

# Financial Analysis and Valuation of the CSPC Pharmaceutical Group

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**Abstract:** As a leader of innovative pharmaceutical industry, CSPC pharmaceutical group will continue to increase capital investment and team motivation to speed up the development process of key drugs based on the original innovative drug pattern with the combination of Butylphthalide, Oxiracetam, Levoamlodipine Maleate Tablets and antineoplastic drugs. This paper is mainly aimed at financial analysis and valuation of the CSPC pharmaceutical group, by combining FCF model, PE and EV/EBITDA, we get a target price for the target company. The target price is 24.08HKD in a year and the corresponding EPS is 0.79. The target price is still 18% higher than the current price, so the 'buy' rating is given. Main Risks reminding include: Regulatory Risks, Market Risks, Economics Risks, Operational Risks. A reduction in the Product promotion shows the growth rate tends to be lower than expectation. Meanwhile, Drug approval progress and the growth of market scale have become unpredictable which may make some difference to the profit situation of company.

**Keywords:** Financial Analysis; CSPC; Financial Valuation; Investment Risks

## 1. Introduction

CSPC pharmaceutical group is a comprehensive pharmaceutical large enterprise. After more than 20 years of development, the current group has become one of the leading enterprises in China's pharmaceutical industry, and it is a component of the stock index of Hong Kong's Hang Seng. The pharmaceutical industry is a defensive industry and is characterized for its high-tech, high-risk and high-returns. At present, the drug market concentration in China is gradually improving, and the number of small-scale pharmaceutical enterprises is gradually decreasing. The pharmaceutical industry went through a tough time in 2016. With the important policies falling down in 2017, the macro data of the industry became better.

## 2. Overview

China is the major exporter of API in the world. Therefore, Chinese pharmaceutical enterprises have advantage in the raw material purchase. However, in recent years, as raw material price rise, the competitiveness of pharmaceutical enterprises will decline undoubtedly. The buyers have a large amount of information and have part of the ability to guide the use of drugs, so the pharmaceutical enterprises are at a disadvantage in the bargaining process. After the reorganization in 2012, CSPC pharmaceutical group gradually transformed from an API manufacturer into a leader of innovative pharmaceutical industry. Compared with the competitor Hengrui Medicine and so on, their major innovative drugs have different functions. CSPC pharmaceutical group has formed the innovative drug pattern with the combination of Bu-

tylphthalide, Oxiracetam, Levoamlodipine Maleate Tablets and antineoplastic drugs. Butylphthalide is the only brain microcirculation reconfiguration agent with mitochondrial protection in the world. The sales of it are over \$474 million in 2016 and it will be expanded in the next two or three years. The market share of Oxiracetam is the largest and the share is still expanding relying on Lyophilized Powder for injection. The competitor of Levoamlodipine Maleate Tablets is the innovation drug, Shi Hui Da, which occupies nearly 60% market share, and Levoamlodipine Maleate Tablets occupies 26% market share ranking second. However, because of the low price, the sales will increase year by year with the sinking of the sales channel. Relying on the dual function of market and policy, antineoplastic drugs, as the focus of innovative drugs in the future, will become a new growth point. In conclusion, the major innovative drugs of CSPC pharmaceutical group have strong competitiveness.

## 3. Financial Analysis of the CSPC Pharmaceutical Group

### 3.1. Increasing and stable market growth

The company's financial is of stability, the ratio of assets and liabilities ratio is not high, the main flow assets are accounts receivable, cash and inventory, non-current assets are mainly factory buildings; liabilities mainly consist of current liabilities, long term interest rate debt is becoming less and less, and company's ability to resist risk is strong. In 2017, the performance of the whole year was significantly increased by 31.4%: the company's 17-year income was from HK \$15 billion to 460 million, with a year-on-year increase of 25%, and the net profit of

returning to the mother was 2 billion 771 million Hong Kong dollars, with a year-on-year increase of 31.9%, slightly exceeding the market expectations. Driven by the core products of ABP and metaphysic, the business of innovative drugs has increased by 38% significantly, and the ratio of the Chinese medicine business is increased by 9.4pp to 60.4%, and the company's profit structure is continuously optimized.

### 3.2. Potential development of drug business

The pharmaceutical business was still a major growth driving force for the stone group, with sales growth of 26.8% to HK \$11 billion 374 million in 2017, of which the group's innovative drug continued to grow strong, sales revenue reached 6 billion 582 million Hong Kong dollars, up 37.9% from the same period, and the total income of innovative drugs increased from 38.6% in 2016 to 42.6% in 2017; as the price of vitamin C products rose sharply in 2017, the profitability of the vitamin C business in 2017 of the group increased significantly, and sales revenue increased from 41.6% to HK \$1 billion 854 million over the same period.

### 3.3. Future expectation

2018's earnings per share growth is expected to reach 30%. Considering:

It is expected to maintain strong growth in the implementation of the new provincial medical insurance directory; Aili benefited from the clinical needs and prices and the rapid release ;

Xuan Ning benefited from the sales model. Changes and proved to be accelerated in a more clinical advantage than complex activities;

A moderate growth in the business of the API is expected, and Yu Changdan has benefited from the profit of 600 million Hong Kong dollars for the vitamin C material business and the continued cost reduction.

## 4. Financial Valuation of the CSPC Pharmaceutical Group

By combining absolute and relative valuations, we get a target price of 24.08 per year for the target company. The absolute valuation adopts the FCF model, PE and EV/EBITDA are used relative to the valuation. Each of the three valuation models has a weight of 1/3.

### 4.1. Absolute valuation

We use the FCF model for valuation because the steady growth in the company's cash flow as the new drug listing of the underlying company and the steady growth in innovative drug research and development investment. Which we think, in the 2018 to 2020, because the company's most of the medicine is still in the clinical trials, bringing the limited to the company's cash flow growth. The stage which we assume that the company free cash

have a growth rate is about 9%. In 2021 and 2021, we think the company will usher in a new round of revenue outbreak period. All kinds of innovative drugs in the market on the objective operating income will bring to the company. The stage we assume that the company free cash have a growth rate of about 20%.

### 4.2. Relative valuation

We use comparable companies listed in Hong Kong as innovative pharmaceutical companies, and their market value is above average. After comparing the data of comparable companies, the current data of the target company is compared with the current data of the target company, where the current PE and industry mean value is 13.5%, the premium of EV/EBITDA is 18.1%. Because of the fundamental of a-share listed innovative pharmaceutical enterprise and development situation is similar to Hong Kong's share, we chose the same drug companies listed on the mainland with the above method to deal with data, which respectively get the information that the underlying company of PE and EV/EBITDA industry average discount of 19.2%, 48.1%.

Although valuations are high in recent years, we believe that the value of the underlying company is still undervalued as a leading innovator in the pharmaceutical industry. The potential of the research product is huge, which can enjoy a reasonable premium. From this, we will give the target company 46.33X, 35.86X and 27.50X respectively, as the PE, in 2018-2020, with a target price of 25.23HKD within one year. We will give the target company an EV/EBITDA of 22.96X, 18.45X and 15.68X respectively in 2018 and 2020 and the target price will be 21.53HKD within one year. The weighted target price is 22.89HKD, compared with the current price of 12.5%. After weighting the three models, the target price is 24.08HKD in a year and the corresponding EPS is 0.79. The target price is still 18% higher than the current price, so the 'buy' rating is given.

## 5. Investment Risks

Main Risks reminding include-A reduction in the Product promotion shows the growth rate tends to be lower than expectation. Meanwhile, Drug approval progress and the growth of market scale have become unpredictable which may make some difference to the profit situation of company. Market warming will also take some time.

Regulatory Risks: The landing and execution of policies is not certain yet. With frequent promulgation of CFDA policy, heavy policy will have a more abyssal impact on the industry, but the policies are still uncertain at the level of each province, the national level, and the time of execution.

Market Risks: Medical insurance fee has always been a big background and an obstacle to the drug market. From angle of the medical enterprise level, the drugs that have

not been evaluated by the consistency of the medicine will be phased out gradually. From point of the hospital, the control medicine and the cost of controlling drugs and equipment will still have an impact on the industry. Though the market for raw material medicine has not been warmer than expected. Since the antibiotic business is affected by the weak-market-demand and the increase in supply, the prices of all antibiotic products have declined in one year, so that the business performance of the year is obviously going backward. The overall over-capacity of vitamin C market still exists, but the price of products has bottomed up after years of continuous decline.

**Economics Risks:** The performance of stock didn't reach the expected level, Considering the reasons of company operation, drug bidding, price fluctuation of raw materials and so on, there are still risks among individual stocks.

**Operational Risks:** The form of large shareholders in the Shijiazhuang group's capital operation is complex, and related party transactions are also considerable, reminding investors to pay attention to the relevant risks. The aim of the acquisition is to expand the product mix of innovative drugs to enhance competitiveness and a further level. The growth rate of EBP is not as good as expected.

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