

## Company Update

# New Ray Medicine International 8180 HK

## Key takeaways from reverse roadshow

- We organized a roadshow to New Ray Medicine's headquarters in Hangzhou to get more updated information about the company's recent development and future plans
- The collective tendering process (CTP) in Zhejiang Province has already been kicked off.
- The company has a clear strategy to integrate upstream and downstream resources with Town Health International (3886 HK) in becoming a comprehensive healthcare services provider
- We reiterate our BUY rating on the company, with a TP of HKD0.94, indicating an upside potential of 94.0%

**Playing a pivotal role in the value chain; its business model fits well in the current medical industry:** New Ray Medicine ("the Company") plays an important role throughout the pharmaceutical distribution channel, from assisting pharmaceutical manufacturers in the collective tendering process (CTP) to promoting and marketing the products to downstream distributors and hospitals. We do not expect any material change in the current distribution model in the middle to long run and we predict the Company will still be able to utilize its unique advantage in the pharmaceutical distribution channel.

**The CTP in Zhejiang has been kicked off after a four year wait:** The CTP in Zhejiang province is currently undergoing, and the results is expected to be released in 1Q FY12/15. In the latest CTP of Zhejiang province, all pharmaceutical manufacturers, if they want to distribute the products in Zhejiang province, have to directly supply their products to the distributors in Zhejiang province instead of distributing through national distributors. We believe this new policy will favour the Company in terms of acquiring extra distribution rights in Zhejiang province and will also have a positive effect on the Company's profit margin in the long run.

**Transforming into an integrated healthcare provider through the potential cooperation with Town Health:** Last week, the board of Town Health International Medical Group (3886 HK) and the board of the Company announced that they have entered into a JV agreement to form a JV company in the PRC. Town Health and the Company will hold 80.0% and 20.0% of the JV, respectively. The JV is mainly for potential business development in the healthcare sector in China in the future. With the cooperation with Town Health, an integrated healthcare service provider in Hong Kong and the PRC, we predict there will be more opportunities to be explored in the massive healthcare market in the PRC and so the Company will be able to gain a wider exposure in the healthcare market in the PRC.

**Eligible to transfer to the Main Board:** As of Q3 FY 12/14, the Company recorded net profit attributable to shareholders of HKD19.1m, and we expect the whole year profit to be ~HKD33.2m. We believe The Company will earn more than HKD20.0m this year, and the total profit for the previous two financial years has exceeded HKD30.0m, meaning that the Company is very likely to have met the financial requirements to transfer to the Main Board of the Hong Kong Stock Exchange.

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**Stock Data (8180 HK)**

Rating	BUY
Price (HK\$)	0.485
Target Price (HK\$)	0.94
12m Price Range (HK\$)	0.445-2.16
Market cap. (HK\$m)	465.6
Daily t/o (HK\$m)	9.4
Free float (%)	52.3

Source: Bloomberg

**Figure 1. Financials and valuation**

	FY12/12	FY12/13	FY12/14E	FY12/15E	FY12/16E
<b>Revenue</b>	<b>175.0</b>	<b>192.9</b>	<b>258.9</b>	<b>319.2</b>	<b>328.4</b>
Cost of sales	(136.0)	(142.2)	(188.9)	(237.1)	(240.1)
<b>Gross profit</b>	<b>39.0</b>	<b>50.6</b>	<b>70.0</b>	<b>82.1</b>	<b>88.2</b>
SG&A	(9.7)	(11.0)	(23.3)	(28.7)	(29.6)
Other income	1.5	1.7	1.9	1.9	2.2
Listing and other expenses	(8.6)	(10.2)	0.0	0.0	0.0
Finance costs	(0.0)	(2.4)	(0.5)	(0.9)	(0.9)
<b>Profit before tax</b>	<b>22.2</b>	<b>28.7</b>	<b>48.1</b>	<b>54.4</b>	<b>60.0</b>
Income tax	(6.9)	(11.3)	(14.9)	(16.9)	(18.6)
<b>Net profit</b>	<b>15.3</b>	<b>17.4</b>	<b>33.2</b>	<b>37.5</b>	<b>41.4</b>
Net profit attributable to shareholders	15.3	17.4	33.2	37.5	41.4

Source: SBI China Capital, Company data

Please refer to important disclosures at the end of this report

**Playing a pivotal role in the value chain; its business model fits well in the current medical industry:** New Ray Medicine focuses on the pharmaceutical distribution business, especially in Zhejiang Province. Under its current business model, the Company sources pharmaceutical products from pharmaceutical manufacturers and national distributors and then distributes those products through the other regional or provincial distributors to public hospitals in the PRC. Aside from pharmaceutical distribution, the Company has also provided various value added services to its suppliers and its distribution customers, such as advisory services in the collective tendering process and assistance in marketing and promotion strategy and activities.

We think current business model of the Company plays a very important role in the supply chain and the Company acts as an important intermediate player in the pharmaceutical distribution channel. Some middle scale pharmaceutical manufacturers may not have the presence in all regions of the PRC and it is very cost consuming for them to operate a large sales team to cover every region in the PRC. For those pharmaceutical manufacturers, the Company will utilise its local expertise to provide assistance in the provincial collective tendering process, marketing and promotion strategy and government liaison work. We believe the above are the Company's competitive edge as a pharmaceutical distributors and it is difficult to duplicate such a competitive edge by other distributors who are outside Zhejiang province. We have discussed with the management on the advantages of the Company: besides the value added services and expertise that the Company can provide as stated above, it is a listed company in Hong Kong which enables it to raise funds at a much lower costs through the equity platform. Last but not least, the Company's current largest shareholder - Town Health International (3886 HK) has been working closely with the Company on exploring opportunities in the PRC market, by utilizing the well established brand and clinic operation experience of Town Health, which provides a huge advantage compared with its peers.

**The collective tendering process in Zhejiang has been kicked off:** After a four years of waiting, the Zhejiang province's CPT is currently undergoing, and the result is expected to be released in 1Q FY12/15. We have discussed with the management and they are quite looking forward to this year's CPT. Recently there is a new policy set out in the rules of the collective tendering process which requires all pharmaceutical manufacturers, if they want to distribute their products in Zhejiang province, have to directly supply their medicines to distributors in Zhejiang province instead of distributing through distributors outside Zhejiang province. Originally, if pharmaceutical manufacturers wanted to distribute their products to Zhejiang province in which they have no presence, they can distribute their products through national distributors in other regions and then sub-distribute to provincial distributors in Zhejiang province. After certain revisions, the new policy has clearly stated out that if pharmaceutical manufacturers want to distribute their products in Zhejiang province, they can only work with distributors in Zhejiang province and without interference by distributors outside Zhejiang province.

We believe the new rules is favourable to the Company in terms of acquiring extra distribution rights in Zhejiang Province and will have a positive effect on the Company's profit margin in the long run as the GPM will be higher if the Company can acquire the products from the pharmaceutical manufacturers directly without going through the national distributors in other regions.

In addition, we have also discussed with the management on the success rate of this year's CTP, The management believes that its major core products, including Levocarnitine Injection, are likely to win the CTP. It is worth noting that Levocarnitine Injection was selected in the Essential Medicines List in Zhejiang province in Sep 2014 and we expect more hospitals of county-level and below will use the medicine in the next few years. Moreover, we believe the Company has good track record in past CTP: during the period between 2009 and 2010, 35 out of 41 products which involves the company's participation won the provincial CTP in Zhejiang, representing a success rate of 85.4%.

**Figure 2. Levocarnitine Injection**



Source: SBI China Capital, Company data

The management also reveals that they have several pharmaceutical products in their product portfolio that were obtained a few years ago that have not participated in the CPT due to the last CTP being held approximately four years ago. All of those new products can only be sold in private healthcare institutions. However, as most of the hospitals in the PRC are government owned, the only way to let the pharmaceutical products break into the public hospitals are through the CTP. We believe once those products win the CTP this year, there will be a boost in the Company's operation and financial performance as it is equivalent to a guarantee of the sale of the drugs over the next few years.

**Transforming into an integrated healthcare provider through the potential cooperation with Town Health:** The current principal business of the Company is pharmaceutical distribution. However, in light of the massive healthcare reform in the PRC, the Company intends to take this advantage to expand its business to the other segments of the healthcare industry that can create synergy to the Group's pharmaceutical distribution business. We believe the healthcare reform in the PRC could provide an opportunity to the Company to expand its business to a more integrated level, such as medical devices distribution, hospital management etc. We have discussed with the management on the future possible opportunities and they believe all those different segments in the healthcare sector can create common synergy, which is beneficial to the Company's future business development.

Last week, Town Health International Medical Group (3886 HK) and New Ray Medicine announced that they entered into a JV agreement to form a JV company in China. Town Health and New Ray Medicine will hold 80.0% and 20.0% of the JV, respectively. The JV is mainly for potential business development in the healthcare sector in China in the future. With the cooperation with Town Health, an integrated healthcare service provider in Hong Kong and the PRC, we predict there should be more opportunities if New Ray Medicine can transfer its advantages in the distribution business to the downstream business. We also believe the cooperation is a win-win deal for both parties – while Town Health can share with New Ray its financial resources and expertise in the healthcare industry, New Ray can leverage on its resources in Zhejiang province, including people network and market knowledge, to help Town Health to make inroads into the healthcare sector in the PRC.

**The pass of the new Good Supply Practice set out by the CFDA** - The China Food and Drug Administration (CFDA) of the PRC has released the revised GSP standard that sets out a stricter management standard from pharmaceutical distributors and retailers. The Company has successfully passed the new GSP standard in November 2014. In addition, in view of the stricter GSP standard and the increasing volume of the Company's business, the Company has recently moved to a bigger warehouse which is more well equipped and large in size.

**Eligible to transfer to the Main Board:** As of Q3 FY12/14, the Company recorded net profit attributable to shareholders of HKD19.1m, and we expect the whole year profit to be ~HKD33.2m, mainly driven by the sale of the new pharmaceutical products that the Company acquired this year including the Italy imported Levocarnitine Injection and Taiwan imported Cefamandole Nafate for Injection. We predict the Company can reach a profit of more than HKD20.0m this year and including the aggregate profit of two previous years, which has exceeded HKD30.0m, means that the Company has met the financial requirements to transfer to the Main Board of the Stock Exchange. We believe that transferring to the Main Board can help boost its the daily turnover of its shares and is also beneficial to the company's reputation. The company does not rule out the possibility to apply for the transfer to the main board next year.

### Valuation

We reiterate a BUY rating on New Ray with a target price of HKD0.94 per share, representing a prospective P/E of 27.2 and 24.1x for FY12/14E and 12/15E respectively, and an upside potential of 94.0% to the current market price. Our target price is derived from the average of our 2-stage DCF valuation method and price-multiple method (refer to our [\*initiation report\*](#) issued in Nov 2014). We will fine-tune our target price once the company releases more concrete information regarding its future development.

Figure 3. Peers comparison

Company	Ticker	Mkt Cap (HKD m)	3M avg turnover (HKD m)	2013 P/E (x)	2014E P/E (x)	P/book (x)	ROE (%)	ROA (%)	Dvd Yield (%)	Net Debt/Total Equity	Major clients
<b>New Ray Medicine International</b>	<b>8180 hk</b>	<b>465.6</b>	<b>9.4</b>	<b>17.5</b>	<b>14.0</b>	<b>1.7</b>	<b>10.0</b>	<b>8.7</b>	<b>5.2</b>	<b>(43.8)</b>	<b>insitutional</b>
Kingworld Medicines	1110 hk	1,263.7	5.8	21.0	n.a.	2.2	10.9	6.5	1.9	1.5	Retail
China Pioneer Pharma Holdings	1345 hk	8,560.0	17.1	23.3	22.0	6.0	46.1	16.8	n.a.	(23.5)	insitutional
Jintian Pharmaceutical Group	2211 hk	5,640.0	55.9	10.2	9.6	1.9	24.5	16.7	0.0	(63.7)	insitutional
China Medical System Holdings	867 hk	28,977.0	103.8	31.3	26.7	6.4	22.3	18.4	1.3	(19.5)	insitutional
China NT Pharma Group	1011 hk	1,309.2	6.4	n.a.	n.a.	4.9	(71.7)	(14.8)	0.0	358.5	insitutional
RM Group	8185 hk	813.7	1.0	n.a.	18.8	4.8	(5.3)	(4.0)	0.0	(71.6)	Retail
Beijing TongRen Tang	8138 hk	8,283.4	10.2	29.0	28.5	n.a.	n.a.	n.a.	0.8	(70.5)	Retail
<b>Average*</b>		<b>7,835.3</b>	<b>28.6</b>	<b>23.0</b>	<b>21.1</b>	<b>4.4</b>	<b>4.4</b>	<b>6.6</b>	<b>0.7</b>	<b>15.9</b>	

Source: SBI China Capital, Company data

\*New Ray Medicine is not included in the average figures.

Figure 4. Per share items

	FY12/12	FY12/13	FY12/14E	FY12/15E	FY12/16E
EPS (HK cents)					
- Basic (HK cents)	3.0	2.8	3.5	3.9	4.3
- Diluted (HK cents)	3.0	2.8	3.5	3.9	4.3
DPS (HKD cents)	0.0	2.5	1.0	1.2	1.3
BVPS (HKD)	0.2	0.3	0.3	0.3	0.4

Source: SBI China Capital, Company data

Figure 5. Ratio analysis

	FY12/12	FY12/13	FY12/14E	FY12/15E	FY12/16E
<b>Growth (YoY)</b>					
Revenue	9.6%	10.2%	34.2%	23.3%	2.9%
Profit before tax	39.7%	29.5%	67.6%	12.9%	10.3%
Net profit	38.9%	13.5%	90.9%	12.9%	10.3%
<b>Margins</b>					
Gross margin	22.3%	26.3%	27.0%	25.7%	26.9%
EBT margin	12.7%	14.9%	18.6%	17.0%	18.3%
Net profit margin	8.8%	9.0%	12.8%	11.8%	12.6%
<b>Other ratios</b>					
Return on average assets	1.8%	1.9%	1.7%	2.9%	2.9%
Return on average equity	2.2%	2.2%	2.0%	3.4%	3.5%
Dividend payout ratio	0%	90.3%	30.0%	30.0%	30.0%
<b>Valuation measures</b>					
P/E (x)	16.4	17.5	14.0	12.4	11.3
P/B (x)	2.9	1.8	1.7	1.5	1.3
Dividend yield	0%	5.2%	2.1%	2.4%	2.7%

Source: SBI China Capital, Company data

Figure 6. Income statement (HKD m)

	FY12/12	FY12/13	FY12/14E	FY12/15E	FY12/16E
<b>Revenue</b>	<b>175.0</b>	<b>192.9</b>	<b>258.9</b>	<b>319.2</b>	<b>328.4</b>
Cost of sales	(136.0)	(142.2)	(188.9)	(237.1)	(240.1)
<b>Gross profit</b>	<b>39.0</b>	<b>50.6</b>	<b>70.0</b>	<b>82.1</b>	<b>88.2</b>
SG&A	(9.7)	(11.0)	(23.3)	(28.7)	(29.6)
Other income	1.5	1.7	1.9	1.9	2.2
Listing and other expenses	(8.6)	(10.2)	0.0	0.0	0.0
Finance costs	(0.0)	(2.4)	(0.5)	(0.9)	(0.9)
<b>Profit before tax</b>	<b>22.2</b>	<b>28.7</b>	<b>48.1</b>	<b>54.4</b>	<b>60.0</b>
Income tax	(6.9)	(11.3)	(14.9)	(16.9)	(18.6)
<b>Net profit</b>	<b>15.3</b>	<b>17.4</b>	<b>33.2</b>	<b>37.5</b>	<b>41.4</b>
Net profit attributable to shareholders	15.3	17.4	33.2	37.5	41.4

Source: SBI China Capital, Company data

**Figure 7. Balance sheet (HKD m)**

	FY12/12	FY12/13	FY12/14E	FY12/15E	FY12/16E
<b>Non-current assets</b>					
Property, plant and equipment	5.7	7.1	5.7	4.4	2.9
Prepaid lease payments	8.5	8.5	8.5	8.5	8.5
Others	0.6	0.6	0.6	0.6	0.6
<b>Total non-current assets</b>	<b>14.8</b>	<b>16.2</b>	<b>14.9</b>	<b>13.5</b>	<b>12.1</b>
<b>Current assets</b>					
Inventories	16.2	9.8	24.5	18.6	25.1
Trade and other receivables	108.5	114.3	143.5	148.8	151.0
Bills receivables	0.3	0.0	0.0	0.0	0.0
Others	0.3	0.2	0.2	0.2	0.2
Cash and cash equivalents	26.3	93.4	96.1	120.7	151.4
<b>Total current assets</b>	<b>151.5</b>	<b>217.7</b>	<b>264.4</b>	<b>288.3</b>	<b>327.8</b>
<b>Current liabilities</b>					
Borrowings	(12.0)	0.0	(15.0)	(15.0)	(15.0)
Payables	(17.4)	(17.4)	(33.4)	(27.8)	(35.2)
<b>Total current liabilities</b>	<b>(29.4)</b>	<b>(17.4)</b>	<b>(48.4)</b>	<b>(42.8)</b>	<b>(50.2)</b>
<b>Non-current liabilities</b>	<b>(2.5)</b>	<b>(3.3)</b>	<b>(4.5)</b>	<b>(5.1)</b>	<b>(5.6)</b>
<b>Net assets</b>	<b>134.4</b>	<b>213.2</b>	<b>226.4</b>	<b>254.0</b>	<b>284.1</b>
<b>Equity</b>	<b>134.4</b>	<b>213.2</b>	<b>226.4</b>	<b>254.0</b>	<b>284.1</b>

Source: SBI China Capital, Company data

**Figure 8. Cash flow statement (HKD m)**

	FY12/12	FY12/13	FY12/14E	FY12/15E	FY12/16E
<b>Operating activities</b>					
Profit before tax	22.2	28.7	48.1	54.4	60.0
Adjustment for non-cash items	0.3	2.2	1.0	1.5	1.3
Operating cashflow before change in WC	22.5	30.9	49.2	55.9	61.3
Change in WC	(22.6)	(1.4)	(27.5)	(5.5)	(1.9)
Tax paid	(6.9)	(7.2)	(14.3)	(15.6)	(17.5)
<b>Net cash generated from operating activities</b>	<b>(7.0)</b>	<b>22.3</b>	<b>7.4</b>	<b>34.7</b>	<b>41.8</b>
<b>Investing activities</b>					
Purchase of PP&E	(0.2)	(2.5)	(0.2)	(0.2)	(0.2)
Interest received	0.1	0.3	0.9	1.0	1.2
Others	1.8	0.5	0.0	0.0	0.0
<b>Net cash flow from investing activities</b>	<b>1.8</b>	<b>(1.7)</b>	<b>0.7</b>	<b>0.8</b>	<b>1.0</b>
<b>Financing activities</b>					
Proceeds from IPO	0.0	70.0	0.0	0.0	0.0
New borrowing raised	12.0	(12.0)	15.0	0.0	0.0
Dividend paid to shareholders	0.0	0.0	(20.0)	(10.0)	(11.3)
Interest paid	(0.0)	(1.5)	(0.5)	(0.9)	(0.9)
Others	(3.4)	(10.6)	0.0	0.0	0.0
<b>Net cash flow from financing activities</b>	<b>8.6</b>	<b>45.9</b>	<b>(5.5)</b>	<b>(10.9)</b>	<b>(12.2)</b>
Net increase in cash and cash equivalent	3.4	66.5	2.7	24.6	30.7
Cash and cash equivalents at the beginning of the year	22.7	26.3	93.4	96.1	120.7
Exchange rate effect	0.2	0.7	0.0	0.0	0.0
<b>Cash and cash equivalents at the end of the year</b>	<b>26.3</b>	<b>93.4</b>	<b>96.1</b>	<b>120.7</b>	<b>151.4</b>

Source: SBI China Capital, Company data

*SBI China Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: [research@sbichinacapital.com](mailto:research@sbichinacapital.com), [thomsononeanalytics.com](http://thomsononeanalytics.com), [factset.com](http://factset.com) and [multex.com](http://multex.com)*

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- STRONG BUY** : absolute upside of >50% over the next three months  
**BUY** : absolute upside of >10% over the next six months  
**HOLD** : absolute return of -10% to +10% over the next six months  
**SELL** : absolute downside of >10% over the next six months

Investors should assume that SBI China Capital is seeking or will seek investment banking or other related businesses with the companies in this report.

**Disclosure of Interest:** SBI China Capital was the placing agent of New Ray Medicine International (8180 HK) in Oct 2014.

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