

Kingworld Medicines

(01110.HK/1110 HK)

Not rated

Price as of January 24 (HK\$)	0.95
12M target price (HK\$)	N/A
Previous target price (HK\$)	N/A
Unchanged / Revised up (down)	N/A
Downside (%)	N/A

Key message

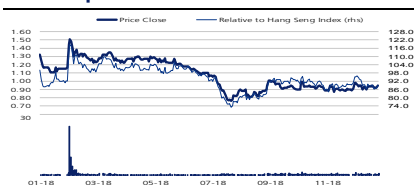
We hosted a conference call with Kingworld's IR Director and our clients yesterday. The company has seen faster sales growth in low-tier cities than in Tier 1-2 cities since the beginning of 2018. There will be ample room for penetration of Nin Jiom Pei Pa Koa in low-tier cities in 2019. The 2019 sales outlook for Nin Jiom Pei Pa Koa is positive as the company completed channel reform in 2018. There has been disruption of the supply of Cuturelle in China since 2018. The counter is trading at historic 2017 PE of 10.3x. We currently do not offer a rating on Kingworld.

Trading data

Mkt cap (HK\$bn/US\$m)	0.591 / 75.37
Outstanding shares (mn)	623
Free Float (%)	31.4
3M avg. daily trading (mn)	0.58
52-week trading range (HK\$)	0.760 - 1.51

Performance	3M	6M	12M
Absolute (%)	1.1	-13.6	-27.5
Relative (%)	-6.3	-8.2	-9.8

Share price chart



Source: TEJ

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See the last page for important disclosures.

Key takeaways from conference call

Event

We hosted a conference call with Kingworld's IR Director and our clients yesterday.

Impact

Benefited from consumption upgrades in 2018. The company has seen faster sales growth in low-tier cities than in Tier 1-2 cities since the beginning of 2018. There will be ample room for penetration of Nin Jiom Pei Pa Koa in low-tier cities' small drug stores and small chains in 2019. A growing number of Chinese people are willing to spend money to buy health supplements. Going forward, the company will introduce more health-care products.

2019 sales outlook. The 2019 sales outlook for Nin Jiom Pei Pa Koa is positive as the company completed channel reform in 2018 and there is ample room for growth in low-tier cities. Culturelle probiotic products were ranked No.1 in the Hong Kong market, with strong sales growth in both Hong Kong and Macau. That said, due to a change in product formula initiated from by the brand owner in the US, there has been disruption of the supply in China since 2018, which is why we saw sales decline in 1H18. The company guides supply will normalize in mid-2019.

Not aggressive in US medical device market. Kingworld acquired a 55% stake in Shenzhen Dong Di Xin in 2015. Dong Di Xin is an OEM manufacturer of household-use medical devices for physical rehabilitation and treatment. All products are exported to the US, Europe, and Southeast Asia. Its products are subject to US import tariffs due to the Sino-US trade war. Tariffs increased from 3% to 10%, with the additional costs born by the company, which could badly affect profitability in 2H18. In 2019, the company will pursue new clients in Europe, Southeast Asia, and the Middle East, but will not be aggressive in the US market. Last year, the company developed in-house medical device brand, Nu-Tek, focusing on postnatal rehabilitation instruments. Products are sold via online platforms, including JD.com.

Valuation & Action

At HK\$0.95 per share, the counter is trading at historic 2017 PE of 10.3x. We currently do not offer a rating on Kingworld.

Risks

Heavy reliance on a single product; ability to identify products with potential in China.

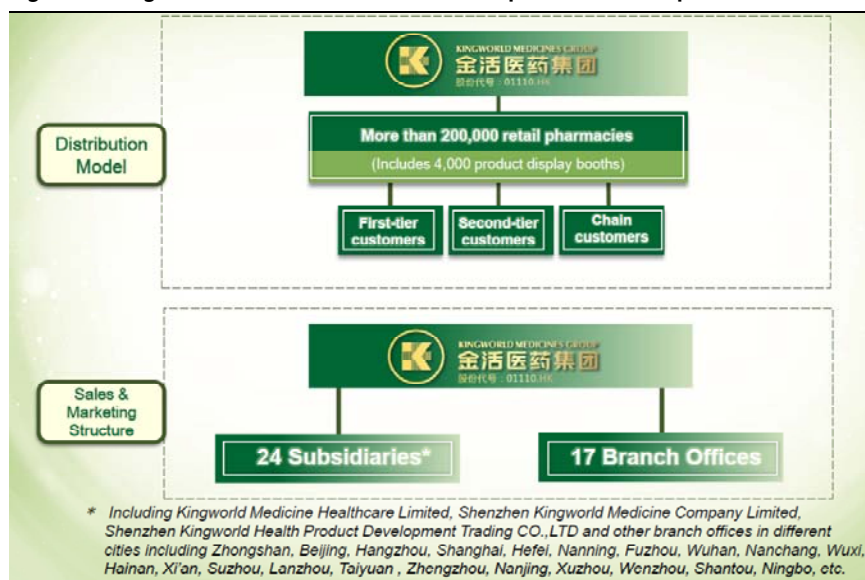
Key financials and valuations

	Dec-15A	Dec-16A	Dec-17A
Revenue (RMBmn)	714	1,054	1,031
Gross profit (RMBmn)	227	324	323
Operating profit (RMBmn)	49	96	96
Net profit (RMBmn)	39	47	51
EPS (RMB)	0.06	0.07	0.08
DPS (RMB)	0.01	0.03	0.03
EPS growth (%)	0.0	22.3	14.0
PE (x)	14.3	11.7	10.3
PB (x)	1.0	1.0	0.9
EV/EBITDA (x)	10.9	6.4	6.7
Net debt to equity (%)	4.0	12.7	28.1
Dividend yield (%)	1.4	3.1	3.5
Return on average equity (%)	0.0	8.4	9.5

Source: Company data, KGI Research estimates

Management will keep an eye on future M&A opportunities. Targets should create synergistic effects for the company's distribution network, improve the product range, and enhance the channel mix. It has an initial plan to cooperate with China's renowned pharmaceutical product brands to jointly promote and sell pharmaceutical products. The company will maintain dividend policy of 25-35% of net profit distributed once a year. Kingworld is scheduled to report 2018 results on March 27.

Figure 1: Kingworld's distribution network for pharmaceutical products in China



Source: Company data; KGI Research

Figure 2: Peer comparison – Valuations

Name	Bloomberg Code	Mkt. Cap. (US\$ mn)	Price (24/1) (LCY)	PE (x)				PB (x)		ROE (%)		Dividend yield (%)	
				2017A	2018F	2019F	2020F	2018F	2019F	2018F	2019F	2018F	2019F
Kingworld	1110 HK	76	0.95	9.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
China Medical System	867 HK	2,499	7.86	9.3	8.7	7.7	6.9	1.9	1.7	24.2	22.4	3.6	4.2
Hin Sang Group	6893 HK	137	0.98	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Besunyen Holdings	926 HK	71	0.34	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Sinopharm Group	1099 HK	13,430	35.25	16.2	14.9	13.2	11.7	2.1	1.9	15.5	15.4	1.8	2.0
H&H	1112 HK	3,587	43.70	26.3	19.4	14.8	12.0	4.6	3.6	24.2	26.7	0.7	1.0
Shanghai Pharmaceuticals	2607 HK	6,717	16.70	11.0	9.7	8.7	7.9	1.1	1.0	11.4	11.3	2.7	3.0
Average				14.4	13.1	11.1	9.6	2.4	2.1	18.8	19.0	2.2	2.5

Source: Bloomberg; KGI Research

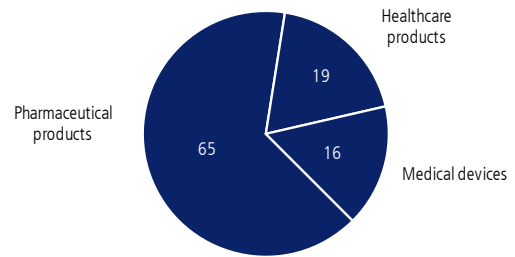
Figure 3: Company profile

Established in 1994, Kingworld is engaged in the distribution of branded imported pharmaceutical and health-care products in China. It distributes more than 60 products, mostly with exclusive distribution rights in China, Hong Kong, and Macau. The Nin Jiom series has been the key product line for the company, contributing 47% of total sales in 2017. In 2014, the company introduced the Culturelle probiotics product line to Hong Kong, Macau, and China. Sales of this line accounted for 19% of the total in 2017. The company was listed in 2010 at HK\$1.6 per share.

Source: KGI Research

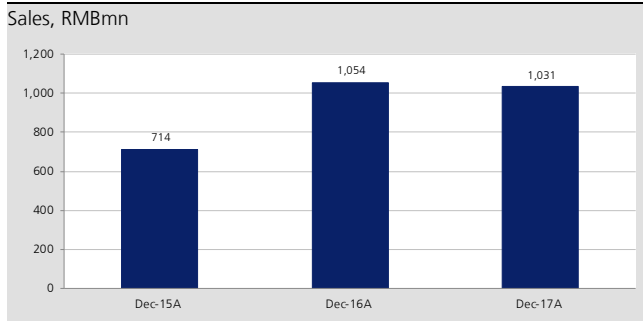
Figure 4: Revenue mix

Revenue weighting in 1H18, percent



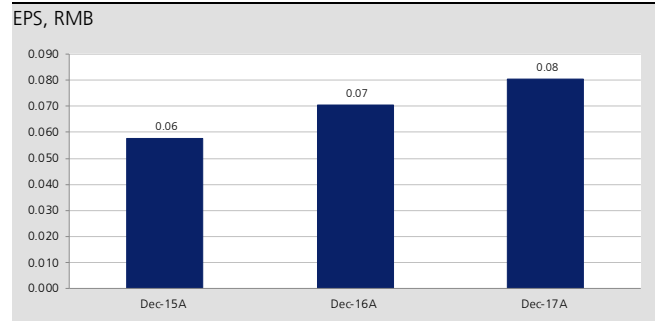
Source: KGI Research

Figure 5: Sales



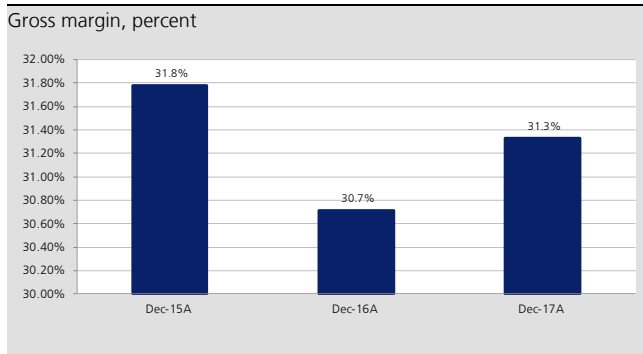
Source: KGI Research

Figure 6: EPS



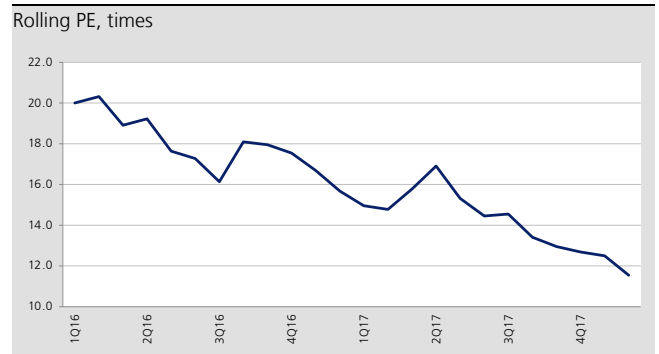
Source: KGI Research

Figure 7: Gross Margin



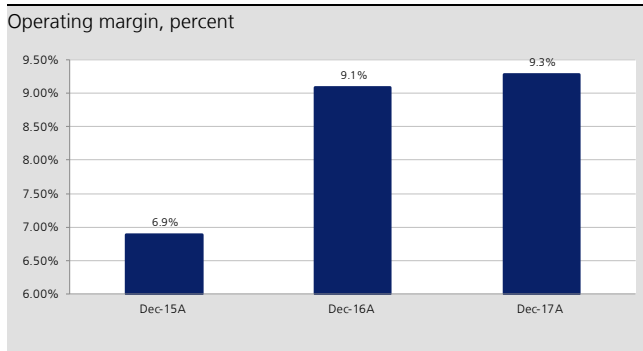
Source: KGI Research

Figure 8: Rolling PE



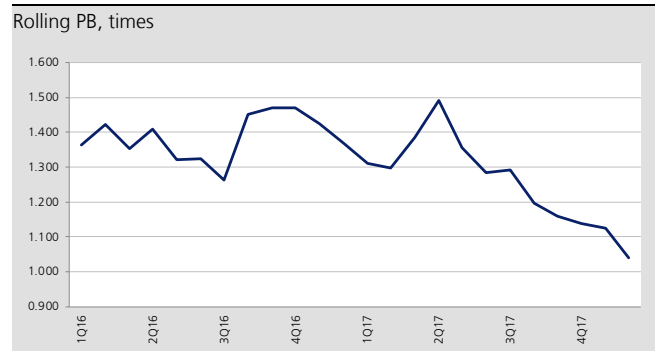
Source: KGI Research

Figure 9: Operating Margin



Source: KGI Research

Figure 10: Rolling PB



Source: KGI Research

Balance sheet

RMBmn	Dec-15A	Dec-16A	Dec-17A
Total assets	1,089	1,394	1,332
Current assets	611	888	839
Cash & ST securities	140	230	233
Inventory	79	128	149
Accounts receivable	287	438	413
Other current assets	105	92	44
Non-current assets	478	506	493
LT investments	108	108	113
Net fixed assets	16	23	57
Total other assets	354	375	323
Total liabilities	402	755	691
Current liabilities	372	727	665
Accounts payable	167	272	242
Interest bearing ST liabilities	168	311	413
Other current liabilities	38	144	10
Non-current liabilities	30	28	26
Long-term debt	-	-	-
Other L-T liabilities	30	28	26
Total equity	687	639	642
Shareholders' funds	591	524	553
Minority interests	96	115	89
Preferred shareholders funds	-	-	-

Key ratios

	Dec-15A	Dec-16A	Dec-17A
Growth			
Revenue growth		47.6%	(2.1%)
Operating profit growth		94.8%	(0.0%)
EBITDA growth		88.7%	2.7%
Net profit growth		19.3%	8.7%
EPS growth		22.3%	14.0%
Profitability			
Gross profit margin	31.8%	30.7%	31.3%
Operating margin	6.9%	9.1%	9.3%
EBITDA margin	7.4%	9.5%	10.0%
Net profit margin	5.5%	4.5%	5.0%
Return on average assets		3.8%	3.7%
Return on average equity		8.4%	9.5%
Stability			
Gross debt to equity	24.4%	48.7%	64.4%
Net debt to equity	4.0%	12.7%	28.1%
Interest coverage (x)	4.3	7.9	4.2
Interest & ST debt coverage (x)	0.2	0.2	0.1
Cash flow interest coverage(x)	6.5	(0.3)	2.8
Cash flow/int. & ST debt (x)	0.6	(0.0)	0.2
Current ratio (x)	1.6	1.2	1.3
Quick ratio (x)	1.4	1.0	1.0
Net debt (RMBmn)	27	81	180
Per share data			
EPS (RMB)	0.06	0.07	0.08
CFPS (RMB)	0.15	(0.01)	0.11
BVPS (RMB)	0.86	0.80	0.89
SPS (RMB)	1.04	1.58	1.62
EBITDA/share (RMB)	0.08	0.15	0.16
DPS (RMB)	0.01	0.03	0.03
Activity			
Sales / avg assets		0.85	0.76
Davs receivable	146.9	152.1	146.1

Profit & loss

RMBmn	Dec-15A	Dec-16A	Dec-17A
Revenue	714	1,054	1,031
Cost of goods sold	(487)	(730)	(708)
Gross profit	227	324	323
Other operating income	(7)	(3)	24
Operating expenses	(171)	(225)	(251)
Operating profit	49	96	96
Other exceptional items	-	-	-
Income from associates	18	6	14
Interest expense	(16)	(13)	(26)
Pre-tax profit	51	89	83
Current taxation	(12)	(22)	(17)
Minorities	(8)	(20)	(15)
Extraordinary items	8	-	-
Net profit	39	47	51
EBITDA	53	100	103
EPS (RMB)	0.06	0.07	0.08

Cash flow

RMBmn	Dec-15A	Dec-16A	Dec-17A
Operations cash flow	103	(4)	72
Operating profit	49	96	96
Depreciation & amortisation	4	4	7
Decrease in working capital	61	25	(112)
Other operating cashflow	16	(94)	125
Interest paid	(16)	(13)	(26)
Tax paid	(12)	(22)	(17)
Investing cash flow	(168)	(18)	24
Sale of ST investment	-	84	65
New investments	-	-	-
Capital expenditure	(6)	(11)	(40)
Others investing cashflow	(162)	(90)	(1)
Free cash flow	96	90	(70)
Financing cash flow	(1)	121	(83)
Increase in short term debt	(61)	144	112
Increase in long term loans	-	-	-
New ordinary shares issued	-	-	-
Ordinary dividends paid	-	(8)	(16)
Other financing cashflow	60	(15)	(179)
Total cash generated	(66)	99	13

ROIC

	Dec-15A	Dec-16A	Dec-17A
1 - COGS/revenue	31.8%	30.7%	31.3%
- Operating exp./revenue	23.9%	21.3%	24.4%
= Operating margin	6.9%	9.1%	9.3%
1 / (Working capital/revenue + Net PPE/revenue + Other assets/revenue)	0.4 0.0 0.5	0.2 0.0 0.4	0.3 0.1 0.3
= Capital turnover	1.1	1.6	1.4
Operating margin	6.9%	9.1%	9.3%
x Capital turnover	1.1	1.6	1.4
x (1 - tax rate)	76.7%	75.7%	79.8%
= After-tax ROIC	5.9%	11.3%	10.4%

Source: Company data, KGI Research estimates

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KGI Ratings

Rating	Definition
Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return* of the KGI coverage universe in the related market over a 12-month investment horizon.
Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return* of the KGI coverage universe in the related market over a 12-month investment horizon.
Underperform (U)	We take a negative view on the stock. The stock is expected to underperform the expected total return* of the KGI coverage universe in the related market over a 12-month investment horizon.
Not Rated (NR)	The stock is not rated by KGI Securities.
Restricted (R)	KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances.
	Total return = (12M target price - current price) / current price

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