"Honey & Ash"
Hong Kong Email Alert

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CITIC 中信証券國際 CITIC Securities International

Guangzhou Pharmaceuticals (600332; 00874.HK; OVERWEIGHT) – Aspiring to be a pharmaceutical carrier in southern China

Event:

We recently attended the 1H10 results announcement of Guangzhou Pharmaceutical Group (the Group). We summarize our views as follows: (i) The Group has initiated integrated operations to raise its competitiveness. We believe internal resource restructuring will be the overall direction for the Group's development going forward. (ii) Since the beginning of 2010, there have been frequent personnel adjustments at both in the Group and its listed arm. Senior managers are now younger and more professionally oriented, indicating management improvement in the future. (iii) Compared with other pharmaceutical groups in China, the Group is still at a nascent stage of development. We see promising growth potential for the Group.

Comment:

- New development strategy launched at end-Jun 2010 aimed at more integrated operations. The Group has two publicly traded companies – Guangzhou Pharmaceutical Company (GZ Pharma (600332; 00874.HK)) and Guangzhou Baiyunshan Pharmaceutical (Baiyunshan Pharma (000522)). Both are influential in the domestic pharmaceutical industry, manufacturing a wide spectrum of drugs and owning a large number of brands. Business coverage is almost inclusive. However, integration within the Group has remained weak so far, with each subsidiary isolated from others in terms of operation.

- Fundamental analysis of the listed plays: Both in the midst of improvement. Highlights of Baiyunshan Pharma: (i) Manufactures a large number of common varieties of drugs. Given rising demand at the grassroots level, revenue is likely to expand going forward. (ii) Has advanced cefaxone medicine, with a particular type protected by China and US drug patents. Its cefaxone drugs enjoy good sales and may become a major growth driver in the future. (iii) New CEO Wang Wenchu used to be a sales manager and has a good grasp of the industry as well as the Company. Highlights of GZ Pharma: (a) operations at subsidiaries Xing Qun Pharmaceutical and Pan Gao Shou Pharmaceutical are likely to experience further rebound; (b) joint venture GZ Wang Lao Ji Pharmaceutical should recover in 2H10E from a product scandal and benefit from the Guangzhou Asian Games; and (c) The sales-manager-turned new CEO Wu Wenhai may play a strong positive role in boosting sales.

- Peers' comparison. Compared with other major groups, the Group holds rich resources in both product variety and brand recognition. It has remarkable influence in the pharmaceutical market in Southern China. Since it is in the early stages of internal consolidation and external expansion, future prospects appear highly promising.

- Risks associated with investing in the Company. Internal restructuring and reconsolidation requires an effective incentive system and organizational structure. It could prove to be highly challenging for management to achieve major breakthroughs in these areas.

- Worth following due to relatively safe valuations and promising internal consolidation. We strongly recommend following the two listed companies of the Guangzhou Pharmaceuticals Group. Our recommendation is based on the following considerations: (i) historically, corporate internal restructuring is typically preceded by personnel changes. Given an effective incentive system and organizational restructuring, the benefits of internal consolidation should emerge over time. As the Group is at the nascent stage of internal consolidation and external expansion, its outlook appears upbeat. (ii) Operations of both listed arms are in the midst of recovery and their valuations are relatively safe. It has been officially announced that factories under the Group will not be suspended from production during the Guangzhou Asian Games. We believe business will fare better than generally expected. We forecast: (i) Baiyunshan Pharma: projected 2010/11/12E EPS of Rmb0.47/0.58/0.74, respectively, implying 2010/11/12E PER of 32x / 26x / 20x (A-share), respectively. We initiate our coverage of the Company with an OVERWEIGHT rating. (ii) GZ Pharma: projected 2010/11/12E EPS of Rmb0.38/0.47/0.58, respectively, implying 2010/11/12E PER of 35x / 28x / 23x (A-share), respectively. We raise our rating to OVERWEIGHT. Considering that future earnings may surpass consensus on recent personnel reshuffling and pending internal consolidation, we see fair valuation of both at projected 2011E PER of 37x. Target prices (A-share) are Rmb21 for Baiyun Pharma and Rmb18 for GZ Pharma (H-share: HK$10.60).

Peers' comparisons – China Pharmaceuticals Industry

Company	Price (HK$)	PER (x) 09	PER (x) 10E	PER (x) 11E	PEG (x) 09-11E	P/B (x) 10E	Yield (%) 10E	RoE (%) 10E
Hong Kong - average		***28***	***20***	***17***	***1.1***	***3.0***	***2.1***	***16***
China Pharma (01093.HK)	4.09	6	9	11	NA	1.1	4.6	14
United Lab (03933.HK)	14.96	33	19	16	0.8	4.4	1.8	26
Guangzhou Pharma (00874.HK)	8.05	27	19	15	0.8	1.6	0.9	9
MY Medicare (00233.HK)	0.86	35	16	13	0.5	1.8	1.4	12
Tong Ren Tang (01666.HK)	16.20	16	14	12	1.1	1.8	3.4	13
Shineway Pharma (02877.HK)	21.15	20	19	15	1.4	4.9	2.2	28
Sinopharm (01099.HK)	31.35	58	48	36	2.1	5.3	0.6	11

Source: Respective companies, Bloomberg, CSI

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Investment rating system

Performance of stock or sector relative to MSCI-China Index over next 6 months after research publications

	Rating	Remark
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

地址：	香港中环 添美道 1 号 中信大厦 26 楼	Address:	26/F CITIC Tower 1 Tim Mei Avenue Central, Hong Kong
电话：	(852) 2237 9250	Tel:	(852) 2237 9250
传真：	(852) 2104 6580	Fax:	(852) 2104 6580
电邮：	hkresearch@citics.com.hk	Email:	hkresearch@citics.com.hk
网址：	http://www.citics.com.hk	Web:	http://www.citics.com.hk