

Sep 26, 2016
Company Report
Rating: HOLD
TP: HK\$ 22.83

Share price (HK\$) 21.45
Est. share price return 6.43%
Est. dividend yield 0.00%
Est. total return 6.43%

Previous Rating SELL
Previous TP 16.10

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Key Data

52Wk H/L(HK\$)	31.8/12.48
Outstanding shares (mn)	630.40
Market cap (HK\$ mn)	13,522
3-mth avg daily turnover (HK\$ mn)	47.72
Major shareholder(s) (%):	
Biostime Pharma China Ltd.	71.38
Morgan Stanley (short position)	-2.32
Morgan Stanley (long position)	1.75
Vanguard Group Inc	0.7

Source(s): Bloomberg, ABCI Securities

Key data

Revenue composition (%)	1H15	1H16
Infant milk formula	86.50	48.55
Adult nutrition products	0.00	42.68
Others	13.50	8.77

Source(s): Company, ABCI Securities

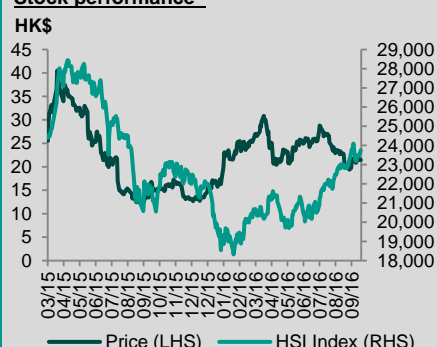
Share price performance (%)

	Absolute	Relative*
1-mth	(6.13)	3.31
3-mth	(15.55)	14.26
6-mth	(20.56)	14.97

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Stock performance



Source(s): Bloomberg, ABCI Securities

* All market data as of closing of Sep 22, 2016

Biostime International (1112 HK)

Cautiously optimistic on profitability improvement

- The newly acquired adult nutrition segment fell short of expectation in 1H16
- The Group's comparable revenue growth only reached 3.21% YoY, as Swisse's comparable revenue growth of 34.9% YoY was unable to compensate for the decline in other segments, especially the infant milk formula segment (13.98% YoY)
- Swisse helped boost overall OPM and NPM, but more S&D expense pressure can be expected in 2H16
- Change rating to **HOLD** and TP to HK\$ 22.83 on possible improvement in profitability and EPS growth

Performance deteriorated further in 1H16. The Group's revenue grew 53.3% YoY, mainly because Swisse's 1H15 result was not consolidated in the corresponding period last year. However, if we factor in Swisse's revenue in 1H15, the Group's revenue growth in 1H16 would only be 3.21% YoY. Revenue of the milk formula business fell 13.98% YoY and combined revenue attributable to Biostime businesses also declined by 12.18% YoY. It is evident that the adult nutrition product segment was not a sufficient growth driver for the Group.

Overall profitability improved although Swisse underperformed. The Group's overall GPM increased from 61.94% in FY15 and 58.23% in 1H15 to 64.09% in 1H16. The GPM of the combined Biostime business was 65.35% as the milk formula segment's GPM improved to 65.54%. However, even though the reported GPM of Swisse improved from 61.29% in FY15 to 62.4% in 1H16, it is still lower than Biostime's traditional business. Assuming GPM of Swisse's business remains at similar level, if the Group expands the adult nutrition business and revenue contribution from the segment increases, the Group's overall GPM would suffer. In addition, the Group's OPM was 28.88% and NPM was 11.86% in 1H16 (FY15: OPM: 11.41% and NPM: 5.22%). Apparently, Swisse's business contributed to the higher OPM and NPM by achieving a lower S&D/Sales ratio of 22.75% (Biostime: 38.43%). Yet, management in the 1H16 results meeting stated that certain marketing and promotion costs incurred in 1H16 will be booked to 2H16 and marketing and promotion efforts would increase in 2H16 for the Swisse products. Hence, the margin improvement may not sustain.

Lower revenue growth outlook with a slightly higher profitability. We are still cautious on the Group's growth outlook as the infant milk formula and adult nutrition products would not receive much support from the consumer market. Also, Swisse's expansion in China entails certain implementation risks. Hence, we revise down our revenue projections. Overall revenue growth would be 31.41% YoY and 4.66% YoY in FY16E and FY17E; Swisse business comparable revenue growth would be 21.25% YoY in FY16E and 17.24% YoY in FY17E. However, we believe that the product mix diversification with the addition of adult nutrition products has the potential to boost profitability at the OPM and NPM level. We project net profit and EPS would grow by 73.63% and 97.01% YoY in FY16E and 20.10% YoY and 20.10% YoY in FY17E; NPM would be 6.9% and 8.83% in FY16E and FY17E

Change rating to HOLD with TP of HK\$ 22.83. Despite headwinds in the short term, we change rating to **HOLD** to reflect the potential for higher bottom line growth and better profitability. TP was adjusted to HK\$ 22.83, representing 2016E P/E of 23.53x or 2017E P/E of 19.57x, and 2016E P/B of 2.87x or 2017E P/B of 2.41x.

Results and Valuation

FY ended Dec 31	FY14A	FY15A	FY16E	FY17E	FY18E
Revenue (RMB mn)	4,731.56	4,818.56	6,332.25	6,627.64	7,250.71
Chg (% YoY)	3.73	(16.12)	(15.20)	(6.42)	1.71
Net Profit (RMB mn)	806.79	251.46	436.61	524.38	606.20
Chg (% YoY)	(1.70)	(68.83)	73.63	20.10	15.60
Basic EPS (RMB)	1.34	0.41	0.81	0.97	1.12
P/E (x)	12.81	35.62	22.11	18.39	15.90
BVPS (RMB)	4.85	5.91	6.85	8.15	9.50
P/B (x)	3.54	2.90	2.70	2.26	1.94
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	3.14	3.86	4.59
ROAE (%)	29.70	7.71	11.23	11.48	11.27

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

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	6,332.25	6,627.64	7,250.71	1,962.90	3,008.30
- Infant formula	3,981.58	3,355.85	2,736.48	2,500.88	2,532.33	1,697.84	1,460.49
- Adult nutrition products	0.00	849.90	2,966.74	3,478.18	4,047.50	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)	(2,366.32)	(2,443.43)	(2,586.15)	(820)	(1,080)
Gross profit	2,926.93	2,984.57	3,965.92	4,184.22	4,664.55	1,142.90	1,928.11
- Infant formula	2,466.91	2,124.12	1,713.45	1,559.34	1,600.18	994.94	957.18
- Adult nutrition products	0.00	520.92	1,921.09	2,284.12	2,649.50	0.00	801.20
- Others	460.02	339.53	337.12	320.51	282.61	147.61	169.73
Other income, gains, and expenses	(64.52)	(178.76)	(50.18)	(43.90)	(48.66)	11.76	60.77
SG&A	(1,763.03)	(2,255.98)	(2,591.47)	(2,793.47)	(3,155.51)	(826.37)	(1,120.07)
Operating profit	1,099.38	549.83	1,324.27	1,346.85	1,460.38	271.07	868.82
Net interest income/(expense)	18.36	(45.50)	(462.28)	(392.99)	(352.25)	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	861.53	953.31	1,107.47	280.12	661.75
Tax	(311.55)	(210.62)	(352.24)	(341.63)	(400.35)	(75.16)	(256.86)
Net profits	806.79	293.32	509.29	611.68	707.12	204.96	404.89
- Profit to owners of the Group	806.79	251.46	436.61	524.38	606.20	204.96	356.91
- Minority interest	0.00	41.86	72.68	87.29	100.91	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	0.81	0.97	1.12	0.34	0.57
- Dilute	1.31	0.45	0.64	0.77	0.89	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	1,869.82	871.51	1,199.83	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	580.28	626.21	615.11	22.40	415.31
Inventories	797.03	856.22	850.88	1,021.19	672.55	626.46	990.90
Others	179.49	243.69	237.72	248.00	224.46	196.71	184.95
Current assets	4,335.72	4,637.99	5,076.82	3,982.06	3,843.52	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	589.12	635.35	606.23	830.39	327.19
Non-current assets	2,295.44	9,206.41	8,847.11	9,247.50	9,329.61	1,770.23	9,276.44
Total assets	6,631.16	13,844.40	13,923.92	13,229.55	13,173.13	6,614.00	13,570.07
Trade and bills payables	294.54	618.71	528.76	1,004.48	174.76	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	1,255.75	1,495.51	1,681.85	122.54	140.90
Current liabilities	1,267.62	6,679.32	2,592.01	3,265.86	2,522.84	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	3,349.88	2,587.36	2,746.73	38.94	3,348.46
Non-current liabilities	2,446.45	3,562.84	7,160.89	4,995.52	4,864.44	2,494.65	5,724.68
Equity	2,917.09	3,602.24	4,171.02	4,968.17	5,785.86	2,958.11	4,154.20
Total liabilities and Equity	6,631.16	13,844.40	13,923.92	13,229.55	13,173.13	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	861.53	953.31	1,107.47	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	(490.50)	902.47	(809.78)	43.13	(244.86)
Others	(347.81)	(230.00)	74.40	(1.05)	(121.86)	(205.93)	45.40
Cash flow from operating activities	972.17	365.73	720.92	2,387.41	843.87	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)	(138.99)	(107.66)	370.96	3.40	(166.32)
Cash flow from investing activities	(460.39)	(4,163.77)	(440.57)	104.81	333.96	(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)	1,400.19	(435.63)	(388.72)	10.96	1,574.09
Cash flow from financing activities	1,171.85	2,570.50	(994.64)	(2,951.29)	(778.82)	(50.53)	(136.12)
Net change in Cash	1,683.63	(1,227.54)	(714.28)	(459.08)	399.01	38.73	195.53
Cash and equivalent at beg	764.84	2,447.16	1,115.24	1,276.13	579.39	2,447.16	1,115.24
Forex effect	(1.30)	(104.38)	875.18	(237.67)	(182.02)	(10.32)	46.31
Cash and equivalent at end	2,447.16	1,115.24	1,276.13	579.39	796.37	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	1.84	31.41	4.66	9.40	-10.33	53.26
Gross profit	-1.62	1.97	32.88	5.50	11.48	-15.06	68.70
Net profit	-1.70	-68.83	73.63	20.10	15.60	-34.36	74.14
Revenue composition (%)							
- Infant formula	84.15	69.64	43.21	37.73	34.93	86.50	48.55
- Adult nutrition products	0.00	17.64	46.85	52.48	55.82	0.00	42.68
- Others	15.85	12.72	9.93	9.79	9.25	13.50	8.77
Profitability ratios (%)							
Gross margin	61.86	61.94	62.63	63.13	64.33	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	53.59	49.42	42.13	66.51	64.34
EBIT margin	23.24	11.41	20.91	20.32	20.14	13.81	28.88
EBITDA margin	24.31	13.22	25.26	28.36	29.35	15.34	31.84
Pre-tax margin	23.64	10.46	13.61	14.38	15.27	14.27	22.00
Net margin	17.05	5.22	6.90	7.91	8.36	10.44	11.86
Return ratios (%)							
ROAA	14.31	2.46	3.14	3.86	4.59	3.09	2.95
ROAE	29.70	7.71	11.23	11.48	11.27	6.98	10.44
ROIC	10.15	6.85	5.18	5.75	6.97	7.56	3.39
Liquidity ratio (%)							
Current ratio	3.42	0.69	1.96	1.22	1.52	4.17	1.16
Quick ratio	2.79	0.57	1.63	0.91	1.26	3.63	0.89
Cash ratio	2.64	0.43	1.30	0.62	0.90	3.44	0.72
Cash conversion cycle (days)							
Days of outstanding receivable	1.05	29.20	65.24	69.91	70.72	1.6	54.9
Days of inventory on hand	178.89	200.48	235.90	273.46	260.16	158.4	156.0
Days of outstanding payable	73.48	88.04	88.70	107.06	96.18	64.3	59.4
CCC	106.46	141.64	212.45	236.32	234.70	95.7	151.6
Leverage ratios (%)							
Total debt/Equity	82.63	205.41	158.06	103.62	82.23	87.57	43.36
Total debt/Total assets	36.35	53.45	47.35	38.91	36.12	39.16	13.27

Source(s): The Group, ABCI Securities estimates

Disclosures

Analyst Certification

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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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