Monday, July 25, 2022

Company Report

China Merchants Securities (HK) Co., Ltd.
Hong Kong Equity Research

3S Bio (1530 HK)

COVID-19 to weigh on sales in 2Q22

- **We expect 1H22E results is negatively impacted by outbreak in 2Q22; but Mandi sales will likely continue to be a surprise**
- **We trimmed adj. NP by -1%/-3% in FY22E/23E to mainly reflect our lowered revenue forecast**
- **Co. trades at 7X/6X FY22E/23E PER, at the lowest quantile within its historical PER band. Maintain BUY with trimmed TP at HKD11.4**

COVID-19 to weigh on TPO/YSP sales 1H22E

We expect the COVID-19 disruption likely to weigh on **TPO/YSP** sales in 1H22E given their reliance on hospital channel. We thus revised down 1H22E sales forecast for TPO/YSP to +5%/-5% yoy (vs our prior estimates of +10%/+0% yoy). That said, we believe Co. can manage to deliver its full year sales target for TPO/YSP (low teen growth/flat sales yoy), representing +15%/+6% yoy sales growth in 2H22E, respectively. This is due to 1) Omicron impacts wane and hospitals are on track to return normalcy in 2H22E; 2) Guangdong-led VBP only accounted for ~25% of YSP's sales in 2021. Meanwhile, for TPO's NRDL renewal in YE22E, we expect a moderate price cut (~15% ASP reduction) given the new NHSA renewal rules. In our base case, we reckon TPO still can manage to deliver a low teen sales growth in 2023E, driven by improving penetration in mass market and label expansion.

Eyes on Mandi growth

We expect Mandi sales growth to remain robust in 1H22E, given Mandi's successful omni-channel distribution less impacted by the outbreak disruptions in 2Q22E. Mandi now has 1) more than 2mn online customers with ~70% of which were new customers in FY21 and still fast growing, and continued increase of female users, and 2) coverage of ~65,000 retail pharmacies in FY21 (or only ~10% penetration rate) and still quickly expanding. We now model an overall ~+50% yoy (vs. our prev. estimates of 30% yoy) sales growth or ~RMB400mn in 1H22E, o/w ~+50%/+100% sales growth from e-commerce/retail pharmacy channel.

Maintain BUY with SOTP-based TP revised down to HKD11.4

We trimmed adj. NP by -1%/-3% in FY22E/23E to mainly reflect our lowered revenue forecast for YSP and TPO, partly offset by lower SG&A expenses in FY22E. We also revised down SOTP-based TP to HKD11.4 from HKD11.7 to reflect changes in our earnings forecast. We think Co.'s risk/reward is attractive given 1) Co. trades at 7X/6X FY22E/23E PER, at the lowest quantile within its historical PER band; and 2) its pipeline upgrades to trigger potential re-rate (10+ potential NDA approvals/label expansions in 2022E-25E). **Key risks:** regional VBPs, NRDL renewal, COVID-19, etc.

RMB mn	2019	2020	2021	2022E	2023E
Revenue	5,318	5,588	6,382	7,291	8,714
Growth	16%	5%	14%	14%	20%
Adj. net income	1,202	1,451	1,769	1,847	2,142
Growth	-17%	21%	22%	4%	16%
Adj. EPS (HKD)	0.54	0.66	0.80	0.84	0.97
P/E (x)	10.5	8.7	7.1	6.8	5.9
P/B (x)	1.2	1.0	0.9	0.8	0.7

Sources: Company, CMS (HK) estimates, Notes: derived from reported NP after excl. one-off items & CB interest expenses; closing price as of July 25, 2022

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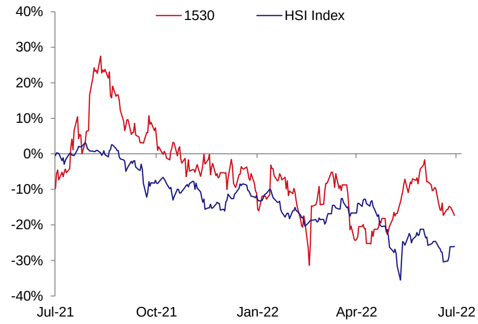
WHAT'S NEW

1H22 results preview; TP revision

BUY

Previous	BUY
Price (July 25, 2022)	HKD5.6
12-month Target Price (Potential up/downside)	HKD11.4 (+104%)
Previous	HKD11.7

Price Performance



Source: Bloomberg

%	1m	6m	12m
1530 HK	(13.6)	(7.0)	(17.3)
HSI	(6.2)	(16.3)	(26.1)

Sector: Pharmaceutical & Healthcare	
Hang Seng Index (July 25, 2022)	20,563
HSCEI (July 25, 2022)	7,077
Key Data	
52-week range (HKD)	4.7-8.9
Market cap (HKD mn)	13,658
Avg. daily traded value (HKD mn)	43.3
BVPS (HKD)	7.2
Shareholding Structure	
Founder and management	27.5%
CITIC PE	11.0%
BlackRock	9.0%
Free float	52.5%

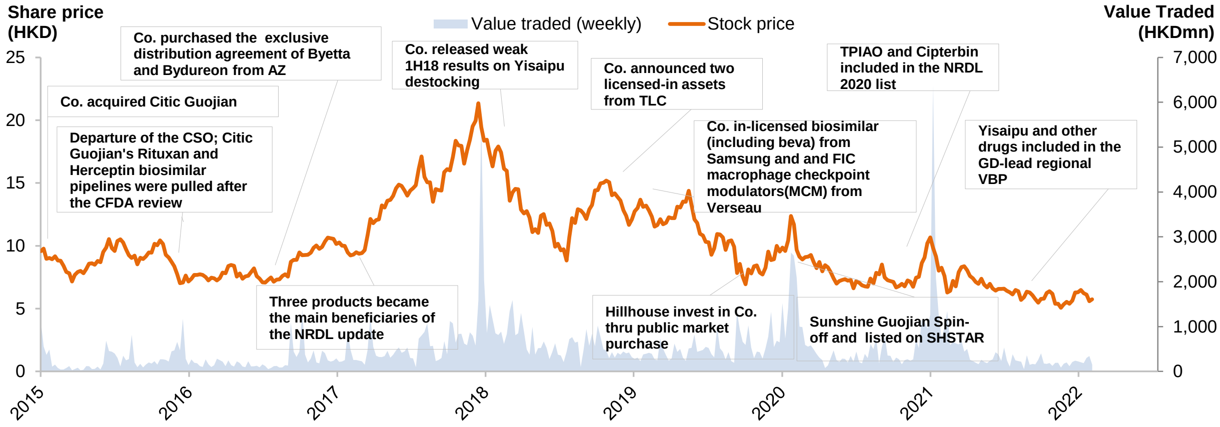
Sources: Company, Bloomberg

Related Research

1. 3SBio (1530 HK) – Regional VBPs to weigh on YSP, eyes on Mandi growth (BUY) (May 5, 2022)
2. 3SBio (1530 HK) – GPM proves resilient amid price risks (BUY) (September 7, 2021)
3. 3SBio (1530 HK) – On track towards pipeline upgrades (BUY) (April 15, 2021)

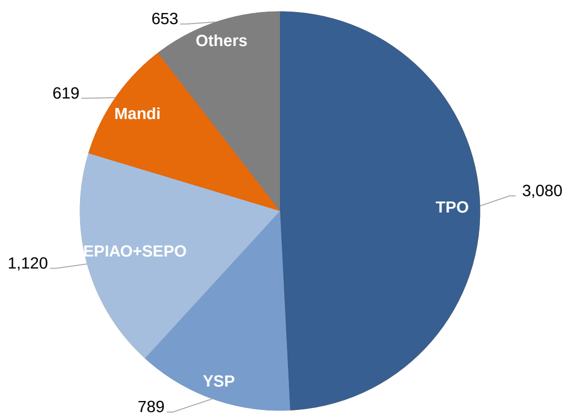
Focus charts

Figure 1: 3S Bio's historical price performance



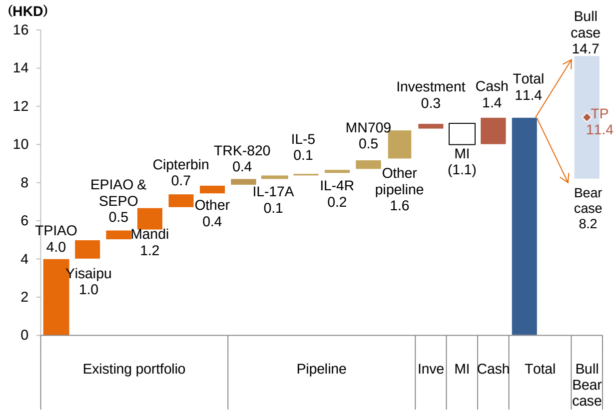
Sources: Bloomberg, CMS (HK)

Figure 2: 2021 revenue breakdown (RMB mn)



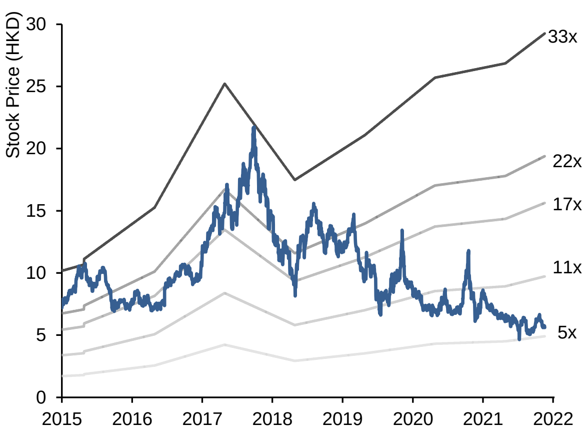
Sources: Company data, CMS (HK)

Figure 3: End-FY22E NAV breakdown



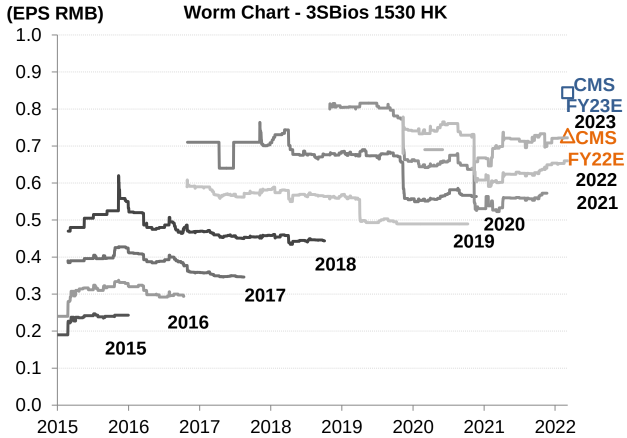
Sources: Company data, CMS (HK) estimates

Figure 4: P/E band



Sources: Bloomberg, CMS (HK)

Figure 5: Consensus worms



Sources: Bloomberg, CMS (HK) estimates

Financial forecast revisions

Figure 6: Financials forecast revision

RMB (mn)	2022E			2023E		
	Before	After	change	Before	After	change
Total Revenue	**7,415**	**7,291**	**-2%**	**8,820**	**8,714**	**-1%**
Cost of sales	(1,361)	(1,357)	0%	(1,669)	(1,723)	3%
Gross profit	**6,054**	**5,935**	**-2%**	**7,151**	**6,991**	**-2%**
SG&A expenses	(3,114)	(3,026)	-3%	(3,705)	(3,660)	-1%
Selling costs	(2,670)	(2,588)	-3%	(3,175)	(3,137)	-1%
General & Admin expenses (ex. R&D)	(445)	(437)	-2%	(529)	(523)	-1%
Research and development	(890)	(875)	-2%	(988)	(959)	-3%
Operating profit	2,050	2,034	-1%	2,459	2,372	-4%
Other income (net)	0	0	n.a.	0	0	n.a.
Finance costs	45	45	0%	72	73	1%
Share of losses of associates	(50)	(50)	0%	(60)	(60)	0%
EBITDA	2,784	2,765	-1%	3,291	3,191	-3%
Profit Before Taxes	**2,044**	**2,028**	**-1%**	**2,471**	**2,385**	**-3%**
Income Tax	(286)	(284)	-1%	(358)	(346)	-3%
Tax rate	14%	14%	0%	15%	15%	0%
Non-controlling interest	35	35	0%	35	35	0%
Net income	**1,793**	**1,779**	**-1%**	**2,148**	**2,074**	**-3%**
Adj. Net income	**1,861**	**1,847**	**-1%**	**2,216**	**2,142**	**-3%**
Adj. EPS (RMB)	**0.73**	**0.73**	**-1%**	**0.87**	**0.84**	**-3%**
Profitability(%)			**p.p.t**			**p.p.t**
Gross margin	*82%*	*81%*	*-0.3*	*81%*	*80%*	*-0.9*
Operating margin	*28%*	*28%*	*0.2*	*28%*	*27%*	*-0.7*
Profit before tax margin	*28%*	*28%*	*0.2*	*28%*	*27%*	*-0.6*
Net margin	*24%*	*24%*	*0.2*	*24%*	*24%*	*-0.5*
Growth (%)						
Total Revenue	*13%*	*14%*	*1.3*	*19%*	*20%*	*0.6*
Gross profit	*12%*	*12%*	*0.3*	*18%*	*18%*	*-0.3*
Operating profit	*13%*	*11%*	*-1.5*	*20%*	*17%*	*-3.3*
Adj. Net Income	*11%*	*4%*	*-6.1*	*19%*	*16%*	*-3.1*
Adj. EPS	*11%*	*4%*	*-6.1*	*19%*	*16%*	*-3.1*

Source: CMS (HK) estimates

Valuation

Figure 7: SOTP valuation

(RMB mn)	Previous	Revised	Chg%
Core portfolio drug (rNPV)			
Existing portfolio	**17,367**	**16,904**	**-3%**
TPIAO (TPO)	8,911	8,593	-4%
Yisaipu (YSP)	2,269	2,183	-4%
EPIAO/SEPO (EPO)	1,129	1,083	-4%
Mandi	2,467	2,529	2%
Cipterbin (HER-2 mAb)	1,630	1,560	-4%
Others	960	956	0%
Pipeline portfolio	**6,531**	**6,335**	**-3%**
TRK-820 (Nalfurafine hydrochloride)	809	761	-6%
608 (IL17A)	310	296	-4%
610 (IL5)	304	291	-4%
611 (IL4R)	465	446	-4%
MN709 (Minoxidil foam)	1,062	1,077	2%
Other pipeline	3,582	3,464	-3%
Add: investment	651	651	0%
Less: MI	-2,395	(2,395)	0%
Add: Net cash	3,056	3,068	0%
Equity value (RMB mn)	**25,209**	**24,562**	**-3%**
Equity value (HKD mn)	**29,747**	**28,983**	**-3%**
TP (HKD)	**11.7**	**11.4**	**-3%**

Sources: Company data, CMS (HK) estimates

Financial Summary

Balance Sheet

RMB mn	2019	2020	2021	2022E	2023E
Total cash and time deposits	2,083	3,091	2,868	3,570	5,203
ST receivables	1,018	983	1,379	1,438	1,504
Inventories	528	620	691	818	1,039
Other current assets	945	1,861	2,669	2,669	2,669
Total current assets	**4,596**	**6,680**	**7,791**	**8,679**	**10,599**
Property. plant & equipment	1,989	2,621	3,440	4,096	4,487
Other assets	1,784	2,340	2,008	1,958	1,898
Other intangible assets	6,311	5,817	5,693	5,545	5,409
Deferred tax assets	129	219	280	280	280
Total non-current asset	**10,213**	**10,998**	**11,422**	**11,880**	**12,074**
Total assets	**14,809**	**17,678**	**19,213**	**20,559**	**22,673**
Trade and other payables	150	203	230	279	354
Bank loans	484	360	150	150	150
Tax payable	21	58	74	74	74
Other current liabilities	957	830	966	966	966
Total current liabilities	**1,612**	**1,451**	**1,420**	**1,468**	**1,544**
Bank loans	13	53	164	164	164
Convertible bond	2,305	2,461	2,272	2,272	2,272
Deferred income	242	308	397	397	397
Deferred tax liabilities	268	272	264	264	264
Other liabilities	10	38	38	38	38
Total non-current liabilities	**2,838**	**3,134**	**3,135**	**3,135**	**3,135**
Total liabilities	**4,450**	**4,585**	**4,555**	**4,603**	**4,678**
Reserves	5,317	6,391	8,075	9,408	11,482
Share premium	4,308	4,298	4,152	4,152	4,152
Minority interest	734	2,404	2,430	2,395	2,360
Total equity	**10,359**	**13,093**	**14,658**	**15,956**	**17,995**
Total liabilities & equity	**14,809**	**17,678**	**19,213**	**20,559**	**22,673**

Cash flow Statement

RMB mn	2019	2020	2021	2022E	2023E
PBT	1,223	979	1,869	2,028	2,385
Cash generated before WC change	1,898	1,900	2,198	2,404	2,768
Working capital	344	(302)	(332)	(138)	(211)
Cash generated from operations	2,243	1,599	1,865	2,265	2,556
Tax paid	(355)	(254)	(287)	(284)	(346)
Interest paid	(38)	(196)	(6)	45	73
Cash from operating activities	**1,849**	**1,148**	**1,572**	**2,026**	**2,283**
Capital expenditure	(471)	(893)	(1,029)	(1,000)	(800)
Interest received	68	35	89	122	150
Others	(731)	(1,012)	(346)	-	-
Cash from investing activities	**(1,134)**	**(1,869)**	**(1,287)**	**(878)**	**(650)**
Issue of shares	7	1	(220)	-	-
Change in bank borrowing	1,230	502	270	-	-
Dividends paid to the owners	(16)	-	-	(446)	-
Others	(1,637)	1,244	(525)	-	-
Cash from financing activities	**(416)**	**1,747**	**(475)**	**(446)**	**-**
Effect of FX rate changes	(9)	(18)	(33)	-	-
Net Change in cash	**299**	**1,026**	**(189)**	**702**	**1,633**
Cash - beginning balance	1,793	2,083	3,091	2,868	3,570
Cash - ending balance	**2,083**	**3,091**	**2,868**	**3,570**	**5,203**

Sources: Company data, CMS (HK) estimates

Profit & Loss Statement

RMB mn	2019	2020	2021	2022E	2023E
Revenue	**5,318**	**5,588**	**6,382**	**7,291**	**8,714**
Cost of sales	(925)	(1,063)	(1,106)	(1,357)	(1,723)
Gross profit	**4,393**	**4,525**	**5,276**	**5,935**	**6,991**
Other income	20	(456)	47	-	-
Selling expenses	(1,951)	(2,020)	(2,324)	(2,588)	(3,137)
Admin expenses	(676)	(453)	(371)	(437)	(523)
Research and development	(527)	(590)	(754)	(875)	(959)
Operating profit	**1,260**	**1,462**	**1,826**	**2,034**	**2,372**
EBITDA	1,866	2,034	2,374	2,765	3,191
Financial expenses	(26)	3	32	45	73
Associates	(11)	(30)	(37)	(50)	(60)
Other gain & loss	134	94	231	-	-
PBT	1,223	979	1,869	2,028	2,385
Income tax	(243)	(208)	(241)	(284)	(346)
Minority interest	(7)	65	24	35	35
Adj. net income*	**1,202**	**1,451**	**1,769**	**1,847**	**2,142**
Adj. EPS (RMB)	**0.47**	**0.57**	**0.70**	**0.73**	**0.84**
Adj. EPS (HKD)	**0.54**	**0.66**	**0.80**	**0.84**	**0.97**
DPS (HKD)	0.01	-	-	0.18	-
Dividend yield	**0.1%**	**0.0%**	**0.0%**	**3.1%**	**0.0%**

Notes: derived from reported net profit after excluding one-off items and CB interest expense.*

Financial Ratios

	2019	2020	2021	2022E	2023E
Growth (YoY)					
Revenue	16%	5%	14%	14%	20%
Gross profit	19%	3%	17%	12%	18%
Operating profit	-23%	16%	25%	11%	17%
Adj. net income	-17%	21%	22%	4%	16%
Adj. EPS	-28%	21%	22%	4%	16%
Margin					
Gross margin	83%	81%	83%	81%	80%
Operating margin	24%	26%	29%	28%	27%
Adj. net profit margin	18%	15%	26%	24%	24%
Efficiency					
Inventory days	208	213	228	220	220
Trade receivable days	70	64	79	72	63
Account payable days	59	70	76	75	75
Financial ratio					
Current ratio (x)	2.9	4.6	5.5	5.9	6.9
Quick ratio (x)	1.9	2.9	3.1	3.5	4.5
Net debt/equity	-16%	-21%	-19%	-22%	-28%
Dividend payout ratio	2%	0%	0%	25%	0%
ROA	7%	5%	9%	9%	9%
ROE	9%	6%	11%	11%	12%

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
NEUTRAL	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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