

111, Inc.

YI: Operating in One of China's Best Industries

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KEY POINTS

- **We hosted CEO and Co-Founder Junling Liu for a fireside chat on September 5, 2024.** The discussion included key takeaways from 111's 2Q24 earnings report, expectations and expansion plans for the remainder of the year, and progress of the rollout of 111's digital innovations. This report contains a transcript of the conversation, which can be accessed [on demand](#).
- **In a good position despite macroeconomic headwinds.** Despite a softer-than-expected quarter for China's economy as consumers reined in their spending habits, including spending on non-essential pharmacy products, 111 still delivered a solid quarter achieving profitability and positive operating cash flow for the second consecutive quarter. Liu does not expect the consumption malaise to last long and sees the pharmacy sector as one of the best industries to participate in with central government reforms encouraging a rapid expansion in retail pharmacies across China. Indeed, Liu indicated that he would not be surprised if the number of pharmacies in China exceeds 700,000 by the end of 2024 from about 600,000 in 2023 and 470,000 when 111 launched its B2B platform in 2017.
- **111 continues to scale up.** The company plans to build out its fulfillment center footprint by adding seven additional centers by the end of the year across various regions to the 11 established centers it operates. This, along with its work with thousands of distributors across the country, is part of a strategy to significantly expand selections for its customers and provide a one-stop shopping experience. 111's business logic is to provide customers (i.e., pharmacies) with the richest selection of pharmaceutical products at competitive prices with the goal of creating customer loyalty.
- **Technology progress.** Liu highlighted 111's few dozen digital operating systems and adoption of AI for application in several areas of the company's B2B platform that have contributed significantly toward its achievement of becoming the industry's most cost-efficient operator. Moreover, these are protected by an expanding IP portfolio of 28 patents.
- **Focus on organic growth.** Liu emphasized that 111's strategy is focused on profitability and building on its core competencies. As long as it keeps delivering sound financial results, it could be in a position to look into other opportunities.
- **Valuation enigma.** We would point out that 111's share price weakness through the summer ignores solid financial results and the company's financial health with its net cash & equivalents of \$58 million (excluding restricted cash) based on today's RMB/\$ exchange rate (7.01). This represents \$0.68 per ADS, effectively valuing a ~\$2 billion business that has achieved operating profitability in the last two quarters despite China's economic headwinds, at \$0.04/ADS or \$3.4 million as the time of writing.
- **Management's faith in the business.** On September 13, 2024, 111 announced that co-founders Dr. Gang Yu and Mr. Junling Liu (who own 42.7% of the company's total issued capital) have started purchasing ADSs from their personal funds and intend to continue to purchase additional shares from time to time during the trading window from the open market at prevailing market prices, with sole discretion as to how many ADSs they will purchase.

KEY STATISTICS

Ticker:Exchange	YI:NASDAQ
Current Price	\$0.75
52-Week Range	\$0.55-\$2.68
Average Volume (30-Day)	228,978
Shares Outstanding (MM)	85.7
Market Cap (\$MM)	\$64.2
Enterprise Value (\$MM)	\$3.4
Fiscal Year-End	December

PRICE PERFORMANCE



ABOUT THE EXECUTIVE



Junling Liu
CEO

Mr. Junling Liu is 111's co-founder and has served as its chairman and chief executive officer since 2015. Mr. Liu co-founded and served as chief executive officer of YHD.com from 2008 to 2015. Prior to founding YHD.com, Mr. Liu served as the global vice president and president for mainland China and Hong Kong at Dell Inc. from 2006 to 2007. He also held numerous executive positions at internationally renowned technology companies such as Avaya China, Openwave Systems and Lucent Technologies Asia. Since January 2015, he has been an independent director of Autohome Inc. (NYSE: ATHM), the leading online destination for automobile consumers. Mr. Liu received his bachelor's degree in education from Flinders University in Australia in 1991 and master's degree in international business administration from Flinders University in 1998.

EXECUTIVE DISCUSSION

Robert Sassoon: Hello, everyone. I'm Robert Sassoon, Senior Analyst at Water Tower Research, and I'm happy to be joined by Junling Liu, CEO and Co-Founder of 111, for this fireside chat. 111 is a tech-enabled company that develops and operates one of the of China's leading healthcare platforms committed to officially manage the pharmaceutical supply chain by digitally connecting the key stakeholders in the supply chain from drug manufacturers through to distributors, pharmacies, and the consumers.

111's safe harbor statements can be found in its company filings, which are filed with the SEC. Let me welcome you again, Junling Liu, and nice to see you. Let's start with the recent event. You recently reported your results for the second quarter. Can you give us your key takeaways from that earnings report?

Junling Liu: Certainly. First of all, we achieved [operating] profitability for the second consecutive quarter. In the meantime, we also realized positive cash flow for the second consecutive quarter. All of our operating metrics are trending better, with a 120-basis point improvement in the operational expenditure margin. We actually feel very proud of that accomplishment given the macroeconomic pressures we're facing.

Robert Sassoon: Right. The last couple of quarters prior to this second quarter were affected by unfavorable comps due to the spike in revenue as a result of the resurgence of COVID cases in China in late 2022 and early 2023. In the latest report, you mentioned macroeconomic challenges. Can you be more specific about how this environment affected your business in 2Q?

Junling Liu: People expected a robust recovery post the pandemic, but the reality didn't quite meet those expectations. Therefore, the confidence level for consumption is relatively low. People are much more conservative when it comes to spending money, including the non-essential spending in the pharmaceutical space. Obviously, despite all of the challenges we faced, 111 still delivered a very solid quarter as I just briefly talked about at the beginning of the call. I believe this situation should not last for too long, and consumer confidence will return in the future and consumption will resume. We believe this is one of the best industries in this vast market, with the aging population and people having a much better awareness of healthcare after a few decades of rapid growth in the country.

Robert Sassoon: Just following up on that, can you give us an overview of the market outlook for the next couple of quarters and your expectations as to how that will affect 111's B2B and B2C businesses and the company's profit goals in the second half of the year?

Junling Liu: Sure. We are very fortunate for that. The current policies from the central government are quite favorable to our business. First of all, there's the anti-corruption campaign in the pharmaceutical space and the separation of medical services from selling drugs in hospitals. There is also the zero-markup policy. If you're not familiar with that policy, let me just go into detail. Before, hospitals were given the right to mark up the drug prices by 15%, so the hospitals were incentivized to sell more drugs. Therefore, there was over-prescription across the country. Recently, the government took that policy away and it calls it the zero-markup policy and the implementation has been quite successful. All of those policies will result in the pharmacy retail market benefiting from those reforms. We should anticipate that more pharmacies will open up. When we started our business seven years ago, there were only about 450,000 pharmacies nationwide. By the end of this year, I wouldn't be surprised if by the end of this year the number of pharmacies in China exceeds 700,000. That says a lot because this is a better industry compared with the majority of other industries because people are still rushing to open more pharmacy stores. Online pharmacies will also benefit from those reforms, and we are happy to see those big forces are reshaping the industry as we will benefit from both our B2C and B2B business. We feel fairly bullish to carry on the momentum from the first half.

Robert Sassoon: That's very interesting. Let's talk about your expansion plans for various parts of your business, including the fulfillment centers, expansion of offerings that you have, and the partnerships across the supply chain ecosystem.

Junling Liu: We're expanding our coverage in 3Q and 4Q with more fulfillment centers being deployed. I think there are six to seven JV fulfillment centers to be launched in the next few months. We also have a couple of teams working directly with the pharmaceutical companies on a direct sourcing relationship in an effort to really solidify our supply base. We also have other teams working with a few thousand commercial distributors across the country. We will significantly increase our selections for our customers, providing a one-stop shopping experience. Our business logic is very simple, which is to provide customers with a one-stop shopping experience with the richest selection and competitive prices and great service. I believe those kinds of services and those kinds of experiences will create the best customer loyalty.

Robert Sassoon: Great. Let's turn to technology, which I suppose represents the core of your business model. Can you highlight your progress this year in that area? What do you expect with respect to the rollout of new innovations in the coming quarters and the importance of AI?

Junling Liu: We acquired a few new patents, with a total of 28 by now. Obviously, digital operating systems are essential to our business. We have a few dozen systems to make our operation 100% digital, which contributed to our accomplishment in operational efficiency. This year, we have made very impressive progress, especially in the adoption of AI and its applications in a few areas such as the acquisition of new customer leads, automated outbound calls, and customer service. We're also leveraging AI to manage our upstream and downstream product database, managing the pricing database, and so on.

Robert Sassoon: Right. Thank you for that. Given the challenging macroeconomic environment and your reasonably strong financial condition, do you see any acquisition opportunities? If so, what type of opportunities would you be looking at?

Junling Liu: Our focus is still centered around being profitable, building our core competencies, and delivering superior customer experience. I believe this is the right strategy to deal with the uncertainties in the marketplace, both in the near term and in the long term, and we will stay focused on those.

Robert Sassoon: Are you focusing on really more organic growth?

Junling Liu: I think, absolutely. If we keep delivering sound financial results, we might be in a position to look into other opportunities.

Robert Sassoon: Okay. Thank you very much for all of that. I think we'll wrap it up here. If you have any questions for Junling, please send them through to me, and I'll pass them on. For analysis of the company, please refer to the Water Tower Research website, www.watertowerresearch.com. It's an open access website.

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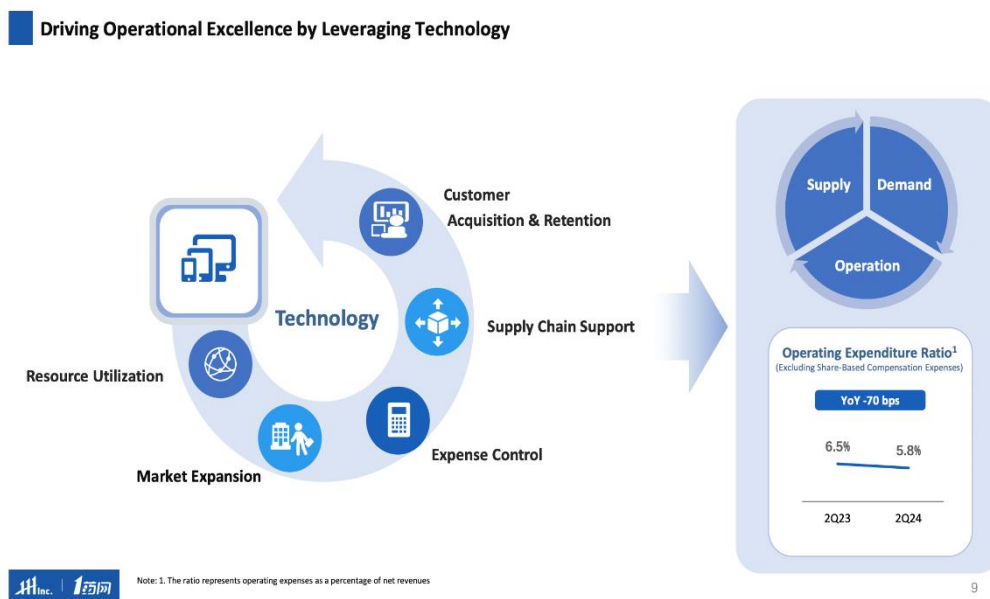
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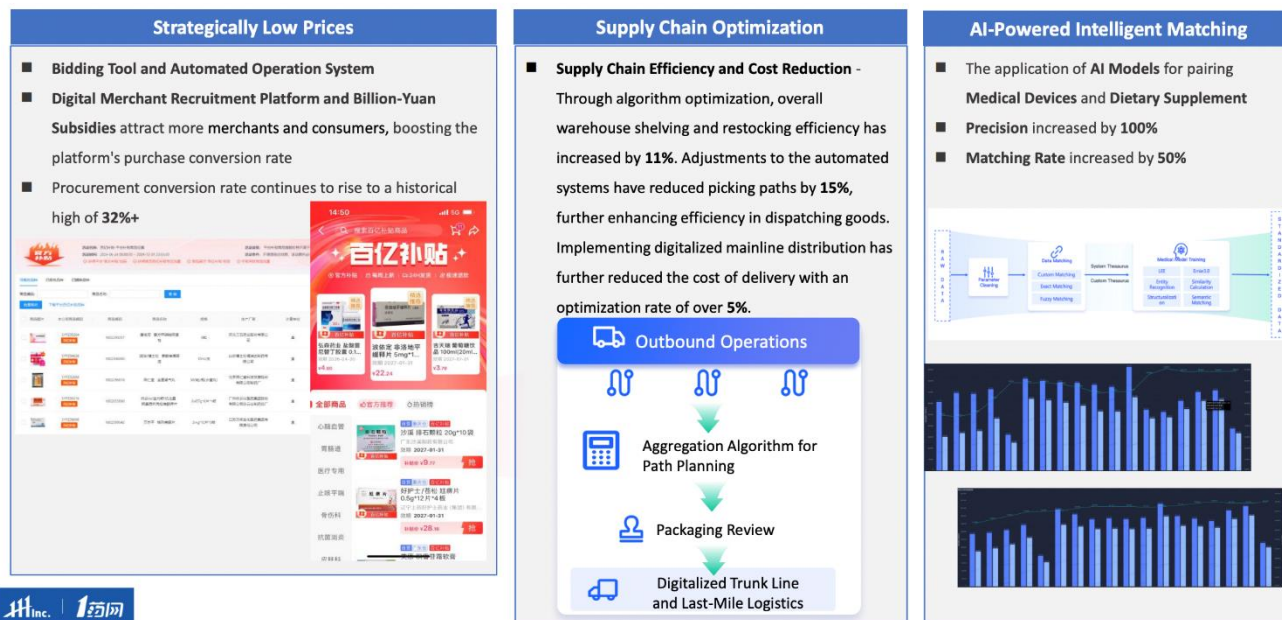
Finally, I'd like to thank you again Junling for the update and have a good day.

Junling Liu: Thank you, Robert.

Figure 1: Digital Technologies Impact on 111's Operating Efficiency & Platform Optimization



Intelligent Integration: Low Prices Mindset, Supply Chain Optimization, AI-Powered Matching



Source: 111

Figure 2: 111 Valuation Comps

Ticker	Company	Description	Exchange	Share Price	MV	EV	LTM Revenue	EV/Revenue	CY 2024E Revenue	EV/Revenue	52 wk Low	52 wk Hi	% of 52 wk Range
				\$	\$	\$	\$						
9885	YSB	B2B Out-of-Hospital	Hong Kong	0.91	588	296	2,542	0.12	N/A	N/A	0.76	7.32	2%
1099	Sinopharm Group	In-Hospital	Hong Kong	2.61	8,131	16,366	81,232	0.20	87,028	0.19	2.06	2.96	61%
2607	Shanghai Pharma	In-Hospital	Hong Kong	1.56	10,147	11,869	36,755	0.32	39,642	0.30	1.29	1.66	73%
3320	CR Pharma	In-Hospital	Hong Kong	0.72	4,542	10,689	34,467	0.31	40,918	0.26	0.57	0.82	60%
600998	Jointown Pharmaceutical	B2B Distributor	Shanghai	0.75	3,775	3,906	20,359	0.19	22,249	0.18	0.62	1.28	20%
241	Alibaba Health Technology	B2C	Hong Kong	0.53	8,532	7,181	3,743	1.92	3,855	1.86	0.33	0.65	62%
6618	JD Health International	B2C	Hong Kong	4.07	12,973	6,169	7,536	0.82	8,248	0.75	2.51	5.31	56%
	B2B/Distributor Average							0.23		0.23			43%
	B2C Average							1.37		1.31			59%
YI	111	B2B - Out-of-Hospital	NASDAQ	0.72	61	3	2,101	0.00	2,042	0.00	0.55	2.68	8%
	Discount to YSB							-99%		N/A			
	Discount to B2B/Distributor Average							-99%		-99%			
	YI EV including Redeemable Non-Controlling Interests			0.72	61	128	2,101	0.06	2,042	0.06	0.55	2.68	4%
	Discount to YSB							-48%		N/A			
	Discount to B2B/Distributor Average							-73%		-73%			

Note: All financial figures, Share Prices are expressed in USD using conversion rates RMB7.01/USD, HKD7.77/USD; Prices as of September 27, 2024

Source: WTR, Kayin

ABOUT THE ANALYST



Robert Sassoon

Senior Research Analyst

Robert Sassoon has been an equity analyst for more than three decades, focusing primarily on global special situations. During his career, Robert has worked for several sell-side institutions in London, Hong Kong, and New York, including Credit Suisse, NatWest Capital Markets, and Societe Generale. In 2017, Robert founded AlphaSituations, an independent idea-generating event driven/special situations investment research service, which produced comprehensive research on early stage/emerging publicly traded and privately owned companies with the goal of telling an underappreciated or unknown story to relevant investors.

Robert has developed a uniquely broad and deep knowledge base in multiple industries from a global perspective and has achieved top five rankings in various analyst surveys, including the Extel and Greenwich surveys. Robert holds an MSc in Economics from the London School of Economics and Political Science, and has held FINRA licenses Series 7, 63, 86, 87, and 24.

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