

Zhongheng Group(600252 CH)

Xueshuantong injection will continue the high growth

Shanghai | Pharmaceutical | Company report

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Xueshuantong injection will continue the high growth

Xueshuantong was continuously selected into National Essential Drug List of the 2009 and 2012 version, and has obtained the separate pricing power from the National Development and Reform Commission with patent protection duration to the year of 2026. Thereby, in recent years, the market shares of Wuzhou Pharmaceutical Co., Ltd has been increasing continuously, and has mainly monopolized the whole Xueshuantong Injection market, becoming the largest single item of traditional Chinese medicine injection. Zhongheng Group also benefited from this. From 2004 to 2013, its revenue and operating profit respectively increased from CNY 150 million and 67 million to CNY 3.64 billion and 726 million Yuan, with the compound annual growth rates of 42.6% and 30.3% separately.

We expect that the high-growth characteristic of Xueshuantong will last. Looking from the cardiovascular and cerebrovascular medicine market that it belongs to, it will not only benefit from the general background of the continuous increase of the rate of cardiovascular disease due to aging of population, but also benefit from the extension of the proportion of essential drugs and the promotion of the rate of seeking medical advice. Regarding traditional Chinese medicine injections, they have characteristics of rapid effect, good effect for treating critical severe cases, and so on. Its clinical prescription rate is very high, even higher than that of general chemical drugs. Compared to the peer, Zhongheng's Xueshuantong is with high proportion of quantifiable ingredients, good solubility and little side effect.

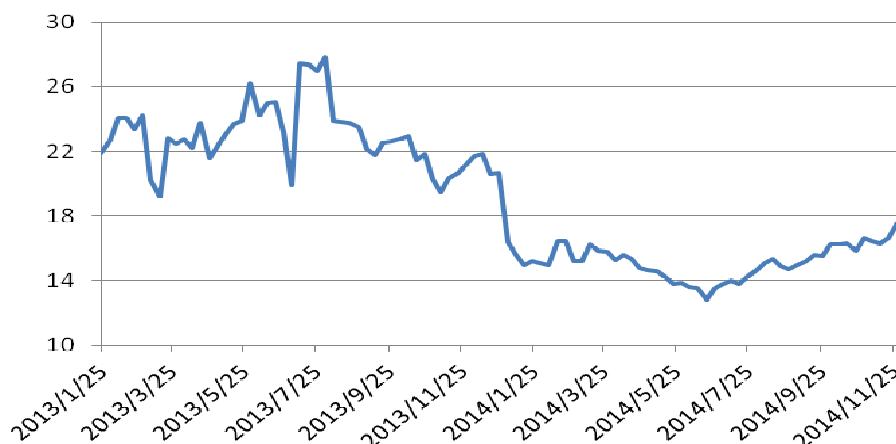
The supervision department has implemented safety reevaluation and strict examination and approval policies on traditional Chinese medicine injections in recent years, and generally presenting the principle of less approval and more elimination. Therefore, traditional Chinese medicine injections with high quality standard and good safety will obtain more market shares in the future, and we believe that Xueshuantong will win more market shares from it.

The price of pseudo-ginseng continues falling and benefits the company's profitability. Looking forwards, due to the increase of harvest area and the long planting cycle, it is expected that more pseudo-ginseng will continuously flow into the market, so the price is expected to maintain low, and its contribution to the performance will still increase.

Low valuation from both horizontal and vertical comparisons

Although the product structure is relatively unitary, Xueshuantong still has pretty large market space, and is hopeful to keep medium and long-term growth. Meanwhile, more than one billion monetary capital will also support the Company to expand extension and acquisitions and cultivate back-up medicine varieties. The valuation of the Company is less than 15X P/E corresponding to 2015 EPS, a low level whether from historical comparison or peer comparison. We grant it 18X 2015EPS, and the target price can be CNY 20.36, with "Buy" rating initially.

Historical P/E FY1 Valuation



Source: Bloomberg, Phillip Securities (HK) Research

BUY (Initially)

CMP CNY16.65

TARGET CNY20.36 (+22%)

COMPANY DATA

O/S SHARES (MN) :	1,158
MARKET CAP (CNYMN) :	19,287
52 - WK HI/LO (CNY):	17.68/ 11.02

SHARE HOLDING PATTERN, %

Guangxi Zhongheng Industrial Corporation Limited:	22.52
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PRICE PERFORMANCE, %

	1 个月	3 个月	1 年
Zhongheng Group	5.92	17.42	23.70
HS300	-8.24	-25.48	-20.90

PRICE VS. HS300



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY12	FY13	FY14E	FY15E
Net Sales	1895	3910	3401	4079
Net Profit	713	743	1023	1310
EPS, CNY	0.65	0.68	0.93	1.13
PER, x	25.50	24.49	17.94	14.72
BVPS, CNY	2.97	3.38	4.69	5.53
P/BV, x	5.61	4.93	3.55	3.01
ROE, %	27.23	21.44	22.43	22.14
Debt/Equity (%)	43.37	64.21	35.49	31.28

Source: Company reports, Phillip Securities Est.

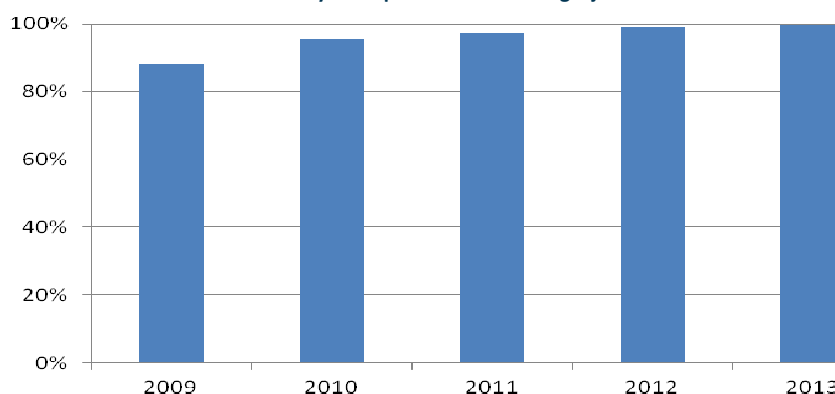
Fan Guohe (+ 86 21 51699400-110)
fanguohe@phillip.com.cn

Traditional Chinese medicine injection is the major contributor

Currently Zhongheng Group runs businesses of medicine, health food and real estate. After going through diversified development in previous years, the Company has focused on the development of pharmaceutical manufacturing industry since 2012, and gradually strips the real estate business. Wuzhou Pharmaceutical Co., Ltd, 99.99% shares hold by the Company, is the main source of revenues and profits, and Xueshuantong injection (freeze-drying) is the leading product. In 2013, the revenue and gross margin of Xueshuantong series occupied respectively 87.1% and 94.5% of the total revenue and gross margin of the Company.

It's worth pointing out that the variety was continuously selected into National Essential Drug List of the 2009 and 2012 version, becoming one of the only 8 kinds of traditional Chinese medicine injections. Also, as the exclusive variety of essential drug and Class A medical insurance list, Xueshuantong injection obtained the individual pricing power from the National Development and Reform Commission with patent protection duration to the year of 2026. Depending on this dominant competitive position, the market shares of Wuzhou Pharmaceutical Co., Ltd is increasing continuously, and has mainly monopolized the whole market of Xueshuantong injection, becoming the largest single item of traditional Chinese medicine injection in term of sales volume. The Company also benefited from this. From 2004 to 2013, its revenue and operating profit respectively increased from CNY150 million and 67 million to CNY 3.64 billion Yuan and 726 million, with the CAGR of 42.6% and 30.3%.

Wuzhou Pharmaceutical has basically monopolized Xueshuantong injection market

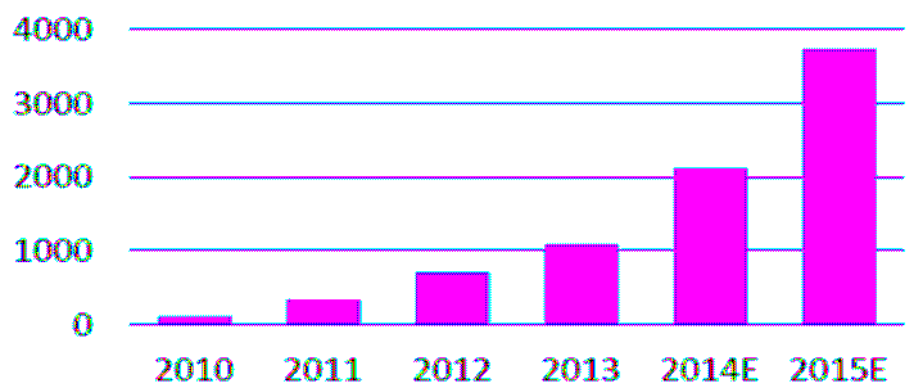


Source: SFDA, Phillip Securities (HK) Research

The high growth trend will keep on

In general, we expect that the high-growth trend of Xueshuantong will last. Looking from the cardiovascular and cerebrovascular medicine market that it belongs to, it will not only benefit from the general background of the continuous increase of the rate of cardiovascular disease due to aging of population, but also benefit from the extension of the proportion of essential drugs and the promotion of the rate of seeking medical advice. Among them, although chemical drugs still holds the dominant position, Chinese patent medicine are being widely used depending on its unique advantages such as multiple targets and little toxic and side effect, and its market shares rise continuously. According to the statistics, the compound annual rate of growth of cardiovascular and cerebrovascular drugs in the market was 21% from 2010 to 2012, among which the compound annual rate of growth of traditional Chinese medicine reached up to 28.8%.

Market scale forecast of national essential drugs (CNY: 100mn)

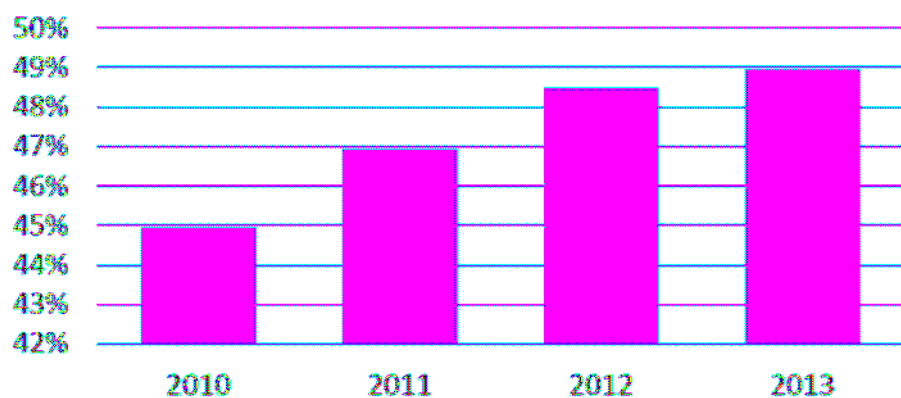


Source: SFDA, Phillip Securities (HK) Research

Traditional Chinese medicine injection has characteristics of rapid effect, good effect for treating critical severe cases, and so on. Its clinical prescription rate is very high, even higher than that of general chemical drugs. Among them, Xueshuantong has characteristics of high proportion of quantifiable ingredients, good solubility and little side effect comparing with similar varieties. After the improvement of new process, the quantifiable ingredients reach 97.2%. It is not only the highest level in injections of extracts of pseudo-ginseng kind, but also starts to approach the proportion of quantifiable ingredients of chemical drugs. In addition, as the unique variety of the national essential drugs, Xueshuantong enjoys the individual pricing power. It maintains the terminal price well, and the list prices in the histories of all places were pretty stable, which sets aside more profit margins for channels, and contributes to maintain reasonable sales model.

It is particularly worth mentioning that the supervision department has implemented safety reevaluation and strict examination and approval policies on traditional Chinese medicine injections in recent years, and generally presenting the principle of less approval and more elimination, which will promote the upgrade of the quality standard of this industry. Therefore, traditional Chinese medicine injections with high quality standard and good safety will obtain more market shares in the future, and we believe that Xueshuantong will win more market shares from it. In the first three quarters of 2014, the Company continued the high-growth trend. The sales volume of Xueshuantong reached 207 million with year-on-year growth of 30%. We expect that it will maintain more than 20% of the growth in the following two or three years.

CR5 of Cardiovascular drugs



Source: SFDA, Phillip Securities (HK) Research

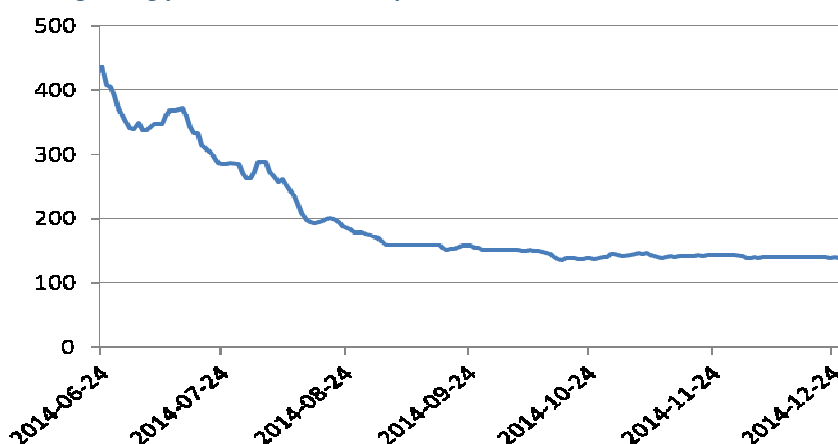
Moreover, the Company is building two production capacities in Nanning and Zhaoqing, which are expected to start to release the production capabilities this year and reach the design capacity in 2018. Therefore, its total production capacity of Xueshuantong will increase 133% to 700 million per year, thereby solving the

bottleneck of production capacity, and then supports the medium and long term growth of the Company.

The profitability will benefit from the dropping price of pseudo-ginseng

Pseudo-ginseng is the main raw material of Xueshuantong injection. Since 4Q13 the price of pseudo-ginseng continues falling, and the extent reaches up to 50% to 60%. Therefore, the material cost can reduce significantly and benefit the company's profitability. The sales volume of the Company of the first three quarters increased 30%, meanwhile the net profit excluding extraordinary items increased significantly about 40%. Looking forwards, due to the increase of harvest area and the long planting cycle of pseudo-ginseng, it is expected that new products will continuously flow into the market, and the price of pseudo-ginseng is expected to maintain low, so its contribution to the performance of the Company is expected to increase.

Pseudo-ginseng price has seen a steep fall



Source: Wind, Phillip Securities (HK) Research

Catalysts

The performance from traditional Chinese medicine injection is beyond expectation; Advances in epitaxial expansion and acquisition.

Risks

The sharp decrease of the retail price of Xueshuantong;
New production capacity releases less than expected.

Financials

Periodicity:	2011	2012	2013	2014F	2015F
Valuation Ratios					
Price Earnings	48.54	25.50	24.49	17.94	14.72
Price to Book	9.10	5.61	4.93	3.55	3.01
Dividend Yield	0.60%	1.20%	1.20%	1.86%	2.22%
Per share data(CNY)					
EPS Adjusted	0.34	0.65	0.68	0.93	1.13
Book Value Per Share	1.83	2.97	3.38	4.69	5.53
Dividends Per Share	0.10	0.20	0.20	0.31	0.37
Growth & Margin					
Revenue growth	-	68.89%	106.31%	-13.02%	19.94%
Gross profit growth	-	78.17%	131.42%	-15.32%	22.70%
Net profit growth	-	90.26%	4.09%	37.76%	28.04%
Gross Margin	67.87%	71.60%	80.32%	78.20%	80.00%
Operating Margin	37.62%	30.04%	20.37%	32.85%	35.00%
Net Profit Margin	33.41%	37.64%	18.99%	30.08%	32.11%
Dividend Payout Ratio %	29.15%	30.63%	29.41%	33.40%	32.71%
Key ratios					
Return on Assets	10.93%	16.68%	13.86%	15.25%	16.62%
Return on Equity	22.72%	27.23%	21.44%	22.43%	22.14%
Liability ratio	48.63%	30.25%	39.10%	26.19%	23.82%
Effective Tax Rate	17.63%	13.90%	15.65%	15.00%	15.00%
Income Statement(CNY: mn)					
Revenue	1,122	1,895	3,910	3,401	4,079
- Cost of Goods Sold	361	538	770	741	816
Gross Income	762	1,357	3,141	2,660	3,263
- Selling, General & Admin Expense	340	788	2,344	1,542	1,836
Operating Income	422	569	796	1,117	1,428
- Interest Expense	64	64	66	25	-7
- Net Non-Operating Losses (Gain)	-97	-324	-148	-110	-105
Pretax Income	454	829	879	1,202	1,540
- Income Tax Expense	80	115	138	180	231
Income Before XO Items	374	714	742	1,022	1,309
- Minority Interests	-1	-1	-1	-1	-1
Net Profit	375	713	743	1,023	1,310

Source: Company, Phillip Securities (HK) Research Estimates

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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Contact Information (Regional Member Companies)

SINGAPORE**Phillip Securities Pte Ltd**

Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG**Phillip Securities (HK) Ltd**

Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA**PT Phillip Securities Indonesia**

ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND**Phillip Securities (Thailand) Public Co. Ltd**

15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website: www.phillip.co.th

UNITED KINGDOM**King & Shaxson Capital Limited**

6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA**PhillipCapital Australia**

Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96188238
Fax (613) 92002272
Website: www.phillipcapital.com.au

MALAYSIA**Phillip Capital Management Sdn Bhd**

B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN**PhillipCapital Japan K.K.**

Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA**Phillip Financial Advisory (Shanghai) Co. Ltd**

No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE**King & Shaxson Capital Limited**

3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES**Phillip Futures Inc**

141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005