

Shandong Xinhua Pharmaceutical (719.HK)

Continuous Growth in Results

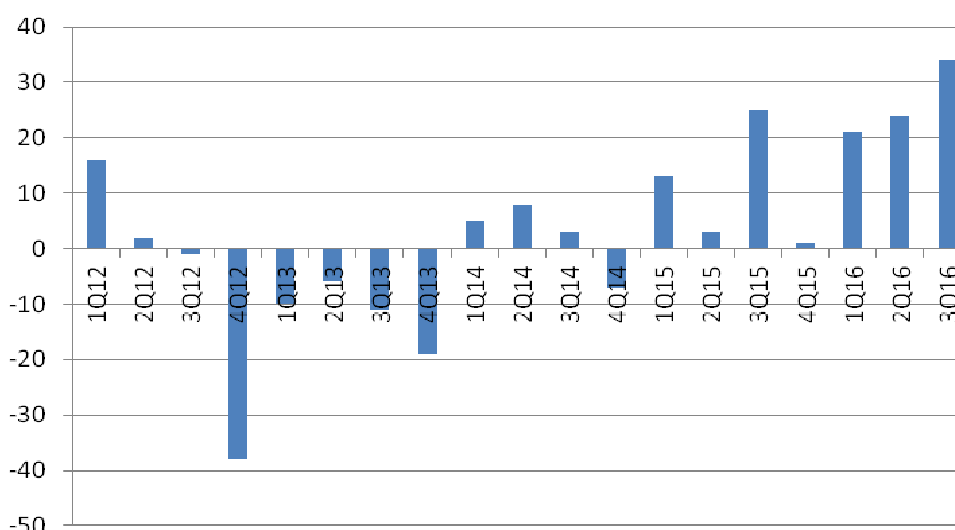
Hong Kong | Pharmaceutical | Company report

23 December 2016

Continuous Growth in Results

According to the Q3 report, Shandong Xinhua Pharmaceutical Company recorded a revenue of RMB980 million in Q3, rose by 18.6% YoY, with a net profit of RMB43.31 million, representing an increase of 20.6% YoY and a net profit excluding non-recurring items of RMB33.8 million, a YoY increase of 37.5%. In the first three quarters, revenue grew by 7.3% YoY to RMB2.98 billion and net profit excluding non-recurring items rocketed by 96.1% YoY to RMB78.52 million. Generally, the company has maintained the continuous improvement in results since 2014.

Improved Net profit attributable to parent company deducting non-recurring items (CNY: mn)



Source: Wind, Phillip Securities (HK) Research

Specifically, revenue growth was mainly benefited by the company's steady promotion of preparations boosting strategy, and the sales volume of major products grew considerably year-on-year. Meanwhile, pollution-intensive, backward production had been phased out, and market concentration of the API industry continued to increase. The competition landscape of the company's main products, including ibuprofen, analgin, caffeine and other antipyretic-analgesic APIs, of which more than 80% have been provided by two to three suppliers, had been stable, and API price rebound also drove revenue growth. Also, the company endeavored to advance technologies and procurement by invitation for bids, with a view to reducing costs, boosting the rise in gross profit margin to 24.2% and contributing to the company's results growth.

Buy (Initially)

CMP: HKD 5.22
(Closing price as at 21 Dec 2016)
TARGET: HKD 7.10 (+36%)

COMPANY DATA

O/S SHARES (MN) :	457
MARKET CAP (HKDMN) :	5,062
52 - WK HI/LO (HKD):	6.4/ 3.52

SHARE HOLDING PATTERN, %

Shandong Xinhua Pharmaceutical Group:	34.46
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PRICE PERFORMANCE, %

	1M	3M	1Y
Shandong Xinhua Pharmaceutical	-10.34	-11.69	5.17
HSI	-7.53	-3.49	5.46

PRICE VS. HSI



Source: Phillip Securities (HK) Research

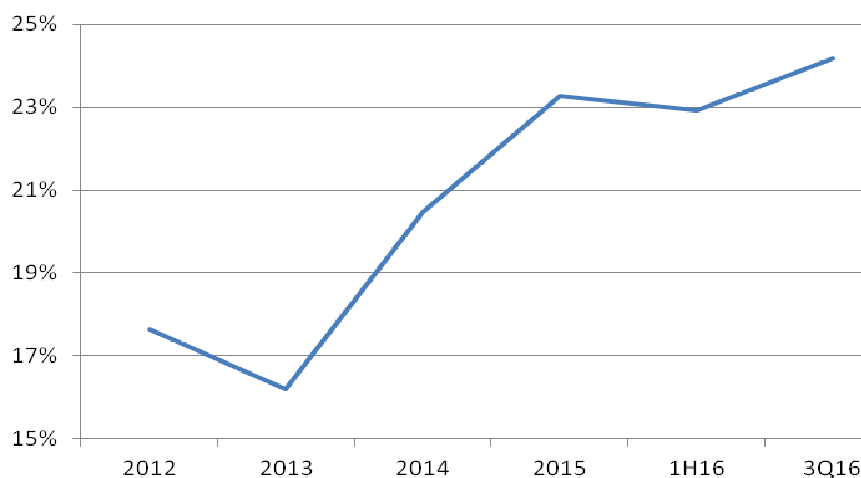
KEY FINANCIALS

CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	3533	3567	3898	4228
Net Profit	50	83	128	161
EPS, CNY	0.11	0.18	0.28	0.31
PER, x	43.5	26.4	16.9	15.4
BVPS, CNY	3.99	4.12	4.40	5.24
P/BV, x	1.19	1.15	1.08	0.91
ROE, %	2.7	4.5	6.3	6.5
Debt/Equity (%)	121.7	126.4	122.2	92.3

Source: Company reports, Phillip Securities Est.

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Gradually improved gross margin



Source: Wind, Phillip Securities (HK) Research

Favorable Competitive Landscape of Strategic Varieties

The company is actively promoting the strategy of boosting preparations business and the main varieties are in favorable competitive landscape, which will promote rapid growth of the preparations business. For example, the company's Polycarbophil Calcium (Baochang), Nimodipine Sustained-release Capsules (Nilisu) and Cefuroxime Axetil Dispersible Tablets (Kuxin, also can be children's medicine) have broad growth prospects, since they are only produced by two companies. Similarly, Rabeprazole Sodium Enteric-coated Tablets (Shutaide) are only produced by around five companies, and the company has price edge over its competitors. And Glimpiride Tablets (Jiaheluo) is a long-acting anti-diabetic medicine, which has obvious price advantage, is expected to benefit from import substitution.

Also worth mentioning is the fact that more than 60 varieties were put on the national low-price medicine list, making the company one of the Chinese enterprises with the most selected varieties. Since last June when China's low-price medicine control was slackened, prices of several varieties of the Company soared and are expected to continue to enhance its profitability.

A Globalization Leader

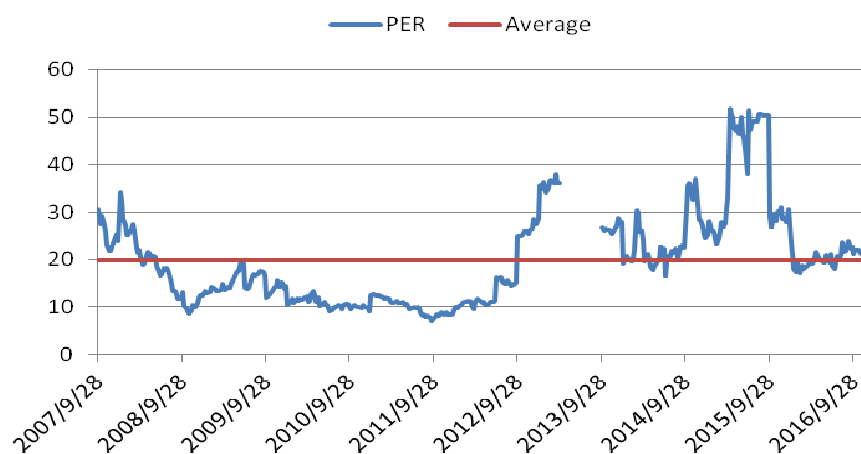
The company is one of China's first 15 enterprises of implementing the preparations globalization strategy, with the current export business (including export to the United States and European countries) accounting for up to 25% of total revenue. The company has around seven products having passed FDA inspection and 10 products with COS certification, and its products are exported to more than 50 countries and regions. Moreover, the company is actively promoting ANDA registration. We believe that the initiatives, such as the quality consistency evaluation for generic drugs, actively promoted by Mainland China will bring competitive edge to enterprises with export superiority, and are expected to optimize the competitive landscape of related products. Shandong Xinhua Pharmaceutical Company is expected to benefit from the process.

Non-Public Offering to Ease Financial Burden

Recently, the company's private placement program was approved and the fund of more than RMB600 million will all go to repayment of bank loans and supplementary of working capital. The company's financial burden is expected to be significantly eased in the coming year. And the new issuance of stocks by way of subscription as part of the Employee Stock Ownership Plan (ESOP) is expected to effectively encourage management and mobilize the employee's enthusiasm.

Generally, the company is expected to sustain growth in profitability of API business and rapid growth in preparations business, and the company's exports are also expected to benefit from RMB devaluation. We expect the company's results to sustain growth. We give an estimation of 21x EPS in 2017 and a target price of HKD7.1, with the "Buy" rating initially. (Closing price as at 21 Dec 2016)

Gradually improved gross margin



Source: Bloomberg, Phillip Securities (HK) Research

Risks

Market expansion below expectations;
Fast-growing crude oil prices.

Financials

FYE	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings	59.32	43.54	26.36	16.93	15.43
Price to Book	1.20	1.19	1.15	1.08	0.91
Dividend Yield	0.4%	0.4%	0.4%	1.1%	1.3%
Per share data(RMB)					
EPS Adjusted	0.08	0.11	0.18	0.28	0.31
Book Value Per Share	3.96	3.99	4.12	4.40	5.24
Dividends Per Share	0.02	0.02	0.02	0.05	0.06
Growth & Margin					
Revenue growth	-	5.8%	1.0%	9.3%	8.5%
Gross Profit growth	-	24.7%	12.0%	15.5%	9.8%
Net Profit growth	-	36.0%	66.2%	54.3%	25.7%
Profitability Ratios					
Gross Margin	17.3%	20.4%	22.6%	23.9%	24.2%
Net Profit Margin	1.1%	1.4%	2.3%	3.3%	3.8%
Dividend Payout Ratio %	25.0%	18.3%	11.1%	17.8%	19.5%
Key Ratios					
Return on Assets	1.0%	1.2%	1.9%	2.8%	3.2%
Return on Equity	2.1%	2.7%	4.5%	6.3%	6.5%
Effective Tax Rate	22.6%	25.4%	20.1%	22.5%	22.5%
Liability ratio	53.0%	54.9%	55.8%	55.0%	48.0%
Income Statement(RMB: mn)					
Revenue	3,339	3,533	3,567	3,898	4,228
- Cost of Goods Sold	2,761	2,813	2,760	2,966	3,205
Gross Income	578	721	807	932	1,023
- Selling, General & Admin Expenses	563	692	652	725	786
Operating Income	128	219	155	207	237
- Interest Expense	66	75	86	58	30
- Net Non-Operating Losses (Gains)	-2	58	-30	-20	-20
Pretax Income	63	91	118	189	234
- Income Tax Expense	14	23	24	42	53
Income Before XO Items	49	68	94	146	181
- Minority Interests	11	18	11	18	20
Net Profit	37	50	83	128	161

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 21 Dec 2016)

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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