

Yunnan Baiyao

Bloomberg: 000538 CH Equity | Reuters: 000538.SZ

Refer to important disclosures at the end of this report

DBS Group Research . Equity

22 Jan 2024

BUY (Initiating Coverage)

Last Traded Price (22 Jan 2024): RMB47.31 (CSI300 Index : 3,219)

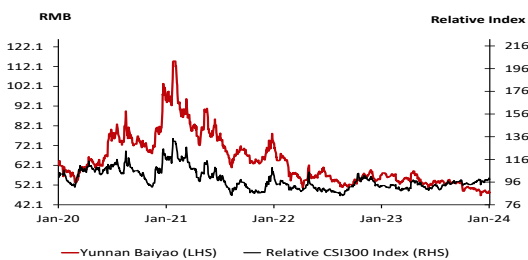
Price Target 12-mth: RMB69.00 (46% upside)

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Price Relative



Forecasts and Valuation

FY Mar (RMBm)	2022A	2023F	2024F	2025F
Turnover	36,488	40,588	45,404	50,803
EBITDA	3,443	4,749	5,342	5,894
Pre-tax Profit	3,377	4,685	5,328	5,875
Net Profit	3,001	4,164	4,735	5,221
Net Pft (Pre Ex) (core profit)	3,001	4,164	4,735	5,221
Net Profit Gth (Pre-ex) (%)	7.0	38.7	13.7	10.3
EPS (RMB)	1.67	2.32	2.64	2.91
EPS (RMB)	1.67	2.32	2.64	2.91
EPS Gth (%)	7.0	38.7	13.7	10.3
Diluted EPS (RMB)	1.67	2.32	2.64	2.91
DPS (RMB)	1.6	1.6	1.6	1.6
BV Per Share (RMB)	21.4	22.6	23.6	24.9
PE (X)	28.7	20.7	18.2	16.5
P/Cash Flow (X)	129.3	24.2	21.4	19.3
P/Free CF (X)	24.7	44.2	37.7	21.5
EV/EBITDA (X)	24.7	13.7	12.3	11.0
Net Div Yield (%)	3.3	3.3	3.3	3.3
P/Book Value (X)	2.2	2.1	2.0	1.9
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE(%)	7.8	10.5	11.4	12.0
Earnings Rev (%)		New	New	New
Consensus EPS (RMB)		2.65	2.85	3.08
Other Broker Recs:		B:18	S:0	H:1

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Turning point

- An established Chinese medicine maker with a rich history spanning 122 years
- Expect at least 50% decrease in non-operating losses in 2023 to enhance its earning quality and re-rate the stock
- Favourable policies to drive share price in 2024
- Initiate with BUY rating, Rmb69 TP

Investment Thesis

An established Chinese medicine maker with a rich history spanning 122 years. Founded in 1902, Yunnan Baiyao is known for its pharmaceutical and toothpaste lines. With its core products being mostly consumer goods, they are less impacted by policy changes, resulting in steady growth in both revenue and profit. The company is now venturing into aesthetic medicine & skincare, capitalizing on its profound TCM roots and strong R&D capabilities.

Expect at least 50% decrease in non-operating losses in 2023 to enhance its earning quality and re-rate the stock. Non-operating losses from investments has introduced uncertainty into our earnings estimates. However, with the substantial reduction in its investment exposure (from RMB 13.8bn in 2020 to RMB 1.7bn in 1H2023), we expect the loss to narrow to Rmb1bn or below in 2023, vs Rmb2bn loss in 2022, with further room to be reduced moving forward. This would alleviate earnings uncertainty and hence should help to lift the stock's valuation.

Favourable industry policies to drive share price. China has consistently supported the Chinese medicine industry, introducing favourable policies every year. This trend is expected to continue in 2024, likely resulting in a positive impact on the sector's share prices. As the second largest player in terms of market cap, the company stands to gain significantly from these developments. Trading at a trough valuation of 18x FY24 PE, Yunnan Baiyao is more attractively valued vs its peers (average at 36x), and presenting an attractive entry point for investors.

Initiate with BUY, Rmb69 TP. We initiate coverage on Yunnan Baiyao with a BUY rating and TP of Rmb69, pegged to 26x FY24F PE, aligning with its 10-year historical average.

Key Risks

Profit margin may come under pressure due to centralised procurement, and new business growth performing below expectations.

At A Glance

Issued Capital (m shrs)	1,784
Mkt Cap (RMBm/US\$m)	84,401 / 11,733
Major Shareholders (%)	
Yunnan State-owned Equity Operation Management Co., Ltd.	25.0
New huadu Industrial Group Co., Ltd.	24.3
Yunnan Hehe (Group) Co., Ltd.	8.1
Free Float (%)	42.6
3m Avg. Daily Val. (US\$m)	43.48
GICS Industry: Health Care / Pharmaceuticals, Biotechnology	

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Yunnan Baiyao

Investment Summary

Century-old Chinese brand and a leading enterprise in the big health industry. Founded in 1902, the company has become a well-known Chinese, time-honoured brand. It was listed on the Shenzhen Stock Exchange in 1993 as the first listed company in Yunnan. Yunnan Baiyao is known for its pharmaceutical and toothpaste lines. These core products, as consumer goods, are minimally impacted by policy changes, showcasing long-standing stability in business operations. The company initiated its industrial strategy of "New Baiyao & Big Health" in 2010, gradually evolving from a Chinese patent medicine enterprise into a leading player in China's extensive health industry with a portfolio of healthcare related products, such as toothpaste.

Continuous extension of brand matrix based on century-old brand. The Yunnan Baiyao series of drugs are the core products of the company and the cornerstone of the brand. According to the Comprehensive Statistical Ranking of China OTC products (Chinese Patent Medicine) in 2022 released by the China Nonprescription Medicines Association (CNMA), Yunnan Baiyao aerosol, plaster, woundplaster, and tincture ranked first in sales value in the orthopaedic category (calculated at ex-factory prices inclusive of tax). The company's toothpaste series successfully surpassed Colgate and Darlie in 2019, with the largest market share in China, and recently this figure steadily increased from 15.6% in 2015 to 24.4% in 2022 and further, to 25% in 1H23, according to Nielsen.

On top of the stable development of the Yunnan Baiyao series of pharmaceuticals and toothpaste, the company has actively expanded into new areas, including aesthetic medicine & skincare, oral care, and others. We expect revenue contribution from these new segments will increase from 17% in 2022 to 18.6% in 2025. Based on the rich traditional Chinese medicine resources in Yunnan and its own strong brand value, the company has doubled its investment in R&D and developed a series of sub-brands (Yangyuanqing, Caizhiji, Yixiaoxiao), thereby improving its big health industry layout.

Expect at least 50% decrease in non-operating losses in 2023 to enhance its earning quality and re-rate the stock. Non-operating losses from investments has introduced uncertainty into our earnings estimates. The loss was Rmb2bn in 2022, and made up 67% of FY22A earnings, and we expect this to narrow to Rmb1bn or even less in 2023. Moving forward, we anticipate the losses to remain steady or decrease, considering that the investment was reduced by 33% in June 2023 vs Dec 2022. This reduction in uncertainty regarding earnings should help to lift the stock's valuation.

Favourable industry policies to drive share price. China has consistently supported the Chinese medicine industry, introducing favourable policies every year. This trend is expected to persist in 2024, likely resulting in a positive impact on the sector's share prices. As the second largest player in terms of market cap, the company stands to gain significantly from these developments. We

think Yunnan Baiyao is more attractively valued than its peers, trading at a lower 18x FY24F PE (vs 36x for the peer average (excl. Yunnan Baiyao) as shown in the peer comparison table), which is also at a historical trough, presenting an attractive entry point for investors.

Risks. 1) Profit margin may come under pressure due to centralised procurement policies in China. In recent years, nine rounds of the centralised bulk procurement policies for drugs have been implemented, further squeezing profit margins of pharmaceutical companies. The company's gross margin has declined accordingly over the past few years. If the company is unable to maintain its R&D capability and develop new products, or successfully transform into a big health enterprise and explore new markets, its revenue and profit will continue to be affected. 2) New business growth coming in below expectations. The company's revenue is largely from three segments: provincial pharmaceutical companies, Yunnan Baiyao series, and toothpaste products. Although the company has laid out its product lines for aesthetic medicine, oral care, and new retail health services, there is still uncertainty on whether this will successfully create a second growth force.

We believe that the company's investment scale in the secondary market has been reduced at a fast pace, and the impact of its fair value gains/losses on net income in 2023 will be smaller than expected. We expect the company's revenue to be recorded at RMB40,588m, RMB45,404m, and RMB50,803m from 2023 to 2025; and attributable profit to reach RMB4,164m, RMB4,735m, and RMB5,221m, up by 38.7%, 13.7%, and 10.3% y-o-y, respectively. We initiate coverage of Yunnan Baiyao with a BUY rating and TP of Rmb69, pegged to 26x FY24F PE, which is around the valuation pivot in the past 10 years.

Yunnan Baiyao

Valuation & Peer Comparison

Key assumptions

Commercial segment (60.89% of total revenue in 2022): The company achieves full coverage of hospitals in the Yunnan province and continuously leads in market share among public hospitals above the county level in Yunnan. We expect the segment to maintain a growth rate of 11% from 2023-2025.

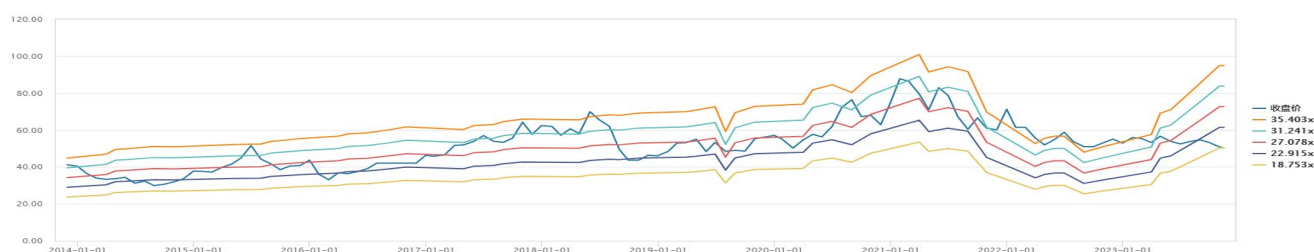
Industry segment (39.11% of total revenue in 2022): The company's core products such as the Yunnan Baiyao series of drugs and toothpaste have entered their maturity, with its aerosol, woundplaster, plaster, and toothpaste, all ranking first in terms of market share in the industry. With the gradual formation of its second growth curve underpinned by the development of aesthetic medicine, oral care, and new retail health services, and dermatological science division, we expect this segment to see a CAGR of c.13.81% from 2023-2025.

Sales expenses: The company's sales expense ratio is much lower than that of its peers such as Tong Ren Tang and Dong-E-E-Jiao, which indicates that its brand power has gradually extended from the Yunnan Baiyao series to its other products, and we believe the expense ratio will remain low, at 11.24%, 11.12%, and 11.26%, respectively, from 2023 to 2025.

Valuation

We believe that the company's investment scale in the secondary market has been reduced at a fast pace, and the impact of its fair value gains/losses on its net income in 2023 will be smaller going forward. We expect the company's revenue to be recorded at RMB40,588m, RMB45,404m, and RMB50,803m from 2023 to 2025; and attributable profit to reach RMB4,164m, RMB4,735m, and RMB5,221m, up by 38.7%, 13.7%, and 10.3% y-o-y, respectively. We initiate coverage of Yunnan Baiyao with a BUY rating and TP of Rmb69, pegged to 26x FY24F PE, which is around the valuation pivot in the past 10 years.

Historical PE



Source: Wind, DBS HK

Peer comparison

Company Name	Code	Price RMB	Mkt Cap RMBm	Fiscal Yr	PE			ROE			Sales			N.Profit		
					23F x	24F x	25F x	23F %	24F %	25F %	23F RMBm	24F RMBm	25F RMBm	23F RMBm	24F RMBm	25F RMBm
Yunnan Baiyao Group 'A'	000538 CH	47.97	86,196	Dec	20.7	18.2	16.5	10.5	11.4	12.0	40,588	45,404	50,803	4,164	4,735	5,221
Pientzhuang Pharms 'A'	600436 CH	219.5	132,428	Dec	43.4	35.8	29.7	22.4	22.2	21.7	10,258	11,968	13,875	3,049	3,704	4,464
Dong-E-E-Jiao 'A'	000423 CH	48.9	31,490	Dec	29.9	24.7	20.5	10.0	11.4	12.9	4,767	5,533	6,417	1,055	1,276	1,539
Guangyuyuan 'A'	600771 CH	24.98	12,227	Dec	169.8	52.3	25.0	4.1	11.7	19.6	1,422	2,134	3,207	72	234	490
Beijing Tongrentang 'A'	600085 CH	50.19	68,834	Dec	38.2	32.5	27.6	13.4	13.9	14.4	18,394	21,031	23,982	1,801	2,121	2,494

Note: based on the closing prices as of January 19, 2024

Source: Wind, DBS HK

Yunnan Baiyao

Key Risks

Profit margin under pressure due to centralised procurement policies. As of Nov 2023, nine rounds of centralised drug procurement have been carried out. The average reduction in drug bidding prices in each round was around 50%. In the future, with the expansion of centralised procurement catalogues and regions, the profit margins of pharmaceutical companies will face further compression. Against the context of normal and standard bulk procurement, if the company is unable to maintain its R&D capability and develop new products, or successfully provide integrated medical and healthcare solutions and explore new markets, its revenue and profit will continue to be affected.

New business growth coming in below expectations. The company's revenue still largely comes from three segments: Provincial pharmaceutical companies, the Yunnan Baiyao series, and toothpaste products. The company has embarked on the digital transformation of its top-level design in 2021, expanded its business lines via strategic cooperation, equity investment, etc., and laid out its product lines for aesthetic medicine, oral care, and new retail health services, but there is still uncertainty on whether this will successfully create a second growth force.

Yunnan Baiyao**SWOT Analysis**

Strengths	Weaknesses
<ul style="list-style-type: none">• Successful cross-industry expansion with its strong brand value• Success in the treatment of patients using its orthopaedic products with its national top-secret formula	<ul style="list-style-type: none">• Stable growth in the main product line while lacking a second growth curve

Opportunities	Threats
<ul style="list-style-type: none">• Continued promulgation of favourable policies for TCM• Further implementation of the mixed-ownership reform strategy with its introduction of new strategic investors	<ul style="list-style-type: none">• Profit margin under pressure due to centralised procurement policies• New business growth coming in below expectations

Source: DBS HK

Yunnan Baiyao

Critical Factors

Continuous extension of brand matrix based on century-old brand

Its powerful brand value is the core strength of the company. Brand value reflects consumers' trust and preference for the company's products, making it easier for the company to gain

consumers' recognition when exploring new markets. Relying on the state-level top-secret formula and Yunnan's abundant TCM resources, the company has formed a strong brand value with its excellent quality and remained at the forefront of the industry in the brand rankings released by Hurun, BrandZ, Forbes, etc.

Selected honours

Issuing agency	Awards
Pharm Exec (pharmaceutical executive)	There were only five Chinese pharmaceutical companies in the TOP 50 Global Pharma Companies 2021, and Yunnan Baiyao ranked 34th.
Hurun	Yunnan Baiyao ranked 14th in the Hurun-China Top 100 Brands with the Most Historical and Cultural Heritage 2022 list.
MSCI	In 2022, Yunnan Baiyao's MSCI ESG rating was maintained at the A level. It is the only listed pharmaceutical company in the Shenzhen Stock Exchange to gain an A rating for two consecutive years as well as the highest rated and only A-level company among the listed corporations in Yunnan.
Brand Finance	In the Healthcare 2022, Yunnan Baiyao was included in the shortlist of "Top 10 Strongest Pharma Brands" and "Top 25 Most Valuable Pharm Brands".
Torrey	Torrey announced its list of "The Pharma 1000 Top Global Pharmaceutical Companies 2021", where Yunnan Baiyao ranked 71st.
Kantar	In the "Kantar BrandZ Chinese Brands Report 2023", Yunnan Baiyao ranked 68th.

Source: Company

The Yunnan Baiyao series of drugs are the company's core products and the cornerstone of its brand that possesses a clear advantage in the treatment of bruises and visceral hemorrhages. According to the Comprehensive Statistical Ranking of China OTC Products in 2022 (Chinese Patent Medicine) released by the China

Nonprescription Medicines Association (CNMA), Yunnan Baiyao aerosol, plaster, woundplaster, and tincture ranked first in sales value in the orthopaedics category (calculated at ex-factory prices inclusive of tax).

Comprehensive statistical ranking of China OTC products in 2022 (Chinese patent medicine in orthopaedic and traumatology category)

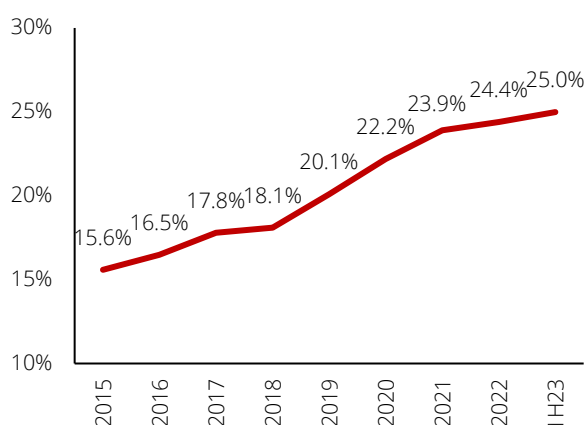
No.	Brand	Drug name	Pharma players
1	Yunnan Baiyao	Yunnan Baiyao Aerosol/Plaster/Woundplaster/Tincture	Yunnan Baiyao Group Co., Ltd.
2	Qizheng	Pain Relieving Plaster	Qizheng Tibetan Medicine Co., Ltd.
3	Lingrui	Meridians-Activating and Pain-Relieving Ointment	Henan Lingrui Pharmaceutical Co., Ltd.
4	Bencaogangmu	Musk Pain-Relieving Liniment	Li-shizhen Medicine Group Co., Ltd.
5	Shangzhuang	Jingfukang Granules	Jingfukang Pharmaceutical Group Co., Ltd.
6	Tianhe	Gutong Plaster	China Resources Sanjiu Medical & Pharmaceutical Co., Ltd.
7	Linrui	Bone Strengthening and Pain-Relieving Musk Plaster	Henan Lingrui Pharmaceutical Co., Ltd.
8	Kanion	Compound Nanxing Ointment for Pain Relieving	Jiangsu Kanion Sunshine Pharmaceutical Co., Ltd.
9	Huahong	Swelling and Pain Relieving Tincture	Guangxi Huahong Pharmaceutical Group Co., Ltd.
10	Renhe	Oyster Calcium Tablet	Renhe Group Development Co., Ltd.

Source: China Nonprescription Medicines Association

Yunnan Baiyao

In 2006, the company established the healthcare products division and extended its product line by leveraging the therapeutical effects of its drugs. Focusing on the main functions of hemostasis and anti-inflammation, the company developed its toothpaste series. In 2019, Yunnan Baiyao Toothpaste surpassed Colgate and Darlie with the highest toothpaste market share in China. In recent years, the company's market share in toothpaste products continues to increase steadily, from 15.6% in 2015 to 24.4% in 2022, and further, to 25% in 1H23, according to Nielsen.

Domestic market share of Yunnan Baiyao toothpaste



Source: Company, Wind

Focusing on its massive toothpaste consumer base, the company began to create a professional oral care brand image and launched a number of new products. The company is committed to building an oral care product group and providing a full range of oral healthcare services, from problem discovery, problem clarification, and problem solving to problem prevention, thus establishing a new ecology of smart oral care.

Oral care product development line



Source: Company, Wind

The company is located in Yunnan with access to the unique resources of TCM. According to the data disclosed by the Yunnan

Forestry Bureau, the planting area of TCM in Yunnan in 2022 was 9.035m mu (c.6,023 square kilometres) with an output of 1.35m tonnes, ranking first in China in terms of both planting area and output. Due to the growth environment requirements of some species of plants, some herbs such as Panax notoginseng (San Qi), Paris polyphylla (Chong Lou), and Gastrodia elata (Tian Ma) are widely planted only in southwest China, so Yunnan's planting areas are leading in the national market in terms of the output of such herbs.

The in-depth development of TCM resources is not only the foundation of corporate development in the industry but also a strong guarantee for the subsequent development of new varieties. By virtue of the rich Chinese herbal medicine resources in Yunnan, the company persists in reshaping its business to build its herbal medicine brand with primary focus on its clients. In addition, by taking advantage of its own supply chain, the company strives to build a Yunnan herbal medicine resource trading platform, plant extract and San Qi product platform, and an active pharmaceutical ingredient platform. Through this type of standardisation and model innovation across all its processes, the company is comprehensively rebuilding its value chain, from upstream planting to the development and sales of downstream terminal products, thus creating the Chinese herbal medicine industry's value chain and also a healthy and sustainable ecosystem for the TCM resource industry.

Taking San Qi as an example, in 2020, the planting area in Yunnan was 394.5 thousand mu (c.263 square kilometres), accounting for more than 98% of the total in China, and the comprehensive output value accounted for nearly 40% of the country's total output value. The company empowers the entire San Qi industry chain via the digital San Qi industry platform, by providing a single solution for sourcing and supplying high-quality resources. Meanwhile, it makes great efforts to maintain quality and standards through digital management during the whole process, gradually reducing costs and improving quality. In the next three to five years, the company's market share of San Qi is expected to increase to over 30%.

Planting area of TCM materials in Yunnan as of the national total in 2020

Medical materials	As of national planting area
Gastrodia elata (Tian Ma)	17%
Polygonatum kingianum (Dian Huang Jing)	33%
Dendrobium (Shi Hu)	67%
Amomum tsao-ko (Cao Guo)	92%
Panax notoginseng (San Qi)	98%
Yunnan Paris polyphylla (Dian Chong Lou)	80%

Yunnan Baiyao

Source: "14th Five-Year Plan for Understory Traditional Chinese Medicine Industry of Yunnan Province" by Yunnan Provincial Forestry and Grassland Bureau

On the basis of the stable development of the Yunnan Baiyao series of pharmaceutical products and toothpaste, the company actively expands into new fields such as aesthetic medicine and skincare, oral care, etc. Utilising Yunnan's abundant TCM resources and its own powerful brand value, the company increases its investment in R&D and has successively developed a series of sub-

brands such as Yangyuanqing, Caizhiji, and Yixiaoxiao. Caizhiji has become the first Chinese brand certificated by Japan in "diminishing fine lines and wrinkles caused by dry skin", and has obtained the USDA certification for being 100% natural as well as the ECOCERT COSMOS NATURAL certification, which makes it qualified to enter European, American, and Japanese markets. The Caizhiji series is expected to achieve stable growth in both domestic and overseas markets in the future, and the company's big health industry map is gradually being improved.

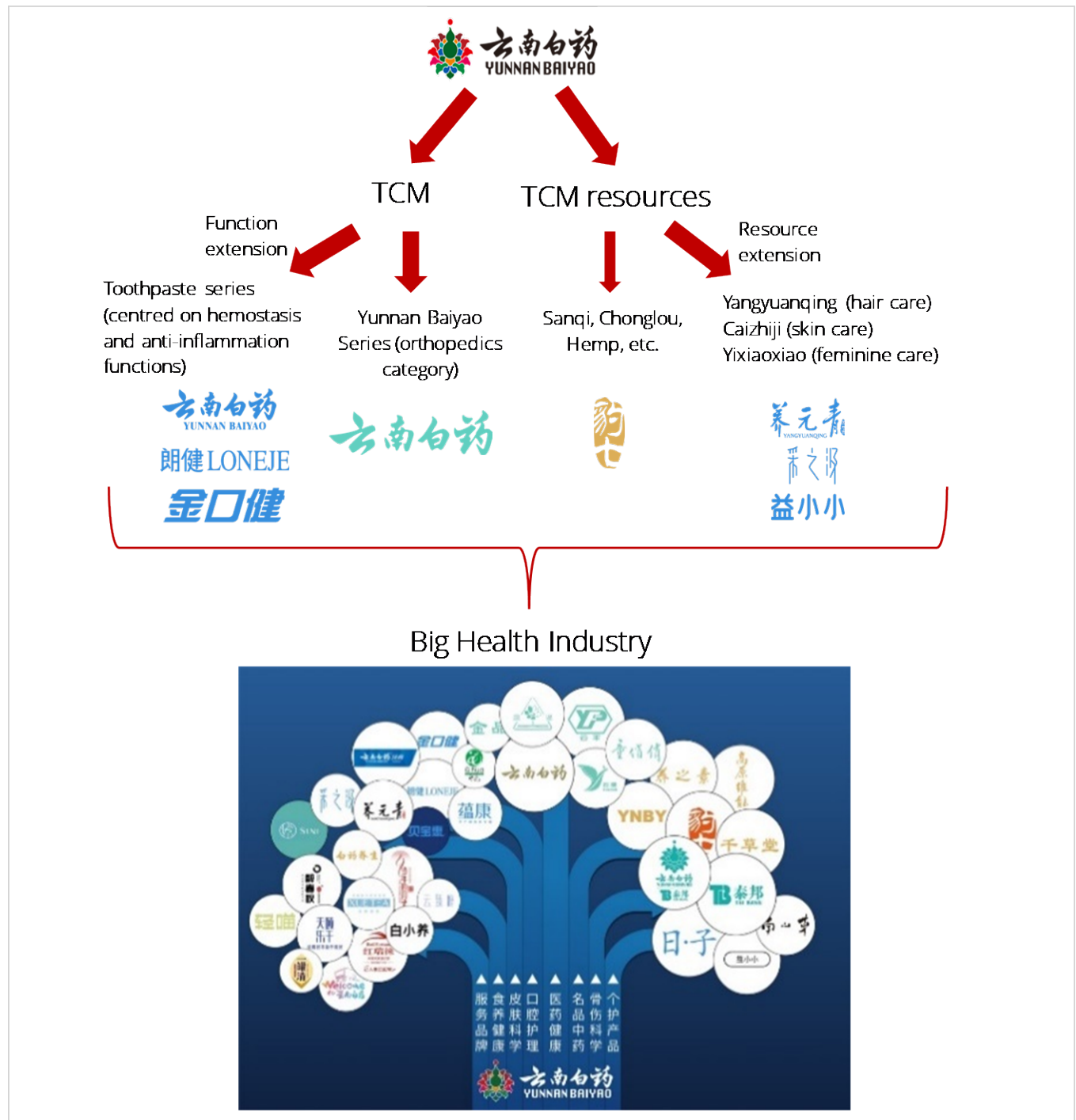
ECOCERT COSMOS NATURAL and USDA official certifications



Source: Company

Yunnan Baiyao

Big health industry brand matrix



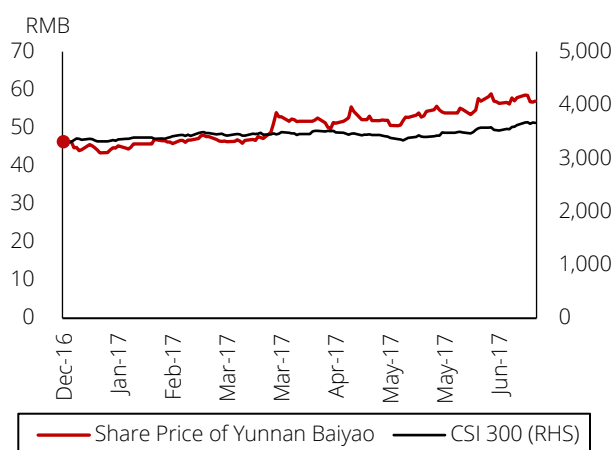
Source: Company

Yunnan Baiyao

Internal and external reforms and innovation to build the second growth curve

The company commenced its mixed-ownership reforms in 2016, and Yunnan Baiyao Holding, which is 100% owned by the State-owned Assets Supervision and Administration Commission of Yunnan Provincial People's Government (SASAC), substantially started the mixed-ownership reforms. Baiyao Holding attracted New Huadu and Jiangsu Yuyue successively as shareholders through capital increase and share expansion respectively. At the end of 2018, the company conducted a merger for Baiyao Holding by issuing shares to the three shareholders of Baiyao Holding: Yunnan SASAC, New Huadu and Jiangsu Yuyue. The fund raised were used for industrial M&As, which improved the company's competitiveness and influence in industrial upgrading and integration, further consolidating its material foundation for the implementation of its "New Baiyao & Big Health" strategy.

Share price performance after announcement of mixed-ownership reform plan



Source: Wind

In the process of building a big health industry, the company has strengthened its product quality and business capabilities through strategic cooperation and equity cooperation, thereby enhancing the chances for new businesses or innovative products to successfully enter the market. In 2020, the company and Peking University jointly established Peking University-Yunnan Baiyao International Medical Research Centre, with an initial funding of RMB2,527m. It is designed for the operation of projects in the fields of medicine, health, and fitness. The company's aesthetic medicine project team and Peking University Health Science Centre became strategic partners in 2021, entering the preliminary cooperation intention in R&D, transformation, and clinical application in the field of "Industry-University-Research-Medicine" for dermatological treatment and aesthetic medicine.

The company entered a deep cooperation with Shanghai Pharmaceutical Group Co., Ltd. in May 2021 by subscribing A shares in a non-public offering. Leveraging the quality platform of

Shanghai Pharma and the resultant industrial and resource synergy, the company further amplified its own resource advantages and grasped the opportunity of industrial integration, thus expanding its main businesses and existing industrial layout as well as improving its overall operational efficiency. Through its integration into and cooperation in areas such as regional complementation, logistics and warehousing, procurement, agency, brand promotion, and new drug development, it further enhanced its core competitiveness and profitability.

Cooperation between the company and Shanghai Pharm



Source: Shanghai Pharm

The company initiated its digital transformation upgrade in 2021. The CEO, Dong Ming, who has many years of work experience in Huawei, introduced the "D to C" (Direct to Customer) reform to help the company position itself as a comprehensive solutions provider. The company has also made some progress in building its digital platform. In 2021, the company independently innovated and developed a series of digital platforms, including a big data AI platform for orthopaedics and traumatology, a 5G smart TCM cloud platform, a digital San Qi industry platform, and a comprehensive solution platform for oral care. From the industrial perspective and user perspective, the company explored the closed loop of "treatment + pharmaceutical + nursing" to construct the layout after considering multiple angles, such as leading medical development, application scenarios, and the demands of clients and patients, thereby building an open industrial ecosystem platform with a strong and independent R&D capability and global resource integration capability.

Yunnan Baiyao

Favourable policies to continue, benefitting sector leaders

In recent years, with the important role TCM played during the pandemic, people's acceptance of TCM has increased significantly. Meanwhile, the supportive policies for TCM will continue to be

introduced in the future, and the whole sector will have the opportunity to take advantage of further development opportunities. As the leading enterprise in the big health industry with a time-honoured brand, the company will benefit significantly from state policies by leveraging its outstanding brand.

Favourable industry policies

Time of issue	Laws and regulations	Issuing authority	Related information
22-Feb-16	《Outline of the Strategic Plan for the Development of TCM (2016-2030)》 《中医药发展战略规划纲要（2016-2030）》	State Council	By 2030, the level of modernization of the TCM governance system and governance capabilities will be significantly improved; full coverage of TCM services will be achieved; and TCM health service capabilities will be significantly enhanced with its leading role in "Zhi Wei Bing", synergy in the treatment of major diseases and central role in disease rehabilitation brought into play. Encourage TCM hospitals and TCM physicians to provide technical support such as health consultation, conditioning and medicated diet for TCM health care institutions. Encourage Chinese medicine institutions to make full use of modern science and technology such as biology, bionics, and intelligence to develop a batch of health food, health supplies, and health equipment. Accelerate the construction of the technical system and industrial system for TCM "Zhi Wei Bing". Promote healthy work and lifestyles that incorporate the concept of TCM "Zhi Wei Bing".
11-Aug-16	《The 13th Five-Year Plan for the Development of TCM》 《中医药发展十三五规划》	National Administration of Traditional Chinese Medicine	New forms of TCM health services continue to emerge, service technologies continue to innovate, product types are enriched, and quality is better, which drives the development of related supporting industries. Promote the sustainable development of TCM resources and improve the quality and efficiency of the entire industrial chain of TCM.
25-Oct-16	《"Healthy China" planning outline》 《健康中国规划纲要》	State Council	By 2030, the leading role of TCM in "Zhi Wei Bing", the synergy in the treatment of major diseases, and the core role in the rehabilitation of diseases will be fully brought into play. Expand the service areas of TCM hospitals, and provide the masses with TCM health consultation and evaluation, intervention adjustment, follow-up management and other services of "Zhi Wei Bing". Encourage TCM medical institutions and TCM physicians to provide technical support such as health consultation and conditioning for TCM health care institutions.
25-Dec-16	《Chinese Medicine Law》 《中华人民共和国中医药法》	Order of the President of the People's Republic of China	People's governments at or above the county level shall develop TCM preventive and health care services, and incorporate them into basic public health service items for overall planning and implementation in accordance with relevant state regulations. The state develops TCM health care services and supports social forces to establish standardized Chinese medicine health care institutions. The norms and standards of TCM health care services shall be formulated by the competent department of Chinese medicine under the State Council.
26-Oct-19	《Opinions of the Central Committee of the Communist Party of China and the State Council on Promoting the Inheritance and Development of TCM》 《中共中央国务院关于促进中医药传承发展的意见》	State Council	Give full play to the advantages of TCM holistic medicine and health care medicine, and build a TCM service system with national and regional TCM medical centers as the leader, various types of TCM medical institutions and other medical institutions as the backbone, and basic medical and health institutions as the foundation. And the system will integrate preventive and health care services, disease treatment and rehabilitation and provide TCM services covering the entire population and the entire life cycle. Strengthen the role of TCM in "Zhi Wei Bing". Combining with the implementation of the "Healthy China Plan", we will promote the upgrading of TCM disease prevention programs.

Source: State Council, State Administration of TCM, DBS HK

Yunnan Baiyao

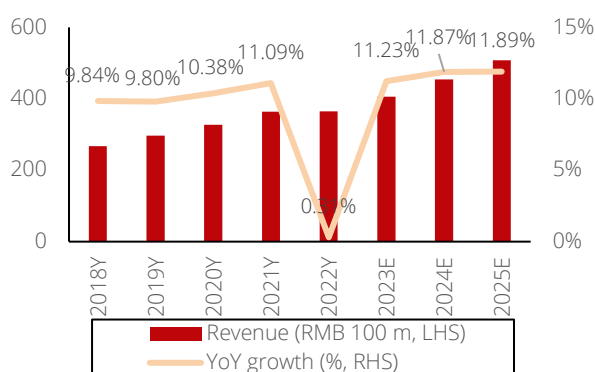
Financials

Revenue

The company's sales revenue has grown steadily in recent years, with revenue of RMB29,665m, RMB32,743m, and RMB36,374m from 2019-2021, or y-o-y growth rates of 9.8%, 10.38%, and 11.09%, respectively, followed by a slight increase of 0.31% to RMB36,488m in 2022. The industry segment has been steadily increasing, and core products such as the Yunnan Baiyao series of drugs and toothpaste have entered their maturity. As of 31 December 2022, its aerosol product captured 92% of the market share, woundplast 66%, plasters 21%, and the toothpaste category 24.4%, all ranking first in their respective sectors. With the gradual formation of the second growth curve underpinned by the development of the aesthetic medicine, oral care, new retail health services, and dermatological science division, the industry segment recorded a CAGR of c.6.81% in 2018-2022 and is expected to grow at a CAGR of c.13.81% from 2023 to 2025. The commercial segment has fully covered all hospitals in the Yunnan province, playing a leading role among public hospitals above the county level in Yunnan. It is expected to reach a CAGR of 11% from 2023 to 2025.

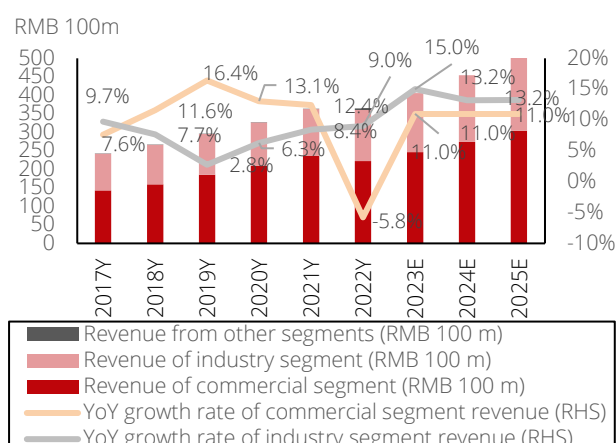
We expect the company's revenue growth rate to come in at 11.23%, 11.87%, and 11.89% from 2023 to 2025.

Revenue trend



Source: Company, Wind

Revenue proportion trend by segment

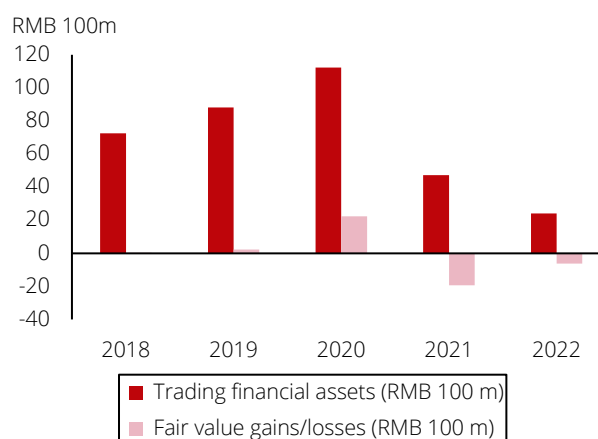


Source: Company, Wind

Fair value gains/losses

In 2018 and before that, the company's financial assets held for trading mainly comprised money funds, with a slight impact from fair value gains/losses on net profit. Therefore, the growth rates of net profit and core profit were similar. The company began to hold stocks and bonds from 2019 in order to gain more profits, and since then, its fair value began to fluctuate significantly, with the growth rate of net profits diverging to that of core profits. Fair value gains were RMB227m and RMB2.24bn, respectively, in 2019 and 2020. At the end of 2020, its total investment volume reached a height of RMB13.8bn. With the stocks and bonds it held turning from profit to loss, the company recorded fair value losses of RMB1,929m and RMB620m in 2021 and 2022, respectively, resulting in a significant 49.17% y-o-y decrease in attributable profits in 2021.

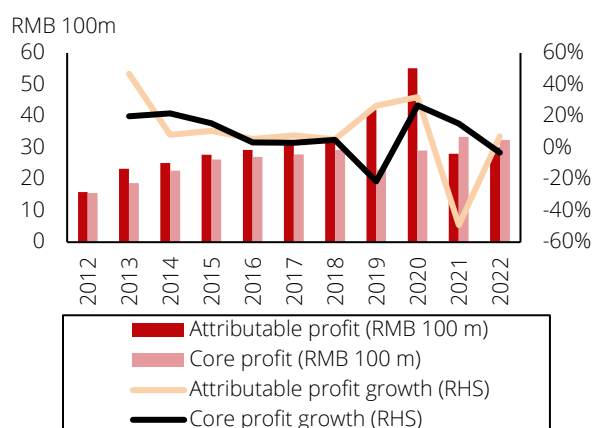
Financial assets held for trading and fair value gains/losses



Source: Company, Wind

Yunnan Baiyao

Attributable profits, core profits, and growth rate



Source: Company, Wind

The company then strictly controlled its secondary market investment on the basis of its original risk control measures upon the prudent demonstration and review of its investment decision-making process, and gradually reduced its position and restrained itself from increasing its holdings. As of 1H23, its total investment volume has been reduced to RMB1.7bn. We expect the company's fair value gains/losses to gradually return to normal levels.

Sales expenses

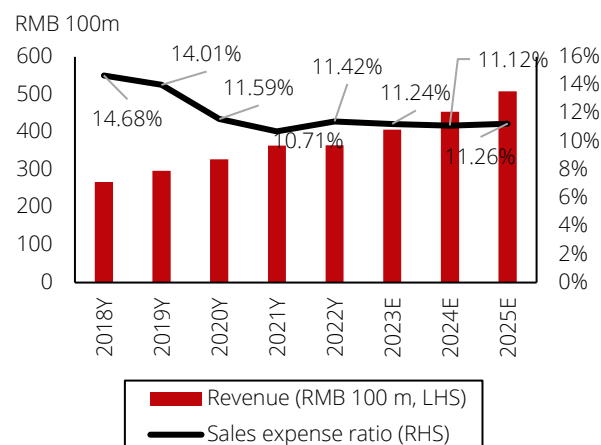
Yunnan Baiyao's sales expenses were RMB4,166m and the sales expense ratio was 11.42% in 2022, much lower than that of comparable companies such as Tong Ren Tang and Dong-E-E-Jiao, and higher than that of Pien Tze Huang – but Yunnan Baiyao has a larger sales scale, more sub-brands, and more balanced product structures compared with Pien Tze Huang. The lower expense ratio indicates that the brand power has gradually extended from the Yunnan Baiyao series to other products, and we expect the expense ratio to remain low, at 11.24%, 11.12%, and 11.26%, respectively, from 2023 to 2025.

Marketing investment of comparable companies

Comparable companies in the same industry	Sales expenses in 2022 (RMB bn)	Sales expense ratio in 2022 (%)
Pien Tze Huang	4.83	5.56
Tong Ren Tang	30.71	19.98
Dong-E-E-Jiao	13.18	32.60
Guang Yu Yuan	8.54	85.82
Yunnan Baiyao	41.66	11.42

Source: Company, Wind

Revenue and sales expense ratio

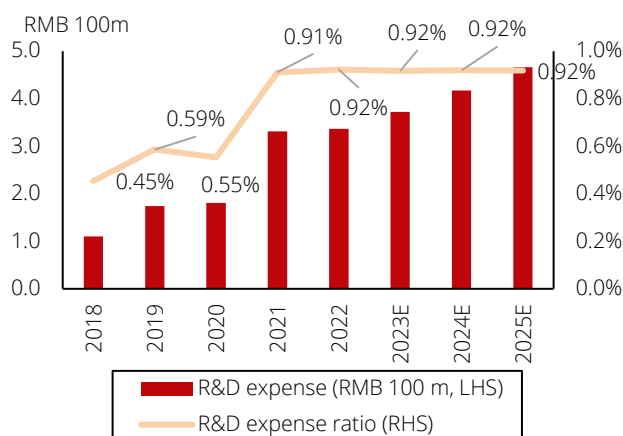


Source: Company, Wind

R&D expenses

The company continued to increase its R&D investment in 2022 with a total of RMB337m. The funds were mainly invested in R&D projects such as the registration of food for special medical purposes and the R&D of Caizhiji biomedical skincare products. The company will actively promote its ecological layout in aesthetic medicine and oral care and increase R&D investment in the future. Its R&D expense ratio is expected to remain at 0.92% from 2023 to 2025.

R&D expenses and R&D expense ratio



Source: Company, Wind

Yunnan Baiyao**Environment, Social, & Governance (ESG)**

Wenshan Qihua Co., Ltd., a subsidiary of the company, adopts advanced online monitoring technology for dust emissions from gas-fired boilers; and employs an airtight disposal process for sewage treatment, where cyclic utilisation can be achieved by recovering San Qi's cleaning water, preparing part of the sewage into reclaimed water, recycling biogas generated by sewage, and recycling condensate water. In 2021, the total amount of sewage disposed of was 321,322m³, the total amount of biogas recovered was 119,565.6m³ with 517.6 tonnes of steam produced, the total amount of San Qi's cleaning water that was recycled was 134,120m³, the total amount of reclaimed water prepared was 10,940.2m³, and the total amount of condensate water recovered was 22,848m³, which altogether saved about RMB1.8613m in energy costs for the company. It thereby realised the rational utilisation of environmentally friendly energy and standard discharge of effluents and atmospheric pollutants for energy-saving and eco-friendly production.

In April 2022, to support Shanghai against the Covid-19 pandemic, the company took the initiative to contact the relevant departments of the Shanghai municipality to donate anti-epidemic products such as Banlangen granules, Shangfengting capsules, Danxi Yupingfeng granules, 75° alcohol disinfectant wipes, medical flat-fold masks, as well as daily products such as Yunnan Baiyao toothpaste and Yangyuanqing shampoo, according to actual anti-

epidemic needs. Moreover, the company actively cooperated with the Yunnan provincial government to donate anti-epidemic materials to Shanghai, and assisted the Health Commission of the Yunnan province to load its anti-epidemic materials such as Banlangen granules, Huoxiang Zhengqi capsules, Reduqing tablets, and anti-inflammatory & fever-cooling granules.

In 2021, the company updated the "Salary Management System of Yunnan Baiyao Group Co., Ltd.", clarifying the components of the employee salary and detailed adjustment mechanism. On the basis of the new salary management system, the Human Resources Centre carried out special work on salary optimisation. Through data analysis, the salary structure was adjusted, and the salary assessment programme was updated across the board to incorporate the four dimensions of historical salary data, historical performance, ability evaluation, and market level. The new performance assessment method adopts a dual mode for both monthly and annual assessments with results on five levels, which will be jointly completed by the assessed employees and their superiors and can provide communication channels for employees to obtain their feedback in time. Since the salary adjustment is reasonable and in line with market competitiveness, it can effectively improve the salary incentive effect and increase the transparency of the salary mechanism, allowing employees to share in the company's achievements.

Yunnan Baiyao

Company Background

Century-old Chinese brand and a leading enterprise in the big health industry

In 1902, Qu Huanzhang created Yunnan Baiyao, a famous trademark of China, which is now among the first batch of national innovative enterprises and is a well-known Chinese time-honoured brand. In 1971, its factory was established as instructed by Premier Zhou Enlai. The company was listed on the Shenzhen Stock Exchange as the first listed company in Yunnan in 1993. It completed the integration and unification of its brand in 1996. It launched its product strategy of "centre stabilisation and wing highlighting" (稳中央、突两翼: emphasising its core baiyao products while expanding transdermal and personal healthcare product lines) in 2005 and started its industrial strategy of "New Baiyao & Big Health" in 2010, gradually developing from a Chinese patent medicine enterprise into one of the leading enterprises in China's big health industry. The company has consistently ranked among the top in the industry in the Chinese brand value rankings lists released by Interbrand, Hurun, BrandZ, and others. It was once listed in Forbes Global 2000, Asia's Top 50 Best Listed Companies, and Fortune China 500, named as one of the top 100 Chinese brands by BrandZ and the State Administration for Market Regulation, and rated as one of the top 500 best employers in the world by Forbes.

Committed to bringing TCM into modern life, the company has developed from being a powder medicine provider to one of China's big health industry pacemakers covering four major sectors: Pharmaceutical, personal care health products, Chinese herbal resources, and pharmaceutical logistics. Its products cover 390 varieties in 36 categories, with 10 of them recording single-product sales of over RMB100m. Its toothpaste, aerosols, woundplaster, and plasters are top-ranked products in China in the relevant categories. Committed to building itself into a leading integrated solutions provider of medicine and health, the company sets its strategic goal of "1+4+1" on top of consolidating its existing business. The first "1" is to deepen the development of TCM products by leveraging modern science; the "4" denotes boosting the TCM industry with a focus on four fields, including the oral field, skin field, orthopaedic injury, and woman care, where the company mainly lays out the products with various forms of pharmaceuticals as well as related medical devices and functional foods, building a whole-product mix, from prevention, detection, and treatment to rehabilitation; and the last "1" refers to digital technologies, where the company introduces cutting-edge digital technologies including artificial intelligence (AI) into all areas of R&D and operation, elevating its capacities of product innovation and business operation to a whole new level.

Selected honours



Source: Company

Product matrix









Source: Company

Yunnan Baiyao

As the core products of the company, the Yunnan Baiyao series products have an exclusive formula patent that is approved by the state. Yunnan Baiyao (Baibao Dan) was classified as a "national top-secret formula" after Qu Huanzhang successfully created it in

1902, and it has now expanded from the initial Yunnan Baiyao powder to six types, including aerosol, tincture, capsule, and plaster.

Product mix of Yunnan Baiyao series

Category	Description	Sample
Yunnan Baiyao	Resolving stasis to stop bleeding, improving circulation to relieve pain, resolving toxins, and dispersing swelling. For bruises, blood stasis, swelling and pain, hematemesis, hemoptysis, hematochezia, bleeding hemorrhoids, metrorrhagia and metrostaxis, surgical bleeding, pyogenic infections, soft tissue injuries, closed fractures, bronchiectasis, coughing up blood due to tuberculosis, bleeding ulcer, and infectious skin diseases	
Yunnan Baiyao Plaster	Promoting blood circulation for removing blood stasis and relieving swelling and pain. For bruises, blood stasis, swelling and pain, rheumatic pain, etc.	
Yunnan Baiyao Aerosol	Promoting blood circulation for removing blood stasis, and relieving swelling and pain. For bruises, blood stasis, swelling and pain, muscle soreness, and rheumatic pain	
Yunnan White Power Capsules (Jiaonang)	Resolving stasis to stop bleeding, improving circulation to relieve pain, resolving toxins, and dispersing swelling. For bruises, blood stasis, swelling and pain, hematemesis, hemoptysis, hematochezia, bleeding hemorrhoids, metrorrhagia and metrostaxis, surgical bleeding, pyogenic infections, soft tissue injuries, closed fractures, bronchiectasis, coughing up blood due to tuberculosis, bleeding ulcer, and infectious skin diseases	
Yunnan Baiyao Tincture	Promoting blood circulation for removing blood stasis, and relieving swelling and pain. For bruises, rheumatic numbness, tendon and joint pain, muscle soreness, and frostbite	
Yunnan Baiyao Woundplaster	Hemostasis, analgesia, anti-inflammation, and wound healing. For small open surgical wounds	

Source: Company

Yunnan Baiyao

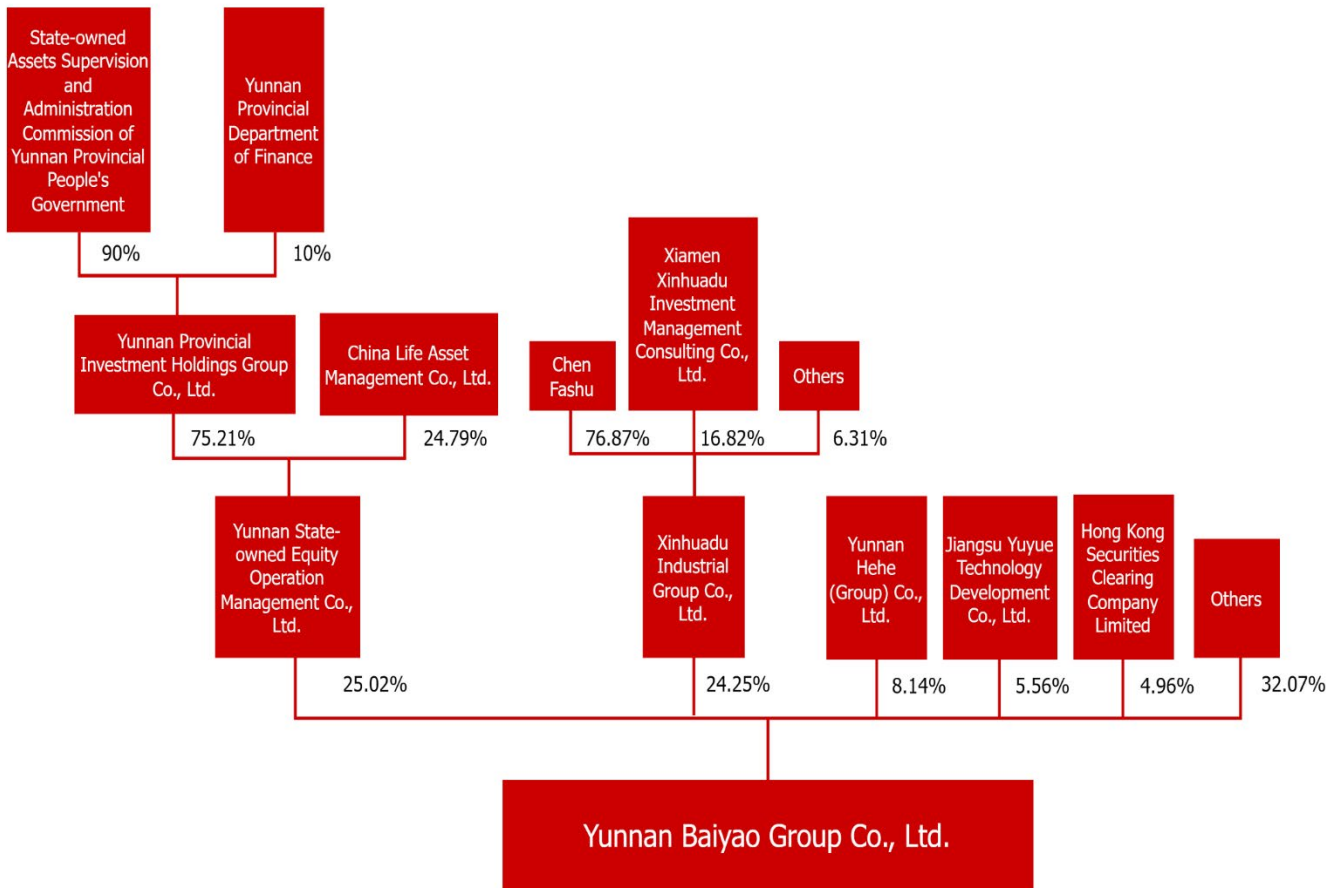
Management & Strategy

Shareholder structure

Chen Fashu is the co-chairman and Dong Ming is the CEO (president). Yunnan State-owned Equity Operation Management

Co., Ltd. and New Huadu Industrial Group Co., Ltd. as well as its persons acting in concert are the largest shareholders of the company, and the company has no actual controller or controlling shareholder.

Shareholder structure



Source: Company

Yunnan Baiyao

Key Management Team

Name	Title	Profile
Chen Fashu	Co-chairman	A member of the 9th Executive Committee of the National Federation of Industry and Commerce. A member of the 9th and 10th Fujian Provincial Committees of the CPPCC. Chairman of the committee directly under the Fujian Federation of Industry and Commerce, and chairman of Yunnan Baiyao Holding Co., Ltd. Serves as the legal representative and chairman of the Board of New Huadu Industrial Group Co., Ltd.
Dong Ming	Chief executive officer (president)	Served as the head of the VIP system department, head of the mobile system department, and vice president of China of Huawei Technologies Co., Ltd.
Yin Pinyao	Chief operating officer, senior vice president	Used to be the deputy manager of the financial department and the manager of the sales management department of KPC Pharmaceuticals (600422.SH) and manager of the financial department and manager of the sales service department of KPC Pharmaceuticals Sales Co., Ltd. Served as the director of the assets and finance department, vice president, chief financial officer, secretary of the board of directors, and director of the company
Yang Yong	Senior vice president	Served as the deputy general manager of Yunnan Pharmaceutical Co., Ltd. Served as director, deputy general manager, and general manager of Yunnan Pharmaceutical Co., Ltd.
Qin Wanmin	Senior vice president	Used to be the manager and deputy general manager of the marketing department of Yunnan Baiyao Group Pharmaceutical E-commerce Co., Ltd. and the general manager's assistant, deputy general manager, and general manager of the Health Products Business Group of the company.
Zhao Yingming	Senior vice president	Served as assistant to president of Wangfujin Department Store Group, general manager of Maoye Commercial, and president of Retail Home & Fashion Business Group, as well as vice president of JD. Serves as an independent director of Zhejiang Red Dragonfly Footwear Co., Ltd.
Ma Jia	Chief financial officer	Worked at Huawei Technologies Co., Ltd. as the CFO in China

Source: Source: Company (as of 3Q23)

Yunnan Baiyao

Segmental Breakdown (RMB m)

FY Mar	2021A	2022A	2023F	2024F	2025F
Revenues (RMB m)					
Drug circulation	23,581	22,219	24,663	27,376	30,387
Drug sales	12,703	6,204	7,134	7,919	8,790
Health and daily chemical products	-	6,197	7,127	8,196	9,425
TCM resources	-	1,447	1,664	1,913	2,200
Others	90	422	-	-	-
Total	36,374	36,488	40,588	45,404	50,803

Source: Company, DBS HK

Income Statement (RMB m)

FY Mar	2021A	2022A	2023F	2024F	2025F
Revenue	36,374	36,488	40,588	45,404	50,803
Cost of Goods Sold	(26,498)	(26,883)	(29,978)	(33,491)	(37,421)
Gross Profit	9,875	9,605	10,609	11,913	13,381
Other Opg (Exp)/Inc	(5,529)	(5,510)	(6,086)	(6,762)	(7,632)
Operating Profit	4,346	4,095	4,524	5,152	5,750
Other Non Opg (Exp)/Inc	(1,131)	(1,756)	(733)	(776)	(825)
Associates & JV Inc	(21)	732	732	732	732
Net Interest (Exp)/Inc	288	306	162	221	218
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	3,482	3,377	4,685	5,328	5,875
Tax	(685)	(537)	(744)	(847)	(934)
Minority Interest	7	161	223	254	280
Preference Dividend	0	0	0	0	0
Net Profit	2,804	3,001	4,164	4,735	5,221
Net Profit before Except.	2,804	3,001	4,164	4,735	5,221
EBITDA	3,475	3,443	4,749	5,342	5,894
Growth					
Revenue Gth (%)	11.1	0.3	11.2	11.9	11.9
EBITDA Gth (%)	(48.4)	(0.9)	37.9	12.5	10.3
Opg Profit Gth (%)	6.9	(5.8)	10.5	13.9	11.6
Net Profit Gth (%)	(49.2)	7.0	38.7	13.7	10.3
Margins & Ratio					
Gross Margins (%)	27.1	26.3	26.1	26.2	26.3
Opg Profit Margin (%)	11.9	11.2	11.1	11.3	11.3
Net Profit Margin (%)	7.7	8.2	10.3	10.4	10.3
ROAE (%)	7.4	7.8	10.5	11.4	12.0
ROA (%)	5.2	5.7	7.6	8.2	8.6
ROCE (%)	8.4	8.3	9.0	9.8	10.5
Div Payout Ratio (%)	73.2	94.6	68.2	60.0	54.4
Net Interest Cover (x)	nm	nm	nm	nm	nm

Source: Company, DBS HK

Yunnan Baiyao

Balance Sheet (RMB m)

FY Mar	2021A	2022A	2023F	2024F	2025F
Net Fixed Assets	2,971	2,723	2,820	2,619	2,439
Invt in Associates & JVs	0	0	0	0	0
Other LT Assets	3,818	14,921	7,075	8,459	10,014
Cash & ST Invt	18,871	13,056	21,692	20,661	21,314
Inventory	8,379	7,993	8,913	9,958	11,126
Debtors	7,513	9,879	9,807	10,971	12,276
Other Current Assets	6,021	2,333	4,214	3,665	2,826
Total Assets	52,293	53,321	56,938	58,748	62,410
ST Debt	1,722	1,851	1,846	1,806	1,834
Creditors	7,341	7,585	9,283	9,695	10,996
Other Current Liab	3,655	4,122	4,308	4,117	4,315
LT Debt	90	2	2	2	2
Other LT Liabilities	1,141	1,236	1,164	1,151	1,184
Shareholder's Equity	38,226	38,504	40,536	42,432	44,815
Minority Interests	208	23	(200)	(453)	(733)
Total Cap. & Liab.	52,293	53,321	56,938	58,748	62,410
Non-Cash Wkg. Capital	10,917	8,498	9,344	10,782	10,918
Net Cash/(Debt)	21,780	13,619	22,260	21,268	21,893
Debtors Turn (avg days)	70.7	87.0	88.5	83.5	83.5
Creditors Turn (avg days)	112.5	102.8	103.5	104.1	101.6
Inventory Turn (avg days)	134.8	112.7	103.7	103.6	103.5
Asset Turnover (x)	0.7	0.7	0.7	0.8	0.8
Current Ratio (x)	3.6	2.6	3.0	3.1	2.9
Quick Ratio (x)	2.4	1.9	2.2	2.2	2.1
Net Debt/Equity (X)					
Net Debt/Equity ex MI (X)					
Capex to Debt (%)					
Z-Score (X)					

Source: Company, DBS HK

Cash Flow Statement (RMB m)

FY Mar	2021A	2022A	2023F	2024F	2025F
Pre-Tax Profit	3,482	3,377	4,685	5,328	5,875
Dep. & Amort.	281	372	226	234	237
Tax Paid	(685)	(537)	(744)	(847)	(934)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	(1,044)	(868)	(868)	(868)	(868)
Chg in Wkg.Cap.	(1,727)	2,543	(1,382)	(1,793)	(487)
Other Operating CF	4,917	(1,678)	270	187	161
Net Operating CF	5,223	3,209	2,187	2,241	3,984
Capital Exp.(net)	283	284	(237)	46	19
Other Invt.(net)	1,044	868	868	868	868
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	2,671	(7,468)	7,517	(1,346)	(1,655)
Net Investing CF	3,999	(6,316)	8,148	(432)	(768)
Div Paid	(2,565)	(2,839)	(2,839)	(2,839)	(2,839)
Chg in Gross Debt	(191)	41	(1,851)	(1,846)	(1,806)
Capital Issues	5	514	0	0	0
Other Financing CF	(4,908)	(3,394)	152	(994)	(757)
Net Financing CF	(7,188)	(5,572)	(4,538)	(5,679)	(5,402)
Currency Adjustments	0	0	0	0	0
Chg in Cash	2,034	(8,679)	5,797	(3,870)	(2,186)
Opg CFPS (RMB)	5.42	0.37	1.99	2.25	2.49
Free CFPS (RMB)	4.29	1.94	1.09	1.27	2.23

Source: Company, DBS HK

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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