortization	87	172	567	697	796
Change in working capital	5	228	(105)	(133)	353
Others	(230)	(313)	(72)	(202)	(388)
Cash flow from operating activities	366	1,543	1,416	1,564	2,195
Change in PP&E	(109)	(62)	(77)	(69)	(72)
Change in intangible assets	(4)	105	(20)	54	41
Others	(4,051)	(778)	181	(185)	177
Cash flow from investing activities	(4,164)	(736)	83	(200)	146
Change in debt	4,740	(2,186)	(873)	(1,067)	(865)
Dividends paid	(196)	0	0	0	0
Others	(1,974)	1,529	(1,077)	(96)	(1,078)
Cash flow from financing activities	2,570	(658)	(1,950)	(1,163)	(1,943)
Net change in Cash	(1,228)	379	(451)	201	398
Forex effect	(104)	(25)	(33)	(41)	(51)
Cash and equivalent - end	1,115	1,469	985	1,145	1,492

Source(s): Company, ABCI Securities estimates

Key operating and financial ratios (2015A-2019E)

FY ends at Dec 31 (RMB mn, except per share data)	2015A	2016A	2017E	2018E	2019E
Growth (YoY %)					
Revenue	1.84	35.01	8.14	7.91	7.01
- Infant formula	(16.12)	(3.67)	7.36	6.46	3.45
- Adult nutrition products	N/A	215.63	9.24	9.94	11.83
- Other pediatric products	(18.29)	1.09	3.58	3.40	3.39
Gross profit	1.97	36.00	8.42	10.39	7.31
- Infant formula	(13.90)	(0.88)	2.55	8.47	2.52
- Adult nutrition products	N/A	1.96	0.25	0.10	0.12
- Other pediatric products	(26.19)	21.19	(22.55)	(11.91)	(4.97)
Operating profit	(49.99)	243.31	(27.14)	9.87	11.23
EBITDA	(45.17)	226.15	(4.92)	13.68	12.15
Net profit (to owners of the company)	(68.93)	280.71	(37.94)	16.69	18.54
Profitability ratios (%)					
GPM	61.94	62.39	62.55	63.99	64.17
- Infant formula	63.30	65.72	62.35	63.19	62.62
- Adult nutrition products	61.29	57.49	65.67	65.46	65.51
- Other pediatric products	55.41	66.42	49.67	42.31	38.89
OPM	11.41	29.02	19.55	19.91	20.69
EBITDA margin	13.00	31.41	27.61	29.09	30.49
Pretax margin	10.46	22.39	14.58	15.84	17.65
NPM (to owners of the company)	5.20	14.67	8.42	9.10	10.09
Revenue contribution (%)					
- Infant formula	69.64	49.24	49.22	48.82	47.20
- Adult nutrition products	17.64	41.23	41.65	42.44	44.35
- Other pediatric products	12.72	9.52	9.12	8.74	8.44
Return ratios (%)					
ROAA	2.45	6.81	4.34	5.31	6.16
ROAE	8.07	29.57	16.95	16.29	15.84
ROIC	14.15	5.39	6.04	7.08	7.90
Liquidity ratio (x)					
Current ratio	0.69	0.85	0.83	0.85	0.95
Quick ratio	0.57	0.70	0.62	0.62	0.72
Cash ratio	0.43	0.48	0.38	0.43	0.47
Cash conversion cycle (days)					
Days of outstanding receivable	24.05	31.97	33.22	31.24	29.64
Days of inventory on hand	164.51	121.71	114.28	119.52	114.95
Days of outstanding payable	88.04	88.78	80.28	85.03	82.70
CCC	100.52	64.89	67.22	65.74	61.88
Leverage ratios (%)					
Total debt/Equity	205.41	211.50	149.94	99.64	66.43
Total debt/Total assets	53.45	47.59	44.89	37.24	28.93
Net debt/Equity	125.60	133.22	108.63	65.12	33.63
Net debt/Total assets	32.68	29.97	32.52	24.34	14.65

Source(s): Company, ABCI Securities estimates

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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.

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