

Guangzhou Pharma



Beaten by snow storms

Key points:

- 1Q FY12/08A results below our expectations.
- Manufacturing business affected by Jan 2008 snow storms.
- Sales of Wanglaoji herb tea up 44%YoY.
- Distribution business sales up 30.4% YoY, but slight margin pressure and one-off promotional efforts reduce bottom line growth to 6.5% YoY.
- Alliance BMP team already in China to oversee the distribution JV with GP.
- Maintain our BUY call on the counter with a revised target price of HK\$7.20.

1QFY12/08A results below expectations. Guangzhou Pharmaceuticals (GP) announced its 1Q FY12/08A results on 29 Apr 2008. Under China's accounting standards, net profit rose 46.0% YoY to RMB113.6m, below our expectations. FY12/07 and FY12/08 numbers are not directly comparable for several of reasons: 1) FY12/08 consolidated only 50% of the wholesale and distribution business and 2) FY12/08 includes a one-off RMB56.0m gain from the sale of 40.1% of the wholesale and distribution business to Alliance BMP. On a proforma basis, we estimate that net profit dropped 16.0% YoY in 1Q.

Manufacturing affected by snow storms. The drop in net profit was mainly due to an abnormally poor performance in its manufacturing business due to snow storms that affected Southern China in 1Q FY12/08A. Even though demand was apparent, GP's distribution system was disrupted eroding segmental revenue 0.8% YoY to RMB705.0m and net profit 20.9% YoY to RMB44.3m. On the positive side, GP's Wanglaoji JV, with its multiple manufacturing base, was less affected and delivered a strong top line growth of 44.0%.

High growth for JV with Alliance BMP. GP's wholesale and distribution sales increased 30.4% YoY to RMB1.797.0m. However, a slight contraction in gross margins, coupled with one-off promotional events during the period, increased operating expenses and pressured margins. This reduced bottom line gains to 6.5% YoY to RMB13.3m. Management indicated that Alliance BMP has already sent a team to oversee the distribution business and was working with the incumbent management on various fronts including strategy development, operating efficiency improvements and product developments.

BUY (unchanged)

China Pharmaceuticals

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Stock data

Price	HK\$6.45
Target price	HK\$7.20 (+13.2%)
12 mth range	HK\$4.60-9.55
Market cap.	(H-Shares) US\$181.8m
Daily t/o, 3 mth	US\$0.72m
Free float %	43.6%
Ticker	0874.HK/874 HK

Financial summary

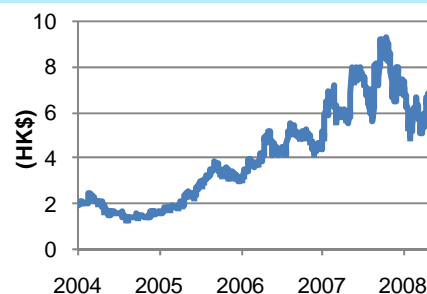
Year to Dec	06A	07A	08F	09F	10F
Turnover (RMBm)	10,241	12,261	9,588	11,453	13,252
Net profit (RMBm)	218.1	320.3	348.9	386.2	492.8
EPS (RMBm)	0.269	0.395	0.430	0.476	0.608
EPS Δ %	10.2	46.9	8.9	10.7	27.6
P/E (x)	21.6	14.7	13.5	12.2	9.6
P/B (x)	1.63	1.49	1.33	1.24	1.07
EV/EBITDA (x)	19.2	16.5	17.8	14.1	11.5
Yield (%)	1.4	2.1	2.2	2.5	3.1
ROE (%)	7.8	10.6	10.4	10.5	12.0
ROCE (%)	10.1	11.5	8.9	11.6	13.3
N. Gear. (%)	16.3	23.2	21.4	Cash	Cash

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	9.5	25.1	-9.2
Actual price changes (%)	24.3	36.2	17.4

	08F	09F	10F
Consensus EPS (RMB)	0.482	0.512	n/a
Previous forecast(RMBm)	407.0	442.1	525.1
Previous EPS (RMB)	0.502	0.545	0.648

Price Chart



Maintain BUY call, revising down estimates and target price. Despite the company's indications that its manufacturing business has returned to normal, we do not expect GP to fully recover its lost sales opportunities in 2Q FY12/08F and the remainder of the year. Hence, we have revised down our net profit estimate to RMB348.9m (from RMB407.0m) for FY12/08F and RMB386.2m (from RMB 442.1m) for FY12/09F after incorporating the weaker 1Q numbers and slightly lower margins. We maintain BUY call on the counter, revising our target price to HK\$7.20, based on a sum of the parts valuation, valuing GP's Wanglaoji JV at 30x FY12/08F P/E and 15.0x FY12/08 P/E for the remaining pharmaceutical business (excluding the one-off gain of HK\$56.0m).

Table 1: 1Q FY12/08 revenue analysis (based on PRC GAAP)

Year to Dec (RMBm)	1Q FY12/07A (Adjusted)* RMBm	1Q FY12/08 RMBm	YoY %/pcp
General financial performance			
Revenue	2089.0	2501.0	19.7
Gross profit	445.5	451.5	1.1
SG&A	338.4	367.2	8.5
Net profit	68.5	57.6**	(16.0)
Gross Margin (%)	21.4	18.1	(3.3)
SG&A ratio (%)	16.2	14.7	(1.5)
Net margin (%)	3.2	2.3	(0.9)
Manufacture			
Revenue	711.0	705.0	(0.8)
Gross profit	365.5	360.4	(1.7)
SG&A	275.7	291.9	5.9
Net profit	56.0	44.3	(20.9)
Gross Margin (%)	51.4	51.1	(0.3)
SG&A ratio (%)	38.8	41.4	2.6
Net margin (%)	7.9	6.3	(1.6)
Distribution			
Revenue	1378.0	1797.0	30.4
Gross profit	80.0	91.1	13.9
SG&A	62.7	75.3	20.1
Net profit	12.5	13.3	6.5
Gross Margin (%)	5.8	5.1	(0.7)
SG&A ratio (%)	4.6	4.2	(0.4)
Net margin (%)	0.9	0.7	(0.2)

Note: *2007 data has been adjusted based on consolidate of 50% of GPC and 48.05% of Wanglaoji Pharmaceutical

**excluding one off item RMB56.0m

Source: Company data

Table 2: P&L

Year to Dec (RMBm)	06A	07A	08F	09F	10F
Turnover	10,241.0	12,260.7	9,587.9	11,452.6	13,252.3
Cost of sales	(8,472.2)	(10,245.3)	(7,938.7)	(9,457.5)	(10,886.9)
Gross profit	1,768.8	2,015.5	1,649.2	1,995.1	2,365.4
Other income and gains	75.2	80.2	67.1	68.7	79.5
Selling and distribution costs	(778.2)	(1,057.3)	(853.3)	(1,012.3)	(1,172.8)
Administrative expenses	(656.5)	(554.2)	(469.8)	(522.3)	(609.6)
Other operating expenses	(14.5)	(4.5)	(4.7)	(6.5)	(6.6)
Operating profit	394.8	479.8	388.5	522.7	655.9
Finance costs, net	(45.4)	(59.7)	(30.1)	(30.1)	(30.1)
Share of profits of an associate	(0.3)	7.9	-	-	-
Exceptionals	-	28.8	56.0	-	-
Profit before taxation	349.2	456.8	414.4	492.6	625.9
Taxation	(118.6)	(127.0)	(59.5)	(98.5)	(125.2)
Profit after tax	230.6	329.9	354.9	394.1	500.7
Minority interests	(12.5)	(9.5)	(6.0)	(7.9)	(7.9)
Profit attributable to shareholders	218.1	320.3	348.9	386.2	492.8
%chg	10.3	46.9	8.9	10.7	27.6
Dividends	(68.1)	(100.5)	(104.7)	(115.9)	(147.8)

Source: Company data

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