

Shanghai Pharma (2607.HK)

Comment on 18H1 Results: Strong Momentum of Manufacturing and Coming Rebound of Distribution

Hong Kong | Pharmaceutical | Company report

12 September 2018

Investment Summary

The company publishes interim results that the manufacturing business and retail part have maintained rapid growth, and the distribution segment has maintained double-digit growth under the influence of the two-invoice system (TIS). Profitability continued to improve with rising margins. It is expected that distribution business will recover in 18H2. We maintain EPS forecasts and adjust the target price to HK\$24.0 to factor into further devaluation of RMB. (Closing price at 10 Sep 2018)

Accumulate

CMP HKD20.1

(Closing price at 10 Sep 2018)

TARGET HKD24 (+19.5%)

Business Overview

Solid 18H1 results. The company achieved topline of RMB75.87bn (+15.35% yoy) and net profit attributable to shareholders of RMB2.03bn (+5.62% yoy). Shareholding enterprises contributed RMB353mn, down by 9.74% yoy, mainly resulting from channel adjustment under TIS and some drugs experiencing price reduction after entering drug reimbursement lists. Net profit after deducting non-recurring G/L and share profit contributed by invested companies increased by 11.58% yoy. **Profit margins steadily increased.** Gross margin recorded 14.10%, up by 1.84 percentage points (ppt), with the manufacturing up by 5.35ppt and the distribution up by 0.62ppt. Excluding management, sales and R & D expenses, OPM rose by 0.17ppt to 4.18%. Operating cash flow fell 14.21% yoy, which was mainly due to the high base of 17H1 according to Mgt, and dose not affect the company's current good operating conditions.

COMPANY DATA

O/S SHARES (MN)	2842.1
MARKET CAP (HKDMN)	18,473
52 - WK HI/LO (HKD):	24.03 / 17.81

SHARE HOLDING PATTERN, %

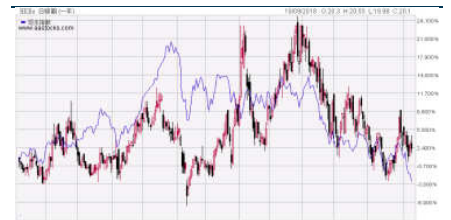
SIIC	34.9
Credit Suisse Group	13.0
JP Morgan	8.24
SOC	8.7
Blackrock	5.77

PRICE PERFORMANCE, %

	1M	3M	1Y
SPH	-2.67	-10.13	4.88
HSI	37.51	-14.44	-3.81

Manufacturing segment. It achieved revenue of RMB9.627bn (+28.31% yoy), GPM of 57.66% (+5.35ppt), R&D expenditure of RMB479mn (+28.29% yoy), accounting for 4.98% of manufacturing revenue. The continued high growth was mainly due to the company's focus on key products and the implementation of "one product, one policy". In 18H1, sales of 60 key products reached RMB5.158bn (+30.19% yoy) and GPM of these was 74.92% (+4.75ppt). With the accomplishment of consistency evaluation of more products, manufacturing segment is expected to continuing growing at a high speed.

RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

Distribution business. Its revenue reached RMB66.25bn (+13.69% yoy) and GPM was 6.68% (+0.62ppt). The company continued to improve the layout of the national network, given it finishes acquisitions of distribution business in Jiangsu, Shanghai, Liaoning, Guizhou, Sichuan, Anhui, Hainan and other provinces, and promotes the sinking of sale channels to city level from province. It progress the integration of SPH and Cardinal, with a professional team of 63 people established. We see the realization of unified management system, and the preliminary combination in terms of DTP (direct high-value drug delivery) pharmacy business and contract sales. We highlight that distribution business still maintained double-digit growth under the influence of TIS is impressive. In 18H2, the growth of distribution business will accelerate given industry recovery.

KEY FINANCIALS

RMB mn	FY16	FY17	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	16.89	15.34	13.63	11.91
BVPS, RMB	11.76	12.66	15.79	16.97
P/BV, x	1.71	1.59	1.27	1.18
ROE, %	10.40	10.23	10.87	11.48

Source: Company, Phillip Securities Est.

Partner	Cooperation of Introduction
Sino-American Squibb	New PD-1 drug Opdivo
Shanghai Roche Pharma	Market expansion and other value-added services
Abbott China	Point-of-Care Testing products
Terumo	Importing Spectra Optia Apheresis System
Shire	Importing all bottled albumin products
Eisai Pharma	Importing key cancer drug Lenvima (Lenvatinib Mesylate)
Gilead Sciences	Importing new HIV drug Genvoya

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Retail segment. Sales reached RMB3.13bn (+15.45% yoy) and GPM of 15.61%, down 0.39ppt yoy. It currently operates 1,981 retail drugstores (including 1,324 self-owned ones), 50 hospital pharmacies and 77 DTP pharmacies. SPH has actively participated in the Shanghai Community Comprehensive Reform Prescription Extension Program, thus it has covered 230 community hospitals and healthcare centers in Shanghai, with a market share of nearly 70%. In 18H1, the company has obtained more than 410,000 prescriptions, with prescription volume increasing by 115.4% yoy. SPH has facilitated the B-round fund of its healthcare e-commerce platform to further expand platform scale, which has processed more than 1.3mn electronic prescriptions and connected with more than 220 hospitals already.

Figure: 18H1 results (unaudited)

RMB mn	18H1	17H1	Change
Revenue	75,878.7	65,778.9	15.35%
-Manufacturing	9,627	7,503	28.31%
-Distribution	66,252	58,521	13.69%
-Retail	3,134	2,714	15.45%
Gross profit	10,660.7	8,061.6	32.2%
GPM	14.1%	12.2%	+1.84ppt
Operating profit	3,303.7	2,724.8	21.2%
OPM	4.18%	4.01%	+0.18ppt
Profit attributable to shareholders	2,033.3	1,925.1	5.62%
NPM	3.23%	3.35%	-0.12ppt
Net Operating cash flow	1,080.5	1,259.5	-14.21%

Source: Company, Phillip Securities

R&D updates. The company increased R&D investment, with an expenditure of RMB479mn (+28.29% yoy), accounting for 4.98% of manufacturing revenue. In 18H1, the company received six clinical approvals of innovative drugs, and promoted the consistency evaluation. It is expected to complete consistency evaluation of around 30 drugs by the end of 2018. At the same time, it focus on strengthening the R&D capability of bio-pharmaceuticals, with formally launching the San Diego R&D Center in US, and carrying out foreign cooperation and equity investment in bio-drugs, so as to enhance the overall innovation capability of bio-medicine.

Figure: Pipeline Updates

Obtained clinical approvals	Injection recombinant Anti-CD30 Human-mouse Chimeric Monoclonal Antibody, SPH3348 Tablet, hydroxyl triptolide tablet, injection recombinant anti-HER2 humanized monoclonal antibody
Gained consistency assessment approvals	Fluoxetine Hydrochloride Capsules, Captopril Tablets
Applied for consistency assessment	Metformin Hydrochloride Sustained-Release Tablets, Ceftriaxone Sodium for Injection, Cefalexin Capsules, Ibuprofen Sustained Release Capsules, Metformin Hydrochloride Tablets, and Hydrochlorothiazide Tablets

Source: Company, Phillip Securities

Valuation and Risks

Our valuation model shows TP of HK\$24.0. Based on target PE 14.25x and unchanged EPS forecast of RMB1.48, we get TP HK\$24.0 (with assumption of Ex rate 0.875 RMB/HK\$). **Downside risks include:** 1) Price reduction after inclusion in NDRL/PDRL; 2) Unfavorable progress in consistency evaluation ; 3) Policy risk.

Figure: PE Band

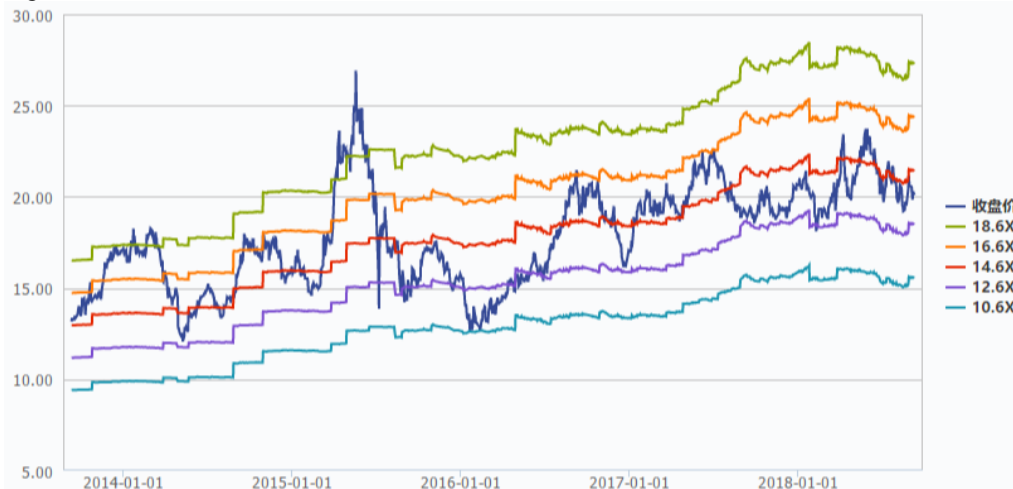
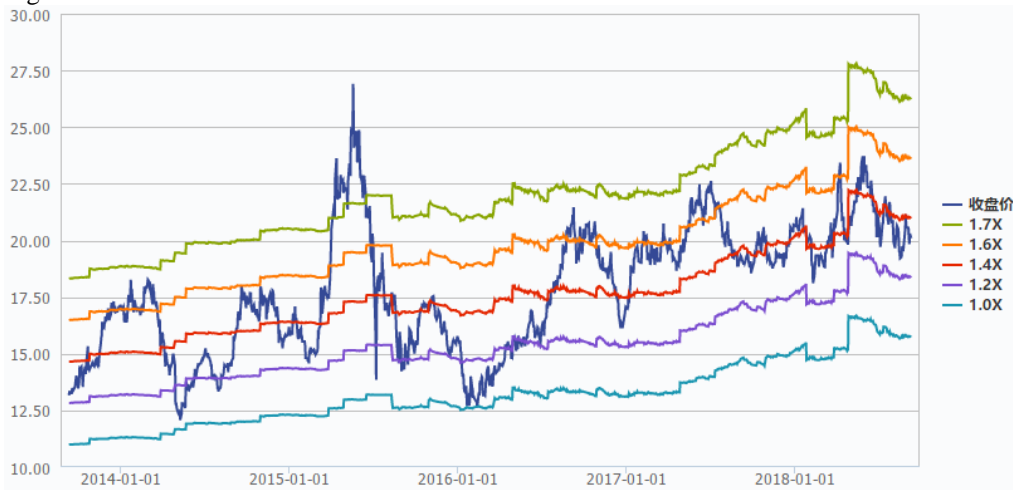


Figure: PB Band



Source: Wind (as at Sep 10), Phillip Securities

Figure: Peers

Ticker	Mrt.Cap (HKD mn)	Revenue	Net profit	ROE (%)	PB (MRQ)	PE			Earnings Growth (%)		
						17A	18E	19E	17A	18E	19E
2607.HK	65,707.83	150,185.00	4,040.96	10.72	1.29	13.56	12.54	11.28	10.14	12.72	11.20
Max	105,287.97	318,760.64	6,063.88	24.84	3.33	22.34	18.26	15.99	36.71	69.58	15.35
Median	65,707.83	150,185.00	3,341.79	11.39	1.86	16.66	13.76	12.22	15.36	17.92	14.09
Average	68,432.47	133,159.51	3,547.06	14.29	2.14	17.21	14.44	13.20	19.52	25.38	8.99
1099.HK	105,287.97	318,760.64	6,063.88	15.75	2.44	16.66	16.63	14.58	13.68	4.39	14.09
3320.HK	77,802.19	166,895.79	3,341.79	8.76	1.86	22.34	18.26	15.99	15.36	22.30	14.25
0874.HK	62,174.30	23,816.79	2,366.34	11.39	1.78	17.90	11.00	12.22	36.71	69.58	-9.96
0867.HK	31,190.08	6,139.34	1,922.33	24.84	3.33	15.57	13.76	11.93	21.72	17.92	15.35

Source: Wind (as at Sep 10), Phillip Securities

Financials

FYE	FY2015	FY2016	FY2017	FY2018E	FY2019E
Valuation Ratios					
Price to Earnings (P/E)	18.79	16.89	15.34	13.63	11.91
Price to Book (P/B)	1.81	1.71	1.59	1.27	1.18
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
FYE					
FY2015					
FY2016					
FY2017					
FY2018E					
FY2019E					
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, Phillip Securities (HK) Research Estimates

Exchange rate assumption is 0.875CNY/HKD.

(Financial figures as at 10 Sep 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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