

### SECTOR UPDATE

## Internet Healthcare – China

Expecting Strong 2H22 Results Despite A Weak 2Q22

**An opinion draft on banning third-party platforms' direct participation in online drug sales has raised concerns over internet healthcare players' direct drug sales business. The companies expect no significant impact from potential regulations. Despite the weak 2Q22 results due to strict COVID-19 measures, we expect the companies' revenue to regain momentum in 2H22 and 2023, supported by easing of restrictions. Maintain MARKET WEIGHT on the internet healthcare sector.**

### WHAT'S NEW

- **According to a recent media report by 21st Century Business Herald**, China National Medical Products Administration (NMPA) released an opinion draft on an amendment bill for the Drug Management Law, stating that third-party platform providers should be banned from directly participating in online drug sales activities. It has completed the one-month consultation period. The report raised concerns that pharmaceutical e-commerce companies could possibly: a) be banned from doing direct drug sales business, or b) need to choose between their direct drug sales business and pharmaceutical e-commerce platform business.
- **Ping An Health (1833 HK)** expects a significant revenue decline of c.29% yoy in 1H22 and c.13-14% yoy in 2022, significantly impacted by China's strict COVID-19 measures in 2Q22.

### ESSENTIALS

- **Expecting limited impact from the opinion draft on internet healthcare companies.** We see that the direct drug sales business is crucial for internet healthcare companies like JD Health (6618 HK) and Ali Health (241 HK). The direct drug sales and e-commerce platform businesses contributed approximately 85% and 15% of JD Health's 2021 total revenue, and approximately 87% and 10% of Ali Health's FY22 total revenue. However, according to the management of the companies: a) they hold valid online drug sales licenses, and b) their online drug sales businesses are based on self-operated or third-party offline pharmacies. The companies indicated that their pharmaceutical e-commerce businesses are compliant with the opinion draft, and expect this regulation to have limited impact on internet healthcare companies.
- **Internet healthcare companies guided slower 2022/FY23 revenue growth, impacted by China's strict COVID-19 measures in 2Q22.** The 1H22 sales revenue growths of internet healthcare companies could be significantly impacted by the strict COVID-19 measures in Shanghai and many other cities in China in 2Q22. **Ping An Health (1833 HK)** expects a significant revenue decline in 1H22 due to: a) significant slowdown of its offline user acquisition activities and offline fulfilment of medical services in 2Q22 amid the COVID-19 outbreak, b) inefficient logistics for drug delivery due to the Zero-COVID policy in China, and c) a significant revenue decline in Group Purchasing Organization (GPO)-related business due to continuous strategy upgrades. The company guided a possible revenue decline of c.13-14% yoy for 2022 vs a previously guided revenue growth of c.6% yoy for 2022. **Ali Health (241 HK)** also guided a lower total revenue growth of approximately 20% yoy for FY23F to reflect the great uncertainty due to this year's COVID-19 outbreak in China.

### PEER COMPARISON

Company	Ticker	Rec	Price @ 27 Jun 22 (lcy)	Target Price (lcy)	Upside/ (Downside) to TP (%)	Market Cap (HK\$m)	P/S		P/B		EV/EBITDA		ROE 2022F (%)	Net Gearing 2022F (%)
							2022F (x)	2023F (x)	2022F (x)	2023F (x)	2022F (x)	2023F (x)		
Ping An Health	1833 HK	BUY	23.40	27.00	15.4	26,180.2	3.6	3.1	1.8	2.0	n.a.	n.a.	n.a.	-15.1
Ali Health	241 HK	HOLD	5.76	6.00	4.2	77,865.2	2.8	2.3	5.0	5.3	n.a.	n.a.	n.a.	-73.8
JD Health	6618 HK	Not Rated	65.95	N/A	N/A	209,615.5	4.2	3.1	4.4	4.3	332.4	122.6	n.a.	-45.5
Yidu Tech	2158 HK	Not Rated	9.28	N/A	N/A	9,165.6	3.9	2.6	2.3	2.8	n.a.	n.a.	n.a.	-86.4

Source: Bloomberg, UOB Kay Hian

## MARKET WEIGHT (Maintained)

### TOP PICKS

Company	Rec	Share Price (LCY)	Target Price (LCY)
Ping An Health (1833 HK)	BUY	23.40	27.00

Source: UOB Kay Hian

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**ACTION**

- **Ali Health (241 HK)** expects to see relatively limited impact from the above-mentioned opinion draft, and indicates that: a) as China's E-Commerce Law does not restrict e-commerce platforms from self-operated businesses, it may not be reasonable to place special restrictions only on pharmaceutical e-commerce platforms, and b) the company's direct sales and platform business do not operate via the same entity. The company expects limited impact caused by the regulation currently. It targets to achieve breakeven in FY23F. We expect the company's revenue to grow at 20.1% yoy in FY23F. We maintain HOLD with a target price of HK\$6.00, based on 2.9x FY23F P/S. Its peers such as Ping An Health (1833 HK) and JD Health (6618 HK) are trading at 3.6x and 4.2x 2022F P/S respectively.
- **Ping An Health (1833 HK)** indicates that its online drug sales business is compliant with current and potential regulations, and believes that the media report is misleading. With online medical services as its business focus, the company expects insignificant impact from the opinion draft. The company is also targeting to achieve breakeven in 2024-25. We cut our 2022 revenue growth estimates from +6.4% yoy to -14% yoy to reflect the significant impact on sales revenue caused by the strict COVID-19 measures in 2Q22. Although the company may experience weak 2Q22 results, we expect its revenue growth to regain momentum in 2H22 and 2023, supported by its clear business model and continuous strategy upgrade efforts. We maintain BUY with a target price of HK\$27.00, based on 4.1x 2022F P/S multiple (assigning 4x 2022F EV/sales for medical services, 3x 2022F EV/sales for health services).

**RISKS**

- **Key risks:** a) Worse-than-expected impact from new COVID-19 outbreaks in China, b) intensifying competition, c) geopolitical tensions and increasing overseas regulations on new product approvals, d) policy changes, such as GPO tenders and unexpected changes in COVID-19 strategies, and e) failure in product innovation and market expansion activities.

**VALUATION/RECOMMENDATION**

- **Maintain MARKET WEIGHT on China's internet healthcare sector.** We expect continuous exposure to policy risks for the internet healthcare sector, but believe the policy uncertainties may have been largely priced in at the current valuation levels. Despite possibly weak 2Q22 results being impacted by the strict COVID-19 measures in China, we believe the companies may deliver relatively stronger revenue growth in 2H22 and 2023, supported by the easing of restrictions. Our top pick is Ping An Health (1833 HK).

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