

China / Hong Kong
Strategic & Tactical
Ideas**Point – CounterPoint**
CTCM (570 HK) – Allegations About Governance

- Third-Party Report attacks CTCM's governance.
- Parent company is strengthening control – logical, but with caveats.
- Financials need to improve further to fully regain investors' confidence.
- We assess that short-selling interest in the stock is relatively subdued.
- More disclosures after 2018 results should help re-rate CTCM.

Point

The share price of China Traditional Chinese Medicine (CTCM, BUY, TP\$6.50) dropped 7% at one stage on Feb 22, after GMT Research issued an AVOID/SELL report on the Company. In the past, short-selling campaigns have devastated the share prices of many Hong Kong stocks, so investors are right to be concerned. The main points of the report are:

- The departure of eight directors and a CFO, including an INED, who wrote an open letter complaining about record keeping and unsanctioned salary increases;
- Disappointment in the original business when it was listed in the US;
- Questions CTCM's financials, including excess capital raising; and
- Related-party transactions and acquisitions indicate governance issues.

Counter-Point

We take governance and financial irregularities seriously; hence, we published a report on the unusual Board-level changes as early as February 1, 2019. Our analyst Harry He's BUY recommendation mainly reflects his views on CTCM's leadership position in TCM granules. As outsiders, we do not know whether the allegations are true, but we note the following:

- 1) CTCM maintains that the personnel changes should improve management, and the ex-CFO is assisting in the preparation of the 2018 results. Managing Director Wang remains in charge of overall operations. As the new non-executive directors, who have a background in risk management and finance, come from the parent CNPGC Group, this suggests the parent is tightening its control over CTCM. Whether this is positive depends on: (i) how CNPGC's interests are aligned with those of the minority shareholders; and (ii) whether there are additional synergies.
- 2) We argued in our earlier report that CTCM should strengthen its independent oversight – the Company then appointed two additional INEDs on February 18, bringing total INED representation to 33%. The presence of institutional investors such as Ping An Insurance (12% interest and one board representative) and GIC (4% stake) should also help. All the newly appointed directors will need to stand for re-election and be approved by shareholders at the next AGM in June.
- 3) We firmly believe CTCM needs to better manage its finances. For instance, although the Company had RMB3.3bn cash in June 2018, it also had RMB4.5bn in borrowings. This will come down only when the underlying domestic bonds mature in 2019/20. We also believe CTCM should improve its working capital position by reducing its sizable receivables and inventories (totaling RMB9bn).
- 4) CTCM is popular with Stock Connect investors, who own 382m shares (7.6% of the Company). Short-selling activity in the stock is muted, with an aggregate position of 32m shares as at Feb 8, and 5m in new positions as at Feb 22.
- 5) The Hong Kong Stock Exchange accepted CTCM's earlier clarifications, but doubts about the management may continue to weigh on its share price. The Company will host an analyst briefing on March 18. If CTCM can use this opportunity to demonstrate stronger corporate governance and financial management, we believe it will lead to a re-rating of the Company.

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Figure 1: Changes in Board Members

Old		New	
Executive Directors		Executive Directors	
CNGPC	Mr. WU Xian (Chairman)	CNGPC	Mr. WU Xian (Chairman)
	Mr. WANG Xiaochun (Managing Director)		Mr. WANG Xiaochun (Managing Director)
CNGPC	Mr. ZHAO Dongji	CNGPC	Mr. YANG Wenming
CNGPC	Ms. HUANG He		
Non-Executive Directors		Non-Executive Directors	
CNGPC	Mr. LIU Cunzhou	CNGPC	Ms. LI Ru
CNGPC	Mr. YANG Shanhua	CNGPC	Mr. YANG Shanhua
CNGPC	Ms. TANG Hua	CNGPC	Mr. YANG Binghua
Pingan	Mr. KUI Kaipin	CNGPC	Mr. WANG Kan
		Ping An	Mr. KUI Kaipin
Independent Non-Executive Directors		Independent Non-Executive Directors	
	Mr. ZHOU Bajun		Mr. XIE Rong
	Mr. XIE Rong		Mr. YU Tze Shan Hailson
	Mr. YU Tze Shan Hailson		
	Mr. LO Wing Yat		

SOURCES: CGI RESEARCH, WIND

Resumes of the New Board Members

Executive Director: Mr. YANG Wenming

- 主持党委工作，主管党群工作部 (Hosts the Party Committee's work, in charge of the Department of Party-Community Work Relationship)
- 协助总裁管理战略与运营部，工程项目建设管理中心 (Assists the President in managing the Strategy and Operations Management Department, as well as Project Construction Management Center)
- 持有高级工程师专业资格 (Has a senior engineer professional qualification)
- 曾于中国医疗器械工业公司'中国医药集团总公司及上海现代制药股份有限公司任 (Previously worked for China National Medical Equipment Industry Corporation, CNPGC, and Shanghai Shyndec Pharmaceutical Co., Ltd.)
- 于 1985 年在浙江大学生物与医学仪器专业毕业，取得工学学士学位 (Graduated in 1985 from Zhejiang University, majoring in Biological and Medical Instruments, with a Bachelor's degree in Engineering)
- 现为上海现代制药股份有限公司职工监事、中药控股党委书记及副总裁 (Currently serves as staff supervisor of Shanghai Shyndec Pharmaceutical Co., Ltd., Secretary of the Party Committee and Vice President of China Traditional Chinese Medicine Holdings Co., Limited)

Non-executive Director: Mr. YANG Binghua

- 曾于国务院国资委办公厅、大庆油田第二采油厂、国务院国资委率公厅任职 (Previously served in the State Council State-owned Assets Supervision and Administration Commission (SASAC) Office, Daqing Oilfield Production Plant No. 2, and then the State Council SASAC Office again)
- 于 2004 年在中国青年政治学院公共管理系政治学与行政学专业本科毕业，并于 2011 年获得北京大学政府管理学院公共管理硕士学位 (Obtained a Bachelor's degree in Politics and Administration from the Public Administration Department of China Youth University for Political Studies, and a Master's degree in Public Administration from the School of Government of Peking University in 2011)
- 现为国药集团党群工作部主任 (Currently Principal of the Department of Party-Community Work Relationship for CNPGC)

Non-executive Director: Mr. WANG Kan

- 曾任职于中国医药工业有限公司、中国生物技术股份有限公司、苏州胶囊有限公司及国药集团 (Previously worked for China National Pharmaceutical Industry Company Limited, China National Biotech Group Company Limited, Suzhou Capsugel Co., Ltd. and CNPGC)
- 于 2007 年在北京大学医学部医学院医学专业本科毕业，并于 2009 年在北京大学医学部医学院完成药理学硕士研究生课程及北京大学中国经济研究中心完成经济学专业 (双学士) 课程 (Obtained a Bachelor's degree in Pharmacy from the School of Pharmacy of Peking University Health Science Center in 2007, and a double Master's degree in Pharmacy from the School of Pharmacy of Peking University Health Science Center and Economics from China Center for Economic Research of Peking University in 2009)
- 现为国药集团投资管理部副主任 (Currently deputy manager of the investment management department of CNPGC)

Non-executive Director: Ms. LI Ru

- 曾先后担任国药集团药业股份有限公司麻醉药品部产品经理、销售地区经理、销售大区经理，及奈科明制药有限公司市场经理 (Previously served at China National Medicines Ltd. as a product manager, regional sales manager and divisional sales manager, and at Nycomed Pharma AS as a marketing manager)
- 于 2001 年在沈阳药科大学药物制剂专业毕业 (Obtained a degree in Pharmaceutical Preparations from Shenyang Pharmaceutical University in 2001)
- 现于中国医药集团有限公司先后担任风险与运营管理部副主任、主任，法务与风险管理部主任 (Now serving at China National Pharmaceutical Group Corporation as the deputy director, director of the risk and operations management, and director of the legal and risk management department)

Independent Non-executive Director: Mr. QIN Ling

- 曾担任德国柏林自由大学医学院创伤和重建外科学系实验室主管 (Previously served as the laboratory director of the Department of Trauma & Reconstructive Surgery at the School of Medicine, Free University of Berlin, Germany)
- 于 1992 年在德国科隆体育大学获得运动科学博士学位 (Obtained a PhD in Exercise Science from German Sports University, Cologne, Germany in 1992)
- 现任香港中文大学医学院骨科教授和实验室主任，博士及博士后导师 (Now serving as a professor of Orthopaedics and director of laboratory in the Faculty of Medicine and doctorate and post-doctorate supervisor at The Chinese University of Hong Kong)
- 兼任中国宇航员研究和训练中心航天医学基础与应用国家重点实验室特聘教授、香港理工大学康复治疗科学系和医疗科技及资讯系特聘兼职教授 (Also serving as a distinguished professor of the State Key Laboratory of Space Medicine Fundamentals and Application, China Astronaut Research and Training Center, and a distinguished adjunct professor in the Department of Rehabilitation Sciences and Department of Health Technology and Informatics at The Hong Kong Polytechnic University)

Independent Non-executive Director: Mr. LI Wei Dong

- 曾于南京中山律师事务所、江苏省经纬律师事务所担任专职律师 (Previously acted as a professional lawyer at Nanjing Zhongshan Law Firm, and a professional lawyer at Jiangsu Jingwei Law Firm)
- 于 1992 年在南京大学获得理学、法学双学士学位，并于 2004 年在香港城市大学获得法学博士学位 (Obtained a Bachelor's degree in science and law from Nanjing University in 1992 and a PhD in law from City University of Hong Kong in 2004)
- 现任海派律师事务所 (深圳、香港) 主任 (Now acting as a director of Haipei Law Firm (Shenzhen & Hong Kong))
- 现任深圳美盈森(002303.SZ)独立董事、远航港口(8502.HK)独立非执行董事、中航三鑫(002163.SZ)独立董事及联建光电(300269.SZ)独立董事 (Also serving as an independent director at MYS Group (002303.SZ), Avic Sanxin (002163.SZ), and Shenzhen Liantronics (300269.SZ), and as an independent non-executive director at Ocean Line Port Development Limited (8502.HK))

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- BUY : share price will increase by >20% within 12 months in absolute terms
- SELL : share price will decrease by >20% within 12 months in absolute terms
- HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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