

Proya Cosmetics (603605 CH)

On track to synergize its R&D franchise, hero products and live-streaming distribution

With warehouse spreading across Hangzhou, Chengdu, Guangzhou and 85% of sales deriving from ecommerce platforms, Proya, in our view, is relatively less impacted by recent lockdowns in Shanghai and Beijing, and hence better earnings certainty for 2Q. On the other hand, the expense related to the recall for its sunblocker could have weighted on Proya's 2Q performance. That said, considering a solid 618 sales momentum and a more controlled promotional expense (to intentionally buffer for the recall), we think Proya is on track to deliver a 2Q that is inline with its full year guidance. Longer term, we are convinced that Proya's 1) hero product strategy, 2) deepening ecommerce platforms penetration, and 3) proprietary R&D capability, will not only enable the company to persistently manage through the pandemic cycles (as it has been since early 2020), but also serves as the winning combo to sustain market share gain. We project an industry-beating 26% 3-year revenue CAGR for 2021-24E, underpinned by 31% growth in its online business, along with a 1.3pp GPM expansion p.a. We initiate Proya with BUY. Proya is our top pick along with Botanee.

- **An irreplicable R&D capability as a strong backup of Proya's marketing strategies.** Proya sets up a new R&D center in Shanghai to gain better access to industry talents. The office will also be responsible for the research on new product formula and raw material experiments. Meanwhile, a research hub/hair care centre will also be established in Japan for the "Off & Relax" brand over 2H22. We think Proya is on a right track to synergize its irreplicable R&D capability with its hero products (Ruby and Double Essence) as well as live-streaming distribution, and hence a self-sustaining tangle between the three.
- **Management guidance maintained despite the strict pandemic controls.** Proya is still confident to achieve 20-30% top line growth with 40%+ growth from online business (implying offline to down by mid-teens). This comes with a similar net profit growth trajectory when a small gross margins expansion is partially offset by a higher opex ratio, in our view.
- **Valuation.** The stock is trading at 43.6 P/E. Our TP is based on 43.5x mid-23E P/E which represents +1sd above the average valuation since 2019, when the market began to re-rate Proya in view of the rising support in domestic brands, and subsequently a timely online migration amid the outbreak of COVID-19.

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	3,752	4,633	5,812	7,337	9,181
YoY growth (%)	20.1	23.5	25.4	26.2	25.1
Net income (RMB mn)	514	627	724	976	1,249
EPS (RMB)	2.4	2.9	3.6	4.9	6.2
YoY growth (%)	20.9	21.2	25.6	34.8	28.0
Consensus EPS (RMB)	N.A	N.A	3.8	5.3	6.5
P/E (x)	N.A	N.A	43.5	32.3	25.3
P/B (x)	N.A	N.A	9.2	7.6	6.2
Yield (%)	0.4	0.5	0.7	0.9	1.2
ROE (%)	21.5	21.8	21.4	24.0	25.3
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Initiation)

Target Price	RMB184
Up/Downside	+17.5%
Current Price	RMB157

China Consumer Staples – Household and Personal Care

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Stock Data

Mkt Cap (RMB mn)	44,238
Avg 3 mths t/o (RMB mn)	232.7
52w High/Low (RMB)	165.6/ 107.1
Total Issued Shares (mn)	281
Source: Bloomberg	

Shareholding Structure

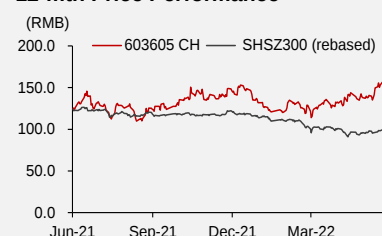
Hou Juncheng	34.7%
HKSC	19.4%
Fang Yuyou	18.1%
Source: Bloomberg	

Share Performance

	Absolute	Relative
1-mth	11.8%	5.5%
3-mth	26.5%	24.8%
6-mth	11.4%	25.8%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

A closer look on Proya

- Proya's "Morning C Night A" formula is gaining traction.** "Morning C Night A" formula refers to the skin care process that consists of using products containing types of vitamin C, such as prototype VC, VC derivatives, in the morning for whitening treatment, and using products containing types of vitamin A (retinoids), such as retinol (视黄醇), retinal (视黄醛), retinyl (视黄酯), in the evening for regenerating/ anti-aging treatment. Thanks to the rise of knowledge-sharing social platforms and push by cosmetics brands, the "Morning C Night A" formula gained high popularity in China in recent years. Proya was one of the first-movers to grasp the business opportunity from such trend, and also one of major promoters of the concept in China. The company launched Proya Deep Ocean Energy Wrinkless and Firming Essence ("Red Ruby Essence") for anti-aging treatment and Proya Double-anti Elastic Brightening Youth Essence ("Double-anti Essence") for anti-aging of relatively younger skin in 2020, which later became two important hero products for the company. The sales volume of Proya Red Ruby Essence ranked no.2 among anti-aging serum/ essences on Tmall, only behind EL's ANR serum. The product contains three core ingredients: 20% hexapeptide, 1% supramolecular retinol and three types of rare seaweed extracts. The supramolecular retinol is Proya's proprietary ingredient, which is less irritative while having the same anti-aging efficacy than traditional retinol, therefore allowing for better user experience and increasing the product's suitability for sensitive skin. The initial success of the core products was followed by steady product upgrade and product portfolio expansion. The company launched the 2.0 version for the two core essences in 2021 and enlarged the Red Ruby series with eye cream, the Double-anti series with eye cream, mask, foundation, the essence family with Proya Deep Ocean Invigorate & Renew Essence ("Roe Essence") etc. We believe such strength in product innovation would allow Proya to keep outperforming the industry in longer-term.

Figure 1: Evolution of Proya's hero products

Feb-20		Nov-20		May-21					
Red Ruby Essence 1.0		Red Ruby Cream		Red Ruby Essence 2.0					
Deep Ocean Energy Series ("Red Ruby Series")	Addition of 20% hexapeptide, 1% proprietary supramolecular retinol Wrinkles-reducing effect		Addition of 5 types of peptide Boost the regeneration of collagen		Replacement of hexapeptide-8 with hexapeptide-1 Enhance wrinkle-reducing effect Addition of retinol booster				
Apr 2020		Jul 2020		Mar 2021		Apr 2021		Aug 2021	
Double-Anti Essence 1.0		Double-Anti Eye Cream		Double-Anti Oil-Control Foundation		Double-Anti Essence 2.0		Double-Anti Mask	
Proya Elastic Brightening Youth Series ("Double-Anti Series")									
	Anti-oxidation, anti-glycation effect Addition of ergothione, astaxanthin and camosine	Addition of bacillus extract, compound caffeine on the back of the base formula of Double-Anti Series	Based on Double-Anti Series core formula Anti-oxidation and anti-glycation effect Long-lasting makeup	Upgrade in 4 dimensions: 1. Enhanced anti-oxidation effect, with combination of ergothione, EuK-134, Lipochroman-6, astaxanthin; 2. Enhanced anti-glycation effect; 3. Help improve skin tone; 4. Improved user sensation, with a lighter texture	Based on Double-Anti Series core formula, with 4 key anti-oxidation ingredients: ergothione, EuK-134, Lipochroman-6, astaxanthin				

Source: Company data, CMBIGM research

- **Notable progresses in ingredients know-how in recent years.** As of 2021, among major domestic cosmetic brand owners, Jahwa, Proya and Jala took the lead in terms of number of patents (374, 201 and 168, respectively). Meanwhile Proya owned the highest number of patents for invention. Of note, invention license is regarded as more difficult to obtain considering a longer time for approval and lower approval rate. According to company data, Proya had 92 patents for invention (30+ among these on ingredient carrier technology) by 2021, which accounted for 46% of the total. It was followed by Jahwa (89 or 24% of the total) and Bloomage (89 or 54% of the total). Proya has made notable progresses especially in cosmetic ingredients-related technology in the past decade, as a result of continued efforts in independent R&D and cooperation with global giants in specific areas. We highlight here below some of the key steps the company completed to build up its technological strength.
- **Proya set up its R&D center in 2012**, a relative early-mover among its domestic peers. The company kept seeking cooperation with global giants in specific areas within the cosmetic industry chain, which was, in our view, a key strategy for Proya to catch-up with its foreign peers. Prior to 2017, the company started to devote efforts in functional skin care segment, which was regarded as a key potential future growth engine by then. Proya strived to expand in the segment through the development of ingredients with high skin care, especially anti-aging, efficacy, and later the introduction of hero products based on such ingredients. The company's R&D team eventually selected retinol and hex peptide as the key ingredients to add into and market for its new functional product series.
- **In our view, the development of retinol-based products has been a smart choice** for Proya to penetrate and differentiate itself in the anti-aging segment, as retinol is the only ingredient officially certified by FDA for its efficiency to resist static wrinkles. However, given the complexity of commercial application, retinol-based essence was not widely used, and that makes Proya to stand out from its peers through its proprietary supramolecular retinol technology. On the other hand, hex peptide would be a good complementary to retinol, as it is efficient to resist dynamic wrinkles.
- **In 2019, Proya tied up its cooperation relationship with LipoTrue**, a globally renowned biotech laboratory specialized in the development of advanced active ingredients. The Hexapeptide Botox, which is a highly efficient anti-wrinkle ingredient, was applied in several products of the leading Spanish anti-aging brand SingulaDerm. The cooperation would ensure Proya with a more secure supply of hexapeptide. Proya also developed the method to measure the concentration of hexapeptide to support its marketing claims and help build the image of a professional brand.
- **On the back of these technical know-how, Proya launched its three core functional skin care products in 2020**, Proya Advanced Original Repair Concentrating Essence for barrier repairing ("Original Essence"), Proya Deep Ocean Energy Wrinkless and Firming Essence ("Red Ruby Essence") for anti-aging treatment, Proya Double-anti Elastic Brightening Youth Essence ("Double-anti Essence") for anti-aging of relatively younger skin.

Figure 2: Proya has a high portion of patents for invention among major domestic cosmetic companies

Company	Ticker	Main brands	N. of patents	N. of patents for invention	N. of patents for new application	N. of patents for appearance
Jahwa	600315 CH	Herborist, Dr Yu	374	89	26	265
Proya	603605 CH	Proya, TIMAGE	201	92	19	90
Bloomage	688363 CH	Biohyalux, Quadha	166	89	49	28
Lafang	603630 CH	Lafang, Raclen	139	74	1	64
Green Pine	300132 CH	Nox Bellcow	99	29	58	12
Botanee	300957 CH	Winona, Winona Baby, Zirun	80	22	31	27
Yatsen	YSG US	Perfect Diary, Little Ondine	50	0	1	49
Marubi	603983 CH	Marubi, Haruki	146	81	0	65
Imeik	300896 CH	EME, Ifresh	45	25	0	20
Syoung	300740 CH	Unifon, Xiaomihu, YuMen	29	17	0	12
Jala	Not listed	Chando, Springsummer	168	41	5	122
Chicmax	Not listed	Kans, One Leaf	62	0	3	52
Huanya	Not listed	Meifubao, Seeyoung	138	63	15	60
Pechoin	Not listed	Pechoin, Sansen	66	0	2	64
Yige	Not listed	Florasis, OGP	98	6	21	71
Dr Plant	Not listed	Dr Plant	93	7	8	78
Total	-	-	1954	635	239	1319

Source: Company data, CMBIGM

Note: as of 2021.

- **In 2021, Proya established its cooperation with Ashland**, which is a global leading provider of special materials, as to further enhance the company's strength in ingredients R&D and procurement. Ashland will provide exclusive 100% natural ingredient research for Proya which includes anti-oxidant and anti-aging formulae. Besides, Proya has also set up cooperation relationship with other global chemical giants including BASF, DSM, Croda, to keep improving the efficacy of ingredients.
- **A pioneer in blockbuster creation and omni-channel marketing**. Proya was one of the first-movers, among both major domestic and foreign players, in building an in-house EC team, initiating KOL marketing on emerging social platforms which helped ensure a relatively high efficiency and profitability of its LS operations. For instance, the company set up its in-house EC team to penetrate Taobao channel as early as in 2012. On the other hand, Proya started to proactively operate on emerging platforms, such as TikTok and Little Red Book, in 2018, which worked well with its hero product strategy. Proya's "Bubble Mask" was the earliest example of a hero product dated. The product achieved the highest monthly sales on Tmall with 1mn+ unit being sold in a single month in 2019. Proya manipulated the same winning formula and launched the "Morning C Night A" combo later in 2020.

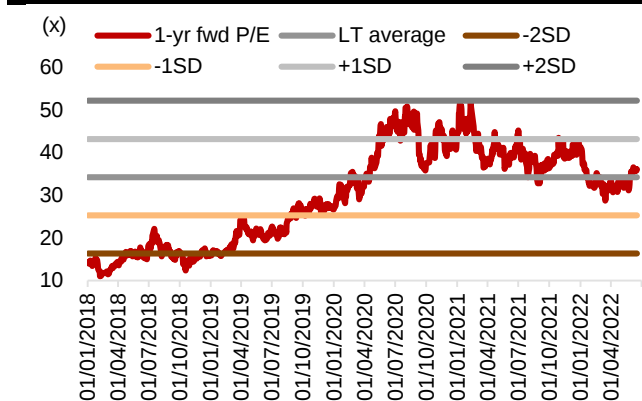
Valuation and risks

- The stock is trading at 43.6 P/E. Our TP is based on 43.5x mid-23E P/E which represents +1sd above the average valuation since 2019, when the market began to re-rate Proya in view of the rising support in domestic brands, and subsequently a timely online migration amid the outbreak of COVID-19.

Investment risks

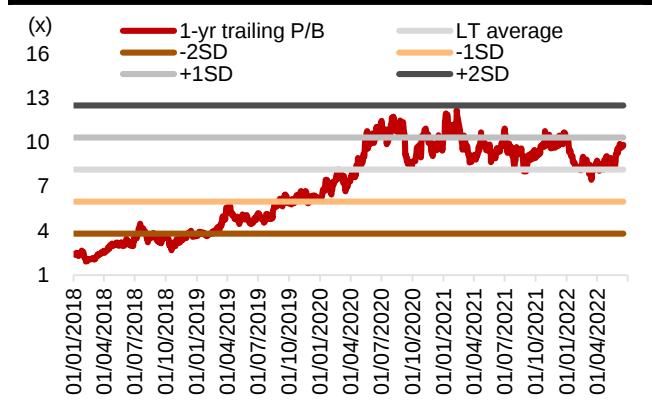
- Failure in further executing its hero product strategy, product recalls, undisciplined promotional efforts among domestic/ foreign brands.

Figure 3: Proya - 12M forward P/E band



Source: Company data, Bloomberg, CMBIGM estimates

Figure 4: Proya - 12M trailing P/B band



Source: Company data, Bloomberg, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	3,752	4,633	5,812	7,337	9,181
Skincare and cleanser	3,242	3,978	4,893	6,019	7,343
Makeup	465	618	876	1,269	1,780
Gross profit	2,385	3,079	3,966	5,109	6,510
D&A	(88)	(96)	(69)	(92)	(120)
Selling expense	(1,497)	(1,992)	(2,586)	(3,338)	(4,269)
Administration expenses	(204)	(237)	(291)	(367)	(459)
Other operating expenses	(17)	(21)	(98)	(119)	(145)
EBIT	578	733	921	1,193	1,517
EBITDA	666	829	991	1,285	1,637
Finance costs, net	14	7	7	7	7
Other income/(expense)	(127)	(161)	(156)	(161)	(197)
Non-operating	(5)	(7)	(4)	-	-
Pre-tax profit	548	668	839	1,131	1,448
Income tax	(96)	(111)	(139)	(188)	(240)
Less: Minority interests	(24)	(19)	(24)	(32)	(41)
Net profit	514	627	724	976	1,249

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net income	452	557	700	944	1,208
D&A	88	96	69	92	120
Change in working capital	(50)	70	(101)	(125)	(324)
Others	(158)	107	22	10	16
Net cash fr. operating act.	332	830	690	920	1,020
Capex & investments	(184)	(194)	(243)	(307)	(385)
Investments	134	(70)	(126)	(159)	(199)
Others	65	(78)	-	-	-
Net cash fr. investing act.	15	(342)	(369)	(466)	(584)
Equity raised	2	1	-	-	-
Change of Debts	85	648	(60)	(60)	(10)
Dividend paid	(128)	(154)	(195)	(255)	(334)
Others	(3)	(5)	(0)	(0)	(0)
Net cash fr. financing act.	(43)	490	(255)	(315)	(343)
Net change in cash	303	977	66	139	93
Cash at the beginning of the year	1,247	1,417	2,391	2,457	2,596
Exchange difference	0	(1)	-	-	-
Cash at the end of the year	1,550	2,393	2,457	2,596	2,689
Less: pledged cash	(133)	(2)	-	-	-

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Non-current assets	1,294	1,474	1,774	2,149	2,613
PP&E/Fixed assets	566	559	756	1,000	1,301
Net intangibles	315	397	501	631	794
Total current assets	47	109	109	109	109
Other non-current assets	367	409	409	409	409
Current assets	2,342	3,159	3,427	3,718	4,283
Cash	1,417	2,391	2,457	2,596	2,689
Account receivable	285	139	239	261	579
Prepayments	83	58	73	90	110
Inventory	469	448	522	618	733
Other current assets	90	123	135	152	171
Current liabilities	1,129	1,025	1,064	1,009	1,123
Borrowings	299	200	150	100	100
Accounts payable	580	483	556	549	659
Other payables	178	252	268	269	274
Tax payables	71	90	90	90	90
Non-current liabilities	26	721	721	721	721
Borrowings	-	-	-	-	-
Deferred tax liabilities	10	11	11	11	11
Other non-current liabilities	15	710	710	710	710
Minority Interest	90	10	34	66	107
Total net assets	2,482	2,887	3,416	4,137	5,052
Shareholders' equity	2,392	2,877	3,382	4,070	4,944

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Sales mix (%)	100.0	100.0	100.0	100.0	100.0
Skincare and cleanser	86.4	85.9	84.2	82.0	80.0
Makeup	12.4	13.3	15.1	17.3	19.4
P&L ratios (%)					
Gross margin	63.6	66.5	68.2	69.6	70.9
Operating margin	15.4	15.8	15.9	16.3	16.5
Pre-tax margin	14.6	14.4	14.4	15.4	15.8
Net margin	13.7	13.5	12.5	13.3	13.6
Effective tax rate	(17.5)	(16.6)	(16.6)	(16.6)	(16.6)
Balance sheet analysis					
Current ratio (x)	0.6	0.8	0.7	0.7	0.6
Net receivable days	28	11	15	13	23
Net payable days	155	113	110	90	90
Inventory turnover days	125	105	103	101	100
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash
Returns (%)					
ROE	21.5	21.8	21.4	24.0	25.3
ROA	14.1	13.5	13.9	16.6	18.1
Dividend yield	0.4	0.5	0.7	0.9	1.2
Per share					
EPS (RMB)	2.4	2.9	3.6	4.9	6.2
DPS (RMB)	0.7	0.9	1.1	1.5	1.9
BVPS (RMB)	12.3	14.4	17.0	20.6	25.1

Source: Company data, CMBIGM estimates

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