

Corporate Flash

Lansen Pharmaceutical Holdings Ltd. 503 HK

Opportunities hide behind Sicorten Plus

- *Our research team held a face-to-face conference with the management of Lansen*
- *Outstanding growth of Plant Extract and Healthcare Products Department has been observed and we think the revenue from it will continue to accelerate*
- *More revenue will be generated since the entire interest of Sicorten Plus and exclusive agency distribution right for Kefumei has been obtained*
- *The sales of Sicorten Plus will grow more rapidly after the sales management being transferred to Lansen in FY12/15*

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Stock Data (503 HK)

Rating	Not Rated
Price (HK\$)	3.54
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	2.66-4.15
Market cap. (HK\$m)	1,469.1
Daily T/o (HK\$m)	3.3
Free float (%)	41.3

Source: Bloomberg

A face-to-face conference was held between the SBI research team and the management of Lansen. Last month, we held a face-to-face conference with the management of Lansen Pharmaceutical (Lansen) to get the most updated information regarding its operations. Specifically, we focused our discussion on the operations of its three departments, its new drugs, the issue of decreasing GPM and potential opportunities next year.

Highest growth rate was achieved by its healthcare related business among its three departments. Earlier in August, Lansen Pharmaceutical (Lansen) announced its interim results for 1H FY12/14. For the period, the company recorded revenue of USD55.4m, a 19.4% YoY increase; gross profit of USD30.4m, a 15.2% YoY increase with a GPM of 54.9%; and profit attributable to shareholders of USD7.3m, a 14.1% YoY increase. The board of the company recommended the payment of an interim dividend of USD1.23 cents per share, indicating a payout ratio of 68.3% for 1H FY12/14. Specifically, the revenue coming from Specialty Pharmaceuticals Department was USD33.4m, a 12.5% YoY increase and Plant Extract and Healthcare Products Department recorded revenue of USD16.5m, a 35.2% YoY increase. For its Other Pharmaceuticals Department, revenue was USD5.5m, representing a 22.2% YoY increase. In other words, its Plant Extract and Healthcare Products Department encountered the highest growth among its three departments. With decades of experiences in producing Pafulin, the company obtained advantages in producing healthcare related products.

The company has obtained the entire interest of Sicorten Plus and exclusive agency distribution right for Kefumei in 1H FY12/14. In March 2014, Lansen entered into an agreement with Novartis, from which Lansen acquired the entire interest of Sicorten Plus product in China's market. In the same period, the company obtained the exclusive agency distribution right and brand usage right of its Kefumei series in certain regions in China. Kefumei are products mainly used for the suppression and mitigation of skin inflammation responses caused by various reasons such as dermatitis, sensitive skin, acne and laser therapy. Currently, the sales of Sicorten Plus are still under the control of Novartis because of unfinished legal materials. We expect that more revenue will be generated from Sicorten Plus after the sales management is transferred to Lansen in FY12/15.

Figure 1. Financials and valuation

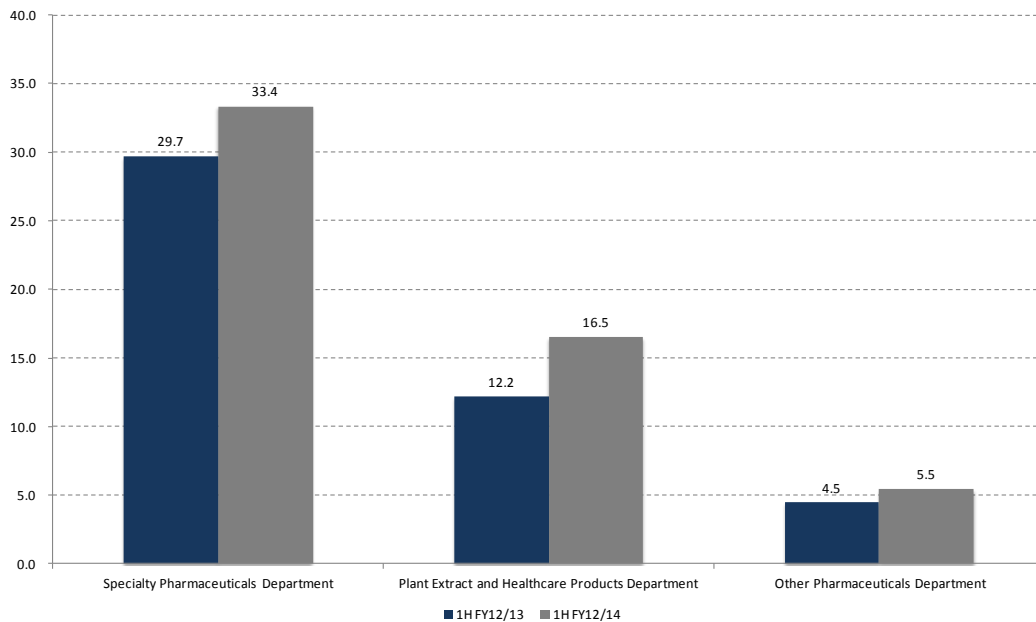
	FY12/11	FY12/12	FY12/13	1H FY12/14
Total revenue (USD m)	74.5	93.8	95.1	55.4
Revenue growth (YoY)	27.1%	26.0%	1.3%	19.3%
Gross profit (USD m)	59.6%	58.0%	54.9%	54.9%
PBT growth (YoY)	18.3%	9.4%	-9.0%	9.5%
Net profit (USD m)	12.5	14.0	11.7	7.3
Net profit growth (YoY)	22.1%	12.4%	-16.5%	15.8%
EPS (USD cents)	3.00	3.40	2.80	1.80
DPS (USD cents)	2.10	2.37	1.98	1.23
P/E (x)	15.4	13.7	16.4	-

Source: Company data

Background of Lansen. Lansen was listed on the Main Board since 2010 and is a medical company principally focusing on the development, production and sales of pharmaceuticals for the treatment of autoimmune rheumatic diseases in China. The company manages three departments, including Specialty Pharmaceuticals Department, Plant Extract and Healthcare Products Department and Other Pharmaceuticals Department. For its Specialty Pharmaceuticals Department, there are three main products involved, contributing approximately 60.3% of the total revenue in 1H FY12/14. Pafulin, as one of its core products, is manufactured by Lansen and contributed to around 35.0% of total revenue at the company’s listing year. Other core products, including Tuoshu and MMF, are not manufactured by Lansen. However, Lansen has acquired the exclusive agency distribution right for these two products. It deserves our attention that all of the three core products, namely Pafulin, Tuoshu and MMF, are under the National Health Insurance Directory. Drugs under the National Health Insurance Directory could be sold in hospitals and will always be selected by doctors with priority. For its Other Pharmaceuticals Department, it mainly covers generic drugs with revenue contribution of 10.0% in 1H FY12/14. We do not think this department will play an important role to Lansen in the future.

In 1H FY12/14, the company recorded revenue of USD55.4m, a 19.4% YoY increase; gross profit of USD30.4m, a 15.2% YoY increase with a GPM of 54.9%; and profit attributable to shareholders of USD7.3m, a 14.1% YoY increase. The board of the company recommended the payment of an interim dividend of HKD9.54 cents per share, indicating a payout ratio of 68.3% for 1H FY12/14. With regard to its departments, Specialty Pharmaceuticals Department recorded revenue of USD33.4m, a 12.5% YoY increase; Plant Extract and Healthcare Products Department recorded revenue of USD16.5m, a 35.2% YoY increase; and the Other Pharmaceuticals Department recorded revenue of USD5.5m, representing a 22.2% YoY increase (See Figure 2).

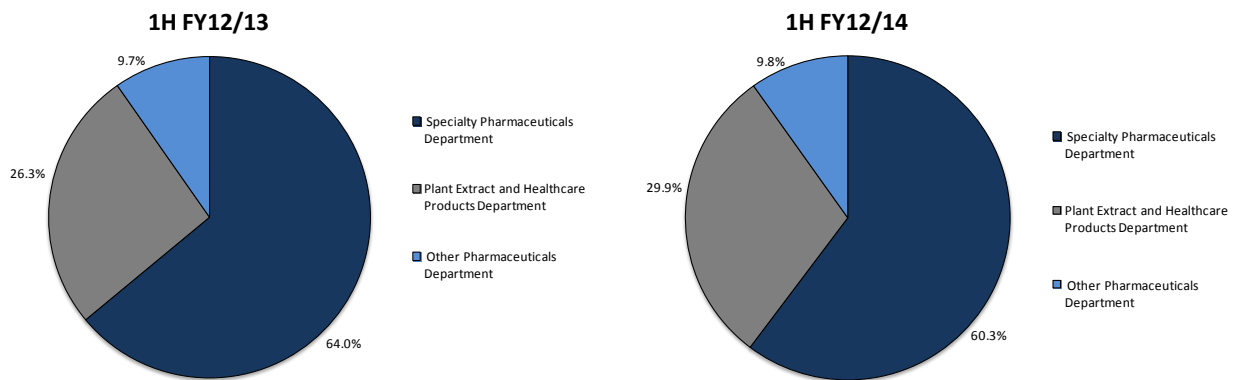
Figure 2. Revenue breakdown by sectors in 1H FY12/13 and 1H FY12/14 (USD m)



Source: Company data

GPM has been negatively affected by its growing healthcare related business. It warrants our attention that the company’s GPM kept decreasing in recent years, falling from 56.9% in 1H FY12/13 to 54.9% in 1H FY12/14. Such change is mainly attributable to the company’s revenue structure (See Figure 3). Revenue contributed from Plant Extract and Healthcare Products Department accounts for an increasing proportion of its total revenue, but the sector only commands GPM ranging from 20.0% to 30.0%, compared with the GPM of ~75.0% recorded by its Specialty Pharmaceuticals Department. Accordingly, we view such decrease as neutral to its operations.

Figure 3. Revenue breakdown by sectors in 1H FY12/13 and 1H FY12/14 (%)

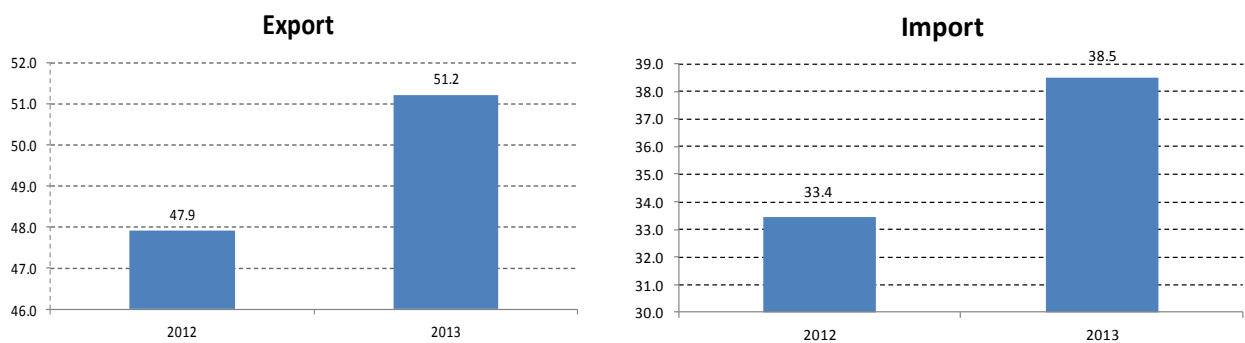


Source: Company data

Outstanding growth of revenue has been observed from its Plant Extract and Healthcare Products Department in 1H FY12/14. What attracts our attention is Lansen’s Plant Extract and Healthcare Products Department, which has been set up since the establishment of the company and recorded the highest growth among its departments for 1H FY12/14. However, it was not until 2013 that Lansen started to calculate revenue generated from this department and correspondingly record the figure on their annual report, given the gradual increase in revenue to the segment. Previously, the department was set up to extract the white peony-one of the elements for Pafulin. But in the recent years, Lansen started to produce healthcare related products under an OEM model under this department. By the end of FY12/13, approximately 30.0% of its total revenue has been generated from this department.

Actually the manufacturing business in pharmaceutical healthcare industry has been growing rapidly in China. For example, the amount of exports and imports of pharmaceutical healthcare products increased by 6.9% YoY and 15.3% YoY, respectively (See Figure 4). For Lansen, it has its own advantage to manufacture the pharmaceutical healthcare products. For example, it has started to process white peony, one of the raw materials for several healthcare products, since its core drug Pafulin being launched decades ago. With decades of experiences in producing Pafulin, the company obtained advantages in producing healthcare related products. Accordingly, we think Lansen’s healthcare related services will grow together with the growing demand in future.

Figure 4. Export and import of pharmaceutical healthcare products in China (USD b)



Source: Sina Health

Entire interest of Sicorten Plus and exclusive agency distribution right for Kefumei have been obtained. In March 2014, Lansen entered into an agreement with Novartis, from which Lansen acquired the entire interest of the Sicorten Plus product in China’s market. This product is a medicinal cream marketed and primarily used to treat certain corticosteroid-responsive inflammatory skin diseases and secondary infection. Currently, the sales management of Sicorten Plus are still under the control of Novartis because of unfinished legal materials. After its sales management is transferred to Lansen in FY12/15, its sales will grow accordingly. Thus we expect more revenue to be generated from Sicorten Plus in FY12/15. In the same period, the company obtained the exclusive agency distribution right and brand usage right of its Kefumei series in certain regions in China. Kefumei are products mainly used for the suppression and mitigation of skin inflammation responses caused by various reasons such as dermatitis, sensitive skin, acne and laser therapy.

Valuation. Lansen has been trading at a P/E of 14.7x for FY12/13. As for the company's HK-listed peers, there are several companies that are engaged in related industries in China. These companies include Pak Fah Yeow International (0239 HK), Tianda Pharmaceutical Ltd. (0455 HK) and Kingworld Medicines Group (1110 HK). On average, these companies are trading at a trailing P/E of 26.3x for 2013 and a prospective P/E of 24.9x for 2014. In our view, the discount that Lansen is trading to its peers is mainly attributable to its low turnover.

Figure 5. Peer comparison

Company	Ticker	Mkt Cap (HK\$ m)	3M avg turnover	2013 P/E (x)	2014E P/E (x)	2015E P/E (x)	P/book (x)	ROIC (%)	ROE (%)	ROA (%)	Dvd Yield (%)	Net Debt/Total
Lansen Pharmaceutical	503.HK	1,469.1	3.3	14.7	-	-	1.7	6.7	11.4	6.2	5.6	43.5
Pak Fah Yeow International	239.HK	1,012.8	0.2	10.6	-	-	1.8	7.7	18.5	13.5	3.7	1.0
Tianda Pharmaceutical Ltd.	455.HK	804.2	0.8	36.6	-	-	1.1	5.5	3.0	2.4	0.6	(52.4)
Sihuan Pharmaceutical Ltd.	460.HK	61,874.2	147.8	32.2	28.0	22.6	5.7	16.8	18.9	15.3	0.9	(29.1)
China Grand Pharmaceutical Ltd.	512.HK	3,374.7	2.2	26.8	-	-	3.6	9.6	14.5	2.8	0.0	168.0
China Traditional Chinese Medicine	570.HK	10,870.4	40.3	26.2	23.8	19.3	3.0	10.5	13.7	8.1	0.0	31.6
Hua Han Pharmaceutical Ltd.	587.HK	11,296.9	51.6	31.9	19.7	19.7	2.2	6.7	7.0	6.2	1.3	(49.6)
Kingworld Medicines Group	1110.HK	1,369.5	8.7	22.5	-	-	2.4	5.8	10.9	6.5	1.7	1.5
China Medical System Holdings Ltd.	867.HK	33,903.1	60.0	36.6	31.2	25.2	7.5	21.3	22.3	18.4	1.1	(19.5)
Baiyunshan Pharmaceutical Ltd.	874.HK	41,865.6	57.4	24.5	21.5	17.6	3.6	11.0	15.5	8.3	-	(18.4)
Average*		16,784.0	37.2	26.3	24.9	20.9	3.2	10.2	13.6	8.8	1.7	7.7

*The average here does not include Lansen Pharmaceutical

Source: Bloomberg, SBI China Capital

Risks involved. (i) the increase in the cost of raw materials, packaging materials, depreciation expenses and direct labour cost; (ii) the potential increase of marketing expenses for Sicorten Plus and other possible new drugs; (iii) the manufacture of healthcare related products may get delayed given potential regulatory factors; and (iv) competition from other autoimmune rheumatic drugs may erode the company's market share in the industry.

Figure 6. Per share items

	FY12/11	FY12/12	FY12/13	1H FY12/14
EPS				
- Basic and diluted (USD cents)	3.00	3.40	2.80	1.80
DPS (USD cents)	2.10	2.37	1.98	1.23
BVPS (USD cents)	0.2	0.3	0.3	0.3

Source: Company data

Figure 7. Ratio analysis

	FY12/11	FY12/12	FY12/13	1H FY12/14
Growth (YoY)				
Revenue	27.1%	26.0%	1.3%	19.3%
Net profit	22.1%	12.4%	-16.5%	15.8%
Margins				
Net profit margin	16.7%	14.9%	12.3%	13.2%
Other ratios				
Return on average assets	8.6%	8.9%	6.9%	-
Return on average equity	12.5%	13.7%	11.1%	-
Dividend payout ratio	70.0%	69.7%	70.7%	68.3%
Valuation measures				
P/E (x)	15.4	13.7	16.4	-
P/B (x)	1.9	1.8	1.7	1.7
Dividend yield	4.6%	5.2%	4.3%	2.7%

Source: Company data

Figure 8. Income statement (USD m)

	FY12/11	FY12/12	FY12/13	1H FY12/14
Revenue	74.5	93.8	95.1	55.4
Cost of sale	(30.1)	(39.4)	(42.8)	(25.0)
Gross profit	44.4	54.4	52.2	30.4
Other income	2.7	2.8	2.6	1.8
Selling and distribution costs	(24.8)	(31.3)	(27.7)	(15.9)
Administration expense	(8.7)	(9.8)	(12.0)	(6.4)
Operating profit	13.7	16.2	15.1	9.9
Finance cost	(0.5)	(1.0)	(1.7)	(1.3)
Share of post-tax profit of an associate	1.9	1.4	1.6	0.7
Profit before income tax	15.1	16.6	15.1	9.3
Income tax expense	(2.7)	(2.6)	(3.4)	(2.0)
Profit for the year	12.5	14.0	11.7	7.3
Total comprehensive income for the year	17.2	14.8	11.7	5.4
Profit attributable to the owners	12.5	14.0	11.7	7.3
EPS (USD cents)				
-Basic and diluted	3.00	3.40	2.80	1.80
Dividend per share (USD cents)	2.10	2.37	1.98	1.23

Source: Company data

Figure 9. Balance sheet (USD m)

	FY12/11	FY12/12	FY12/13	1HFY12/14
Non-current assets				
PPE	22.8	29.7	35.0	34.2
Prepaid land lease payment	2.5	2.4	2.4	2.4
Intangible assets	9.9	11.2	13.3	22.6
Goodwill	6.8	6.8	6.8	6.8
Interest in an associate	27.7	32.0	34.1	33.5
Total non-current assets	69.7	82.1	91.7	99.5
Current assets				
Inventory	9.6	11.8	17.2	18.2
Trade receivables	42.2	55.2	57.5	65.2
Prepaid land lease payment	0.1	0.1	0.1	0.1
Tax recoverable	-	-	0.5	0.1
Pledged bank deposits	7.3	8.3	14.5	19.6
Cash and cash equivalents	15.6	11.4	11.0	17.2
Total current assets	74.7	86.7	100.7	120.4
Non-current liability				
Borrowings	(9.2)	-	-	-
Deferred tax liabilities	(0.2)	(0.2)	(0.4)	(0.4)
Total non-current liabilities	(9.3)	(0.2)	(0.4)	(0.4)
Current liabilities				
Borrowings	(19.2)	(42.3)	(59.2)	(79.4)
Current tax liabilities	(1.3)	(1.0)	(1.6)	(1.1)
Trade and other liabilities	(15.2)	(20.1)	(20.6)	(25.7)
Other financial liability	-	-	-	(1.1)
Total current liabilities	(35.8)	(63.3)	(81.4)	(107.2)
Net assets	99.3	105.4	110.7	112.3
Equity				
Share capital	4.2	4.2	4.2	4.2
Share premium	58.3	49.6	39.6	35.9
Foreign exchange reserve	9.2	10.0	13.5	11.6
Statutory reserve	4.0	5.3	6.7	6.7
Retained profits	23.7	36.4	46.7	54.0
Total equity	99.3	105.4	110.7	112.3

Source: Company data

Figure 10. Cash flow statement (USD m)

	FY12/11	FY12/12	FY12/13	1H FY12/14
Operating activities				
Profit before income tax	15.1	16.6	15.1	-
Adjustment for:	0.0	0.0	0.0	-
Finance costs recognised	0.5	1.0	1.7	-
Interest income	(0.2)	(0.3)	(0.4)	-
Share of post-tax profit of an associate	(1.9)	(1.4)	(1.6)	-
Depreciation of PPE	1.3	1.5	1.8	-
Others	0.6	0.7	0.6	-
Increase in inventory	(3.1)	(2.1)	(5.1)	-
Increase in trade and other receivables	(11.6)	(9.6)	(2.9)	-
Increase in trade and other payables	6.5	4.6	0.0	-
Interest paid	(0.5)	(1.3)	(1.7)	-
Income tax paid	(2.8)	(2.9)	(3.1)	-
Net cash generated from operating activities	3.9	6.9	4.3	2.8
Investing activities				
Increase in pledged bank deposits	(7.0)	(1.0)	(5.8)	(5.4)
Decrease in pledged other receivables	-	(3.3)	2.7	0.7
Purchase of PPE	(3.2)	(7.8)	(6.4)	(1.0)
Purchase of intangible assets	(1.0)	(1.7)	(2.7)	(8.7)
Purchase of additional interest in an associate	-	(2.2)	-	-
Capital contribution to an associate	(0.4)	(4.6)	-	-
Dividend received from an associate	0.4	4.2	0.4	0.8
Others	0.2	0.3	0.5	0.2
Net cash used in investing activities	(11.0)	(16.1)	(11.3)	(13.4)
Financing activities				
Proceeds from borrowings	22.2	34.2	65.0	48.9
Repayment of borrowings	(4.9)	(20.5)	(48.7)	(28.3)
Dividends paid	(10.1)	(8.8)	(9.9)	(3.7)
Net cash used in financing activities	7.2	4.9	6.4	16.9
Net increase/ (decrease) in cash and cash equivalent	0.0	(4.3)	(0.6)	6.3
Cash and cash equivalents at 1 January	14.8	15.6	11.4	11.0
Exchange losses on cash and cash equivalents	0.7	0.1	0.3	(0.1)
Cash and cash equivalents at 31 December	15.6	11.4	11.0	17.2

Source: Company data

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