



Company Report

Biostime (1112 HK)

May 16, 2013

Rating: Buy
TP: HK\$43.8

Key data

Share price (HK\$)	43.15
Upside potential (%)	1.5
52Wk H/L(HK\$)	46.3 / 16.0
Issued shares (mn)	602
Market cap (HK\$mn)	26,471
30-day avg vol (HK\$mn)	146.5
Auditors	Ernst & Young
Major shareholder (%): Biostime Pharm	74.7

Source: Company & Bloomberg

Revenue composition in FY12 (%)

Probiotic supplements	11.2%
Infant formulas	80.3%
Dried baby food products	4.0%
Baby care products	3.1%
Nutrition supplements	1.4%

Source: Company

Share performance (%)

	Absolute	Relative*
1-mth	6.0	0.2
3-mth	28.2	30.3
6-mth	111.5	96.8

*Relative to Hang Seng Index

Source: Bloomberg

1 year share price performance



Source: Bloomberg

Analyst

Report Date: 16 May 2013

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Niche player in infant formula market

Biostime entered the premium formula milk market at the right time and revenue posted CAGR growth of 82.2% during the 2008-2012. The strategy to sell through maternity stores rather than supermarkets successfully helps avoid direct competition with foreign competitors. But shifting from supreme tier to high-tier products with greater market potentials will lower GP margin. We initiate our coverage with a HOLD recommendation with TP set at HK\$43.8.

Niche player in the premium market: Biostime has positioned itself as a high-end imported infant-formula brand since early 2008 which has successfully capture the rapid growth in demand for premium or foreign brand products especially after the Melamine incident. Supreme tier and High-tier formula milk accounted for 60% and 40% of the group's revenue. Management indicated that high-tier products growth will continue to outpace supreme-tier growth due to larger potential market size and therefore we expect GP margin to fall marginally due to change of product mix.

Baby specialty stores to gain market share: The group planned to increase its POS to 13,000 (up 25% YoY) VIP baby specialty stores, 5,000 (up 20%) supermarkets and 1,500 (up 101%) pharmacies with Mama100 Member Zone by the end of 2013. Revenues from maternal channel and mass market accounted for 70% and 30% of total revenue in FY12 as compared to 35%/60% mix of global brands. In our view, putting more focus in developing maternal channel in comparison to mass market channel (e.g supermarkets) is a smart move as it not only helps avoids direct competition with well-known foreign brands but also provides personalized services which helps differentiates itself from competitors and is a key to gain market share

Cross-selling by Mama 100 membership platform: The integrated database platform enables the group to enhance cross-selling, consumer loyalty and support a series of database marketing activities to achieve higher sales and promotion efficiency. By the end of 2012, the platform has attracted 1.4mn members (up 69.7% YoY), who contributed to 85% of total sales.

Valuation: Based on our DCF model with 11.8% WACC, we value the stock at HK\$43.8, which represents est FY13 PE of 24.4x and PB of 7.9x. We initiate coverage with HOLD rating.

Risk factors: Supply risks and FX risks due to heavy reliance on imports, intense competition from both foreign and domestic competitors

Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12A	FY13E	FY14E
Revenue (Rmb mn)	1,234	2,189	3,382	4,419	5,423
<i>Chg (%YoY)</i>	120.7	77.5	54.5	30.7	22.7
Net Income (Rmb mn)	266	527	743	866	1,045
<i>Chg (%YoY)</i>	145.3	98.5	40.9	16.6	20.7
EPS (Rmb)	0.58	0.88	1.24	1.44	1.74
<i>Chg (%YoY)</i>	-	51.7	40.9	16.0	20.7
NBV (Rmb/share)	2.77	3.28	3.86	4.42	5.15
PE (x)	-	-	28.2	24.3	20.2
PB (x)	-	-	9.1	7.9	6.8
ROAA (%)	24.31	24.30	24.89	22.60	23.61
ROAE (%)	29.03	29.00	34.56	34.76	36.27
Net D/E (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company annual reports, ABCI Securities estimates



Profit Forecast

FY ended Dec 31 (Rmbmn)	FY10	FY11	FY12	FY13F	FY14F
Revenue	1,233.6	2,189.0	3,381.9	4,419.4	5,423.0
Cost of sales	(356.4)	(732.9)	(1,153.0)	(1,566.7)	(1,949.1)
Gross profit	877.2	1,456.1	2,228.9	2,852.7	3,473.9
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)	(1,735.4)
Admin expenses	(87.6)	(82.0)	(116.9)	(154.7)	(189.8)
Other expenses	(10.4)	(23.3)	(38.6)	(48.6)	(59.7)
EBIT	334.1	713.9	1,052.7	1,235.2	1,489.0
Finance costs	0.0	0.0	(2.1)	(6.2)	(6.2)
EBT	334.1	713.9	1,050.6	1,229.0	1,482.8
Tax	(68.4)	(186.6)	(307.5)	(362.6)	(437.4)
Net profit attributable to owners	265.7	527.4	743.1	866.5	1,045.4
D&A	(7.1)	(13.0)	(22.6)	(49.8)	(67.8)
EBITDA	341.1	726.9	1,075.3	1,285.0	1,556.8
Dividends	101.4	372.5	526.6	606.5	731.8
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	13.8	13.8
Total issued & issuable shares	622.3	627.7	630.3	630.0	630.0
Per share value (Rmb)					
FD EPS	0.58	0.86	1.22	1.38	1.66
NBV	2.77	3.28	3.86	4.42	5.15
DPS	0.17	0.62	0.87	1.01	1.21

Source: Company annual reports (for historical figures only), ABCI Securities estimates

Key Financial Ratio

FY ended Dec 31	FY10	FY11	FY12	FY13F	FY14F
Profitability ratio					
Gross profit margin	71.1%	66.5%	65.9%	64.6%	64.1%
EBIT margin	27.1%	32.6%	31.1%	28.0%	27.5%
EBITDA margin	27.7%	33.2%	31.8%	29.1%	28.7%
Net profit margin	21.5%	24.1%	22.0%	19.6%	19.3%
ROAA	24.3%	24.3%	24.9%	22.6%	23.6%
ROAE	29.0%	29.0%	34.6%	34.8%	36.3%
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%	-3.5%
Effective tax rate	-20.5%	-26.1%	-29.3%	-29.5%	-29.5%
Leverage					
Current ratio	7.88	5.18	2.02	2.00	2.17
Quick ratio	7.43	4.46	1.56	1.58	1.65
Net debt/total equity	Net cash	Net cash	Net cash	Net cash	Net cash
Working capital cycle					
Receivables turnover days	1.3	1.2	0.5	0.5	0.5
Inventory turnover days	95.8	100.5	129.9	130.0	130.0
Payables turnover days	74.3	49.5	62.9	65.0	65.0

Source: Company annual reports (for historical figures only), ABCI Securities estimates



Balance Sheet Forecast

As of Dec 31 (Rmbmn)	FY10	FY11	FY12	FY13F	FY14F
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	592.7	795.7
Trade and bills receivables	5.2	9.7	0.4	11.7	3.1
Prepayments, deposits and other receivables	22.6	29.2	85.7	83.8	94.5
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	2,090.0	2,440.2
Current assets	1,862.1	2,150.4	2,291.0	2,790.9	3,346.1
Trade payables	65.8	67.2	263.1	294.9	399.3
Other payables and accruals	142.3	265.1	443.8	672.2	716.3
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	1,393.3	1,541.9
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	4,133.5	4,720.9
Net assets	1,659.9	1,977.6	2,322.7	2,662.6	3,101.5
Issued capital	5.1	5.2	5.2	5.2	5.2
Reserves	1,553.4	1,679.0	1,903.5	2,243.4	2,682.3
Others	101.4	293.4	414.0	414.0	414.0
Equity attributable to owners	1,659.9	1,977.6	2,322.7	2,662.6	3,101.5

Source: Company annual reports (for historical figures only), ABCI Securities estimates

Cash Flow Forecast

As of Dec 31 (Rmbmn)	FY10	FY11	FY12	FY13F	FY14F
EBITDA	341.1	726.9	1,075.3	1,285.0	1,556.8
Change in working capital	74.6	(71.8)	114.6	181.2	(56.5)
Others	9.0	(16.0)	2.0	0.0	0.0
Cash (used in)/generated from operations	424.7	639.2	1,191.8	1,466.2	1,500.4
Interest paid					
Income tax paid	(43.7)	(123.0)	(244.6)	(362.6)	(437.4)
CF from operating activities	381.0	516.2	947.2	1,103.6	1,062.9
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)	(606.5)
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)	(612.7)
Net (decrease)/increase in cash and cash equivalents	1,602.6	(181.9)	(1,095.0)	420.9	350.2
Cash and cash equivalents at beginning of year/period	133.8	1,728.2	1,490.5	400.6	821.5
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	821.5	1,171.7

Source: Company annual reports (for historical figures only), ABCI Securities estimates

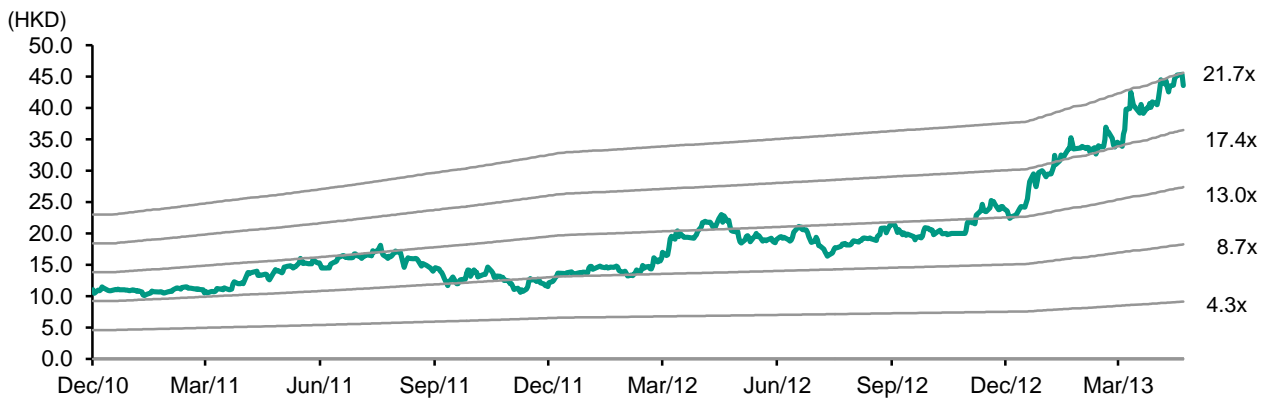


Exhibit: Financial forecasts vs Consensus (Rmb mn)

	Our forecast		Consensus		Difference	
	FY13F	FY14F	FY13F	FY14F	FY13F	FY14F
Revenue	4,419	5,423	4,467	5,647	-1.07%	-3.97%
Gross Profit	2,853	3,474	2,691	3,621	6.02%	-4.07%
Net profit	866	1,045	948	1,168	-8.58%	-10.50%
FD EPS (Rmb)	1.375	1.659	1.549	1.924	-11.21%	-13.75%

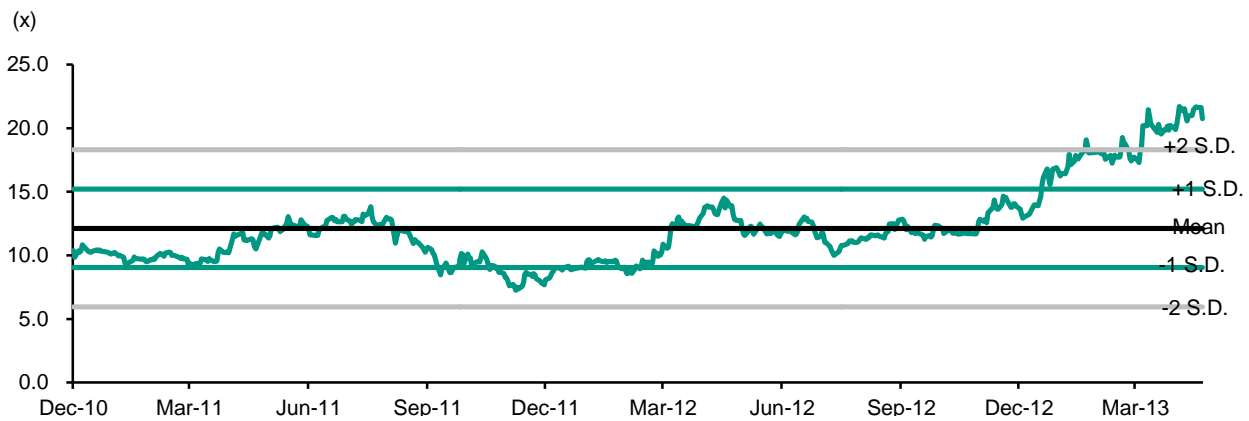
Source: Bloomberg; ABCI Securities estimates

Exhibit: Historical PE of the group



Source: Bloomberg, ABCI Securities

Exhibit: PE standard deviation of the group



Source: Bloomberg, ABCI Securities



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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

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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