INITIATE COVERAGE

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Sector: Healthcare

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CCM Duopharma Biotech Berhad

A Leading and Growing Generic Drug Player

TP: RM2.45 (+13.4%)

Last Traded: RM2.16

BUY

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We initiate coverage on CCM Duopharma Biotech Bhd, a leading generic drug manufacturer in Malaysia, with a **BUY** recommendation and TP of RM2.45/share. Key highlights include:

Leading Generic Drug Player in Malaysia. The pharmaceutical industry thrives on a growing and ageing population, growing affluence and the rising prevalence of non-communicable diseases. In Malaysia, the group ranks 1st in terms of sales volume and 3rd both in terms of market share and sales value.

Opportunities from Emerging 'Patent Cliff'. For the years to come, the expiry of patents of many blockbuster drugs developed by foreign companies will present opportunities for local generic drug manufacturers. As it is, Malaysia is still heavily reliant on imports with ~70% of its pharmaceutical needs imported.

Evolving Product Portfolio. Looking to stay ahead of the curve, in recent years, the group has been focusing on high value products in niche therapeutic areas such as cardiology, diabetes, oncology and renal. This includes biosimilars, a fast-growing segment within the pharmaceutical industry. Today, the group has two of the largest biosimilars in Malaysia, erythropoietin and insulin, under its belt.

Preparing for the Future. To facilitate future growth and expansion into specialty products, the group is rationalising and upgrading its manufacturing facilities into state-of-the-art facilities with enhanced current Good Manufacturing Practices under its Manufacturing Optimisation Strategy which is expected to complete by 2020.

Earnings Growth and Decent Dividend Yield. For FY17/FY18/FY19, we project earnings growth of 31.6%/7.4%/8.0% on the back of sustained growth in demand for pharmaceuticals from the government and private sector as well as export markets. Besides, dividend yields are decent, estimated at 3.9%/4.2%/4.4%.

Deserves a Premium. We opine that our target PE of 18.0x versus domestic peers of 15.0x is reasonable, notably with the encouraging development the group has been making with its foray into high value niche therapeutic areas.

Earnings Summary

FYE Dec (RM mn')	FY15	FY16	FY17F	FY18F	FY19F
Revenue	269.8	312.9	453.8	473.7	496.0
EBITDA	71.7	55.3	71.9	76.5	84.8
PBT	47.8	31.5	45.8	49.2	53.2
Taxation	(11.4)	(4.7)	(10.5)	(11.3)	(12.2)
PAT (-MI)	36.4	26.8	35.3	37.9	40.9
EPS (sen)	13.0	9.6	12.7	13.6	14.7
EPS growth (%)	3.2	(26.3)	31.6	7.4	8.0
PER (x)	16.6	22.5	17.1	15.9	14.7
DPS (sen)	9.5	6.5	8.5	9.0	9.5
Dividend yield (%)	4.4	3.0	3.9	4.2	4.4

Stock Return Information	
KLCI	1,740.93
Expected Share Price Return (%)	13.4
Expected Dividend Return (%)	4.2
Expected Total Return (%)	17.6

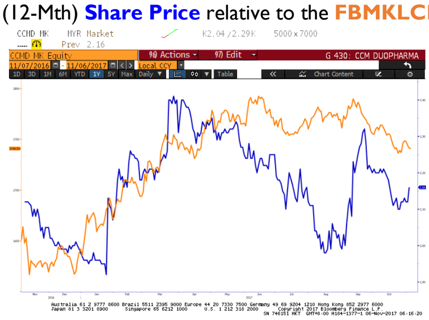
Share Information	
Bloomberg Code	CCMD MK
Stock Code	7148
Listing	Main Market
Issued Share (mn)	279.0
Market Cap (RMmn)	602.6
52-wk Hi/Lo (RM)	2.43/1.90
Estimated Free Float (%)	26.6
Beta (x)	0.6
3-Month Average Volume ('000)	83.2

Top 3 Shareholders (%)	
Chemical Company of Malaysia Bhd	73.4
EPF	3.8
Skim Amanah Saham Bumiputera	3.3

Share Performance (%)		
Price Change	CCMD	FBM KLCI
1 mth	(2.3)	(1.3)
3 mth	5.9	(1.9)
12 mth	0.5	5.6

Financial Info	FY17	FY18
Debt to Equity Ratio	0.6	0.8
ROA (%)	5.1	4.7
ROE (%)	7.7	8.0
NTA/Share (RM)	1.6	1.7
Price/NTA (x)	1.3	1.3

(12-Mth) **Share Price** relative to the **FBMKLCI**

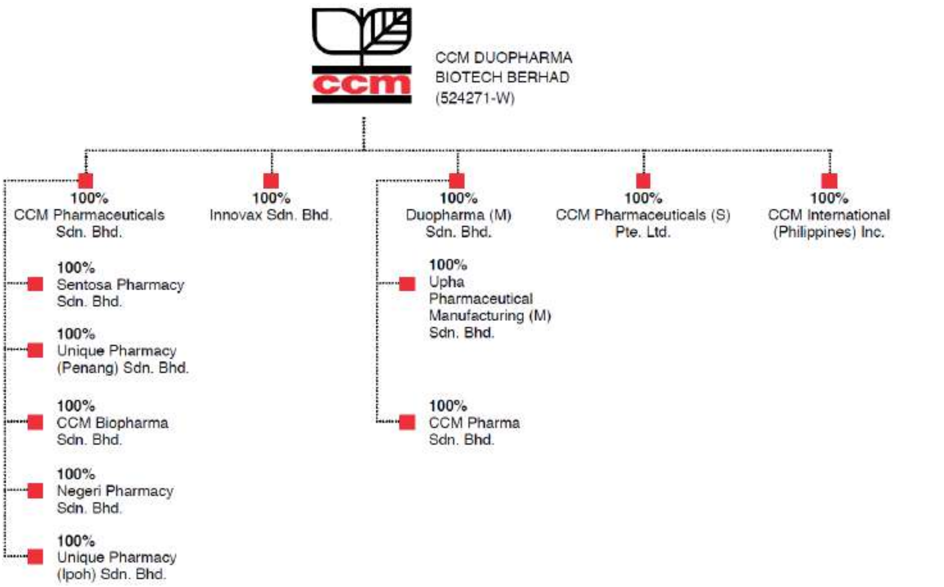


Source: Bloomberg

Background

CCM Duopharma Biotech Berhad (CCMD) is involved in the development, manufacturing and marketing of generic drugs and branded pharmaceuticals products. **It is a leading generic drug manufacturer in Malaysia and according to IMS Health, ranks 1st in terms of sales volume and 3rd both in terms of market share and sales value.** The group's product portfolio consists of over 500 ethical (also known as prescription) and over-the-counter (OTC) products across all key therapeutic areas. They include established market leading brands such as Champs, Flavettes and Naturalle, which are under the OTC product portfolio. Looking to stay ahead of the curve, in recent years, the group has been focusing on high value products in niche therapeutic areas to enhance its product portfolio. This includes areas such as cardiology, diabetes, oncology, renal as well as biosimilars. Apart from that, **the group is also a champion on the Halal front with it being the first pharmaceutical company in the world to receive Halal certification for ethical drugs by Jabatan Kemajuan Islam Malaysia** (JAKIM). Among others, the group's various accolades include 'Pharmaceutical Company of the Year – Generics Market' in 2016 and 'Halal Pharmaceutical Company of The Year for its Prescription Pharmaceuticals' in 2017, both awarded by Frost & Sullivan.

Figure 1: Group Structure



Source: Company, TA Securities

Table 1: Group Details

Company	Stake (%)	Principal Activities
CCM Pharmaceuticals Sdn Bhd	100	Marketing and sales of medicine and pharmaceutical products
Sentosa Pharmacy Sdn Bhd	100	Distributor of pharmaceutical products
Unique Pharmacy (Penang) Sdn Bhd	100	Distributor of pharmaceutical products
CCM Biopharma Sdn Bhd	100	Dormant
Negeri Pharmacy Sdn Bhd	100	Dormant
Unique Pharmacy (Ipoh) Sdn Bhd	100	Dormant
Innovax Sdn Bhd	100	Research and development of pharmaceutical products
Duopharma (M) Sdn Bhd	100	Manufacturing, distribution, importing and exporting of pharmaceutical products and medicines
Upha Pharmaceutical Manufacturing (M) Sdn Bhd	100	Manufacturing of pharmaceutical products and sales of medicines
CCM Pharma Sdn Bhd	100	Property management and services
CCM Pharmaceuticals (S) Pte Ltd	100	Distribution, wholesaler of medicinal and pharmaceutical products
CCM International (Philippines), Inc	100	Distribution, importing and exporting of pharmaceutical and chemical products

Source: Company, TA Securities

History

The group's history dates back almost 40 years to 1979 when it was founded by two experienced pharmacists, Chia Ting Poh @ Cheah Ting Poh and Ang Bee Lian. It commenced as a trading company, importing and marketing pharmaceutical products and later on in 1986, embarked on manufacturing. Manufacturing started with tablets, capsules, oral preparations and progressively expanded into other forms such as haemodialysis solutions, small volume injectables and eye drop preparations. The group was listed on the then Second Board of Bursa Malaysia on 18 July 2002. It then transferred to the Main Market of Bursa Malaysia on 3 November 2003. One of the group's key milestone was in 2005 when Chemical Company of Malaysia Bhd (CCMB) emerged as a major shareholder with a stake of ~74%. Another major milestone was on 1 June 2015 when CCMD acquired and merged all the pharmaceutical companies of CCMB, which then set the group on course to evolve into Malaysia's leading pharmaceutical manufacturer.

Table 2: Key Milestones

Year		Event
1979	-	Commenced as trading company, importing and marketing all pharmaceutical products to doctors and hospitals.
1986	-	Started new production plant for tablets capsules and oral preparations.
1993	-	Started construction of new factory in Klang to cater for increased production.
1996	-	Haemodialysis liquid production facilities approved and commenced operations.
	-	Received approval for small volume injectables facilities and commenced production of eye drops and antibiotic powders.
	-	Large volume infusion facilities approved.
1997	-	Commenced production of large volume infusion.
2002	-	Listed on the then Second Board of Bursa Malaysia under the company name Duopharma Biotech Bhd.
2005	-	Became a subsidiary of CCMB and company name was rebranded to CCM Duopharma Biotech Bhd.
2015	-	Acquired and consolidated all of CCMB's pharmaceutical assets for RM245.1mn.
2016	-	Awarded 'Pharmaceutical Company of the Year – Generics Market' by Frost & Sullivan.
2017	-	First pharmaceutical company in the world to receive Halal certification for ethical drugs by JAKIM.

Source: Company, TA Securities

Key Management

The group is spearheaded by Chief Executive Officer, **Leonard Ariff bin Abdul Shatar**. He has been with the group since 2008 and assumed his current role since 1 January 2008. In addition, he holds key positions at the group's parent company, CCMB, whereby he is the Group Managing Director since 9 January 2015 and also the Chief Executive Officer of the Pharmaceuticals Division. He kickstarted his career in 1988 in various capacities including the legal profession, business development and business management. In 2000, he was also the Managing Director of Usaha Pharma (M) Sdn Bhd, which was CCMB's pharmaceutical arm.

Billy Urudra is the group's Chief Commercial Officer. In his current role which he assumed on 1 January 2012, he oversees all of the group's commercial activities, both locally and abroad. Of his nearly 23 years of commercial experience, 13 years are in the pharmaceutical industry. His stint in the pharmaceutical industry begun in July 2004 where he was appointed as CCMB's Director, Group Strategic Planning & Business Development.

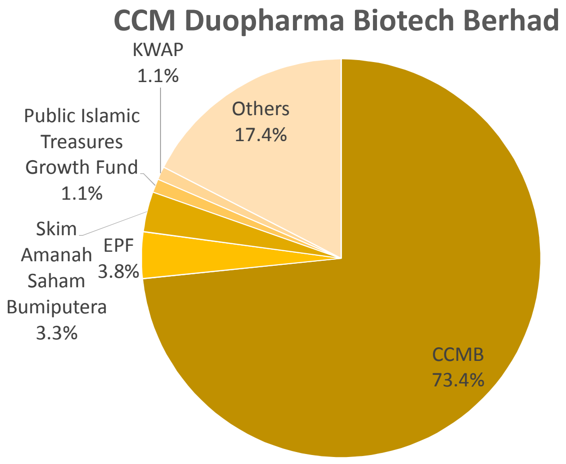
Chek Wu Kong is the group's Chief Financial Officer. He assumed his current role in 2012 and is responsible for finance, IT and human resources portfolios. His stint with the group begun in August 2000 when he joined as a Financial Controller. He kickstarted his career in 1990 at an international firm of public accountants where he honed his experience in taxation, auditing and accounting and later on joined Komarkcorp Bhd in 1994 where he was responsible for corporate restructuring, accounting and finance.

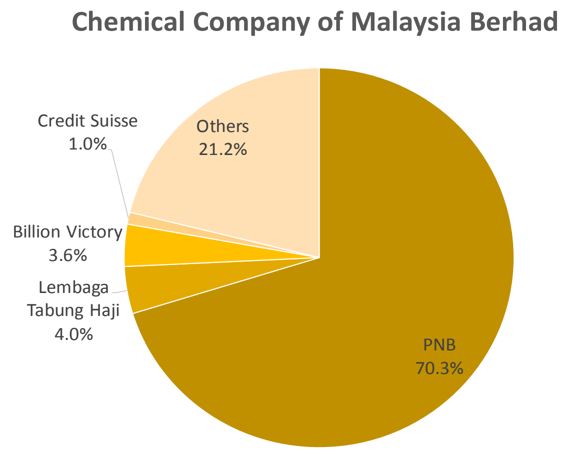
Wan Amir-Jeffery bin Wan Abdul Majid is the group's Chief Strategy Officer. He joined the group on 5 September 2016 and is responsible for business development, Halal initiatives and government business of the group. Prior to joining the group, he honed his experience in identifying, structuring, securing and implementing biomedical investment projects, especially in the pharmaceutical and biopharma industries at Malaysian Biotechnology Corporation. Furthermore, in his dual role as the Chief Executive Officer of Johor Biotechnology & Biodiversity Corporation and J-Biotech Holdings Sdn Bhd, he was responsible for the development and implementation of key bioeconomy and biotech initiatives in Johor.

Substantial Shareholders

The group's largest shareholder is CCMB with a direct stake of 73.4%. As Permodalan Nasional Bhd (PNB) is a substantial shareholder of CCMB with a 70.3% stake, the group is a government linked company. The other shareholders of CCMD include funds such as the Employees Provident Fund (3.8%), Skim Amanah Saham Bumiputera (3.3%), Public Islamic Treasures Growth Fund (1.1%) and KWAP (1.1%). **Note that CCMB is currently undertaking multiple proposals, one of which would lead to CCMD being demerged from CCMB by way of distribution in specie.** Contingent on the outcome of preceding proposals, upon completion of the demerger exercise estimated to be in January 2018, PNB's stake is expected to be diluted to 50.4% to 57.1%. **We view the demerger exercise positively as it would result in a larger free float from 26.6% to at least ~40% and in turn, bode well for the stock's trading liquidity.**

Figure 2: Shareholding Structure



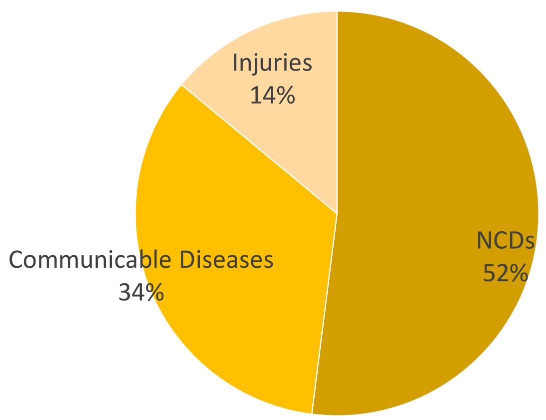


Source: Company, TA Securities

❖ *A Defensive & Growing Industry*

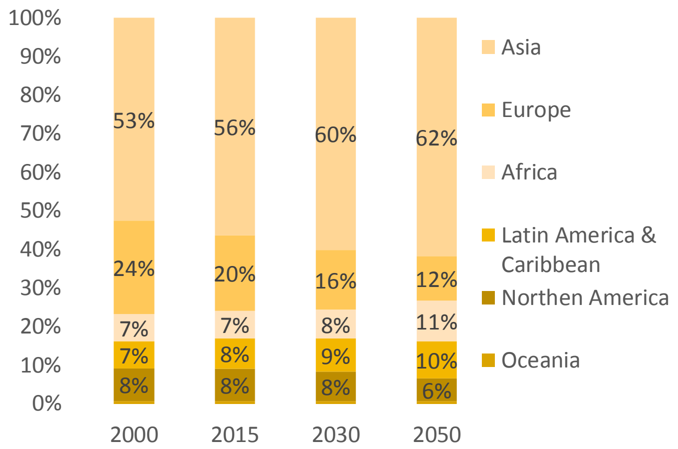
Pharmaceuticals is generally a defensive and growing industry. **The industry naturally thrives on a growing and ageing population, growing affluence and the rising prevalence of non-communicable diseases (NCDs).** A greater proportion of aged population is typically associated with higher incidences of age-related diseases and higher income levels mean more disposable income available to spend on health and wellness. In addition, the urbanisation and globalisation of preventable behavioural risk factors such as sedentary lifestyles, unhealthy diets and tobacco use have resulted in rising cases of NCDs such as cancer, cardiovascular diseases, respiratory diseases and diabetes, which are the leading causes of global mortality. **Over the past decade, Malaysia's pharmaceutical industry grew at a CAGR of 8% to 10% largely on the back of imports of both patented and generic drugs.** Estimated to be worth US$2.3bn in 2015, the industry is projected to grow at a CAGR of 9.5% to US$3.6bn by 2020.

Figure 3: Global Mortality <70 Years by Cause (2012)



Source: World Health Organisation, TA Securities

Figure 4: Distribution of Population ≥60 Years by Region



Source: United Nations, TA Securities

❖ *Malaysia's Forte – Manufacturing of Generic Drugs*

Malaysia's strength within the pharmaceutical industry lies in the manufacturing of generic drugs. Pharmaceuticals generally can be classified as: 1) ethical, 2) OTC, 3) traditional medicines, and 4) health and food supplement. Promoting the development of the industry, incentives for pharmaceutical manufacturers include Pioneer Status or Investment Tax Allowances. As of November 2015, there were 77 companies licensed with the Drug Control Authority (DCA) for the manufacturing of pharmaceuticals. The DCA is the principal regulatory authority that manages the registration, production, import and sale of pharmaceuticals in Malaysia. To name a few, major pharmaceutical manufacturers include CCM Duopharma Biotech Bhd, Pharmaniaga Bhd, Apex Healthcare Bhd, Y.S.P. Southeast Asia Holding Bhd, Hovid Bhd and Kotra Industries Bhd.

Opportunities from Emerging 'Patent Cliff'

For the years to come, **opportunities for local generic drug manufacturers are present from the emerging 'Patent Cliff' – whereby the patents of many blockbuster drugs developed by USA and European companies will expire across 2010 to 2018**. We foresee them to benefit from a product portfolio enhanced by the introduction of newly expired patented drugs. As a matter of fact, **Malaysia is still heavily reliant on imports with ~70% of its pharmaceutical needs imported** as they are not available locally. This includes drugs that are essential for the treatment of contemporary diseases such as cancer, cardiovascular diseases and diabetes.

More specifically, at the government sector, which is the largest purchaser of pharmaceuticals in Malaysia, while ~60% of the drugs it dispenses are generic, only ~30% of them are sourced locally. Generic drugs are essentially equivalent to patented drugs. They offer the same clinical benefits (i.e. safety, strength, quality, performance) but are generally much cheaper due to the minimal research and development and marketing expenses involved. The development of newly expired ethical patented products would enable local generic drug players to capture a larger share of spend on generic drugs. **Also encouraging, the government is looking to source for more generic drugs to better manage its healthcare expenditure**.

Table 3: Description of Patented and Generic Drugs

Product Type	Description
Ethical Patented Products	• Innovated mostly by multinational corporations. • About 50 to 100 times more expensive than old ethical products. • Patent normally lasts for 20 years giving patent holder exclusivity to market the products.
Newly Expired Ethical Patented Products	• Prices are reasonable. • Not many players as testing and development of these products are costly. • Players who enter this market will reap a larger share of profit and market share. • Minimal advertising and promotional cost needed.
Old Ethical Products	• Patent of these products have long expired. • Many players in the market resulting in lower prices and margins.

Source: Company, TA Securities

Biosimilars – A Budding Segment

Apart from the emerging 'Patent Cliff', the area of biosimilars (also known as biogenerics) also presents opportunities for local pharmaceutical players. **It is a fast-growing segment within the pharmaceutical industry** that is dominated by global pharmaceuticals. **Since 2000, the global biologics industry recorded double-digit CAGR of 20%** and such robust growth is expected to sustain in the foreseeable term. In a nutshell, biosimilars are less costly replications of original biologic drugs that were previously patented. They are manufactured from bioactive compounds originating from animals and plant. However, when compared to conventional generic drugs, they are much more expensive as they are complex to manufacture. Unlike conventional generic drugs, which contain the same active ingredients as its patented counterpart, for biosimilars, it is impossible to replicate the molecule of the biologic drug that has come off patent. Principally, the impetus for local pharmaceuticals players to tap into the area of biosimilars lies in the high value they fetch as well as the regard as being superior to generic drugs in treating life-threatening diseases like AIDS, Alzheimer's and cancer.

❖ *Manufacturing Capabilities*

The group's product portfolio consists of over 500 ethical and OTC products across all key therapeutic areas. Ethical products are drugs that require prescription by doctors while OTC products do not require prescription. They come in various dosage forms such as capsules, creams, dental cartridges, eye drop preparations, haemodialysis solutions, oral antibiotics, small volume injectables, sterile irrigation solutions, sterile powder injectables, syrups and tablets. In terms of contributions, ethical products have historically accounted for ~80% of sales, with the balance ~20% by OTC products.

Figure 5: Products

Source: Company, TA Securities

Currently, the group has 3 manufacturing facilities located in Klang, Bangi and Glenmarie. They are all certified by the Ministry of Health (MoH) as meeting the Good Manufacturing Practice guidelines of the Pharmaceuticals Inspection Convention and Cooperation Scheme. In addition, **the group is also a champion in the Halal front with it being the first pharmaceutical company in the world to receive Halal certification for ethical drugs by Jabatan Kemajuan Islam Malaysia**. Keeping the product pipeline alive, the group has an in-house research and development arm under Innovax Sdn Bhd, which is continuously focused on product innovation. Looking to stay ahead of the curve, in recent years, the group has been focusing on high value products in niche therapeutic areas to enhance its product portfolio. This includes areas such as cardiology, diabetes, oncology, renal as well as biosimilars. The move serves to guard the group's profit margins amidst intensifying competition from both local and regional players in the conventional generic drugs space.

Figure 6: Facilities

Bangi Plant  	Established Workforce Types of Products	• 1976 • 656 people (including CCMD Sales & Marketing team) • Ethical and OTC Products – mainly in oral solid dosages, soft gels, liquids and cream forms
Klang Plant  	Established Workforce Types of Products	• 1979 • 446 people • Oral solids dosages, Haemodialysis & SVI Products, LVI – Irrigation solution products, dental cartridge and sterile cephalosporin
Glenmarie Plant 	Established Workforce Types of Products	• 2008 • 37 people • HAPI plant for Oncology • Innovax Sdn Bhd, the division's R&D centre is located in this plant

Source: Company, TA Securities

Also note that an instrumental factor to the group's market leading position today was its acquisition and merger of all 6 pharmaceutical companies of its parent company, CCMB, for RM245.1mn on 1 June 2015. In all, the exercise yielded the following synergies:

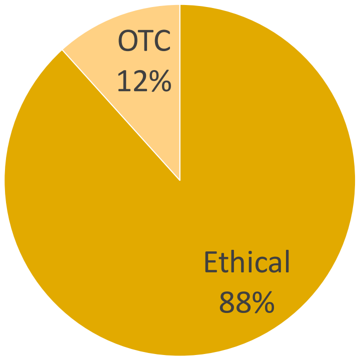
- **Increased cross selling opportunities** from a broader product portfolio and distribution network. CCMB complemented CCMD's ethical product portfolio with its OTC products, which include established market leading brands such as 'Champs', 'Flavettes' and 'Naturalle';
- **The needed increase in manufacturing capacity and scale** to facilitate: 1) the growing demand for the group's generic drugs, and 2) the group's bid for large government contracts. Prior to the acquisition, the group's facilities in Klang were operating at almost optimal capacity while CCMB's in Bangi were operating at 30% to 40%. Accordingly, the acquisition provided an immediate boost to the group's manufacturing capacity to expedite its growth.

Domestically Driven Sales

The group's **sales are primarily driven by the government and private sector – for FY17, estimated at ~65% and ~27% respectively** with the balance ~8% being exports. The high concentration to the government sector is not surprising given that ~60% of Malaysians seek healthcare services at public hospitals, which are more affordable compared to private hospitals. Generally, the government sources its drugs through: 1) concessionaire Pharmaniaga Bhd, and 2) invitation for tender submissions for products not listed in the Approved Product Purchase List (APPL). In more detail, under the former method, dubbed the 'APPL method', Pharmaniaga Bhd as the concessionaire receives tender submissions from potential vendors for products listed in the APPL on behalf of the MoH, which in turn evaluates and selects the vendors. The concessionaire's role is to procure, store, supply and distribute the approved drugs and medical supplies to government hospitals and clinics.

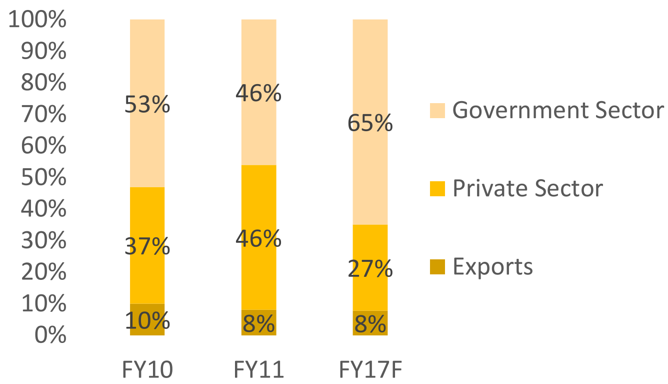
For the most part, the government's annual allocation to healthcare expenditure has been steadily on the rise to meet the rise in demand for healthcare from the public. In Budget 2018, RM4.1bn was allocated for drugs, medical supplies and consumables to all government healthcare facilities, a 2.5% YoY increase over Budget 2017's of RM4.0bn.

Figure 7: Sales Breakdown by Product (FY17F)



Source: Company, TA Securities

Figure 8: Sales Breakdown by Customer



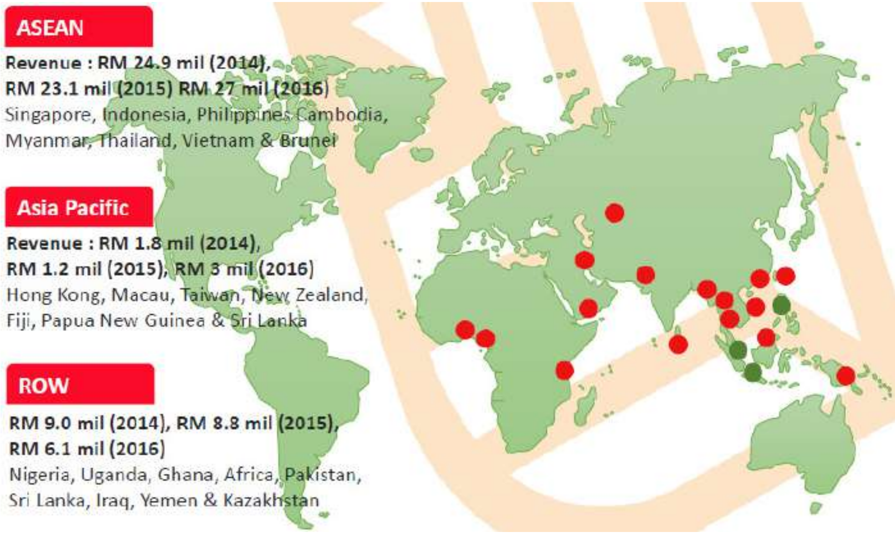
Source: Company, TA Securities

❖ ***Targets to Grow Export Contributions***

While export contributions are relatively small at ~10% of sales, **the group has a long-term target to grow it to up to 40% in 5 to 10 years**. **We expect such efforts to increase geographic diversification and mitigate foreign currency risk on its cost of goods sold, particularly that of active ingredients which are in hard currencies**, mainly the USD and partially Euro. The group currently exports to over 30 countries and has a strong presence in ASEAN region. It has a local presence in Singapore and the Philippines via its wholly-owned subsidiaries, CCM Pharmaceuticals (S) Pte Ltd and CCM International (Philippines), Inc respectively as well as a representative office in Indonesia. **In 2016, export contributions were led by the ASEAN region (RM27mn)** and followed by Asia Pacific (RM3mn) and the rest of the world (RM6.1mn). **The ASEAN region's performance is very much driven by Singapore.**

Going forward, alongside efforts to grow export contributions, primary focus will be placed on the ASEAN region, especially in countries with large populations like Indonesia, the Philippines and Vietnam. Positively, countries within the region like Brunei, Philippines and Singapore have pharmaceutical regulatory framework that are rather similar to Malaysia's. Besides, we also view that the Halal certification accorded to the group's ethical products by JAKIM would bode well for their market potential not just locally but also abroad alongside the growing awareness on the high safety and hygiene standards of Halal certified products. On a side note, **it is also noteworthy that over the years, the group has been exploring merger and acquisitions opportunities abroad**. **Recently, management have highlighted of potential in countries like Indonesia and the Philippines**.

Figure 9: International Business



Source: Company, TA Securities

- ***Focus on High Value Products Paying Off***

The group's focus on high value products in niche therapeutic areas appears to be paying off. To reiterate, this represents a strategic direction that is envisioned to guard the group's profit margins amidst intensifying competition from both local and regional players in the conventional generic drugs space. Progress thus far has been encouraging, particularly in the area of biosimilars, which we have highlighted earlier as a fast-growing segment within the pharmaceutical industry that is dominated by global pharmaceuticals. **Today, the group has two of the largest biosimilars in Malaysia, erythropoietin (EPO) and insulin, under its belt.** Note that this achievement is a result of strategic partnerships with global pharmaceuticals, which facilitates the sharing of innovations and expertise. For EPO and insulin, the group has a partnership with PanGen Biotech Inc, Korea and Biocon Ltd, India (Biocon) respectively.

Attesting to be a strategic acumen, the group had in 2016 bagged a RM300.0mn contract from the MoH to supply human insulin for the treatment of diabetes to all government hospitals and clinics for 3 years from 2 December 2016 until 1 December 2019. The group's partnership with Biocon grants it the exclusive rights to market and distribute its insulin products, Insugen® and Basalog® in Malaysia.

As for EPO, it is en route to commercialisation following the success of its Phase III Clinical Trial in Korea and Malaysia in February 2017. EPO is an injectable drug used for the treatment of anaemia in end-stage renal failure patients and according to management, **its market potential in Malaysia is estimated to be worth ~RM60mn to RM70mn per annum.** The group's partnership with PanGen BioTech Inc, Korea to jointly conduct the Phase III Clinical Trial gives it the exclusivity to package, fill and finish and distribute EPO in Malaysia, Singapore and Brunei. **The product will be launched and marketed on a trading basis (prior to completion of a dedicated production line under its on-going expansion plans) upon receipt of marketing authorisation from the National Pharmaceutical Regulatory Agency.**

In all, for biosimilars, **management has targets for revenue contributions from the segment to reach ~30% by 2020**. We view that the group is on track to achieve this with FY17's contributions from the segment estimated at ~22%. This was mainly attributed to the contract from the MoH to supply human insulin to all government hospitals and clinics worth ~RM100.0mn per annum as aforementioned.

Apart from biosimilars, **the group has also been making headways in other niche areas like oncology**. In this area, the group launched a Cancer Care Franchise in 2016 to raise awareness for the early detection of cancer and increase the accessibility to more affordable generic oncology drugs. Also, **in April 2017, the group entered into a technological partnership with Natco Pharma Ltd, India (Natco) to develop Malaysia's first High Active Potent Ingredient (HAPI) Drug manufacturing facility to localise the manufacturing of 8 generic oncology drugs over the next 7 years.** Eventually, the group's generic oncology drug portfolio will be enhanced with those to treat blood cancer, breast cancer, cervical cancer, colorectal cancer, and lung cancer. Its existing oncology drugs include Letronat and Kytron, which have received positive take-ups.

Table 4: Strategic Partnerships

Year	Description
2012	➢ **Inked a collaboration with PanGen Biotech Inc, Korea to pioneer EPO in Malaysia.** • The collaboration entails a Joint Clinical Trial (JCT) for EPO and kicked off CCMD's foray into biosimilars. • Via the JCT, CCMD obtained exclusivity to package, fill and finish and distribute EPO in Malaysia, Singapore and Brunei. • The JCT commenced in February 2014 with a total investment cost of RM18.0mn and completed in January 2017. • Prospects for EPO in Malaysia: 1) rising incidence of renal patients and 2) high market value. ➢ **Partnered with Biocon Ltd, India for the marketing and distribution of a range of insulin products in Malaysia and Brunei.** • Offers more affordable insulin therapy (i.e. Insugen® and Basalog®) for diabetes patients in Malaysia. • Bagged a contract worth RM300.0mn from the MoH to supply human insulin to all government hospitals and clinics from 3 years from 2 December 2016 until 1 December 2019.
2017	➢ **Entered into a technological partnership with Natco to develop Malaysia's first HAPI Drug manufacturing facility.** • Natco will provide facility design, manufacturing technology transfer and active pharmaceutical ingredients to localise the manufacturing of 8 cancer products in Malaysia over the next 7 years. • This will be the first plant in Malaysia to manufacture generic oncology drugs and other High Active Potency products.

Source: Company, TA Securities

❖ *'Manufacturing Optimisation Strategy' to Facilitate Growth*

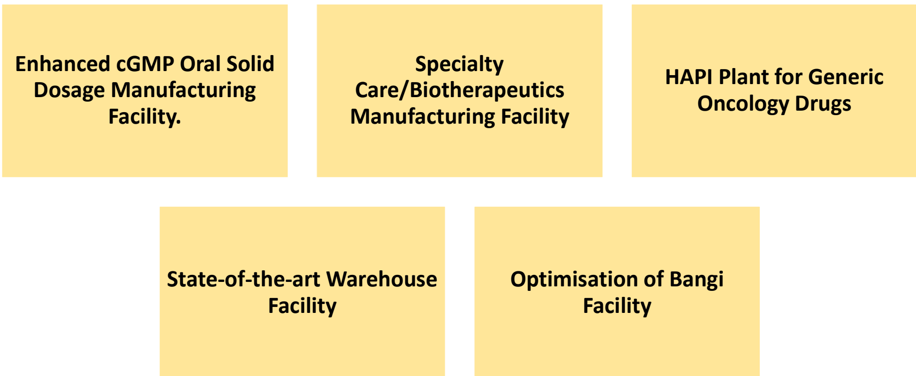
In 2016, the group embarked on a Manufacturing Optimisation Strategy (MOS). **The MOS is intended to facilitate its growing operations, enhance its product portfolio into specialty products as well as to keep abreast with current Good Manufacturing Practices (cGMP).** It entails the rationalisation and upgrading of its manufacturing facilities in Klang, Bangi and Glenmarie into state-of-the-art facilities with enhanced cGMP, purposed designed warehouse and distribution hub. Among others, the group will have a production line dedicated to the manufacturing of EPO. In all, **the MOS is estimated to necessitate capital expenditure of RM306.0mn throughout 2016 to 2019.** To support its capital commitment, the group announced in June 2017 that it had entered and executed financing facilities amounting to RM280.0mn with AmBank Islamic Bhd. Following are the key developments for respective facilities under the MOS:

i. **Taman Jaya Klang, Klang:** Construction of a new state-of-the-art plant (K3) at RM103.7mn and a new warehouse with roof top car park at RM37.1mn. K3 will replace K1 which is the group's existing plant also located in Taman Jaya Klang, Klang. Estimated to complete in 2020, it will enlarge production capacity by approximately 40% to 50% and house the manufacturing of oral solid dosage and specialty products.

ii. **Glenmarie, Shah Alam:** The existing plant will be retrofitted to a new HAPI plant at RM15.0mn. This is in conjunction with the group's partnership with Natco. Estimated to complete 2020, it will be the first plant in Malaysia to manufacture generic oncology drugs and other High Active Potency products. Then, the group expects to be eligible for Pioneer Status that grants income tax exemption of 70% to 100% of statutory income for 5 to 10 years.

iii. **Bangi:** Optimisation of facilities and expansion of the warehouse.

Figure 10: Manufacturing Optimisation Strategy



Source: Company, TA Securities

Financial Highlights

❖ *Historical Financial Performance*

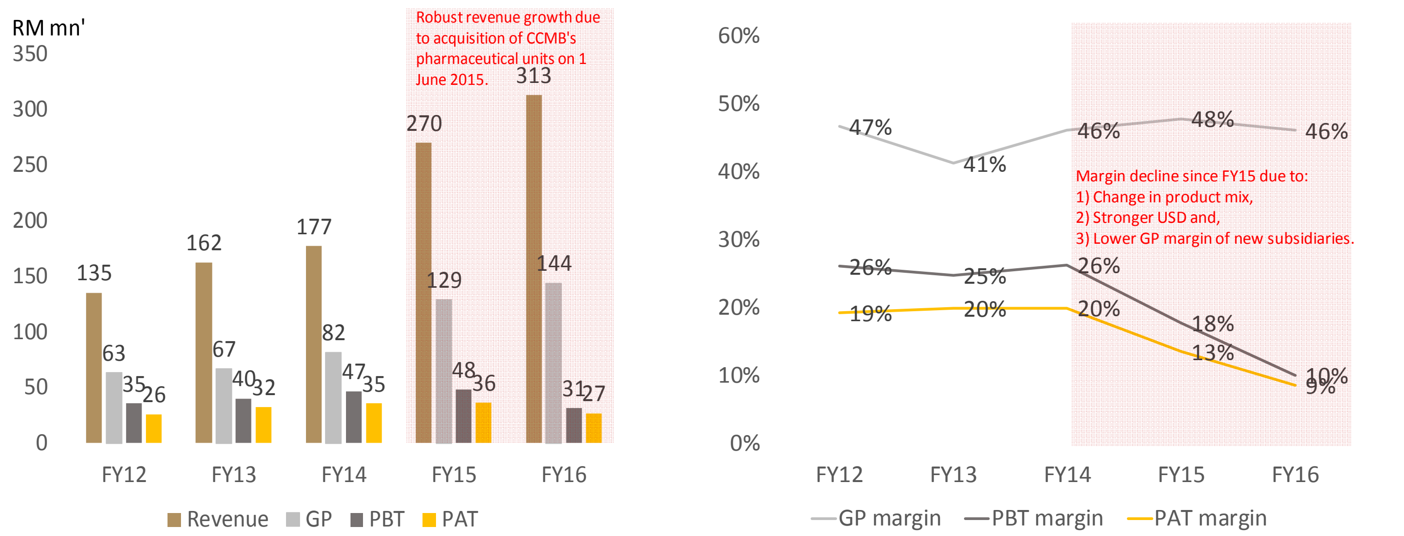
Except for FY16, the group displayed steady earnings growth over the years. During FY12 to FY15, PBT grew at a CAGR of 10.7% to RM47.8mn (vs. peers of 6.8%). This was on the back of growing demand from both local and export markets. Revenue grew at a CAGR of 25.9% to RM269.8mn (vs. peers of 6.9%).

As for FY16, revenue grew by 16.0% YoY to RM312.9mn but PBT contracted by 34.2% YoY to RM31.5m, leading to PBT margin compression of 7.7pp to 10.1%. The weaker bottom line performance was attributed to: 1) changes in product mix, 2) higher production cost caused by the strengthening of the USD against the MYR, and 3) lower margins of the pharmaceutical companies acquired from CCMB on 1 June 2015. Notwithstanding the robust top line growth, it was partly offset by slower off-take from the government sector due to more stringent dispensing practices (i.e. from 3 months of supply to 1 month) to curb wastages.

Compared against peers, we observe them exhibiting similar trends in CY16 with PBT -22.4% YoY and PBT margins -1.7pp to 5.5%. Note that the group used to command the highest margins in the industry with PBT margin during CY12 to CY14 at ~26% versus peers of ~7%. However, it has declined to ~10% lately partly due to the lower margins of its newly acquired subsidiaries from CCMB on 1 June 2015. Nonetheless, among its peers, the group still commands above average margins with CY16's PBT margin at 10.1%, which is above peers 5.5%.

As for 1HFY17, the group's revenue and PBT grew by 51.5% YoY to RM240.4mn and 40.2% YoY to RM24.8mn. This was driven by increased demand for endocrine and renal products as well as increased demand from the government sector via tenders.

Figure 11: CCMD's Historical Financial Performance (FY12-FY16)



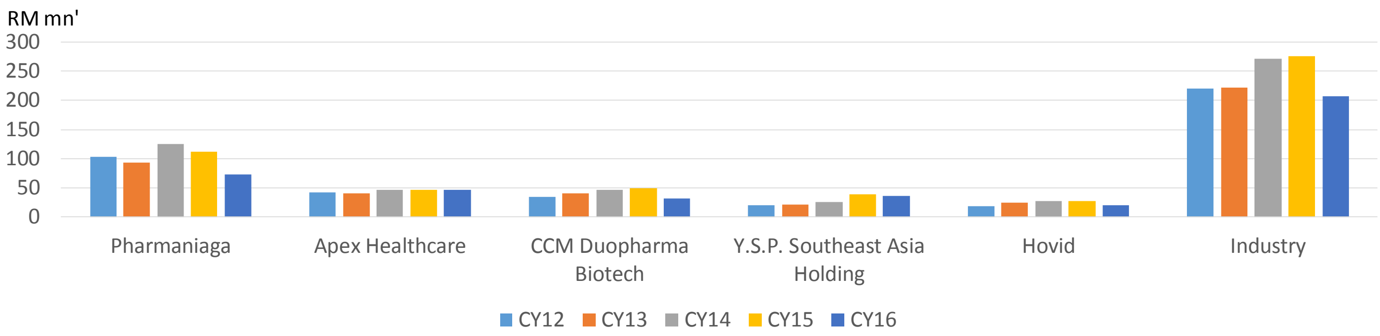
Source: Company, TA Securities

Table 5: 1HFY17 Results

FYE Dec (RM mn')	2QFY16	1QFY17	2QFY17	QoQ	YoY	1HFY16	1HFY17	YoY
Revenue	79.1	123.3	117.0	(5.1)	146.9	158.6	240.4	51.5
EBITDA	13.7	18.2	19.3	6.1	139.1	29.5	37.4	27.1
Depreciation & amortisation	(5.6)	(5.4)	(5.9)	8.1	103.7	(11.1)	(11.3)	1.7
EBIT	8.1	12.7	13.4	5.3	163.5	18.3	26.1	42.5
Finance income	0.9	0.7	0.6	(17.8)	61.0	2.2	1.3	(40.0)
Finance costs	(1.4)	(1.3)	(1.3)	2.0	97.0	(2.8)	(2.7)	(6.6)
PBT	7.7	12.1	12.6	4.3	162.7	17.7	24.8	40.2
Tax	(3.8)	(2.6)	(3.0)	17.3	78.3	(5.9)	(5.6)	(5.7)
PAT	3.9	9.6	9.6	0.8	243.6	11.8	19.2	63.2
EPS	1.4	3.4	3.5	0.9	244.4	4.2	6.9	63.2
DPS	2.5	0.0	2.5	nm	99.0	2.5	2.5	0.0
Profitability ratio	%	%	%	pp	pp	%	%	pp
EBITDA margin	17.4	14.7	16.5	1.7	(0.9)	18.6	15.6	(3.0)
EBIT margin	10.3	10.3	11.4	1.1	1.2	11.6	10.9	(0.7)
PBT margin	9.8	9.8	10.8	1.0	1.0	11.1	10.3	(0.8)
Tax rate	49.0	21.1	23.7	2.6	(25.2)	33.4	22.4	(10.9)
PAT margin	5.0	7.8	8.2	0.5	3.3	7.4	8.0	0.6

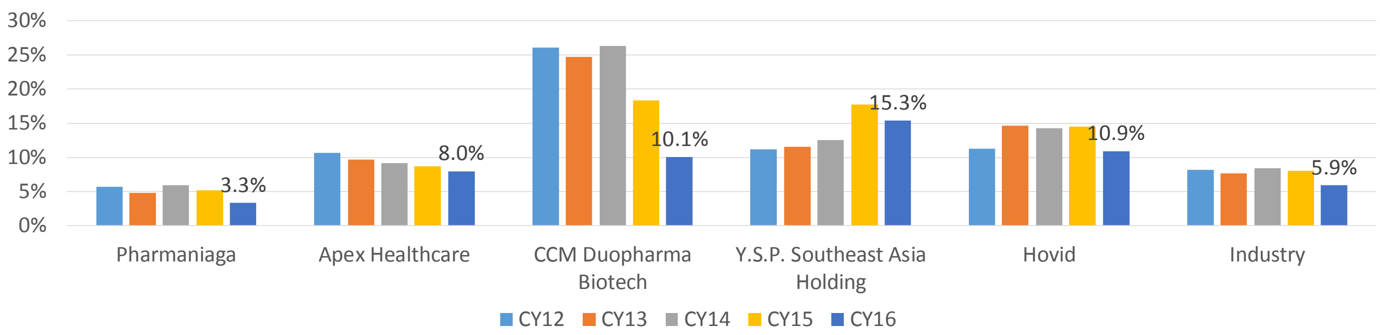
Source: Company, TA Securities

Figure 12: Industry PBT (CY12-CY16)



Source: Companies, TA Securities

Figure 13: Industry PBT Margin (CY12-CY16)



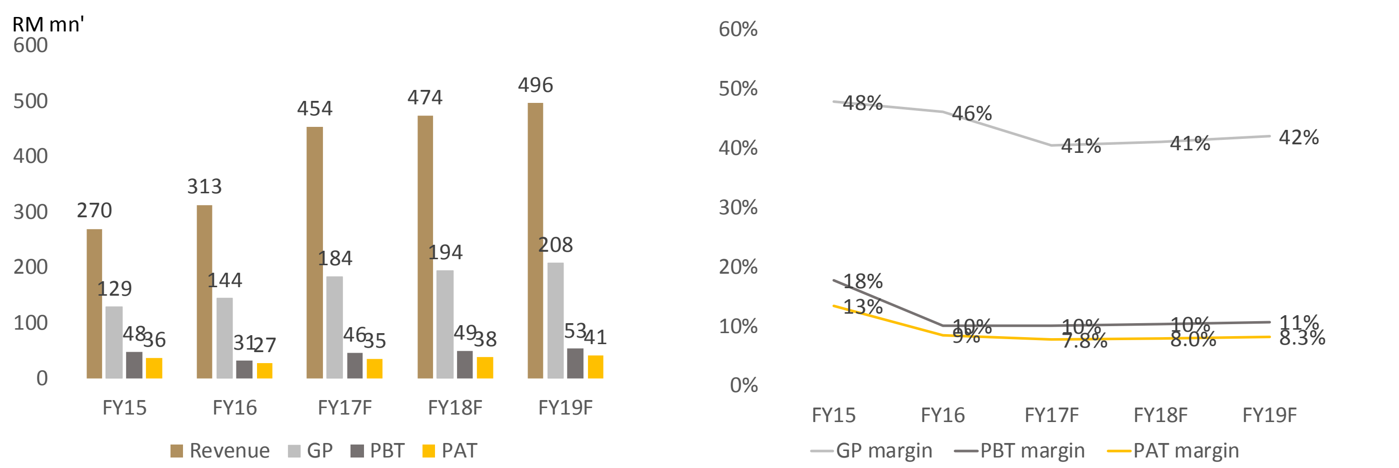
Source: Companies, TA Securities

Financial Projections

Going forward, we expect the group's earnings growth momentum to resume, driven by the sustained increase in demand for pharmaceuticals from the government and private sector as well as export markets. From FY16 to FY19, we are projecting revenue and PAT to grow at a CAGR of 16.6% and 15.1% respectively. Our expectations for robust revenue growth is underpinned by the RM300.0mn contract from the MoH to supply human insulin to all government hospitals and clinics for 3 years from 2 December 2016 to 1 December 2019 ,which on average translates into annual sales contribution of ~RM100.0mn. Stripping out contributions from this contract, revenue from other ethical and OTC products is expected to grow at a CAGR of 8.2%, close to the projections for the local pharmaceutical industry to expand at a CAGR of 9.5% by 2020.

As for margins, we conservatively expect gradual improvements with FY17/FY18/FY19 PAT margins at 7.8%/8.0%/8.3% respectively alongside the group's growing exposure to high value products in niche therapeutic areas. And in tandem with management's guidance, we have assumed effective tax rates for FY17/FY18/FY19 to be at 23%, slightly lower than the statutory tax rate of 24% on the utilisation of tax incentives. We expect the group to enjoy greater tax benefits from its upcoming HAPI plant in 2020, which according to management is eligible for Pioneer Status.

Figure 14: CCMD's Projections for FY17 to FY19

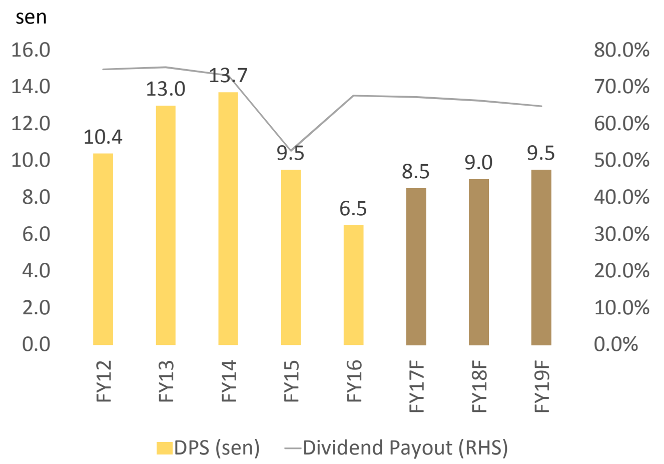


Source: Company, TA Securities

In terms of financial strength, the group appears to be in healthy financial standing with net gearing of 0.1x as at 2QFY17. However, with expectations for the group to draw down on its RM280.0mn financing facilities to support the capital expenditure for its MOS, we expect net gearing to stretch to 0.6x in FY19. We estimate CAPEX for FY17/FY18/FY19 at RM70.0mn/RM128.0mn/RM138.0mn.

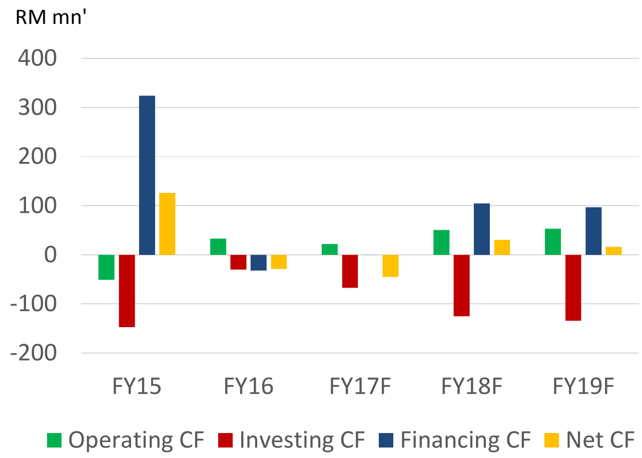
As for dividends, the group has no dividend policy but has historically paid out more than 50% of its profits. Alongside its expansion phase, we view that the group will be able to continue doing so in tandem with its year-to-year financial performance. As aforementioned, CAPEX for the group's MOS will be supplemented by its RM280.0mn financing facilities. For FY17/FY18/FY19, we have assumed the group to pay out 65% to 70% of its profits, implying decent yield of 3.9%/4.2%/4.4%.

Figure 15: DPS (sen) and Dividend Payout Ratio (%)



Source: Company, TA Securities

Figure 16: Cash Flow



Source: Company, TA Securities

Key Risks

Dependence on a Single Customer. The group is highly dependent on the government sector, which contributes >50% of sales. Such concentration is not surprising given that in Malaysia, the government's universal healthcare scheme caters to ~60% of citizens with the balance ~40% by the private healthcare system. **The government's demand for drugs is ultimately contingent on the government's budget allocation to healthcare expenditure.** Notwithstanding, to protect against risk of dependence on a single customer, **the group endeavours to ensure its products are of high quality and competitively priced**. Apart from that, other measures being undertaken include its foray into high value niche therapeutic areas where the competitive space is better as well as increasing its penetration in the private sector and export markets. According to management, the group has over 150 sales representatives across Peninsular and East Malaysia and it targets to serve 80% of the private sector.

Foreign Exchange Fluctuations. The bulk of the group's cost of goods sold is in foreign currency, mainly the USD and partially Euro. The foreign currency purchases relate to the purchase of raw materials comprising active ingredients not available locally as well as bottlings and packaging. **As the group does not have a hedging policy, fluctuations in foreign currency whereby the MYR depreciates poses downside risk to the group's profitability.** The impact is amplified in cases where the group locks into long-term contracts with its customers. This particularly applies to the government sector whereby tender awards can span over ~3 years. Mitigating risk of foreign currency fluctuations, the group's sales contributions from exports at ~10% provides a natural hedge, albeit not entirely, as they are USD denominated.

Competition. In Malaysia, the drug prices are not regulated, leaving it to be dictated by market forces. Naturally, **biddings for contracts are rather competitive**. **And as a result, the group is susceptible to lumpy changes in orders in the event its bags or losses sizeable contracts, especially from the government sector, which is a key segment.** Besides, competition in the generic drug space is also present from the emerging 'Patent Cliff'. Posing a risk to margins, **the group will be selective on the type of generic drugs it manufactures**. Also helping to preserve its margins, in recent years, it has been focusing on carving a niche in high value products in niche therapeutic areas such as cardiology, diabetes, oncology and renal as well as biosimilars.

Product Recalls. Product recalls are generally viewed negatively and poses downside risks to a company's reputation, market share and profitability. Also, **in the event of prolonged suspension, the company's going concern would also be threatened**. Beyond product quality, at times recalls may be triggered by non-compliance with operational product requirements or international standards. To prevent such risks, the group has quality assurance and quality control departments to ensure the quality of its products are in check across the full spectrum of production from receipt of raw materials to release of finished goods as well as compliance with the MoH's and Good Manufacturing Practice guidelines. Furthermore, the group is currently in the midst of upgrading its manufacturing assets to keep abreast with cGMP.

Valuation

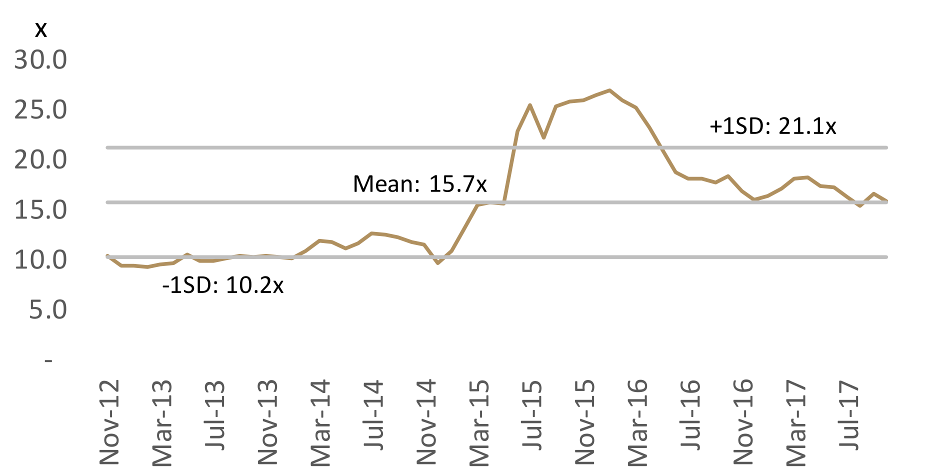
We value CCMD at a **TP of RM2.45/share,** based on a target PE of 18.0x against CY18 EPS of 13.6sen. Our target PE is at a premium of 20.0% over domestic peers of 15.0x. We opine that this is reasonable, notably with the encouraging development the group has been making with its foray into high value niche therapeutic areas. Apart from that, riding on the back of the sustained growth in demand for pharmaceuticals, earnings growth prospect for the group is commendable with FY17/FY18/FY19's estimated at 31.6%/7.4%/8.0%. Also boding well for the group's future growth would be the rationalising and upgrading of its manufacturing facilities under its MOS. Decent dividend yield for FY17/FY18/FY19 estimated at 3.9%/4.2%/4.4% should provide support for the share price. With all these in mind, we initiate coverage on CCMD with a **Buy** recommendation.

Table 6: Peers Comparison

Company	Country	Mkt Cap	EPS Growth (%)		PER (x)		ROE (%)		ROA (%)		Dividend Yield	
		(MYR mn)	CY17	CY18	CY17	CY18	CY17	CY18	CY17	CY18	CY17	CY18
Pharmaniaga Bhd	Malaysia	1,039.3	33.5	12.8	17.0	15.1	10.3	12.3	3.9	4.4	3.2	3.7
Apex Healthcare Bhd	Malaysia	615.0	10.7	10.6	15.9	14.4	11.7	12.1	8.8	8.7	1.9	3.8
Y.S.P. Southeast Asia Holding Bhd	Malaysia	407.5	(7.3)	15.8	15.7	13.5	9.0	9.9	8.5	9.4	3.0	3.3
Hovid Bhd	Malaysia	299.6	(64.3)	166.7	48.7	18.3	3.2	8.3	2.2	5.5	1.4	2.1
Weighted Average		***725.9***	***8.1***	***32.3***	***20.5***	***15.0***	***9.5***	***11.3***	***5.7***	***6.5***	***2.6***	***3.4***
CCM Duopharma Biotech Bhd	Malaysia	602.6	31.6	7.4	17.1	15.9	7.7	8.0	5.1	4.7	3.9	4.2

Source: Bloomberg, TA Securities

Figure 17: Forward PE



Source: Bloomberg, TA Securities

Earnings Summary

P&L

FYE Dec (RM mn')	FY15	FY16	FY17F	FY18F	FY19F
Revenue	269.8	312.9	453.8	473.7	496.0
EBITDA	71.7	55.3	71.9	76.5	84.8
Depreciation & amortisation	(21.5)	(22.5)	(23.5)	(24.2)	(25.6)
Net finance cost	(2.4)	(1.3)	(2.6)	(3.1)	(6.0)
PBT	47.8	31.5	45.8	49.2	53.2
Taxation	(11.4)	(4.7)	(10.5)	(11.3)	(12.2)
MI	0.0	0.0	0.0	0.0	0.0
PAT (-MI)	36.4	26.8	35.3	37.9	40.9
EPS (sen)	13.0	9.6	12.7	13.6	14.7
DPS (sen)	9.5	6.5	8.5	9.0	9.5

Ratios

FYE Dec	FY15	FY16	FY17F	FY18F	FY19F
Valuations					
PER (x)	16.6	22.5	17.1	15.9	14.7
Dividend yield (%)	4.4	3.0	3.9	4.2	4.4
PBV (x)	1.3	1.3	1.3	1.3	1.2
Profitability ratios (%)					
ROAE	11.3	5.9	7.7	8.0	8.4
ROAA	8.5	4.1	5.1	4.7	4.3
EBITDA margin	26.6	17.7	15.9	16.1	17.1
PBT margin	17.7	10.1	10.1	10.4	10.7
Liquidity ratios (x)					
Current ratio	4.7	3.5	2.8	2.5	2.3
Quick ratio	4.7	3.5	2.8	2.5	2.3
Leverage ratios (x)					
Total liabilities/equity	0.4	0.5	0.6	0.8	1.1
Net debt/equity	(0.0)	(0.0)	0.1	0.3	0.6
Int. coverage ratio	21.3	24.9	18.6	17.0	9.9
Growth ratios (%)					
Sales	52.5	16.0	45.0	4.4	4.7
PBT	2.9	(34.2)	45.6	7.4	8.0
PAT (-MI)	3.2	(26.3)	31.6	7.4	8.0
Total assets	184.7	4.4	9.7	20.3	16.4

Balance Sheet

FYE Dec (RM mn')	FY15	FY16	FY17F	FY18F	FY19F
Fixed assets	269.3	276.2	322.8	426.6	539.0
Others	9.8	19.0	19.0	19.0	19.0
LT assets	279.1	295.3	341.8	445.6	558.0
Inventories	103.5	139.1	151.3	157.9	165.3
Trade receivables	105.6	101.0	151.3	157.9	165.3
Cash	143.5	114.8	69.8	100.3	116.5
Others	1.8	11.2	11.2	11.2	11.2
Current assets	354.3	366.2	383.6	427.3	458.4
Total assets	633.4	661.5	725.4	872.9	1,016.4
Trade payables	55.8	81.7	110.3	115.1	120.5
ST borrowings	18.9	21.5	27.4	53.4	78.1
Others	0.0	0.0	0.0	0.0	0.0
Current liabilities	74.7	103.2	137.7	168.5	198.6
LT borrowings	103.8	91.8	109.6	213.6	312.4
Others	5.2	12.0	12.0	12.0	12.0
LT liabilities	109.0	103.8	121.6	225.5	324.4
Total liabilities	183.7	206.9	259.3	394.0	523.0
Share capital	139.5	139.5	139.5	139.5	139.5
Reserves	193.5	193.8	193.8	193.8	193.8
Retained earnings	116.8	121.3	132.8	145.6	160.1
MI	0.0	0.0	0.0	0.0	0.0
Total equity	449.7	454.5	466.1	478.9	493.3
Total liabilities and equity	633.4	661.5	725.4	872.9	1,016.4

Cash Flow

FYE Dec (RM mn')	FY15	FY16	FY17F	FY18F	FY19F
PBT	47.8	31.5	45.8	49.2	53.2
Depreciation and amortisation	21.5	22.5	23.5	24.2	25.6
Net interest	2.4	1.3	2.6	3.1	6.0
Other non-cash	0.0	2.5	0.0	0.0	0.0
Changes in WC	(106.2)	(6.3)	(33.8)	(8.5)	(9.4)
Interest paid	(3.7)	(5.6)	(5.6)	(5.9)	(9.5)
Tax paid & others	(12.7)	(12.6)	(10.5)	(11.3)	(12.2)
Operational cash flow	(50.9)	33.2	22.0	50.9	53.6
Capex	(40.0)	(34.3)	(70.0)	(128.0)	(138.0)
Interest received	1.4	4.2	3.0	2.8	3.6
Others	(108.7)	(0.4)	0.0	0.0	0.0
Investing cash flow	(147.3)	(30.4)	(67.0)	(125.2)	(134.4)
Net share issue	251.1	0.0	0.0	0.0	0.0
Dividend paid	(31.4)	(22.3)	(23.7)	(25.1)	(26.5)
Net change in debts	103.7	(9.5)	23.7	129.9	123.6
Others	0.7	0.0	0.0	0.0	0.0
Financial cash flow	324.1	(31.8)	0.0	104.8	97.1
Net cash flow	125.9	(29.0)	(45.0)	30.4	16.2
Opening cash flow	18.3	143.5	114.8	69.8	100.3
Forex	(0.7)	0.3	0.0	0.0	0.0
Closing cash flow	143.5	114.8	69.8	100.3	116.5

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Stock Recommendation Guideline

BUY : Total return within the next 12 months exceeds required rate of return by 5%-point.
HOLD : Total return within the next 12 months exceeds required rate of return by between 0-5%-point.
SELL : Total return is lower than the required rate of return.
Not Rated: The company is not under coverage. The report is for information only.

Total Return is defined as expected share price appreciation plus gross dividend over the next 12 months. Gross dividend is excluded from total return if dividend discount model valuation is used to avoid double counting.

Required Rate of Return of 7% is defined as the yield for one-year Malaysian government treasury plus assumed equity risk premium.

As of Monday, November 06, 2017, the analyst, Wilson Loo Jia Chern, who prepared this report, has interest in the following securities covered in this report:
(a) nil

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