

Shanghai Pharma (2607.HK)

Manufacturing and Retail Segments Accelerated

Hong Kong | Pharmaceutical | Company report

9 May 2018

Investment Summary

SPH announced FY17&18Q1 results, beat our expectation. We see that momentum of manufacturing maintain strong and growth of retail business steps up. We highlight that BE test will increase sales volume and ASP in future, thus we adjusted EPS estimation to be RMB1.48/1.69 in 18E/19E. Assuming target PE 14.25x (roughly par to 2-y historical PE), we get target price of HKD25.5. (Exchange rate= 0.823 RMB/HKD) (Closing price at 7 May 2018)

Accumulate

CMP HKD21.8

(Closing price at 7 May 2018)

TARGET HKD25.5 (+17%)

Business Overview

Robust FY17& 1Q18 results. In FY17/18Q1, the company realized revenue of RMB130.8bn/36.69 (+8.35%/9.83% YoY), NP attributable to shareholders of RMB3.52bn/1.02bn (+10.14%/2.07% YoY) and NP excluding non-recurring items of RMB2.65bn/996mn (+2.73%/6.08% YoY).

COMPANY DATA

O/S SHARES (MN) :	2842.1
MARKET CAP (HKDMN) :	19668
52 - WK HI/LO (HKD):	24.25 / 18.2

SHARE HOLDING PATTERN , %

SIIC.	34.9
Credit Suisse Group	13.0
JP Morgan.	8.24
SOC	8.7
Blackrock	5.77

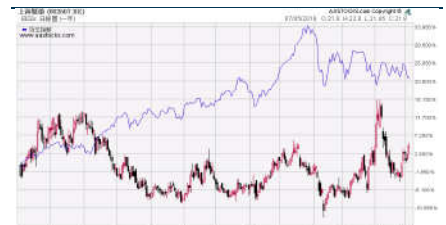
Manufacturing kept rapid growth. This segment achieved revenue of RMB14.99bn (+20.71% YoY) with GPM rising by 3.3pp to 53.86%. 28 products reported over RMB100mn sales and 60 core products reported sales of RMB7.98bn (+14.42% YoY) and GPM 71.28% (+2.65pp). In 18Q1, the company realized sales of RMB4.96bn (+30.82% YoY) and we expect growth momentum will maintain in 18E19E.

PRICE PERFORMANCE , %

	1M	6M	1Y
SPH	5.83	12.02	7.39
HSI	-4.52	3.76	22.54

Retail business stepped up. In 2017, the company realized revenue of RMB5.64bn (+9.44% YoY) with GPM of 16.36% (+0.84pp). In 18Q1, retail business continues high growth given segment revenue rose by 12.78% YoY to RMB1.44bn with GPM of 15.95%. As up to end 2017, SPH operated 1892 chain pharma stores (1247 of which were self-owned) and continued to expansion hospital coverage. Based on its e-commerce platform (上药云健康) to explore e-prescription business, SPH signed strategic cooperation agreement with Tencent, which facilitates a integrated system involving acquirement of prescription, drug delivery and value-added services. During 2017, the company disposed over 2mn e-prescription and cooperated with 214 hospitals. Meanwhile, it continues to enhance DTP network and now operates over 70 DTP pharma stores in China after acquiring Cardinal China. We highlight that retail business will continue high growth given SPH's rich drug resources and strong channel advantage.

RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

Distribution segment in line with expectation. Influenced by two-invoice system, the distribution segment slowed down in short term. It reported revenue of RMB115.86bn/31.42bn (+6.93%/6.66% YoY) and GPM of 6.12%/6.48%. SPH is the largest pharmaceutical importer and distributor in China with 223 imported products. To maintain profitability of distribution business, the company makes efforts to improve product structure, control expenses and explore hospital supply chain business (managing 226 hospital pharmacies). In long run, we highlight TIS will increase industry concentration and improve efficiency. And we expect distribution business to rebound in 18H2.

KEY FINANCIALS

RMB mn	FY16	FY17E	FY18E	FY19E
Net Sales	120,765	130,847	146,074	164,222
Net Profit	3,196.4	3,520.6	3,966.5	4,539.4
EPS, RMB	1.19	1.31	1.48	1.69
PER, x	18.32	16.64	14.78	12.91
BVPS, RMB	11.76	12.66	15.79	16.97
P/BV, x	1.85	1.72	1.38	1.28
ROE, %	10.40	10.23	10.87	11.48

Source: Company, Phillip Securities Est.

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BE test provides future driver. China government published policies (《關於改革完善仿製藥供應保障及使用政策的意見》) to facilitate the replacement of original imported drug with generic drug. It indicates that qualified generic drugs should be included into public purchase lists and be paid just as original drugs. This means that part of market share of original drugs will be taken by generic drugs, and players who pass BE test earlier are likely to grasp more market share. Meanwhile, ASP will increase given the generic drugs will be sold at price of original drugs, which is usually higher than related generic drugs now. So we see potential hike both in volume and ASP after passing BE test. SPH now has 70 products in BE test and invested 20.8% of R&D expenditure in BE test (R&D expense rose by 20.79% YoY, 5.27% in manufacturing sales).

Valuation and Risks

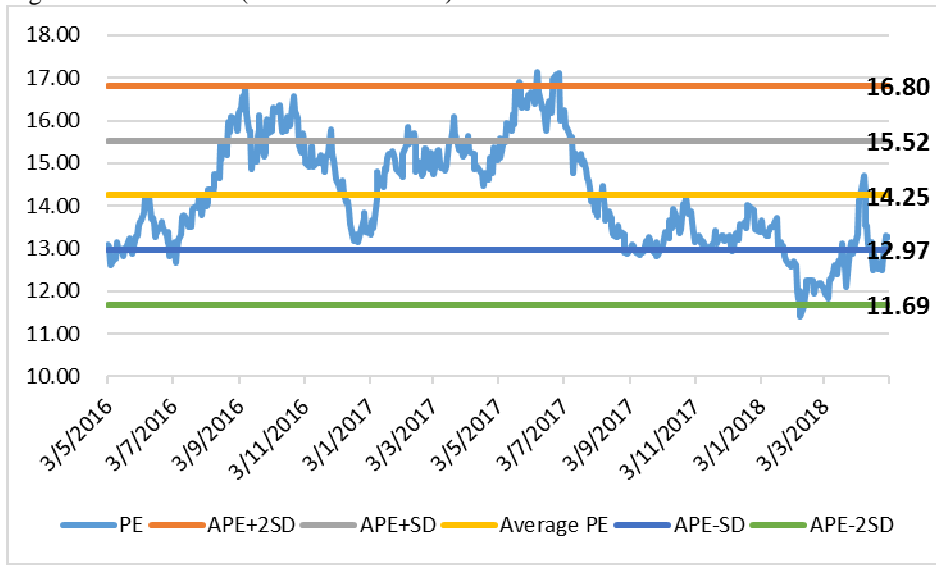
Our model gives target price of HKD25.5. A share peers valuation now is around PE 22.5-28.9x, while PE 14-19x for H share peers. We assume 2018 target PE to be 14.25x (roughly par to 2-y historical average) and estimate 18E/19E EPS to be RMB1.48/1.69 to get target price of HKD25.5. **Risks include:** 1) Two-invoice system's effect on inventory allotment business; 2) Integration of Cardinal fails expectation; 3) BE test progresses not well; 4) Policy risk. (Exchange rate= 0.823 RMB/HKD)

Figure: A/H Peers

H share							
Code	Firm	Mtk Cap/HKD mn	17 GPM	17 ROE	PE (TTM)	PE 18E	PE 19E
2607.HK	上海醫藥	70,022.1	12.37	10.72	13.92	12.66	10.87
Average			12.36	11.75	15.81	14.18	12.35
Median			12.37	10.72	14.50	13.03	11.56
1099.HK	國藥控股	88,132.0	8.31	15.75	14.50	13.03	11.56
3320.HK	華潤醫藥	66,238.7	16.39	8.76	19.02	16.87	14.63
A share							
Code	Firm	Mtk Cap/RMB mn	17 GPM	17 ROE	PE (TTM)	PE 18E	PE 19E
601607.SH	上海醫藥	62,107.1	12.37	10.72	19.28	17.41	15.23
Average			18.55	13.63	28.89	25.45	20.42
Median			14.08	12.30	22.55	19.12	15.96
000963.SZ	華東醫藥	67,814.8	25.69	22.71	35.79	32.03	25.86
600998.SH	九州通	35,281.3	8.22	9.77	23.82	25.62	20.18
600056.SH	中國醫藥	22,502.3	14.03	17.74	16.13	14.76	12.04
600511.SH	國藥股份	22,011.0	7.60	19.51	17.54	17.40	15.34
000028.SZ	國藥一致	21,277.4	10.51	11.85	21.08	19.12	16.67
002589.SZ	瑞康醫藥	22,465.3	18.13	13.73	22.55	17.05	13.09
603883.SH	老百姓	22,134.5	14.12	11.70	21.83	15.45	11.94
603939.SH	益豐藥房	21,768.9	34.86	15.51	57.05	48.80	38.75
000078.SZ	海王生物	15,218.0	39.60	10.23	63.08	52.11	39.39
002727.SZ	一心堂	17,680.4	41.05	13.66	38.71	34.14	27.40
600090.SH	同濟堂	12,237.1	14.71	9.11	23.67	-	-
603368.SH	柳州醫藥	9,720.8	9.28	12.01	22.56	19.82	15.96
002462.SZ	嘉事堂	6,010.1	9.50	12.59	21.44	17.14	13.61

Source: Wind (as at May 4), Phillip Securities

Figure: Historical PE (2016.5.3-2018.5.4)



Source: Bloomberg, Phillip Securities

Financials

FYE	FY2015	FY2016	FY2017	FY2018E	FY2019E
Valuation Ratios					
Price to Earnings (P/E)	20.37	18.32	16.64	14.78	12.91
Price to Book (P/B)	1.96	1.85	1.72	1.38	1.28
Per Share Data (RMB)					
EPS	1.07	1.19	1.31	1.48	1.69
Book Value Per Share	11.13	11.76	12.66	15.79	16.97
Dividend Per Share	0.33	0.36	0.38	0.44	0.51
Growth (%)					
Revenue	14.20	14.45	8.35	11.64	12.42
Gross Profit	12.19	10.80	16.52	9.07	13.66
Operating Income	18.54	16.23	24.96	10.35	13.52
Net Profit	11.03	11.10	10.14	12.67	14.44
Margins (%)					
Gross Profit Margin	11.88	11.50	12.37	12.09	12.22
Operating Profit Margin	3.44	3.49	4.03	3.98	4.02
Net Profit Margin	2.73	2.65	2.69	2.72	2.76
Key Ratios					
ROE (%)	9.95	10.40	10.23	10.87	11.48
ROA (%)	4.53	4.63	4.30	4.57	4.94
Income Statement (RMB Mn)					
Revenue	105,516.6	120,764.7	130,847.2	146,073.5	164,222.4
- Cost of Goods Sold	92,979.1	106,872.6	114,660.5	128,418.4	144,154.9
Gross Income	12,537.5	13,892.1	16,186.6	17,655.1	20,067.5
- Operating Expenses	8,906.3	9,671.5	10,912.4	11,835.0	13,460.2
Operating Income	3,631.2	4,220.6	5,274.2	5,820.2	6,607.4
+ Net Non-Operating G/L	540.7	418.4	-69.4	98.4	109.8
Pretax Income	4,171.9	4,639.0	5,204.8	5,918.6	6,717.2
- Income Tax Expenses	807.5	809.3	1,147.0	1,302.1	1,477.8
- Minority Interest	487.4	633.3	537.1	650.0	700.0
Net Profit	2,877.0	3,196.4	3,520.6	3,966.5	4,539.4

Source: Company, Bloomberg, Phillip Securities (HK) Research Estimates

Exchange rate (0.823) is HKDCNY1Y forward contract price on May 7 from Wind.

(Financial figures as at May 7 2018)

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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