

Stock price runs ahead of fundamentals

SELL (unchanged)

Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (RMBm)	12,260.73	4,450.63	4,440.43	814.44	2,005.5
Net Profit (RMBm)	320.3	181.8	139.5	200.2	258.9
EPS (RMB)	0.395	0.224	0.172	0.247	0.319
EPS Δ%	46.9	(43.2)	(23.3)	43.4	29.3
P/E (x)	5.8	10.2	13.3	9.3	7.2
P/B (x)	0.61	0.74	0.59	0.54	0.52
EV/EBITDA (x)	2.5	4.8	5.1	4.5	4.0
Yield (%)	5.2	1.7	2.2	3.1	4.0
ROE (%)	10.6	6.3	4.7	5.9	7.2
ROCE (%)	11.5	3.0	-	1.7	-
N. Gear. (%)	6.3	Cash	2.3	2.5	1.8

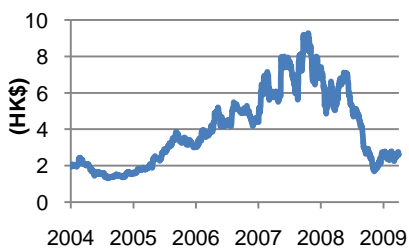
Source: SBI E2Capital

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+0.6	+6.5	-19.1
Actual price changes (%)	+5.7	-0.4	-52.4

	09F	10F	11F
Consensus EPS (RMB)	0.179	0.239	0.270
Previous forecasts (RMBm)	3,695.5	4,054.8	
Previous EPS (RMB)	0.181	0.266	

Price Chart



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been cleared since beginning of 2009. Pan Gao Shou and Jing Xiu Tang report loss of RMB15.7m and RMB0.1m respectively.

Wang Lao Ji facing the margin pressure. For 2H FY12/08A, the 48.05%-owned Wang Lao Ji's revenue increased by 33.4% YoY (but decreased 13.5% on a HoH basis) to RMB598.2m while the profit contribution increased only 0.6% YoY (decreased 49.4% HoH) to RMB58.0m. We think the market competition and slow down in economy would not only slow down the growth of Wang Lao Ji Herbal tea but also bring margin pressure.

Distribution JV performance is satisfactory. The 50%-owned distribution JV's revenue increased 13.3% YoY and decrease 3.2% HoH with the net profit up 20.8% YoY and 1.0% HoH to RMB46.1m. The result is tracking slightly ahead of our projections as we had expected synergies with Alliance Boots to take some time to materialise.

Ticker:	874.HK	12 mth range:	HK\$1.63-7.15
Price:	HK\$2.61	Market cap(H):	US\$696.0m
Target:	HK\$1.40(-46.4%)	Daily t/o, 3 mth:	US\$0.6m
		Free float %:	52.2%

Key points:

- * FY12/08A net profit down 43.2% to RMB181.8m
- * GP's subsidiaries report a net loss of RMB116.9 for 2H FY12/08A
- * Wang Lao Ji's bottom line contribution crimped. Net profit contribution only increased 0.6% YoY to RMB58.0m
- * Distribution JV's net profit up 20.8% YoY to RMB46.1m
- * We think GP issues with its excess inventory, supply chain and marketing control will take another 1 to 2 quarters to digest
- * We think flawed rabies vaccines issue made the launch of GP's rabies vaccines delayed
- * GP has been unable to leverage its portfolio of well known brands
- * The counter is currently trading at a significant premium to HK-listed healthcare companies. We reiterate our SELL call on the counter, target price HK\$1.40

FY12/08A net profit down 43.2% YoY. GP's FY12/08A net profit was RMB181.8m, down 43.2% YoY, beating our expectations mainly from larger than expected contribution in other incomes and other gains. For 2H FY12/08A, the total revenue of GP's subsidiaries decreased 19.2% YoY and 24.3% HoH to RMB1,687.8m with a net loss of RMB114.5m. The excess inventory problem that had severely affected the performance of the company's manufacturing business in 3Q persisted into 4Q as expected.

Inventory problem still there. GP's main manufacturing subsidiaries all recorded a big drop in both the top line and the bottom line. For 2H FY12/08A, the sales of Xingqun 星群 (maker of Xiasangju 夏桑菊) dropped 59.5% YoY and 58.1% HoH to RMB55.9m with a net loss of RMB50.4m; the sales of Qixin 奇星 (maker of Huatuozaizaowan 华陀再造丸) decreased by 51.7% YoY and 45.9% HoH to RMB79.9m with a net loss RMB30.9m. Management said the excess inventory problem of these two subsidiaries would take to the end of 2009 or even the beginning of 2010. Even Zhong Yi 中一, manufacturer of its blockbuster Xiao Ke Wan 消渴丸 diabetes drug, recorded a loss of RMB13.9m in 2H FY12/08A. Chenliji 陈李济 (maker of Wu Ji Bai Feng Wan 乌鸡白凤丸) made nominal profit of RMB6.8m. The management indicated that the excess inventory for this particular subsidiary had

Launch of rabies vaccine delayed. According to various news reports in March 2009 ([article](#)), Da Lian Jingang-Andi Biopharmaceutical Co. (大连金港安迪生物制品公司) was accused of using flawed rabies vaccines contained nucleic acid. The addition of nucleic acid (a non-approved ingredient for human rabies vaccine in China), lowers the manufacturing cost of rabies vaccine. Key officers involved have been forbidden from engaging in any production activities within the pharmaceutical industry for a period of ten years. Two senior executives and one purchasing agent of Dalian JGAD have been detained by local authorities. We think news of this may adversely effect Guangzhou Pharma's (through its Baidi subsidiary) new rabies vaccine. Though the drug has already obtained SFDA approval and GMP certificate, the negative sentiment on rabies vaccine and potential stricter quality control going forward may delay the launch schedule of the drug. This is negative for Guangzhou Pharma as the company has earmarked the vaccine as a future growth driver.

2009 would be a correction year. We think GP continues to face serious problems with: 1) destocking inventory in its supply chain; 2) gaining control of its marketing strategy and R&D development. Moreover, a key growth driver of previous years, WLJ JV is also beginning to show signs that growth momentum is slowing and facing the margin pressure. Despite owning a portfolio of well-known brands, GP has failed to leverage and utilize its brand equity advantage in its marketing and revenue drive. We think the FY12/09F would be a correction year for the company as it fights to secure more control of its supply chain and re-invigorate growth in its WLJ and accelerate growth in its distribution JVs.

Reiterate SELL call. We think that GP's stock price has run ahead of its fundamentals, mainly on its A-shares (600332 CH) counterpart and rumours that the company may sell its WLJ business to PepsiCo. The counter is currently trading at 13.3x FY12/09F P/E, at a significant premium to the HK-listed China pharmaceutical sector of 7.6x despite poorer fundamentals. We revised slightly revised our FY12/09F net profit forecast to RMB139.5 (previously RMB146.8m) and FY12/10F to RMB200.2m (previously RMB215.8m). We maintain the SELL call on the counter, with SOTP target price of HK\$1.40, representing blended 7.2x FY12/09F P/E.

Table 1: 2H FY12/08A revenue growth

Year to Dec (RMBm)	% held	2HFY08	2HFY07	YoY chg (%)	1HFY08	HoH chg (%)
Subsidiary						
<u>Manufacturing</u>						
Guangzhou Xing Qun	89.0	55.9	138.0	(59.5)	133.2	(58.1)
Guangzhou Zhongyi	100.0	201.1	370.0	(45.7)	361.4	(44.4)
Guangzhou Chen Li Ji	100.0	75.8	103.6	(26.8)	120.8	(37.3)
Guangzhou Qi Xing	75.0	79.9	165.6	(51.7)	147.8	(45.9)
Jing Xiu Tang	88.4	77.0	104.6	(26.3)	111.1	(30.7)
Guangzhou Pan Gao Shou	87.8	80.8	142.2	(43.2)	167.8	(51.9)
Others		46.1	46.3	(0.3)	53.0	(13.0)
Subtotal		616.5	1070.3	(42.4)	1095.1	(43.7)
<u>Distribution</u>						
Chinese Medicine Corp	100.0	713.7	667.5	6.9	685.5	4.1
Guangzhou Pharma Import and Export Corp	100.0	143.9	122.4	17.5	152.2	(5.5)
Others		213.7	227.7	(6.2)	297.8	(28.3)
Subtotal		1071.3	1017.6	5.3	1135.5	(5.7)
Total		1687.8	2087.9	(19.2)	2230.6	(24.3)
JV						
Guangzhou Pharmaceutical Corp	50.0	4847.9	4277.7	13.3	5006.4	(3.2)
Wang Lao Ji JV	48.1	598.2	448.4	33.4	691.2	(13.5)

Source: Company data

Table 2: 2H FY12/08A net profit growth

Year to Dec (RMBm)	% held	2HFY08	2HFY07	YoY chg (%)	1HFY08	HoH chg (%)
Subsidiary						
<u>Manufacturing</u>						
Guangzhou Xing Qun	89.0	(50.4)	11.5	-	(8.7)	-
Guangzhou Zhongyi	100.0	(13.9)	69.1	-	43.1	-
Guangzhou Chen Li Ji	100.0	6.8	10.4	(35.1)	12.6	(46.2)
Guangzhou Qi Xing	75.0	(30.9)	9.3	-	11.4	-
Jing Xiu Tang	88.4	(0.1)	1.7	-	13.6	-
Guangzhou Pan Gao Shou	87.8	(15.7)	15.9	-	22.4	-
Others		(25.9)	(41.0)	-	(12.4)	-
Subtotal		(130.0)	76.9	-	81.9	-
<u>Distribution</u>						
Chinese Medicine Corp	100.0	12.4	1.4	814.2	1.1	1069.5
Guangzhou Pharma Import and Export Corp	100.0	0.7	0.5	50.0	1.2	(37.7)
Others		2.5	1.1	123.6	1.6	57.0
Subtotal		15.6	2.9	429.9	3.8	311.6
Total		(114.5)	79.8	-	85.7	-
JV						
Guangzhou Pharmaceutical Corp	50.0	46.1	38.2	20.8	41.8	10.2
Wang Lao Ji JV	48.1	58.0	57.6	0.6	114.6	(49.4)

Source: Company data

Table 3: P&L

Year to Dec (RMBm)	07A	08A	09F	10F	11F
Turnover	12260.7	3450.6	3440.4	3814.4	4200.5
Cost of sales	(10245.3)	(2446.6)	(2453.2)	(2700.9)	(2965.9)
Gross profit	2015.5	1004.0	987.1	1113.5	1234.6
Other income and gains	80.2	195.4	20.6	22.9	25.2
Selling and distribution costs	(1057.3)	(626.2)	(588.2)	(614.0)	(655.1)
Administrative expenses	(554.2)	(452.6)	(430.9)	(458.7)	(484.1)
Other operating expenses	(4.5)	(10.5)	-	-	-
Operating profit	479.8	110.0	(11.3)	63.8	120.6
Finance costs, net	(59.7)	(7.8)	(11.5)	(12.6)	(12.0)
Share of profits of an associate	7.9	(5.2)	-	-	-
Share of profit from JV		111.5	141.2	159.0	172.4
Exceptionals	28.8	0.0	0.0	0.0	0.0
Profit before taxation	456.8	208.6	118.4	210.2	281.0
Taxation	(127.0)	(37.3)	1.1	(10.2)	(21.7)
Profit after tax	329.9	171.3	119.5	199.9	259.3
Minority interests	(9.5)	10.5	20.0	0.2	(0.4)
Profit attributable to shareholders	320.3	181.8	139.5	200.2	258.9
%chg	46.9	(43.2)	(23.3)	43.4	29.3
Dividends	100.5	32.4	41.9	60.0	77.7

Note: Distribution JV & WLJ JV is deconsolidated in 2008A, 2009F, 2010F&2011F

Source: Company data & SBI E2Capital

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