

The Rise of China National Medicines: Strategy and Financial Analysis of Medical industry

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Abstract. China's ageing population is becoming increasingly severe, so the demand for social medical and health services is growing. This also means that the demand for pharmaceutical consumption is promoting the market expansion of pharmaceutical circulation. This phenomenon has also promoted the continuous development of China's pharmaceutical circulation industry. China National Medicines is one of the largest and most comprehensive pharmaceutical and health industry groups in China and has made great contributions to China's pharmaceutical industry. This paper focuses on the factors affecting the existing business and future development of China National Medicines. First, it adopts PESTEL's non-financial analysis of China's National Medicines. Then, the profitability and liquidity indicators are taken as the means of analysis in the financial indicators. Thus, the value of selecting China National Medicines as an investment object is determined. The research found that China National Medicines has a strong ability to make profits and pay debts and has a better performance than other companies in the same industry, and some of the company's drugs have certain advantages in the Chinese market. Therefore, the company has a specific investment value for investors.

Keywords: Anaesthetics; financial analysis; China National Medicines; Solvency; Pharmaceutical industry.

1. Introduction

China, once the country with the largest population in the world, is now facing a severe problem of population ageing. In 2024, the number of people over 60 will exceed 300 million, and the accelerated population ageing will also bring more significant demand for medical care. At the same time, as the demand for medical products increases, there will always be some pharmaceutical companies that will enjoy the dividends they bring. China National Medicines, a pharmaceutical company founded in Shanghai in 1999, is one of China's leading suppliers to hospitals and pharmacies. In China's current situation, many people believe that expanding China's healthcare needs will first increase these pharmaceutical companies' production capacity and sales volume so that China National Medicines will have a huge investment opportunity for a long time.

So, the gradual expansion of the medical industry's demand has become the most concerning issue for many investors, especially regarding whether China National Medicines will bring more significant development potential and whether it has investment value. Therefore, this study will analyse China National Medicines Corporation in-depth. At the end of the study, a correct investment suggestion is provided for the investors. The study will begin with a brief overview of the company and a non-financial and financial analysis. The non-financial analysis will use the Pestle model to analyse enterprises' current situation from six dimensions: politics, economy, society, technology, law and environment. Subsequently, the company will be independently analysed and compared with other companies in the same industry through the profitability and liquidity indicators in the financial analysis.

2. Overview of China National Medicines

China National Medicines was established in December 1999 as a subsidiary of Sinopharm Group. The company was listed on the Shanghai Stock Exchange in November 2002 with the stock code 600511.

China National Medicines is a leading wholesale and retailer of medical and health products and medical devices and a leading supply chain service provider in China. Relying on a nationwide distribution and distribution network, China National Medicines provides comprehensive distribution services for domestic and foreign manufacturers and suppliers of medical products, medical devices consumables and other healthcare products.

In addition, the company uses the innovation of information technology, medical digitalisation and artificial intelligence to accelerate the reform and innovation of the service model of the pharmaceutical circulation industry [1]. China National Medicines' biopharmaceutical sector covers six biological products, including human vaccines, blood products, medical beauty, animal health, antibody drugs and medical diagnostics. As the world's largest vaccine manufacturer, it has the most significant blood product production capacity in China, with more than 2,000 tons of plasma used to manufacture blood products every year.

Regarding chemicals and pharmaceuticals, China National Medicines has become the fourth largest chemical and pharmaceutical manufacturer in China, with product lines covering a wide range of therapeutic fields such as anti-tumour, cardiovascular and cerebrovascular, anti-infection, anaesthetic and psychosis.

3. Strategic Analysis

3.1. PESTEL Analysis

PEST (EL) analysis can be a tool to measure the external environment that may hinder or promote the growth of a company or business from political, economic, socio-cultural, technological, ecological and legal factors to find out how they affect the operations and development of the pharmaceutical industry. This analysis benefits company managers by reducing their decision-making mistakes, thus enabling the company to grow better.

This PESTEL analysis will discuss the global macro-environment of the pharmaceutical industry by identifying the possible threats and opportunities that may arise from the political, economic, socio-cultural, technological, environmental and legal factors that affect the business of the national pharmaceutical companies.

Social demand has become an essential factor in the development of Chinese pharmaceutical enterprises. With the gradual recovery of hospital outpatient and inpatient volume, the rigid demand for the anaesthetics market continues to improve, thus showing that the social demand for anaesthetics is increasing, which is a positive signal for Sinopharm. Older people, as a group with a high demand for pharmaceutical services, will also bring considerable dividends to the development of the pharmaceutical industry by promoting the strategy of combining medical care and nursing care put forward by the state on the issue of population ageing [2]. In addition, the advancement of urbanisation and the continuous improvement of the new rural cooperative medical system are also driving the continued improvement of China's medical resources and quality. These vast investments and wide-ranging national pharmaceutical enterprise market reforms have brought new profit growth points.

Although the development of China's national medicine is closely related to the reform of China's healthcare system, the pharmaceutical industry is less affected by the macro-economy and is more resistant to market risks. Most consumers will purchase the relevant medicines according to their doctor's medical plan and have no bargaining power over the products, and the pharmaceutical

industry generally outperforms other industries in terms of sales, even in cycles of economic downturn [2].

China National Medicines is a policy-driven industry that is more sensitive to the impact of policies. The reform of the State Council organisation has prompted the gradual completion of the corporate system reform of Sinopharm enterprises, and the corporate system of Sinopharm enterprises has been improved. In addition, the mixed ownership system has also enabled Sinopharm to drive the development of many social capitals with fewer state-owned funds, thus improving the overall level of the entire medical industry [3]. However, the drug distribution system under the planned system has revealed problems in its operation: for example, some drug prices are not adjusted promptly, and the ratio of prices is unreasonable, resulting in a disconnect between the production and marketing of medicines. These problems have caused severe waste to enterprises.

The products of China National Medicines are inseparable from the development of technology. After technological innovation, Sinopharm has accelerated the investment, merger, and acquisition of medical device commercial enterprises nationwide, becoming China's largest medical device distribution enterprise. In addition, with the development of technology, the digital transformation of the pharmaceutical business has improved operational efficiency and customer experience, thus expanding the industry's diversified businesses, such as health management and pharmaceutical consulting, to improve profitability [4].

Ecological trends are significant for the pharmaceutical industry. Sinopharm strictly abides by various environmental laws and regulations as well as environmental protection and regulatory systems and constantly improves and revises its internal systems to prioritise environmental protection [5]. In addition, the Group has set up an energy-saving and environmental protection working Group to further promote energy-saving and pollution reduction and effectively implement energy-saving and environmental protection measures. All these initiatives are conducive to improving corporate image and market competitiveness. They are an excellent advantage for Sinopharm in developing its business.

The legal and regulatory industry is also key to China National Medicines's success. Every new drug developed by China National Medicines is subject to the supervision of the FDA, from the initial theoretical construction and clinical trials to the final production. At the same time, the successful development of new drugs requires expensive technology and investment. Therefore, China National Medicines needs to protect the patents of new drugs in order to generate superior returns.

4. Financial Ratio Analysis

When studying the financial ratio of China National Medicines, two companies with similar market value and scale in the same industry were selected, namely China Meheco Group (600056) and China National Accord Medicines (000028). The two pharmaceutical companies selected are also relatively high market capitalisation companies.

4.1. Profitability Analysis

Profitability analysis is used to evaluate a company's performance over a specific period. An investor usually analyses the company's profitability before making an investment decision. To gain a comprehensive understanding of the company's performance relative to its competitors [6]. This chapter will cover Gross Revenue with its growth rate, net profits with its Growth Rate, Gross Margin, Net Profit margin and ROE.

4.1.1. Gross Revenue and Gross Revenue Growth Rate.

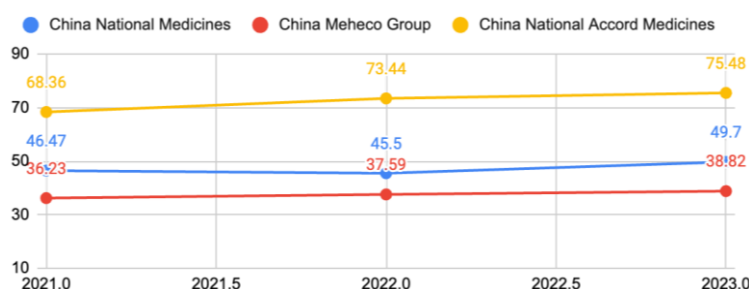


Figure 1. Gross Revenue of three companies from 2021 to 2023

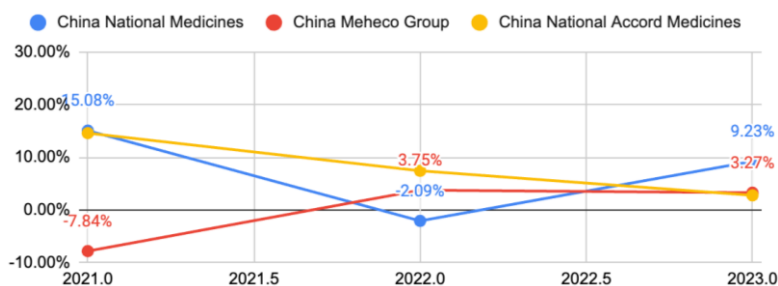


Figure 2. Gross Revenue Growth Rate of three companies from 2021 to 2023

China National Medicines' total revenue change in the past three years is relatively stable, and the overall change shows slow growth (Figure 1). The growth rate is maintained between -5% and 15%, and the total operating income is at a medium level compared with the other two companies in the same industry (Figure 2). In 2022-2023, the growth rate of the remaining two companies has been lowered to varying degrees, and China National Medicines is the only company with an increase in Gross revenue. It reflects the excellent performance of China National Medicines in the market competition and can achieve counter-trend growth in the industry's slowing growth.

4.1.2. Net Profits and Net Profits Growth Rate.

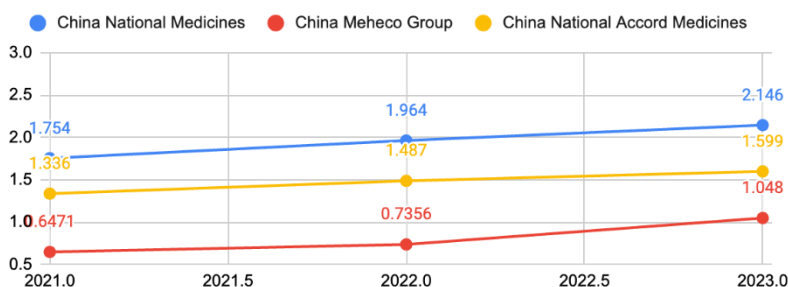


Figure 3. Net Profits of three companies from 2021 to 2023

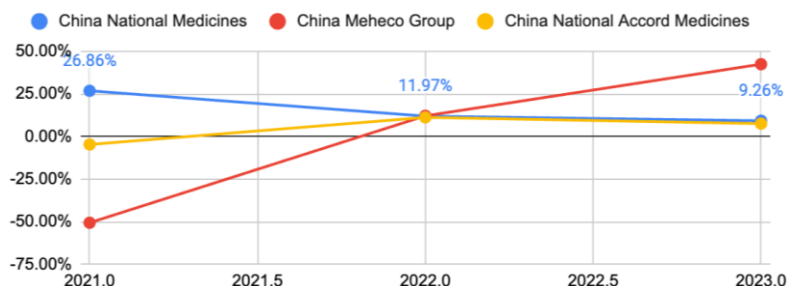


Figure 4. Net Profits Growth Rate of three companies from 2021 to 2023

China National Medicines' net profit has continued to rise in the past three years, showing the company's stable performance in the market and excellent profitability (Figure 3). Although the growth rate of net profit has decreased year by year, it still has a growth rate of 9.26% in 2023, and

the decline trend has slowed down (Figure 4). Meanwhile, China National Medicines' net profit is superior, ranking the highest within the same industry.

4.1.3. Compare with Gross Margin and Net Profit margin and ROE.

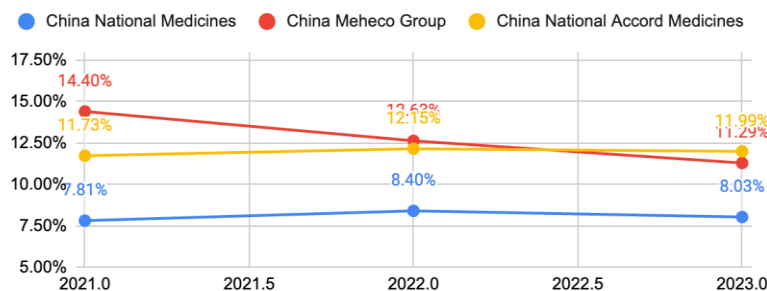


Figure 5. Gross Margin of three companies from 2021 to 2023

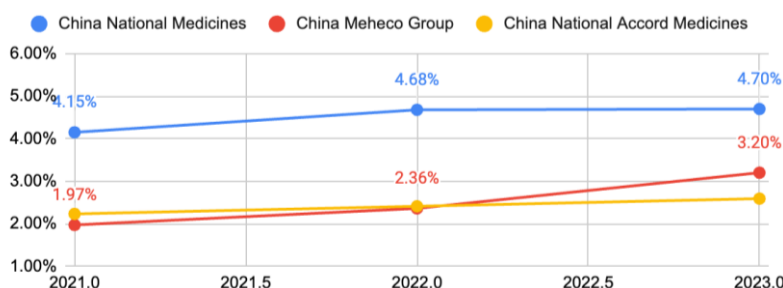


Figure 6. Net Profit Margin of three companies from 2021 to 2023

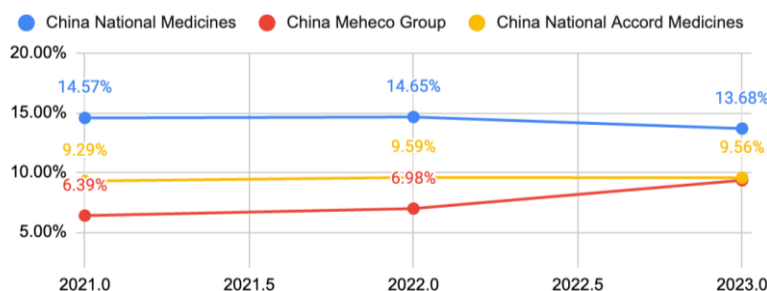


Figure 7. ROE of three companies from 2021 to 2023

From the changes in the gross profit rate in the past three years, it can be found that the gross profit rate of China National Medicine is lower than that of the same industry, less than 10% (Figure 5). The gross margin has no obvious growth trend, and the ROE has a downward trend. However, China National Medicine's net profit margin has continued to rise over the past three years, and both its net profit margin and ROE are much higher than those of the other two companies (Figure 6, Figure 7). This may be due to the company's higher efficiency in operations management production processes, reducing operating costs. The company also has other highly profitable businesses and investment income.

Table 1. The ratio of sales to expenses of the three companies

	China National Medicines	China Meheco Group	China National Accord Medicines
Sales to Expenses Ratio	1.94%	4.15%	7.06%
SG&A Expense Ratio	0.94%	2.82%	1.47%

The comparison of operating costs in each company's income statement shows that the proportion of selling, General & Administrative Expenses in the total revenue of China National Medicine is the lowest (Table 1). As mentioned by BOCOM International Research, China National Medicines is a

national giant in the distribution of anaesthetics. Narcotic and psychotropic drugs are controlled substances in China, and there are incredibly high restrictions on both production and circulation. The drugs can only be sold through government-designated distributors, and China National Medicine is one of three in the country. It is the national narcotics distribution giant, commanding absolute market share [7]. The barriers of high restrictions also bring higher profit margins, so the company's overall profit margin is significantly higher than its peers.

4.2. Liquidity Analysis

4.2.1. Current Ratio/Quick Ratio.

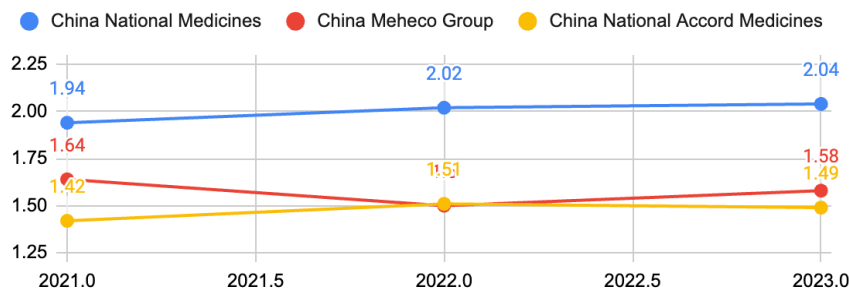


Figure 8. Current Ratio of three companies from 2021 to 2023

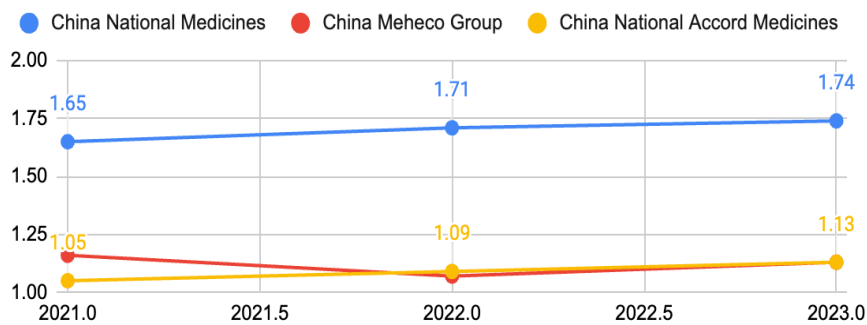


Figure 9. Quick Ratio of three companies from 2021 to 2023

The current ratio of these companies is maintained above 1.5 in 2023, and the quick ratio is also above 1.1. That means they face less risk of defaulting on their short-term debt. However, the difference is that these two ratios of China National Medicines are significantly higher than the two competitors. Moreover, China National Medicines is the only one among the three companies whose current and quick ratios will continue to rise from 2021 to 2023 (Figure 8, Figure 9). In 2022, the company's current ratio exceeds 2, holding a higher proportion of current assets.

Moreover, the quick ratio rose to 1.74 in 2023, 0.6 higher than that of the same industry competitors. The other two companies' indicators remained relatively stable. It shows that China National Medicines has better liquidity and lower default risk. Furthermore, the company is expected to continue to maintain a strong financial position.

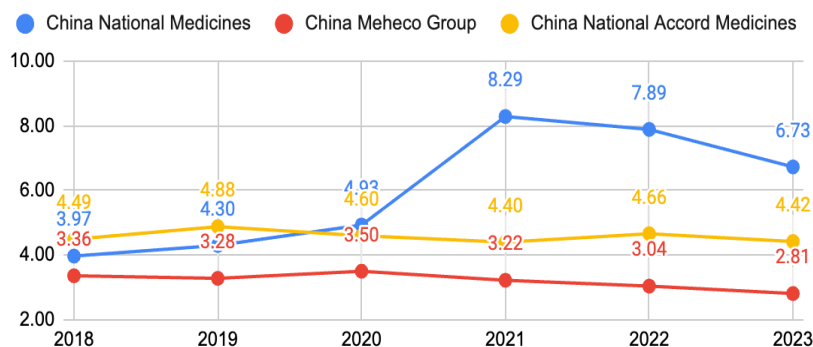


Figure 10. Accounts receivable turnover of three companies from 2021 to 2023

4.2.2. Accounts Receivable Turnover.

Accounts receivable turnover reflects the average number of times a company collects outstanding accounts receivable in a given period. There are differences in the industry benchmark of accounts receivable turnover [8]. According to a study of the Chinese pharmaceutical industry by CHFT Advisory and Appraisal LTD, the expected turnover rate of the pharmaceutical industry is approximately 4.1 times per year, compared to the average level of companies [9].

China National Medicines' Accounts receivable turnover exceeded the industry average in 2019. In 2021, with rapid growth, even more than double the average, reaching 8.29. During the next few years, although the company's Accounts receivable turnover declined significantly in 2022, it still rose compared with previous years and was well above the average of the company and its competitors (Figure 10). Overall, this shows that the efficiency of receivables collection at China National Medicines is improving, and the risk of capital collection for enterprises is reduced.

4.3. Long-Term Solvency

4.3.1. Asset-Liability Ratio.

The asset-liability ratio, the ratio of liabilities to assets, is also a leverage ratio. It reflects the financial stability of the company and is an important index to judge the long-term solvency of the company [10].

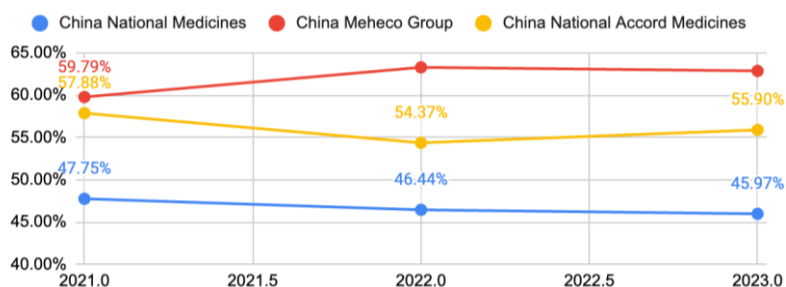


Figure 11. Asset-liability ratio of three companies from 2021 to 2023

The asset-liability ratio of China National Medicines in 2021-2023 is 47.75%, 46.44% and 45.97%, respectively (Figure 11). Overall, the index data declined year by year, indicating that the company's liabilities accounted for less and less of the total assets, and most of the company's assets are financed through equity. The asset-liability ratio of China National Medicines is much lower than that of other pharmaceutical companies each year, indicating that China National Medicines has not fully exerted the financial leverage effect. However, a highly leveraged company may have a more challenging time operating during a recession than a less leveraged company. It shows that the company has a sound capital structure management and avoids significant debt risks.

4.3.2. Interest Coverage.

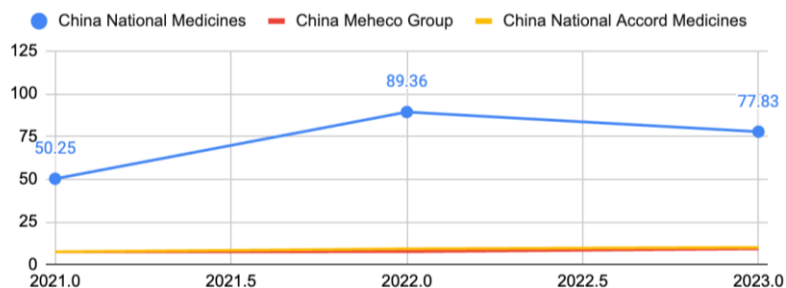


Figure 12. Interest coverage times of three companies from 2021 to 2023

Interest coverage is derived from the ratio of EBIT to interest expense, which reflects how many times the profits earned by an enterprise can repay the loan interest. The higher the interest coverage, the better the company's long-term solvency.

China National Medicines' interest coverage from 2021 to 2023 is 50.25, 89.36 and 77.83, respectively (Figure 12). Although the index of China National Medicines in 2023 fell against the trend when the same industry rose, the overall index is upward. In addition, the index of China National Medicines is much higher than that of the other two companies, indicating that the company's annual profits still have a high degree of protection for interest expenses.

5. Conclusion

China National Medicines, as a subsidiary of China Pharmaceutical Group, has achieved an indispensable position in China's pharmaceutical market after more than 20 years of development. This study uses a pestle analysis and comprehensive analysis of the company's profitability and solvency financial indicators, and it makes comparisons with companies in the same industry.

In the analysis of financial indicators in this study, after an in-depth analysis of the company's profitability and liquidity, it is found that the indicators of China National Medicines are better than those of companies at the same level in the industry, and some indicators are even several times higher than those of peers. Because of the Chinese government's strict control of anaesthetics, the company sells indispensable anaesthetics in the Chinese market. With increased social demand for pharmaceuticals, the company's total revenue, net profit, gross profit margin, and net profit margin steadily increase yearly. At the same time, as China's ageing problem intensifies, the company's profitability will continue to rise in the next few years. The liquidity of the company's funds is also very excellent; whether it is short- or long-term debt, the company can repay. The company has the lowest risk of default in its industry.

Therefore, through the above analysis, it can be concluded that China National Medicines is a company worthy of investment. The company's pharmaceutical products have a large share of the Chinese market and a unique advantage in the sales of spermine drugs. On top of that, the company's profitability has been stable, with sustained gains and a shallow risk of default.

Acknowledgements

All the authors contributed equally, and their names were listed alphabetically.

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