

# 中国医药业2017年下半年展望

2017年7月14日

## 中国医药业

在2017年上半年，拥有强劲产品组合的药品生产商表现最为突出。我们相信，投资者将在2017年继续追捧这个投资主题，我们较看好能够受惠行业整合的龙头企业。对于2017年下半年，我们的首选是**石药集团[1093.HK;买入]**、**东阳光药[1558.HK;买入]**及**中国中药[570.HK;买入]**。

### 上半年回顾

在今年上半年，大型的药品生产商表现最突出（跑赢恒生指数，其在年初至今上涨19.5%），主要是受助于行业整合；分销商在今年初段亦表现不俗，到近日两票制政策导致板块出现调整；医院运营商的表现较差（图1）。

总体而言，许多行业政策在2017年上半年出台，反映当局有决心：1）支持国内创新型药品；2）支持一些国内病患者必需用到的创新外来药物（加快进口登记）；3）对价格不合理地高的药品进行降价，以减轻病人和医保基金的负担；4）加快子分部的整合，缓解供过于求的情况。尤其是，1月份出台了“两票制”；2月份推出全国医保目录（NRDL）；3月份出台有关加快进口药品登记管理的政策和福建医保支付政策。我们预计这些政策将在2017年下半年逐步落实，并为龙头企业带来实际益处。

### 2017年下半年展望

展望今年下半年，我们在之前的2017年策略报告中提到的挑战仍然不变，其中包括：1）招标平均价下降；2）医保控费；3）医院改革（药品销售限制、零加成、二次价格谈判等）；4）更严格的规则，如一致性评价。另外，正如我们在2017年6月12日发布的医院改革报告中所指，我们仍预期医院板块的表现未来一至两年继续落后。但是，随着政策逐步落地，我们认为医疗保健行业上游和中游存在机会，其中龙头企业将真正受益于政策对行业整合的鼓励。我们还在后文对两票制的实施进度有更多讨论。

**首次覆盖东阳光药[1558.HK]，首予买入评级** - 尽管过去三周股价上涨了20%，但由于HEC的显著增长潜力，与同业相比，估值相对较低，我们认为仍有上涨空间。公司的短期催化剂包括：预计良好2017年中期业绩、获纳入港股通的潜力（H股市值已接近50亿港元）。因此，我们在下半年展望报告中对该股进行首次覆盖，并将其列为我们的首选之一。我们的目标价为25.20港元（我们的目标2018年市盈率为17倍，较历史平均水平高一个标准差）。

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## 东阳光药 [1558.HK]

### 另一牛股；首次覆盖并予买入

东阳光药业绩主要由一只星级药品可威所贡献。我们认为个股吸引，主要由于 (i) 未来几年增长可见性高；(ii) 母公司的研发产品丰富，有望资产注入；(iii) 有机会成为沪深港通股票。自我们上一份调研报告于今年6月底发布以来，公司的股价飙升了20%以上，但由于预计2016 - 2019年的每股盈利年均复合增长率达24%，我们认为目前的估值仍然不高。我们的目标价25.20港元（我们的目标2018年市盈率为17倍，较历史平均水平高一个标准差，图6）。首次覆盖并予买入评级。

#### 投资亮点

**可威的强劲增长势头有望持续：**可威是磷酸奥司他韦（OP），用于预防和治疗流感，该药品收入占2016年总收入78%。由于可威的价格较便宜，耐药性较低，我们预计其强劲增长势头将持续，并继续取代金刚烷胺，同时推动公司整体增长。

**预计2017年上半年业绩良好：**我们预计公司2017年上半年利润将实现超过20%增长，这有望成为短期催化剂。

**预期获得母公司的资产注入：**该公司与母公司Yichang HEC（拥有50.04%股权的最大股东）达成战略协议，公司将获优先引进成熟的研发成果。在东广的基地有1600个研发人员，研发渠道中的普药超过200多种，1.1类药物亦有超过50类（主要用于犬冠状病毒病、肿瘤科和消化治疗等领域）。这些药物的研发费用（约5亿至6亿美元/年）不会在上市公司中入账，但一旦推出，上市公司将可优先购买。

**有潜力被纳入港股通：**目前，其H股市值约为45亿港元（49.96%为H股，50.04%为内资股，这些内资股现时被注入A股上市平台东阳光科（600673.CH），代价为32亿元人民币，相当于16.0港元/股），因此该股份或将满足深港通对市值要达到50亿港元的要求。

**财务状况健康：**截至2016年底，公司的净现金头寸为13亿元人民币（约占A + H总市值的20%）。

**风险：**可威的销售表现较预期差；销售团队扩张导致销售成本高于预期。

截至12月底止年度	2015A	2016A	2017E	2018E	2019E
收入（百万元人民币）	693	942	1,254	1,589	1,940
实际净利润（百万元人民币）	266	381	469	596	728
核心净利润（百万元人民币）	286	381	469	596	728
核心净利润率（%）	41.3%	40.4%	37.4%	37.5%	37.5%
每股实际盈利（人民币）	0.79	0.84	1.04	1.32	1.61
百分比变动	-	6.6%	22.8%	27.2%	22.1%
每股核心盈利（人民币）	0.85	0.84	1.04	1.32	1.61
百分比变动	-	-0.9%	22.8%	27.2%	22.1%
市盈率（倍）	22.4	21.1	17.1	13.5	11.0
市净率（倍）	2.8	3.3	2.7	2.3	1.9
股本回报率（%）	-	16.6	17.4	18.5	18.7
EV/EBITDA（倍）	13.0	13.6	10.9	8.2	6.2

来源：公司，中国银河国际证券研究部

中国医药业

## 买入

首次覆盖并予买入

收盘价：20.20港元（2017年7月13日）

目标价：25.20港元（+24.8%）

#### 股价表现



市值	11.692亿美元
已发行股数	4.52亿股
核数师	KPMG
自由流通量	55.8%
52周交易区间	13.82-20.2港元
三个月日均成交量	196萬美元
主要股东	HEC Pharm Co., Ltd (50.04%)

来源：公司，彭博

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# China Healthcare 2H2017 Outlook

July 14, 2017

## China Healthcare Sector

In 1H2017, drug manufacturers with a strong product portfolio outperformed. We believe that this investment theme will continue in 2H2017 and prefer leading players that should benefit from industry consolidation. Our top picks for 2H2017 are **CSPC [1093.HK; BUY]**, **HEC [1558.HK; BUY]** and **CTCM [0570.HK; BUY]**.

### 1H2017 Review

In 1H2017, leading drug manufacturers were the best performers (outperforming the HSI, which YTD is up 19.5%), driven by favourable policies calling for industry consolidation. Distributors also outperformed before the recent correction in 1H2017, driven mainly by the two-invoice system, while hospitals underperformed (Figure 1).

Overall, many industry policies commenced in 1H17, indicating the authorities' determination to 1) support innovative domestic drugs; 2) support innovative foreign drugs that are indispensable to Chinese patients (by accelerating their import registration); 3) cut unreasonably high drug prices to reduce the burden on patients and medical insurance funds; and 4) accelerate some sub-sector consolidation and reduce oversupply. In particular, in January, the "two-invoice-system", in February the National Reimbursement Drug List (NRDL), and in March, the accelerating imported drug registration management policy and Fujian's medical insurance payment policy were published. We are expecting these policies to be gradually executed in 2H2017 and to generate actual benefits for the leading players.

### 2H2017 Outlook

Looking ahead to 2H2017, the challenges which we mentioned in our early 2017 strategy report remain unchanged, including the following: 1) a tender ASP cut; 2) medical insurance cost controls (醫保控費); 3) hospital reforms (drugs sales percentage restriction, zero-price mark up, secondary price negotiation etc.); and 4) stringing regulations, such as generics consistency assessment (一致性評價). Also, as we previously discussed in our hospital reform report dated June 12, 2017, we still expect the hospital sector to continue to underperform the market in next one or two years. However, we see opportunities in the upstream and mid-stream of the healthcare sector in 2H2017 with policies gradually being executed and the leading players truly enjoying the positive results of policies encouraging consolidation. We also update the two-invoice system implementation progress in detail in the "Two Invoice System Progress Updates" section later.

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**Initiation of HEC [1558.HK] with a BUY** – Despite the 20% rally in its share price in the past three weeks, we believe there is still upside, given HEC's visible growth potential and relatively undemanding valuation compared to that of its peers. Its expected solid 1H2017 results, and Stock Connect potential with its H-share market cap approaching HK\$5bn should provide short-term catalysts. We therefore initiate the stock in our 2H2017 sector report and recommend it as one of our top picks. We value it at HK\$25.20 (17x 2018 CGIS research PER, multiple +1 standard deviation to its historical average).

Figure 1: Healthcare stocks YTD performance

Company name	Ticker	Price (HK\$)	Market cap (HK\$m)	PE			PB			ROE			EV/EBITDA			Share price performance			
				2016	2017E	2018E	2016	2017E	2018E	2016	2017E	2018E	2016	2017E	2018E	WTD	MTD	QTD	YTD
<b>China Tradition Medicine</b>																			
TRAD CHI MED	570	4.30	19,055	17.4	14.1	11.9	1.3	1.3	1.2	8.0	9.7	10.6	11.8	9.9	8.4	-0.5%	-4.4%	-4.4%	19.8%
TONG REN TANG-H	1666	11.76	15,062	20.6	19.5	16.9	2.5	2.3	2.1	15.2	12.3	11.8	n.a	n.a	n.a	-0.5%	-2.5%	-2.5%	-18.2%
TONGRENTANGCM	8138	11.00	9,208	21.0	18.3	16.2	4.2	3.6	3.1	21.7	21.7	21.1	14.2	11.9	10.2	2.2%	-3.7%	-3.7%	5.0%
Simple average				19.7	17.3	15.0	2.7	2.4	2.1	14.9	14.6	14.5	13.0	10.9	9.3	0.4%	-3.5%	-3.5%	2.2%
Median				20.6	18.3	16.2	2.5	2.3	2.1	15.2	12.3	11.8	13.0	10.9	9.3	-0.5%	-3.7%	-3.7%	5.0%
<b>Drugs manufacturer</b>																			
CSPC PHARMACEUTI	1093	11.90	72,043	33.8	26.3	21.1	7.0	6.0	5.0	21.8	23.9	25.4	21.4	17.1	13.7	5.5%	4.4%	4.4%	43.7%
BAYUNSHAN PH-H	874	21.50	49,494	19.2	19.2	17.5	2.0	1.6	1.5	12.3	8.7	9.1	23.2	n.a	n.a	1.4%	0.2%	0.2%	7.2%
SINO BIOPHARM	1177	6.92	51,292	25.3	23.9	21.0	5.0	4.4	3.7	22.8	21.0	19.9	14.8	12.8	11.1	1.8%	0.3%	0.3%	26.7%
LIVZON PHARM-H	1513	45.55	29,374	27.3	15.9	19.3	3.6	2.9	2.6	14.2	19.0	13.9	18.5	15.4	12.9	3.3%	7.7%	7.7%	30.4%
3SBIO INC	1530	9.94	25,171	29.0	23.9	18.3	3.5	3.0	2.6	11.9	13.1	15.1	21.5	16.7	13.3	-3.9%	-4.1%	-4.1%	31.7%
SIHUAN PHARM	460	3.29	31,160	17.9	14.4	13.3	2.4	2.3	2.0	13.6	16.1	15.9	12.1	9.3	8.1	1.9%	0.6%	0.6%	52.3%
LUYE PHARMA GROU	2186	4.29	14,247	14.0	11.6	10.3	1.9	1.7	1.5	14.0	15.0	15.1	10.9	8.6	7.3	0.2%	0.2%	0.2%	-6.7%
SSY GROUP LTD	2005	3.18	9,031	18.7	14.9	13.0	3.4	2.9	2.5	18.3	20.3	20.4	n.a	n.a	n.a	-0.6%	-0.3%	-0.3%	28.7%
THE UNITED LABOR	3933	5.08	8,265	101.6	19.2	15.8	1.2	1.3	1.2	1.4	6.5	7.2	8.7	5.7	4.7	0.4%	-1.4%	-1.4%	-3.8%
CK LIFE SCIENCES	775	0.66	6,343	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	0.0%	0.0%	0.0%	-4.3%
SHANGHAI FUDAN-H	1349	4.51	4,163	23.0	21.2	16.0	4.3	3.7	3.0	19.4	18.8	23.1	15.4	14.4	9.6	-4.0%	-1.3%	-1.3%	-30.4%
SHANDONG XINHU-H	719	7.41	6,326	23.0	n.a	n.a	1.5	1.2	n.a	6.3	6.5	n.a	n.a	n.a	n.a	-0.3%	-1.7%	-1.7%	41.4%
LEE'S PHARM	950	6.38	3,766	15.2	13.4	12.0	2.2	2.0	1.8	16.7	17.5	19.3	n.a	n.a	n.a	-2.7%	-2.1%	-2.1%	1.6%
CONSUN PHARMACEU	1681	6.28	5,201	18.2	11.9	10.1	n.a	2.4	2.0	18.3	22.6	24.5	n.a	7.2	5.7	-0.8%	3.6%	3.6%	62.7%
DAWNRAYS PHARMAC	2348	5.12	4,095	11.2	11.7	8.4	2.2	1.9	1.7	n.a	n.a	n.a	6.5	n.a	n.a	-3.2%	0.8%	0.8%	9.9%
Simple average				27.0	17.5	15.1	3.1	2.7	2.4	14.7	16.1	17.4	15.3	11.9	9.6	-0.1%	0.5%	0.5%	19.4%
Median				21.1	15.9	15.8	2.4	2.4	2.0	14.2	17.5	17.6	15.1	12.8	9.6	0.0%	0.2%	0.2%	26.7%
<b>Distributor</b>																			
SINOPHARM-H	1099	35.15	97,263	18.2	16.0	14.1	2.4	2.2	2.0	14.1	14.9	14.4	9.3	8.3	7.1	1.9%	-0.4%	-0.4%	10.0%
SHANGHAI PHARM-H	2607	22.15	77,178	15.9	14.4	12.7	1.6	1.5	1.4	10.2	10.7	11.3	13.4	13.0	11.6	-3.1%	-4.7%	-4.7%	24.6%
CHINA MEDICAL SY	867	13.08	32,533	21.4	17.0	14.5	4.3	3.6	3.1	22.4	23.9	23.7	18.7	14.0	11.8	3.6%	-3.1%	-3.1%	6.5%
FOSUN PHARMA-H	2196	29.35	82,990	21.4	18.6	16.0	2.8	2.5	2.2	13.9	14.0	14.9	31.8	27.4	22.8	2.1%	-3.0%	-3.0%	23.6%
CHINA RESOURCES	3320	9.84	61,840	20.5	17.9	15.6	1.4	1.4	1.3	8.9	8.0	8.3	8.2	8.0	6.9	0.3%	0.9%	0.9%	12.5%
YESTAR HEALTHCAR	2393	4.03	8,766	28.5	23.3	18.4	7.7	6.8	5.6	26.4	28.1	29.4	13.2	11.5	10.1	1.5%	1.3%	1.3%	7.2%
PIONEER PHARM	1345	2.81	3,747	16.3	11.6	9.8	n.a	n.a	n.a	n.a	25.4	26.8	n.a	n.a	n.a	8.9%	9.8%	9.8%	0.4%
Simple average				19.5	16.8	14.6	2.5	2.2	2.0	13.9	14.3	14.5	16.3	14.1	12.0	1.0%	-2.1%	-2.1%	15.4%
Median				20.5	17.0	14.5	2.6	2.3	2.1	14.0	14.9	14.9	13.3	12.2	10.9	1.9%	-0.4%	-0.4%	10.0%
<b>Device manufacturers</b>																			
SHANDONG WEIG-H	1066	6.15	27,530	18.9	16.9	14.9	2.0	1.8	1.7	9.8	12.4	11.8	14.5	10.0	8.6	5.1%	0.3%	0.3%	18.7%
SHANGHAI HAOHA-H	6826	42.50	6,802	19.6	15.6	13.2	2.0	2.0	1.8	10.7	13.0	14.6	11.8	9.4	7.2	2.0%	0.2%	0.2%	12.1%
BLOOMAGE BIOTE	963	14.74	5,379	21.6	17.1	14.1	3.4	2.7	2.3	17.7	17.4	17.4	11.7	9.5	7.4	-1.6%	-1.9%	-1.9%	26.2%
MICROPORT SCIENT	853	6.90	9,966	68.0	30.5	21.0	3.8	3.7	3.4	5.3	10.9	12.6	17.2	11.9	10.0	11.7%	12.2%	12.2%	18.2%
LIFETECH SCI	1302	1.71	7,395	64.6	53.1	28.6	13.5	5.7	4.6	36.0	16.3	19.1	54.6	25.3	17.5	-5.0%	-7.6%	-7.6%	-8.1%
Simple average				38.5	26.6	18.4	4.9	3.2	2.7	15.9	14.0	15.1	21.9	13.2	10.2	2.4%	0.7%	0.7%	13.4%
Median				21.6	17.1	14.9	3.4	2.7	2.3	10.7	13.0	14.6	14.5	10.0	8.6	2.0%	0.2%	0.2%	18.2%
<b>Hospitals</b>																			
CHINA RESOURCES	1515	9.29	12,046	29.6	26.5	21.5	2.7	2.1	1.9	13.9	8.9	9.6	25.5	16.3	13.0	-1.8%	-3.3%	-3.3%	-6.4%
HARMONICARE MEDI	1509	3.95	2,996	23.7	20.8	19.4	1.7	1.7	1.6	7.7	8.6	8.8	9.0	9.0	7.9	0.8%	-0.5%	-0.5%	-23.2%
WENZHOU KANGNI-H	2120	36.10	2,637	31.1	27.8	21.4	2.3	2.1	2.0	7.1	7.7	9.0	19.0	14.7	11.7	0.3%	-1.4%	-1.4%	6.2%
GUANGDONG KANG-H	3689	10.66	3,565	19.3	16.6	14.1	2.6	2.4	2.1	17.5	14.9	15.4	n.a	7.0	5.6	-2.2%	-3.1%	-3.1%	-5.7%
Simple average				25.9	22.9	19.1	2.3	2.1	1.9	11.6	10.0	10.7	17.8	11.7	9.6	-0.7%	-2.1%	-2.1%	-7.2%
Median				26.6	23.6	20.4	2.4	2.1	1.9	10.8	8.7	9.3	19.0	11.9	9.8	-0.8%	-2.2%	-2.2%	-6.0%
<b>Leasing</b>																			
UNIVERSAL MEDICA	2666	6.12	10,504	10.0	7.9	6.3	1.4	1.2	1.1	13.9	15.8	17.5	20.3	18.8	17.4	1.2%	-1.9%	-1.9%	-4.5%

Sources: Bloomberg

### CGIS Research 2H2017 Healthcare Sector Top Picks

In a challenging 2H2017, we continue to prefer the leading players, which should benefit from industry consolidation. Our top picks are as follows:

- 1) **CSPC [1093.HK; BUY]** - RMB appreciation, expected solid Q2 2017 results, expected NRDL benefits in 2018, Vitamin C value unlock in 2018, and new product Paclitaxel-albumin (白蛋白紫杉醇) expected to come out in 2018. We have a Target Price of HK\$13.6 (24x 2018E PER), indicating 14.3% upside. ([report link](#))
- 2) **HEC [1558.HK; BUY]** - The Company is a “one-drug” Company, driven by its compelling star drug *Kewei*. Visible high growth potential for next few years, asset injection expectations backed by its parent’s strong R&D pipeline, and Stock Connect potential make it an appealing stock. Although the share price has surged recently, its valuation is still undemanding (please see our initiation report below).
- 3) **CTCM [570.HK; BUY]** - The expected >20% CCMG (中藥配方顆粒) growth in 2017 and CCMG market opening-up policy expected soon are big positives for CCMG leader CTCM, along with surging market volume and an attractive valuation. There are market rumors that the CCMG market opening up policy will be launched shortly, which we believe should be a major positive for the Company. (The logic is that the market volume will increase sharply, but that the entry barriers will remain, so the present leading player CTCM will enjoy first-mover advantage.) We have a Target Price of HK\$4.82 (16x 2017E PER), indicating 12.1% upside ([report link](#)).

### 2H2017 Other Healthcare Investment Theses

- 1) Expected solid 1H2017 results. According to our channel check, we expect solid 1H2017 results to be announced in August to provide catalysts for CSPC [1093.HK; BUY], SSY [2005.HK; BUY] and HEC [1558.HK; BUY].
- 2) Leading manufacturers with key products that are clinically indispensable are expected to keep outperforming, as innovative drugs recommended by clinical guidance and necessary for treatment will continue to be prescribed, although sales could be affected by tender price pressure, medical insurance controls (醫保控費) and hospital drug sales percentage control. The impact on these innovative drugs will be lower than that on supplementary/nutritional drugs, as the former will be driven by patients’ rigid demand, and their manufacturers have more bargaining power than hospitals. Also, innovative drugs will benefit from NRDL (全國醫保目錄) and medical insurance payment reforms to out-compete low-quality generics; related stocks are CSPC [1093.HK; BUY], 3SBio [1530.HK; HOLD], CTCM [570.HK; BUY] and HEC [1558.HK; BUY].
- 3) RMB appreciation. We previously assumed RMB depreciation for the whole year in 2017, but the current moderate RMB appreciation has benefited some companies whose sales are in RMB but are reported in HK\$ (CSPC [1093.HK; BUY], SSY [2005.HK; BUY] and TUL [3933.HK; HOLD]). Companies with net HK\$ denominated debt will also benefit (3SBio [1530.HK; HOLD]).
- 4) Some fast-growing mid-caps with low valuations (including potential Stock Connect candidates whose H-share market cap is approaching HK\$5bn) may move up if investors shift their focus to mid/small-cap laggards (HEC[1558.HK; BUY]).
- 5) Policy support for TCM and continuing benefits from zero-price markup policy, which turns drug sales from a major profit centre to a cost centre for hospitals. However, a 25% markup is allowed for traditional Chinese medicine (TCM), which should encourage hospitals to sell more TCM (CTCM[570.HK; BUY]).
- 6) The two-invoice-system still provides room for consolidation. We reiterate our view that 1) we expect to see fewer small companies with no upstream or downstream sales network survive; 2) the most promising way out for small-to-medium size companies with certain resources is to seek coordination with the leading distributors or be acquired by big players (as invoices from subsidiaries of one group are not considered to be an additional invoice). This basically offers plenty of M&A opportunities for the leading players with acquisition costs as low as 5-8x PER; and 3) we expect the leading distributors to benefit from the expected industry consolidation: Sinopharm [1099.HK; NOT RATED], SH Pharma [2607.HK; NOT RATED] and CR Pharm [3320.HK; NOT RATED].

### *Two Invoice System Progress Updates*

Since the central authority requires each province to make two-invoice system progress by June 30, 2017, we see satisfactory progress (see table below).

<b>Progress</b>	<b>Provinces</b>
Under execution	Fujian, Anhui, Chongqing, Qinghai
To be executed in July	Shannxi
To be executed in August	Shanxi
To be executed in September	Liaoning, Tianjin, Heilongjiang, Jilin, Guangxi
To be executed in October	Sichuan, Hunan, Gansu
To be executed in November	Hainan, Hebei, Inner Mongolia, Zhejiang
By 2017 end	Shanghai
By early 2018	Hubei

*Source: CGIS research*

## HEC [1558.HK]

The next bull stock. Initiate with BUY.

HEC is a "one-drug" Company driven by compelling star drug Kewei. Visible high growth potential for next few years, asset injection expectations backed by the parent's strong R&D pipeline and potential to be included in Stock Connect make it an appealing stock. Its share price has soared by >20% since our last company visit note at end-June 2017, but we believe the current valuation is still undemanding, given its expected 24% EPS CAGR in 2016-2019E. We value the stock at HK\$25.20 (17x 2018 CGIS research PER, multiple +1 standard deviation to its historical average, Figure 6). Initiate with BUY.

### Investment Highlights

**Kewei's strong growth momentum expected to continue:** Kewei, which is *Osetamivir Phosphate (OP)* (磷酸奧司他韋), used for the prevention and treatment of influenza (流感), accounted for 78% of HEC's 2016 total revenue. We expect its strong growth to continue and to drive HEC's overall growth by continuing to replace *Amantadine*, given Kewei's easily affordable price and less drug resistance.

**Expected solid 1H2017 results:** We expect the Company to deliver >20% profit growth in its 1H2017 results, which should provide a short-term catalyst.

**Asset injection expectation from the parent:** The listco has a strategic agreement with its parent Yichang HEC (largest shareholder with a 50.04% stake) with priority to introduce its mature R&D. There are 1,600 R&D staff in its Dongguang base and >200 generics and >50 Class 1.1 drugs in the pipeline (mainly in the CCV, oncology and digestive therapeutic area). These drugs' R&D costs (~RMB500m-600m/year) will NOT be booked in the listco, but once launched, the listco has priority to buy them.

**Potential to be included in Stock Connect:** Currently, its H-share market cap is ~HK\$4.5bn (49.96% H-shares, 50.04% domestic shares which are now injected in the A-share listing platform HEC technology (600673.CH) for a consideration of RMB3.2bn, equivalent to ~HK\$16.0/share), so there is potential to meet the HK\$5bn requirement for inclusion in Shenzhen Stock Connect.

**Healthy financial position:** As of end-2016, the Company had net cash >RMB1.3bn (~20% A+H total market cap).

**Risks:** Kewei's growth below expectations, and higher-than-expected selling expenses because of HEC's sales team expansion.

Y/E Dec 31	2015A	2016A	2017E	2018E	2019E
Turnover (RMB m)	693	942	1,254	1,589	1,940
Reported net profit (RMB m)	266	381	469	596	728
Core net profit (RMB m)	286	381	469	596	728
Core net margin (%)	41.3%	40.4%	37.4%	37.5%	37.5%
Reported EPS (RMB)	0.79	0.84	1.04	1.32	1.61
% Change	-	6.6%	22.8%	27.2%	22.1%
Core EPS (RMB)	0.85	0.84	1.04	1.32	1.61
% Change	-	-0.9%	22.8%	27.2%	22.1%
PER (x)	22.4	21.1	17.1	13.5	11.0
PBR (x)	2.8	3.3	2.7	2.3	1.9
ROE (%)	-	16.6	17.4	18.5	18.7
EV/EBITDA (x)	13.0	13.6	10.9	8.2	6.2

Sources: Company, CGIS Research

### China Healthcare Sector

# BUY

Initiate with BUY

Close: HK\$20.20 (Jul 13, 2017)

Target Price: 25.20 (+24.8%)

### Price Performance



Market Cap (Domestic+ H shares)	US\$1,169.2m
Shares Outstanding	452.0m
Auditor	KPMG
Free Float	55.8%
52W range	HK\$13.82-20.2
3M average daily T/O	US\$1.96m
Major Shareholding	HEC Pharm Co., Ltd (50.04%)

Sources: Company, Bloomberg

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### Flagship product-Kewei

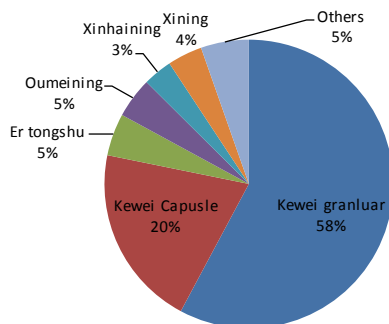
*Kewei* has delivered a 95% revenue CAGR in the past three years, reaching RMB736m in 2016, accounting for 78% of HEC's 2016 total revenue. *Kewei* is *Oseltamivir Phosphate (OP)* (磷酸奧司他韋), used for the prevention and treatment of influenza (流感).

We expect *Kewei* to continue to generate >30% revenue CAGR in next few years for the following reasons:

- 1) It will continue to replace *Amantadine*. Compared with *Amantadine*, OP has less drug-resistance (耐藥性) and much better efficiency and safety. Thus, OP is well-recognized by healthcare institutions worldwide and is included in their anti-influenza guidance. As a result, we have seen *Amantadine* losing market share, from ~97% in 2012 to ~80% in 2016, and OP gaining market share, from ~3% in 2012 to ~17% in 2016;
- 2) *Kewei* is easily affordable. Although *Amantadine* is a Category I drug (醫保甲類), *Kewei* (both capsules and granular form) is a Category II drug, and patients pay only ~RMB30 (based on the adult dose of a 75mg/capsule twice daily for 5 consecutive days) after 80% reimbursement to treat influenza, so it is easily affordable for patients; and
- 3) Strong growth from its granular form (顆粒劑型) is expected to continue. Some 74% of *Kewei* sales in 2016 were granular form; the remaining 26% were capsules. *Kewei*'s granular form is growing (69% YoY in 2016), much faster than capsule form (45% YoY). *Kewei*'s granular form is exclusive (protected by patent until 2026) and it is especially suitable for children because of its more convenient intake method and adjusted/reduced dosage. Considering the influenza incidence rate for children (發病率) is 20-30%, much higher than the 5-10% for adults, we expect the momentum of *Kewei*'s granular form to remain strong.

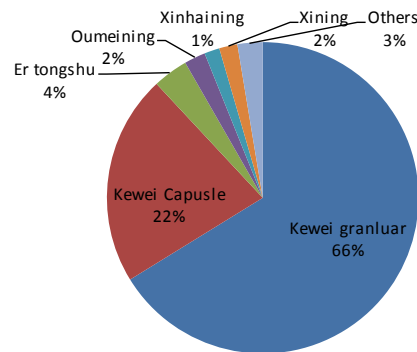
Given this, we project *Kewei*'s granular/capsule sales to deliver 33/30% CAGR in 2016-2019E, reaching RMB1,284/424m in 2019 respectively. With the fast growth of *Kewei* (granular and capsule form), we expect its revenue percentage to increase from 78% in 2016 to 88% in 2019E.

Figure 2: 2016 revenue breakdown



Source: Company

Figure 3: 2019E revenue breakdown



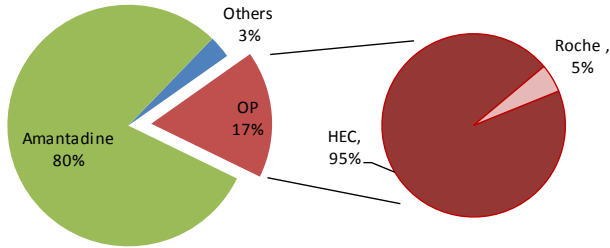
Source: CGIS research estimate



### OP market overview

The market size for anti-influenza drugs (抗流感) was ~RMB4.3bn in terms of sales in 2016, of which ~80% were *Amantadine* (金剛烷胺) and ~17% were OP (Figure 1). We estimate that if OP fully replaces *Amantadine*'s volume (the former's ASP is much higher), the full market size will be at least >RMB8bn. HEC doesn't have the OP patents; HEC licensed it from Roche in 2006 and will pay some percentage of OP's net sales to Roche for its patent licences (專利許可) (booked in COGS) until 2024.

Figure 4: Anti-influenza market landscape



Source: CGIS Research

### Products other than Kewei

Ertongshu (爾同舒), Benzbromarone is a drug used for the treatment of excess uric acid in blood (hyperuricemia), which can often lead to gout (痛風). Previously HEC used third parties for its marketing and promotion. Now HEC is establishing its own sales team for this.

This accounted for ~5% of HEC's total revenue in 2016, and we expect it to deliver a mid-teen CAGR in 2016-2019E, driven by HEC's strengthened marketing activity.

The other two hypertension drugs, Oumeining and Xinhaining, together accounted for ~8% of HEC's total revenue in 2016 and are expected to deliver single-digit growth in the next few years.

### Lisco's R&D

HEC listco's R&D pipeline includes mainly 2nd generation insulin (expected to be launched in 2018-2019) and 3rd generation insulin (expected to be launched in 2019-2020). We agree that local insulin players (currently ~15% market share vs. international players 85%) will keep gaining market share from the big international names (particularly Novo Nordisk, Sanofi and Eli Lilly) because of a >30% price discount with similar efficiency. We expect HEC to compete mainly with leading local players, including TUL(3933.HK), Ganli, Tonghua Dongbao (600867.CH) and 3Sbio (1530.HK), when it launches its insulin products. Considering the ~RMB18bn market size of insulin products, every ~1% increase in market share will generate extra revenue of ~RMB180m for HEC, or ~9% of 2019E revenue, i.e. a significant increment in sales. We expect insulin products to contribute profit in ~2019-2020.

Another R&D product is *Yimitasvir Phosphate* (磷酸依米他韋), used for HCV (丙肝). It is currently in Phase II and is expected to come out in 2020.

Overall, in the next three years, HEC's growth will rely on its existing portfolio, especially Kewei. Its R&D pipeline will pave the way for longer-term growth.

## Key financials

### Balance Sheet

Year ended Dec 31 (RMB m)	2015A	2016A	2017E	2018E	2019E
Cash & cash equivalents	1,395	1,454	1,642	1,991	2,500
Inventories	155	111	142	180	218
Trade & note receivables	261	337	451	572	698
Others	0	0	0	0	0
<b>Current assets</b>	<b>1,810</b>	<b>1,901</b>	<b>2,235</b>	<b>2,743</b>	<b>3,417</b>
PP&E	463	496	516	534	549
Prepayments for intangible assets <sup>Note 1</sup>	290	400	500	600	700
Others	15	34	34	34	34
<b>Non-current assets</b>	<b>767</b>	<b>930</b>	<b>1,050</b>	<b>1,168</b>	<b>1,283</b>
<b>Total assets</b>	<b>2,577</b>	<b>2,831</b>	<b>3,285</b>	<b>3,911</b>	<b>4,700</b>
Trade and bills payables	156	182	228	287	349
Other payables	6	28	28	28	28
ST borrowings	105	70	30	0	0
Others	4	4	4	4	4
<b>Current liabilities</b>	<b>271</b>	<b>284</b>	<b>290</b>	<b>319</b>	<b>381</b>
LT borrowings	90	20	0	0	0
Others	73	69	69	69	69
<b>Long-term liabilities</b>	<b>163</b>	<b>89</b>	<b>69</b>	<b>69</b>	<b>69</b>
<b>Total liabilities</b>	<b>435</b>	<b>373</b>	<b>359</b>	<b>388</b>	<b>450</b>
Share capital	451	451	451	451	451
Reserves	1,692	2,007	2,476	3,072	3,799
<b>Total equity</b>	<b>2,143</b>	<b>2,458</b>	<b>2,926</b>	<b>3,522</b>	<b>4,250</b>

### Profit and Loss

Year ended Dec 31 (RMB m)	2015A	2016A	2017E	2018E	2019E
<i>Kewei granular</i>	322	544	778	1,027	1,284
<i>Kewei Capsule</i>	132	192	261	339	424
<i>Ertongshu</i>	37	45	54	62	71
<i>Oumeining</i>	50	43	43	43	43
<i>Xinhaining</i>	32	31	31	31	31
<i>Xining</i>	35	37	37	37	37
<i>Others</i>	86	51	51	51	51
<b>Revenue</b>	<b>693</b>	<b>942</b>	<b>1,254</b>	<b>1,589</b>	<b>1,940</b>
Cost of goods sold	(178)	(214)	(285)	(359)	(436)
<b>Gross profit</b>	<b>515</b>	<b>727</b>	<b>969</b>	<b>1,230</b>	<b>1,503</b>
Other gains / (losses)	16	16	8	8	8
Selling expense	(77)	(181)	(244)	(310)	(378)
Admin & other expenses	(120)	(133)	(175)	(222)	(272)
Other expenses and losses	7	31	0	0	0
<b>Operating profit</b>	<b>340</b>	<b>460</b>	<b>557</b>	<b>705</b>	<b>861</b>
Finance cost	(25)	(7)	(2)	0	0
Pretax income	315	453	555	705	861
Income taxes	(49)	(72)	(86)	(109)	(133)
Net profit	266	381	469	596	728
<b>Core net profit <sup>Note 2</sup></b>	<b>286</b>	<b>381</b>	<b>469</b>	<b>596</b>	<b>728</b>
EBITDA	365	488	587	737	896
Basic EPS (RMB)	0.792	0.844	1.037	1.318	1.610
Fully diluted EPS (RMB)	0.792	0.844	1.037	1.318	1.610
Basic core EPS (RMB)	0.852	0.844	1.037	1.318	1.610
Fully diluted core EPS (RMB)	0.852	0.844	1.037	1.318	1.610
Dividend (RMB)	0.150	0.300	0.311	0.396	0.483

Source: Company data, CGIS Research estimates

## Key financials

### Cash Flow

Year ended Dec 31 (RMB m)	2015A	2016A	2017E	2018E	2019E
Profit before tax	315	453	555	705	861
Depreciation & amortization	26	27	30	32	34
Change in working cap.	(51)	(3)	(101)	(98)	(103)
Income tax paid	(57)	(52)	(86)	(109)	(133)
Others	55	(29)	2	0	0
<b>Operating cash flow</b>	<b>287</b>	<b>397</b>	<b>400</b>	<b>530</b>	<b>659</b>
CAPEX	(28)	(63)	(50)	(50)	(50)
Prepayment for intangible assets <sup>Note 1</sup>	(290)	(110)	(100)	(100)	(100)
Change in other assets	(26)	(195)	242	0	0
<b>Investment cash flow</b>	<b>(344)</b>	<b>(368)</b>	<b>92</b>	<b>(50)</b>	<b>(150)</b>
Issuance of shares	1613	2	0	0	0
Net change in debt	(220)	(105)	(60)	(30)	0
Others	(70)	(98)	(2)	0	0
<b>Financing cash flow</b>	<b>1,323</b>	<b>(201)</b>	<b>(62)</b>	<b>(30)</b>	<b>0</b>
<b>Net change in cash</b>	<b>1,267</b>	<b>(171)</b>	<b>430</b>	<b>350</b>	<b>509</b>
Cash at beginning of the year	87	1,354	1,212	1,642	1,991
Effect from foreign exchange	0	30	0	0	0
<b>Cash at the end of the year</b>	<b>1,354</b>	<b>1,212</b>	<b>1,642</b>	<b>1,991</b>	<b>2,500</b>

Note 1 for right to use all the relevant knowhow and patents relating to yimitasvir phosphate and follow-up direct anti-viral agent compounds from Sunshine Lake Pharma. Co., Ltd. (廣東東陽光藥業有限公司) which is a related party of the Group. Total consideration is RMB 700m.

Note 2: adjusted by CGIS research

Source: Company data, CGIS Research estimates

### Key Ratios

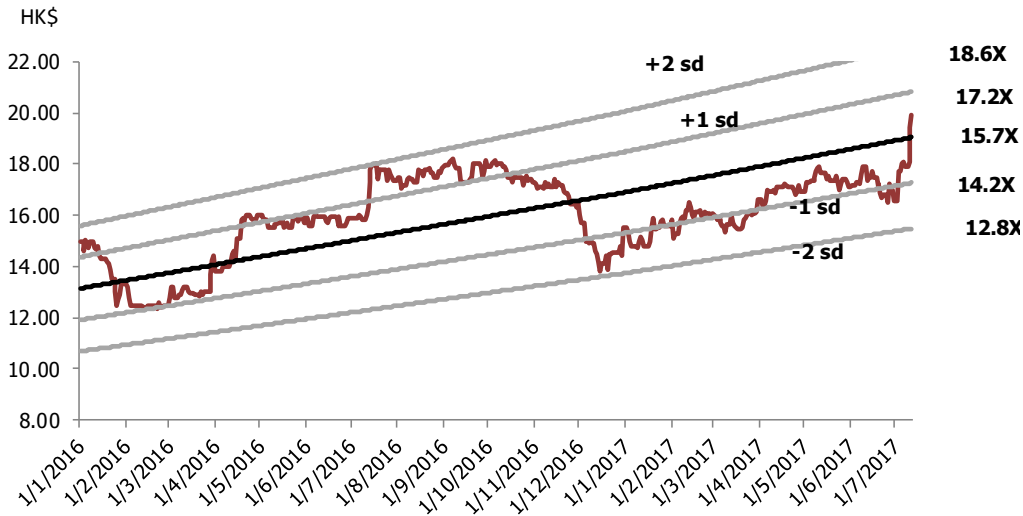
Year ended Dec 31	2015A	2016A	2017E	2018E	2019E
<b>Growth (% YoY)</b>					
Sales	-	35.9	33.1	26.8	22.1
Operating profit	-	35.5	210	26.7	22.1
EBITDA	-	33.5	20.3	25.7	21.5
Core net profit	-	33.1	23.1	27.2	22.1
Basic EPS	-	6.6	22.8	27.2	22.1
Core basic EPS	-	(0.9)	22.8	27.2	22.1
<b>Profitability (%)</b>					
Gross margin	74.3	77.2	77.3	77.4	77.5
Operating margin	49.0	48.9	44.4	44.4	44.4
EBITDA margin	52.7	51.8	46.8	46.4	46.2
Core net profit margin	41.3	40.4	37.4	37.5	37.5
ROA	-	14.1	15.3	16.6	16.9
ROE	-	16.6	17.4	18.5	18.7
<b>Balance sheet ratios</b>					
Current ratio (X)	6.7	6.7	7.7	8.6	9.0
Quick ratio (X)	6.1	6.3	7.2	8.0	8.4
Cash ratio (X)	5.1	5.1	5.7	6.2	6.6
Trade & bill receivables days	137	131	131	131	131
Trade & bill payable days	319	311	292	292	292
Inventory turnover days	316	188	183	183	183
Total debt to equity ratio (%)	9	4	1	0	0
Net debt to equity ratio (%)		Net cash	Net cash	Net cash	Net cash

Figure 5: Peer comparison

Company	Ticker	Price		Mkt Cap		PER(x)			PBR(x)			ROE(%)			EV/EBITDA (x)		
		HK\$	HK\$m	2016	2017E	2018E	2016	2017E	2018E	2016	2017E	2018E	2016	2017E	2018E		
YICHANG HEC CH-H	1558	20.15	9,108	21.1	17.1	13.5	3.3	2.7	2.3	16.6	17.4	18.5	13.6	10.9	8.2		
THE UNITED LABOR	3933	5.07	8,248	101.4	19.1	15.7	1.2	1.3	1.2	1.4	6.5	7.2	8.7	5.7	4.7		
FOSUN PHARMA-H	2196	29.35	83,907	21.4	18.6	15.9	2.8	2.5	2.2	13.9	14.0	14.9	32.1	27.7	23.0		
CSPC PHARMACEUTI	1093	11.80	71,437	33.5	26.0	20.9	6.9	5.9	5.0	21.8	23.9	25.4	21.2	16.9	13.5		
LUYE PHARMA GROU	2186	4.28	14,214	14.0	11.6	10.2	1.9	1.7	1.5	14.0	15.0	15.1	10.9	8.6	7.3		
LIVZON PHARM-H	1513	46.00	29,404	27.5	16.2	19.5	3.7	2.9	2.6	14.2	19.0	13.9	18.5	15.4	12.9		
SSY GROUP LTD	2005	3.20	9,088	18.8	15.0	13.1	3.4	2.9	2.5	18.3	20.3	20.4	n.a	n.a	n.a		
HUA HAN HEALTH I	587	0.53	3,814	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a		
SHANGHAI FUDAN-H	1349	4.50	4,154	23.0	21.1	15.9	4.3	3.6	3.0	19.4	18.8	23.1	15.3	14.3	9.6		
DAWNRAYS PHARMAC	2348	5.15	4,119	11.3	11.8	8.5	2.2	1.9	1.7	n.a	n.a	n.a	6.5	n.a	n.a		
CONSUN PHARMACEU	1681	6.31	5,225	18.3	11.9	10.1	n.a	2.5	2.0	18.3	22.6	24.5	n.a	7.2	5.7		
LEE'S PHARM	950	6.34	3,743	15.1	13.3	12.0	2.2	2.0	1.8	16.7	17.5	19.3	n.a	n.a	n.a		
<b>Simple average</b>				<b>28.4</b>	<b>16.5</b>	<b>14.2</b>	<b>3.2</b>	<b>2.7</b>	<b>2.3</b>	<b>15.3</b>	<b>17.5</b>	<b>18.2</b>	<b>16.2</b>	<b>13.7</b>	<b>11.0</b>		
<b>Median</b>				<b>20.1</b>	<b>15.6</b>	<b>14.4</b>	<b>2.8</b>	<b>2.5</b>	<b>2.1</b>	<b>16.7</b>	<b>18.8</b>	<b>19.3</b>	<b>15.3</b>	<b>14.3</b>	<b>9.6</b>		

Source: Bloomberg

Figure 6: Historical PE band



Source: CGIS Research estimates

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