

# Pharmaceuticals

## (Hold)

### Holding companies to spearhead investments

- Government to launch several funds in 2H to foster the pharmaceuticals industry
- Holding companies likely to be tapped as strategic partners
- Watch Hanmi Pharm, Hanmi Science, Dong-A Socio Holdings, Green Cross Holdings

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Daewoo Securities Co., Ltd.

Pharmaceuticals/Bio

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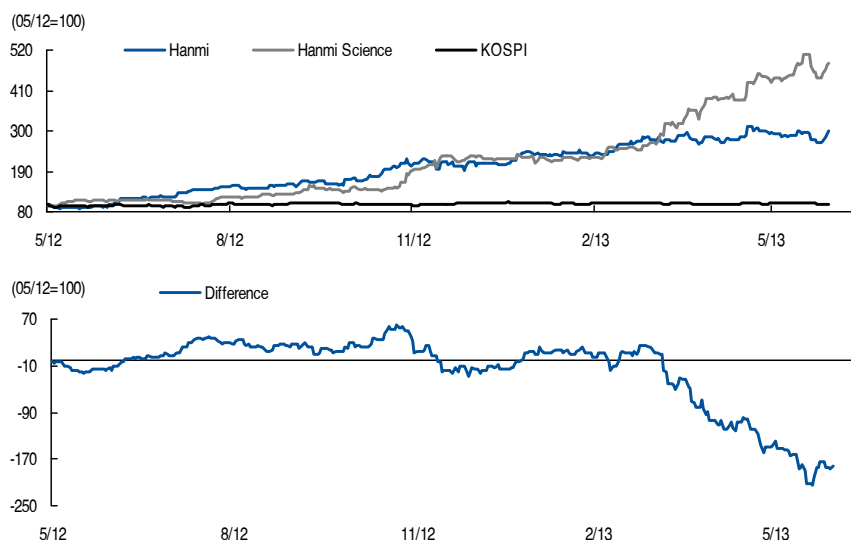
### In an age of low-growth, organic growth may not be enough

Although population aging has led to increased demand for aging-associated drugs, drug pricing power in the hands of the government and insurers has heavily weighed on drugmakers' shares. Only after regulatory drug price cuts were finally imposed, did pharmaceuticals begin to widely outperform the market, due to the temporary removal a major uncertainty. As drug prices continue to fall amid limited volume growth, organic growth alone cannot ensure top-line as well as bottom-line growth. However, we see opportunities for domestic drugmakers that have converted to a holding company, as they are demonstrating a strong willingness to expand into new business fields.

### Holding companies to spearhead investments

The government intends to tap a number of public funds, such as the Ministry of Health and Welfare (MW), National Pension Service (NPS), and Korea Finance Corporation (KoFC), to foster the domestic pharmaceuticals industry, which has grown increasingly dependent on foreign-made drugs. Since the government can not control the consumption of imported drugs, we believe it wants to at least enable domestic drugmakers to become more self-reliant by promoting exports (in terms of both range and volume), which should narrow the trade deficit and nurture home-grown global pharmaceuticals.

Figure 1. Share performances of Hanmi Pharmaceutical and Hanmi Science



Note: Stock price difference between Hanmi Science and Hanmi Pharmaceutical

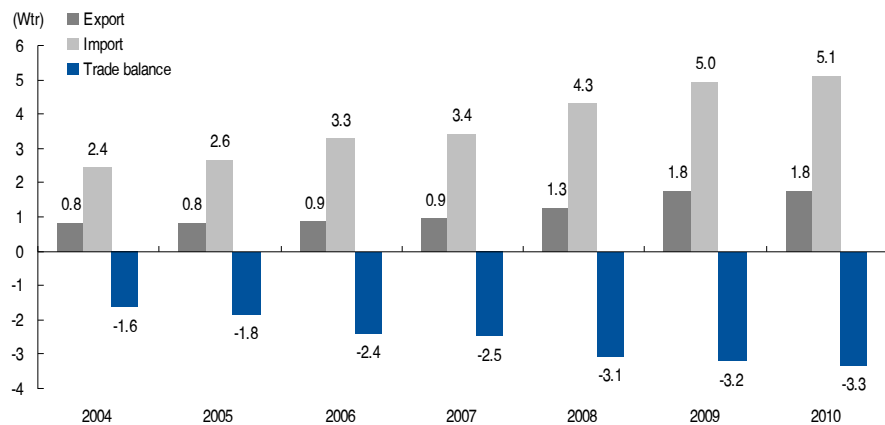
Source: KDB Daewoo Securities

### Government and holding companies to join hands

Domestic pharmaceutical companies—which focus on generic drugs—have experienced big changes, including drug price cuts, restrictions against rebates, FTAs, and the entry of multinationals. We believe they will need three to four years to adjust to the new challenges and enhance their global competitiveness. Given expanding trade deficits related to drugs, the Korean government seems determined to support pharmaceutical exports and the industry itself.

KoFC, NPS, and MW have plans to invest to boost the pharmaceutical industry. KoFC announced a plan to launch a private equity fund with the aim of improving the competitiveness of the Korean pharmaceutical and biotech industries. KoFC will contribute 50% to the fund, while strategic investors 30-40%, and general partners 5-15%. NPS plans to establish a matching fund (1:1) with a drugmaker to pursue overseas M&A deals. NPS has reached out to Dong-A Pharmaceutical and LG Life Sciences. MW recently selected a general partner to run a W100bn matching fund designed to promote the industry. The Ministry plans to launch the fund once it recruits limited partners (each limited partner is supposed to finance a company by W5~10bn) by the end of the year.

**Figure 2. Korea’s pharmaceutical-related trade deficit is growing**



Source: Korea Health Industry Development Institute, KDB Daewoo Securities Research

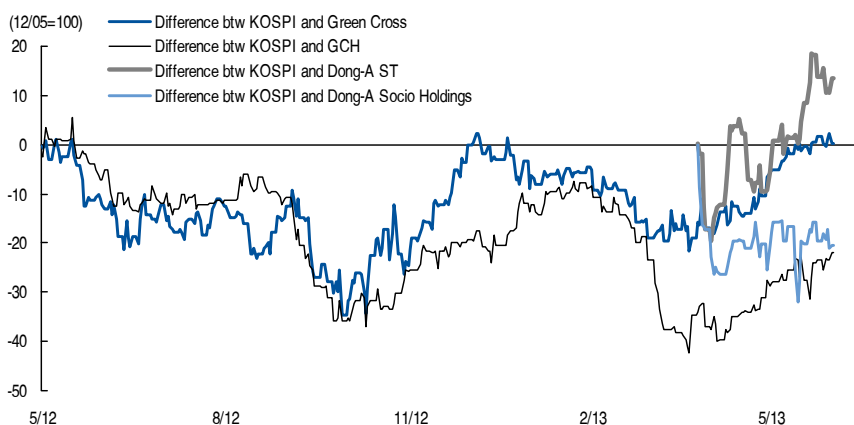
### Holding companies to lead the industry realignment

We maintain our Hold rating on the industry. We expect the pharmaceutical sectors’ YoY operating profit growth to slow in 2H, and margin improvement to be limited by increased R&D spending. Furthermore, competition in the domestic market is heating up with the entry of not only original drugs but also generics from overseas. Hence, pharmaceutical companies are seeing top line contract and margin erode. Still, we advise investors to accumulate shares of companies with the potential to achieve drug export-led growth. We note the following companies for their product quality, marketing ability, brand power, overseas potential, and new drug development ability. We select Hanmi Pharmaceutical (Buy/TP: W210,000) as our top pick for the sector. We also like Hanmi Science, Dong-A Socio Holdings, and Green Cross Holdings as they 1) released new drugs or managed to enter the overseas markets (despite drug price cuts), and 2) could pursue M&A deals or make new investments to accelerate overseas expansion.

**Figure 3. Shares performances of operating company & holding company**



Source: KDB Daewoo Securities Research



Source: KDB Daewoo Securities Research

**Hanmi Pharmaceutical (128940 KS) and Hanmi Science (008930 KS)**

Hanmi Pharmaceutical’s shares have been bullish recently as the company’s global expansion efforts are bearing fruit, boosting its fundamentals. The company is ahead of its domestic peers with regard to global market expansion. As Hanmi Pharmaceutical’s global sales are expected to take off in 2H13, Amosartan (under the trademark Cozaar XQ), Esomezole (a reflux esophagitis treatment), and Palpal (an ED treatment) will drive the company’s top-line growth after 2013.

Hanmi Science, a holding company, has solidified top-line growth and cash flow by acquiring Online Pharm, a drug distributor. Online Pharm was selected to distribute drugs for Merck, Sanofi, Joongwae Pharmaceutical, CJ Cheiljedang, Hanmi Pharmaceutical, and the drug packaging machines of JVM. Thus, Hanmi Science is also anticipated to see steady top-line growth starting this year. In addition, the launch of Esomezole in the US should generate sales commissions from Hanmi USA. Thus, the company’s earnings structure should improve further going forward.

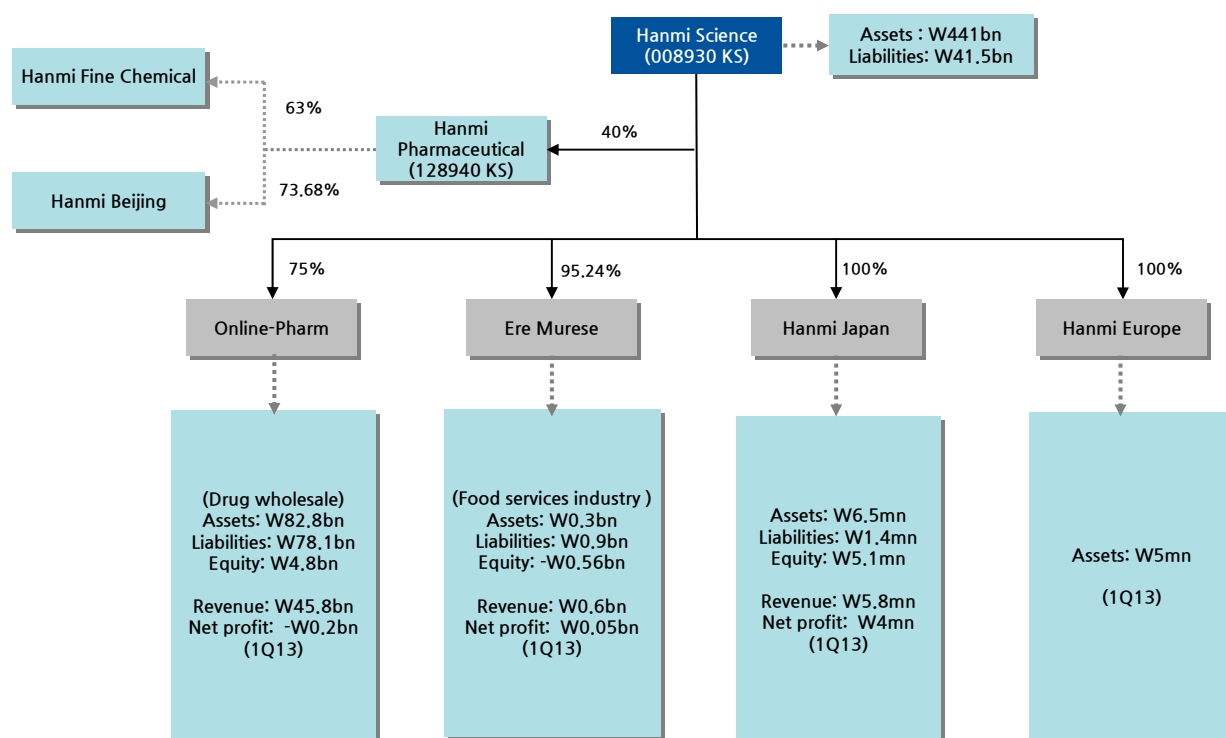
Hanmi Science is best positioned to receive investments from Korea Finance Corporation’s PEF, which was designed to support industries with strong growth potential. As a pharmaceutical company with the longest track record of global market expansion in Korea, the company is expected to achieve a steady export growth from its various R&D pipelines on the back of strategic cooperation with overseas pharmaceutical firms. For a PEF, Hanmi Science should be an attractive investment. Meanwhile, Dong-A and LG have already selected as the beneficiaries of the National Pension Service’s Corporate Partnership Fund. The Ministry of Health & Welfare is also creating a fund, but small- to medium-sized or biomedical firms are expected to be major beneficiaries in light of the smaller size of the fund.

Table 1. Major shareholders of Hanmi Science

Name	Relation	Number of shares	% of shares
Im Sung-ki	Largest shareholder	18,788,390	36.1
Im Jong-yoon	Relative	1,911,740	3.7
Im Ju-hyun	Relative	1,884,639	3.6
Im Jong-hoon	Relative	1,879,363	3.6
Im Jin-hee	Relative	1,078,943	2.1
Hanmi Medicare	Affiliate	1,241,068	2.4
Affiliated parties		8,406,626	16.2
<b>Total</b>		<b>35,190,769</b>	<b>67.6</b>

Source: KDB Daewoo Securities Research

Figure 4. Ownership structure of Hanmi Science



Source: KDB Daewoo Securities Research

Table 2. Valuation of Hanmi Science

(Wbn)

	Ownership stake (%)	Book value	Fair value	Notes
Operating value			12,329	Based on the weighted average of 2013F and 2014F EPS, and the MSCI Pharma P/E of 17x
- Hanmi Science	40			
- Hanmi Pharmaceutical				
Value of investments			14,713	Based on June 14 <sup>th</sup> closing price
- Dong-A ST	4.8	66.1		
- Dong-A Pharmaceutical	4.8			
- Cristal	3.8	8.0		
Net debt			1,420	
Outstanding shares			52,049,591	
<b>Per share value (W)</b>			<b>25,621</b>	

Source: KDB Daewoo Securities Research

**Dong-A Socio Holdings (000640 KS)**

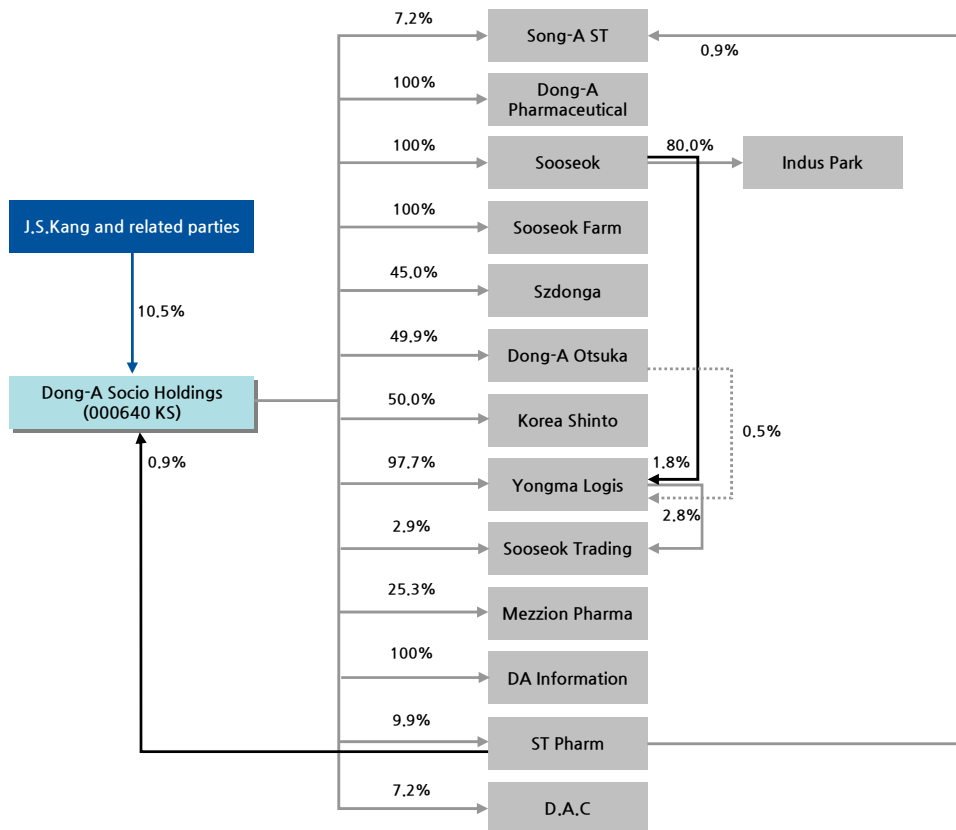
Dong-A Pharmaceutical converted to a holding company structure in March 2013. After spinning off Dong-A ST (new entity, ETC drugs) from Dong-A Socio Holdings (surviving entity, a holding company), Dong-A Socio Holdings split off Dong-A Pharmaceutical (a wholly-owned subsidiary of Dong-A Socio Holdings, OTC drugs and Bacchus). By adopting a holding company structure, the company aims to strengthen management control of the largest shareholder (14.6%) and to enhance profitability by separating ETC and OTC businesses. Dong-A Socio Holdings is expected to enjoy stable growth over the medium to long term as the Bacchus and OTC businesses are immune from the government’s price cut pressure. The steady cash flow from the Bacchus business is likely to be used by the holding company to expand into new businesses. Thus, we are bullish on the company’s medium- to long-term growth outlook.

**Table 3. Major shareholders of Dong-A Pharmaceutical**

Name	Relation	Number of shares	% of shares
Kang Jung-suk	Largest shareholder	240,574	5.54
Kang Woo-suk	Relative	5,300	0.12
Kang In-kyung	Relative	2,568	0.06
Yoo Choong-sik	Board member	108,617	2.63
Sangju Academy	Foundation	23,354	0.54
Sooseok Culture Foundation	Foundation	26,766	0.62
Affiliated parties		49,472	1.01
DM Bio Limited		207,226 (preferred shares)	50.12
<b>Total</b>	<b>Common shares</b>	<b>456,651</b>	<b>10.52</b>
	<b>Preferred shares</b>	<b>207,226</b>	<b>50.12</b>

Source: KDB Daewoo Securities Research

**Figure 5. Ownership structure of Dong-A Socio Holdings**



Source: KDB Daewoo Securities Research

Table 4. Valuation of Dong-A Socio Holdings

(W/bn)

		Ownership (%)	Book value	Market value	Fair value	Notes
Song-A ST	Listed	7.24	75.3	67.3	95.8	Market cap relative 2014F net profit, MSCI Pharma P/E of 17x, and 30% discount given its public status
Dong-A Pharmaceutical	(Bacchus, OTC unit)	100.0	39.8		433.2	
Sooseok		100.0	47.2		37.7	20% discount
Sooseok Farm		100.0	4.3		3.4	20% discount
Dong-A Otsuka		49.9	36.8		29.5	20% discount
Korea Shinto		50.0	6.1		4.9	20% discount
Yongma Logis		97.7	22.2		17.8	20% discount
Mezzion Pharma	Listed	25.3	4.3	34.7	34.7	Market value
DA Information		100.0	1.6		1.3	20% discount
ST Pharm		9.9	109.7		87.7	20% discount
D.A.C		100.0	0.6		0.5	20% discount
Szdonga		45.0	0.6		0.5	20% discount
<b>Total</b>			<b>348.4</b>	<b>317.1</b>	<b>746.8</b>	
Net debt					90.5	
Enterprise value					656.4	
# of outstanding shares					4,133,412	
<b>Per share value (W)</b>					<b>158,795</b>	

Source: KDB Daewoo Securities Research

Table 5. Major shareholders of Green Cross Holdings

Name	Relation	Number of shares	% of shares
Hur Il-sup	Largest shareholder	5,117,770	10.33
Hur Eun-chul	Related party	1,171,680	2.36
Hur Yong-jun	Related party	1,207,430	2.44
Hur Jung-me	Related party	1,558,880	3.15
Park Yong-tae	Related party	1,708,790	3.45
Mogam Biotechnology	Foundation	4,715,710	9.50
Other related parties	Related party	4,299,170	8.69
<b>Total</b>		<b>19,799,430</b>	<b>39.92</b>

Source: KDB Daewoo Securities Research

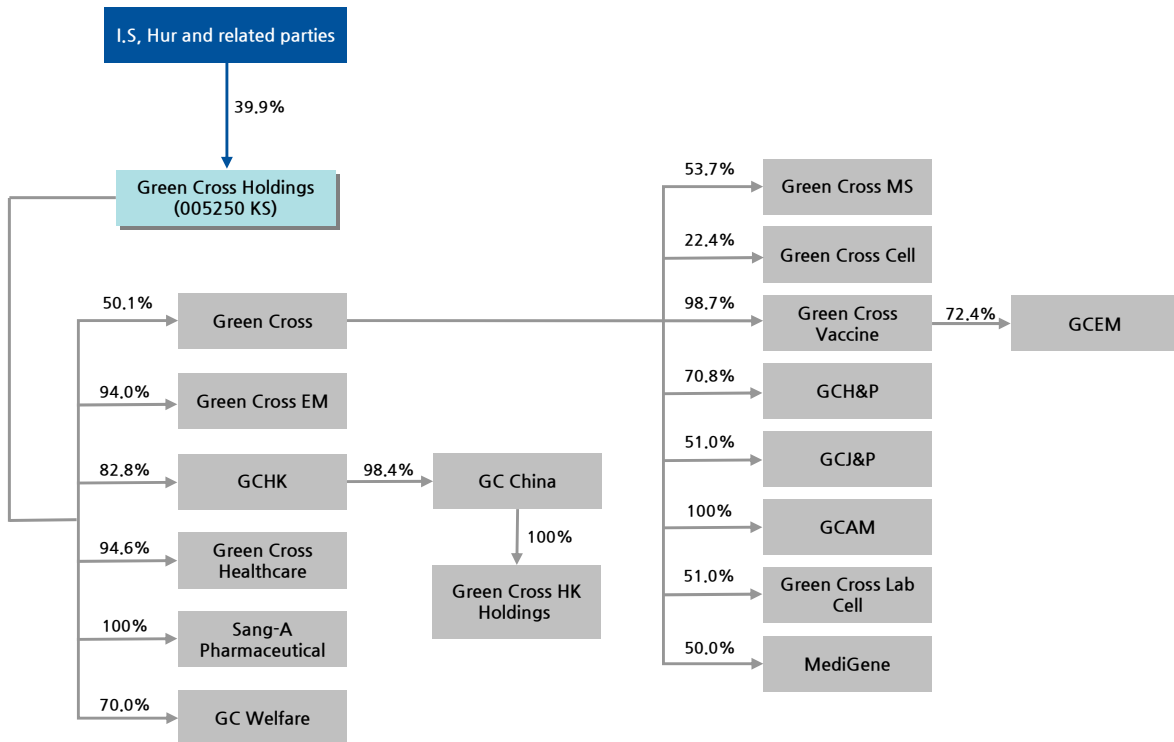
### Green Cross Holdings (005250 KS)

Green Cross converted to a holding company structure in 2001. Green Cross Holdings controls its subsidiaries based on the largest shareholder's stake in the holding company, as with other holding companies. Green Cross Holdings has sold Green Cross Life Insurance, and it is currently composed of the pharmaceutical business (Green Cross, Green Cross MS, Green Cross EM, Green Cross Cell) and overseas business (Green Cross China).

Green Cross made a bid to acquire Plasma Recourses UK (PRUK) for overseas expansion. The company has already conducted a rights offering and a bonus issue to finance this potential acquisition. The UK government has set a deadline to sell PRUK by the end of June. An acquisition of PRUK would likely have a positive short-term impact on the company's stock. Green Cross uses 700,000 tonnes of plasma (a raw material for blood products) annually, 200,000 tonnes of which the company procures from Red Cross. The company also procures plasma overseas. The cost of overseas procurement is 1.5 times higher than domestic procurement. In addition, global blood prices are rising on higher blood demand. As such, if the company could secure various blood sources, it would help stabilize raw material sourcing. PRUK, a state-owned corporation (100% owned by the UK National Health Service), is composed of DCI which collects blood from donors in the US and a UK-based manufacturer of plasma-derived products. The other contenders in the acquisition of PRUK are Baxter, Grifols, and Biotest. Even if Green Cross does not win the bid for PRUK, we are optimistic that the company will find another investment opportunity.

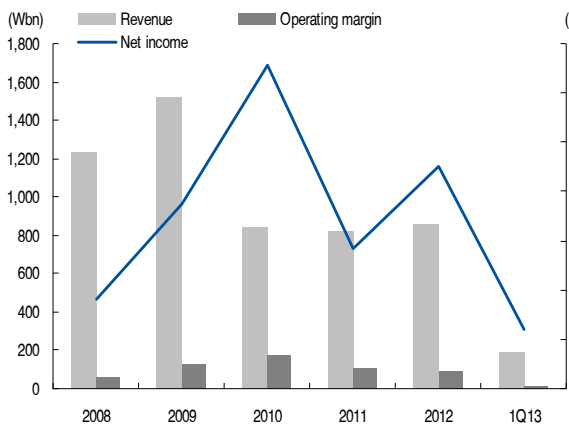
Of note, Green Cross' Chinese operations have entered into an expansionary phase. Green Cross China, which specializes in producing blood products, recorded revenues of W19.5bn in 2011 and W14.4bn in 2012. Although the Chinese subsidiary suspended production due to capacity expansion in 1H, its capacity utilization should normalize in 2H thanks to the completion of the expansion project, leading to revenue growth.

Figure 6. Green Cross Holdings ownership



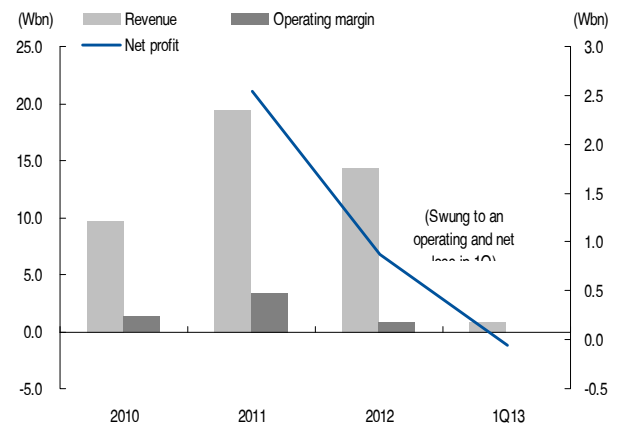
Source: KDB Daewoo Securities Research

Figure 7. Green Cross Holdings revenues



Source: KDB Daewoo Securities Research

Figure 8. GC China revenues



Source: KDB Daewoo Securities Research

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Sell	Relative performance of -10%		

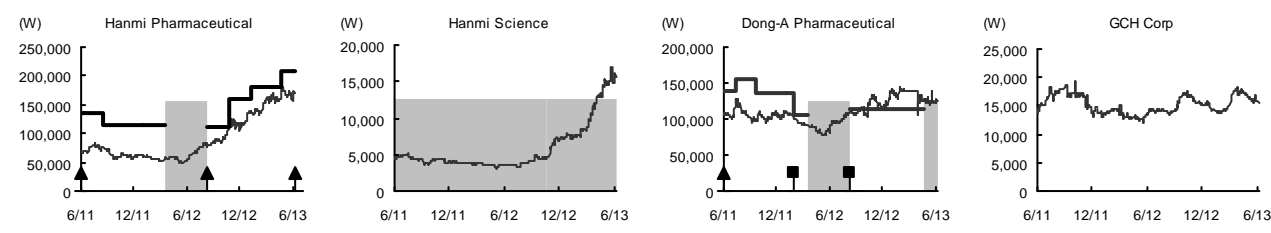
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