

13 April 2015

**BUY**  
Initiation of Coverage

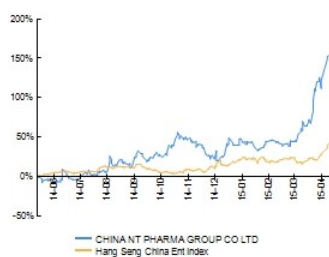
# 凤凰涅槃

## 泰凌医药 (1011:HK)

### Market Data: Apr, 10

Closing Price (HK\$)	2.18
Price Target (HK\$)	2.80
HSCEI	13,988
HSCCI	5,247
52-week High/Low (HK\$)	2.37/0.79
Market Cap (US\$m)	363
Market Cap (HK\$m)	2,817
Shares Outstanding (m)	1,298
Exchange Rate (Rmb-HK\$)	1.26

### Price Performance Chart:



Source: Bloomberg

### Analyst

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### Financial summary and valuation

	2013	2014	2015E	2016E	2017E
Revenue (Rmbm)	739.13	864.62	811.16	951.40	1,166.80
YoY (%)	2.03	16.98	(6.18)	17.29	22.64
Net income (Rmbm)	(673.46)	2.09	72.47	133.87	172.29
YoY (%)	NA	NA	3,372.58	84.72	28.70
EPS (Rmb)	(0.62)	0.00	0.06	0.10	0.13
Diluted EPS (Rmb)	(0.62)	0.00	0.06	0.10	0.13
ROE (%)	(322.54)	0.98	15.51	22.27	22.28
Debt/asset (%)	85.52	85.66	64.57	59.13	56.01
Dividend Yield (%)	0.00	0.00	0.00	0.00	0.00
PE (x)	(2.80)	904.14	31.24	16.91	13.14
PB (x)	9.04	8.86	4.85	3.77	2.93
EV/Ebitda (x)	(4.83)	21.66	13.49	9.50	7.49

Note: Diluted EPS is calculated as if all outstanding convertible securities, such as convertible preferred shares, convertible debentures, stock options and warrants, were exercised. P/E is calculated as closing price divided by each year's EPS.

成功转型为创新药企业。泰凌医药建立于 1995 年，并于 2011 年在香港主板上市。公司曾经是中国最大的疫苗分销商。然而，考虑到政策变动可能对进口疫苗产生持续的负面影响，公司于 2012 年决定退出疫苗业务。在经过 2-3 年的艰难重组后，公司成功转型为专注于创新药研发和销售的企业。

旗舰产品里葆多（盐酸多柔比星脂质体）持续高增长。由于多柔比星的脂质体剂型相较于传统蒽环类抗生素的安全性有显著提升，我们认为多柔比星脂质体将会逐渐取代传统蒽环类抗生素。在样本医院市场，多柔比星脂质体在蒽环类抗生素药品中的市场份额已经由 2011 年的 4.5% 提升到了 2014 年的 16.8%。在样本医院市场，里葆多占据多柔比星脂质体 80% 的份额。我们预期里葆多将在更多省份中标，由此将驱动里葆多的销售增长。我们预测里葆多的销售额在 2015 年继续 50% 的高增长。

王牌产品喜滴克（尿多酸肽注射液）潜力巨大。喜滴克是由食药监局批准的 1.1 类新药，已获批适应症包括非小细胞肺癌和晚期乳腺癌。目前喜滴克正在申请新增骨髓增殖异常综合症（MDS）适应症。由于 MDS 疾病目前几乎无药可治，我们认为药监局可能会加快对于喜滴克新适应症的审批，或将于 2016 年底批准喜滴克的 MDS 适应症。我们估计喜滴克的高峰销售量将达到 160 万支。基础情形下，我们预计喜滴克的高峰除税销售额将达到 3 亿元人民币。

与国药控股强强联手。2015 年 2 月，公司宣布与国药控股（1099.HK）成立合资公司。双方将致力于将合资公司发展为第三方药品经销的龙头企业。我们认为，借助于国药控股健全的配送网络以及泰凌医药丰富的营销经验，该合资公司的代理品种将会迅速丰富，业务规模将较快壮大。

首次覆盖予以买入评级。我们预计公司净利润将从 2014 年的 210 万人民币上升到 2015 年的 7250 万人民币。我们认为公司盈利的高成长可以支撑较高的估值水平。我们的目标价为 2.8 港币，对应 40 倍 15 年市盈率、22 倍 16 年市盈率，及 28% 的上涨空间。

### Investment Highlights:

China NT Pharma Group became China's largest vaccine distributor in 2009 with a market share of 23%. Due to policy headwinds, the company terminated its vaccine businesses in 2012. After two to three years of restructuring, it has successfully transformed its business to manufacture and sell innovative drugs.

**Successful flagship product.** NT Pharma's flagship drug, Libod (doxorubicin hydrochloride liposome injection), is used for the treatment of lymphoma, multiple myeloma and other malignant tumours. Given its safety, we expect Libod to gain market share from traditional anthracycline antibiotics. In 412 sample hospitals, sales of doxorubicin liposome, as percentage of all anthracycline antibiotics, rose from 4.5% in 2011 to 16.8% in 2014. Libod is the most successful drug in China's doxorubicin liposome market, with a market share of 80% in sample hospitals in 2014. We expect tender wins to drive Libod revenue to grow 50% YoY in 2015.

**New drug with pending approval.** In 2013, the company acquired the intellectual property rights and patents for Xi Di Ke (uroacitides injection), a class-one new drug used in combined chemotherapy for the treatment of advanced breast cancer and non-small cell lung cancer. We expect the application of a new indication, myelodysplastic syndromes (MDS; pre-leukaemia), for Xi Di Ke to be approved in end-2016. Since Xi Di Ke is one of the few drugs to treat MDS in the market, we forecast peak sales volume of 1.6m units by 2020. Our base case scenario indicates that peak sales revenue (excluding tax) of Rmb300m during the same period.

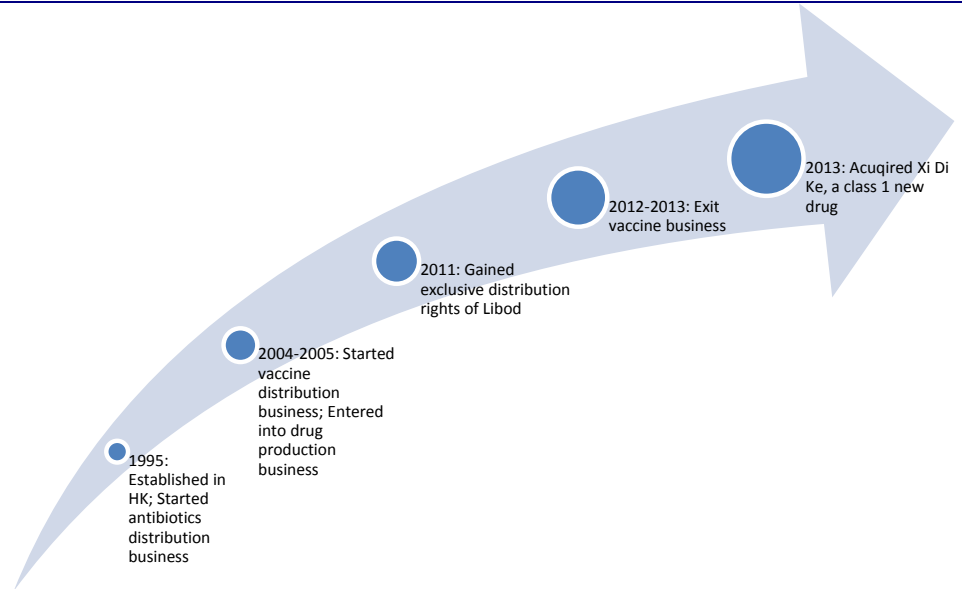
**Venturing out.** In February 2015, the company announced plans to establish a JV with Sinopharm Nutraceuticals, a subsidiary of Sinopharm Group (1099:HK). NT Pharma and Sinopharm aim to develop the JV into a leading third-party drug promotion firm. By leveraging Sinopharm's well-established distribution network and NT Pharma's ample promotional experience in innovative drugs, we believe the JV will accelerate its business development.

**Medical matter.** We believe the stock deserves a valuation premium given its strong earnings growth momentum. We expect earnings to rebound from Rmb2.1m in 2014 to Rmb72.5m in 15E (+3,352% YoY). NT Pharma is trading at 31x 15E PE and 17x 16E PE, while its Chinese peers trade at an average of 29x 15E PE and 21x 16E PE. Our target price is HK\$2.8, implying 40x 15E PE and 22x 16E PE. With 28% upside, we initiate coverage of NT Pharma with a BUY recommendation.

## Transforming into an innovative player

Established in 1995 and listed in HK mainboard in 2011, NT Pharma was China's largest vaccine distributor with 23% market share in 2009. Company also provided vaccine promotion and sales services for vaccine manufactures. In order to pursue for higher returns, company exit the vaccine business in 2012. In the future, company will mainly focuses on the production and sales of innovative drugs.

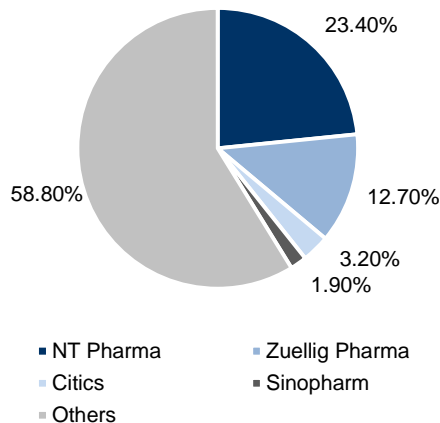
Figure 1: History of NT Pharma



Source: Company information, SWS Research

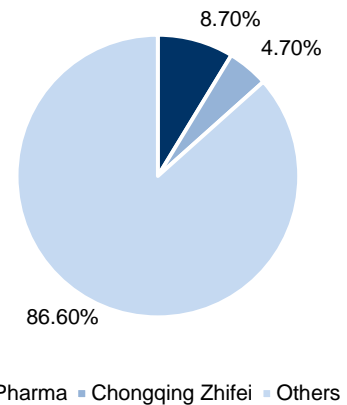
**Company was a leader in vaccine market.** Company has 23% share in China's vaccine distribution market in 2009. Moreover, as of 2009, 58% of vaccines were sold by third party promotion service providers. NT Pharma took 8.7% share in this sub-market, which made it the largest vaccine promotion service provider in China. Company mainly focused on the distribution and sales of imported type II vaccines which required out-of-pocket payments. Total domestic market size of type II vaccines amounted to Rmb7.9bn in 2009.

Figure 2: China's vaccine distribution market share split (2009)



Source: Company data, SWS Research

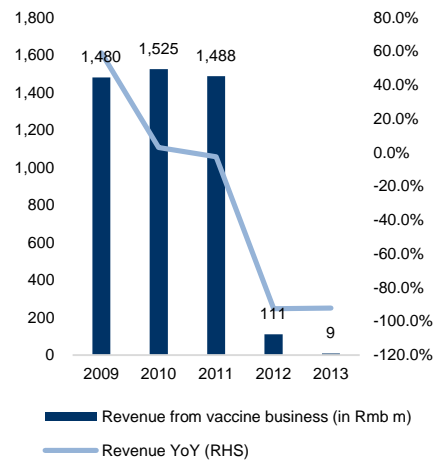
Figure 3: China's vaccine promotion market share split (2009)



Source: Company data, SWS Research

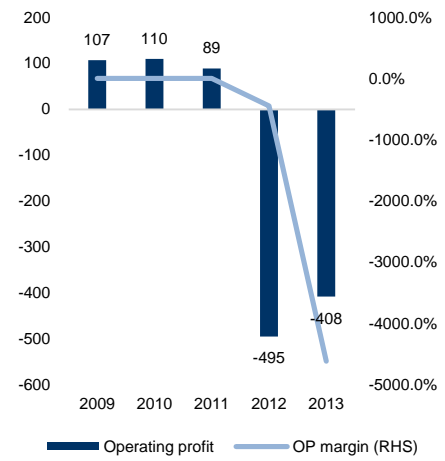
**Company initiated business restructuring to adapt to policy changes.** Implemented since October 2010, the 2010 Edition of the Chinese Pharmacopeia raised the quality standards of vaccine products. As it is complicated and time-consuming for global vaccine producers to alter their production processes to adapt to the requirements by Chinese authorities, the sales of imported vaccines has slumped since late 2010. Facing policy headwinds, the return of the vaccine business became no longer attractive to NT Pharma. As such, company decided to gradually exit the vaccine business during 2012 and 2013. In addition, company also terminated the low-margin promotion businesses of dermatological drugs and OTC drugs in 2012. Company booked Rmb676m and Rmb406m of restructuring cost in 2012 and 2013, respectively. The costs were mainly attributable to write-down in inventories and impairment of receivables. No restructuring cost was booked in 2014 as the restructuring was completed in 2013.

**Figure 4: Revenue from vaccine business declined**



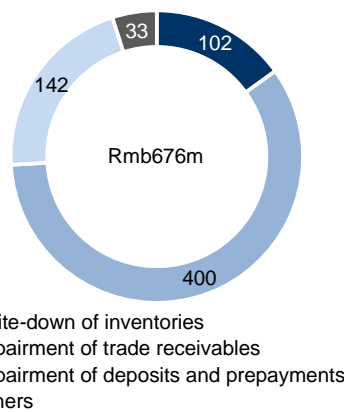
Source: Company data, SWS Research

**Figure 5: Operating margin of vaccine business dropped**



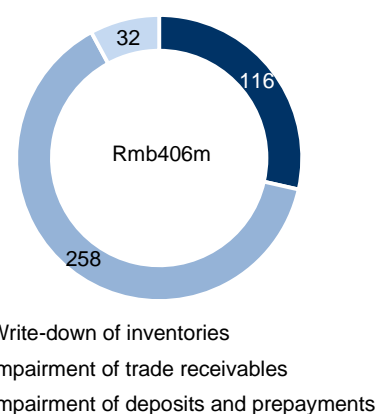
Source: Company data, SWS Research

**Figure 6: Restructuring cost split (2012)**



Source: Company data, SWS Research

**Figure 7: Restructuring cost split (2013)**

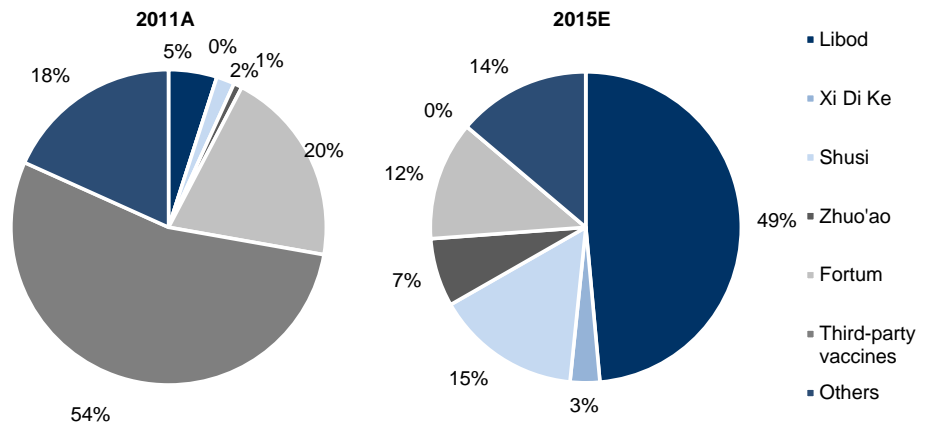


Source: Company data, SWS Research

**Future focus will be research and promotion of innovative drugs.** In 2011, merely 5% of revenue was from *Libod* while 54% revenue was from vaccine business. According to our estimates, innovative drugs like *Libod*, *Xi Di Ke* and

Shusi will account for 67% of revenue in 2015. Vaccine businesses have been completely terminated since 2014.

Figure 8: Revenue mix upgrade



Source: Company data, SWS Research

Company's major products include *Libod*, *Xi Di Ke*, *Shusi*, *Zhuo'ao* and *Fortum*. *Xi Di Ke*, *Shusi* and *Zhuo'ao* are company's proprietary drugs. Company is the sole distributor of *Libod* (manufactured by Fudan Zhangjiang (1349:HK)) and *Fortum* (manufactured by GSK) in China. Company will exit the sale of *Fortum* in May 2015 given the unattractive margins from *Fortum*.

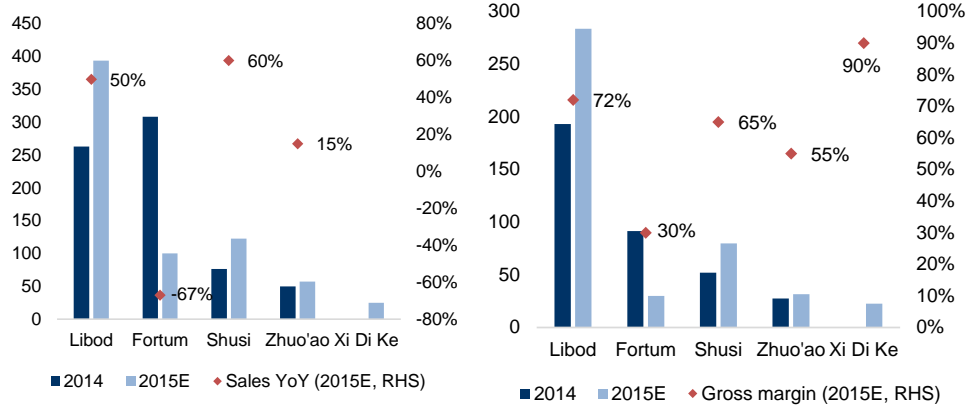
*Libod* and *Shusi* recorded 127% YoY and 43% YoY sales growth in 2014. We expect the strong sales growth in these two drugs to extend into 2015. We estimate sales of *Libod* to grow by 50% YoY in 2015, mainly driven by tender wins and channel expansion. Sales of *Shusi* may expand by 60% YoY in 2015 because it may gain market share from the original drug, *Siruikang* by AstraZeneca.

Figure 9: NT Pharma's key product highlights

Brand name	Generic name	Business model	Indication	Reimbursement	Tenders	Sales (in Rmb m, 2014)	12-14 Cagr	Sales YoY change (2015E)	Remark
<i>Libod</i>	Doxorubicin Hydrochloride Liposome Injection	Third-party drug	Cancer (lymphoma, multiple myeloma and other malignant tumors)	3 PRDL	24 Provinces	262.8	66.30%	50%	<i>Libod</i> was included in the reimbursement list of critical illness insurance in Zhejiang Province in Feb 2015. <i>Libod</i> may win more tenders in 2015.
<i>Fortum</i>	Ceftazidime Injection	Third-party drug	Anti-biotics	NRDL (Type II)	28 Provinces	308.2	6.15%	-67%	Company to exit the sale of <i>Fortum</i> in May 2015 due to its low profitability.
<i>Shusi</i>	Quetiapine Fumarate Tablets	Proprietary drug	Schizophrenia, bipolar affective disorder	NRDL (Type II)	26 Provinces	76.6	9.31%	60%	<i>Shusi</i> to substitute the original drug, <i>Siruikang</i> , in the domestic market.
<i>Zhuo'ao</i>	Ambroxol Hydrochloride Injection	Proprietary drug	Bronchitis, Bronchial asthma	NRDL (Type II)	15 Provinces	50	27.00%	15%	Growth capped by capacity constrain and competition.
<i>Xi Di Ke</i>	Uroacitides Injection	Proprietary drug	Breast cancer, Non-small cell lung cancer	NA	NA	NA	NA	Rmb25m	The factory to get the new GMP approval in Oct 2015. The application of the new indication (MDS) to be approved in end-2016.

Source: Company data, SWS Research

**Figure 10: Sales forecasts of key products**      **Figure 11: Gross profit forecasts of key products**



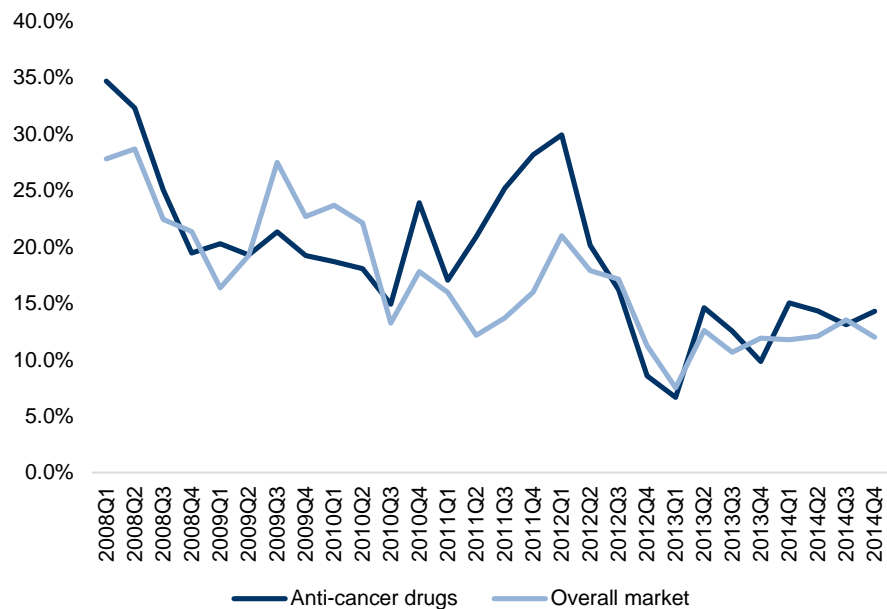
Source: Company data, SWS Research

Source: Company data, SWS Research

## Well positioned in anti-cancer market

**Company's flagship products target China's growing anti-cancer market.** We estimate *Libod* and *Xi Di Ke* to contribute 49%/3% of company's topline and 60%/5% of its gross profit in 2015. According to data from Phama Database, sales of anti-cancer drugs in the 412 Chinese sample hospitals grew at 12.6% Cagr during 2012 and 2014. In 2014, anti-cancer drugs accounted for 9.8% of total drug sales in sample hospitals, making it the fourth largest category in terms of sales.

**Figure 12: Drug sales revenue growth (YoY) in 412 sample hospitals**

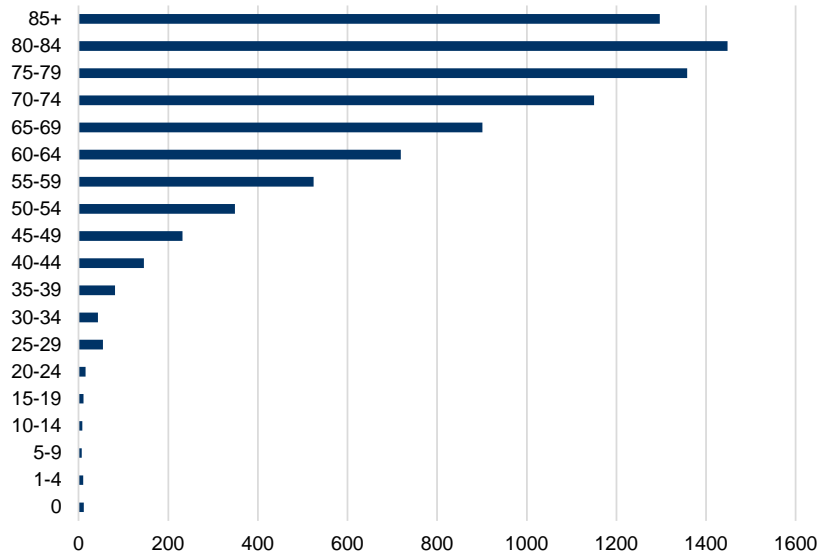


Source: Pharma Database, SWS Research

**Anti-cancer drugs to continue robust growth given increasing cancer incidence.** According to data from National Central Cancer Registry (NCCR), the age-standardised incidence of cancers in China were 181 per 100,000 population. There were 3.09m new cancer cases in 2010. In addition, as per data from NCCR, age is significantly positively correlated with cancer incidence. The incidence rate per 100,000 population is 1,296 for Chinese people aged over 85 while merely 15

for those aged from 20 to 24. In addition, cancer incidence increases notably in people aged over 45. China is experiencing fast population aging, indicating rising cancer incidence. As per data from National Bureau of Statistics of PRC, people aged 45 and above is 36% of overall population and people aged 35-39 is 17% of total population.

Figure 13: Age-specific incidence for cancers in China (per 100,000 population, 2010)

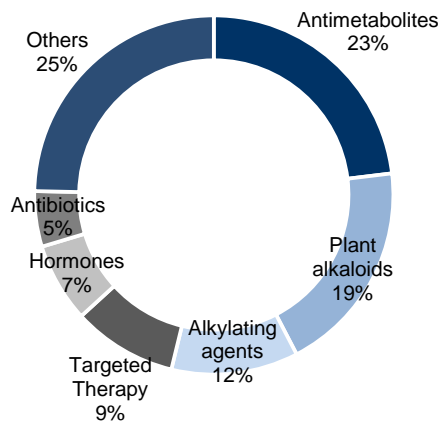


Source: NCCR, SWS Research

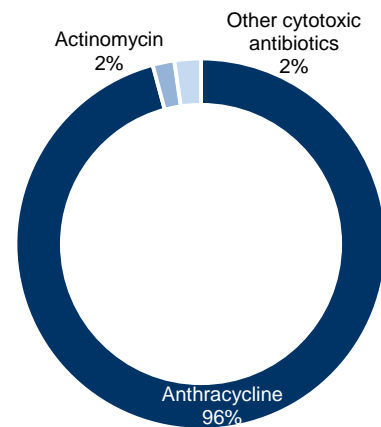
### Libod, the key earnings driver

**Superior advantages of Libod’s liposomal dosage.** Launched in 2009, *Libod* (doxorubicin hydrochloride liposome injection) is a first-to-market generic to *Doxil*. NT Pharma has 8-year sole distribution rights of *Libod*, lasting from 2011 to 2019. Doxorubicin is a kind of anthracycline antibiotics which are widely used to treat cancers, including lymphoma, multiple myeloma, ovarian cancer, breast cancer and other malignant tumors. As of 2014, antibiotics account for 7% of anti-cancer drug sales in sample hospitals. Anthracycline antibiotics is a major type of anti-cancer antibiotics, taking 96% market share in this category in 2014.

Figure 14: Market share split of anti-cancer drugs (2014)      Figure 15: Market share split of anti-cancer antibiotics



Source: Pharma Database, SWS Research



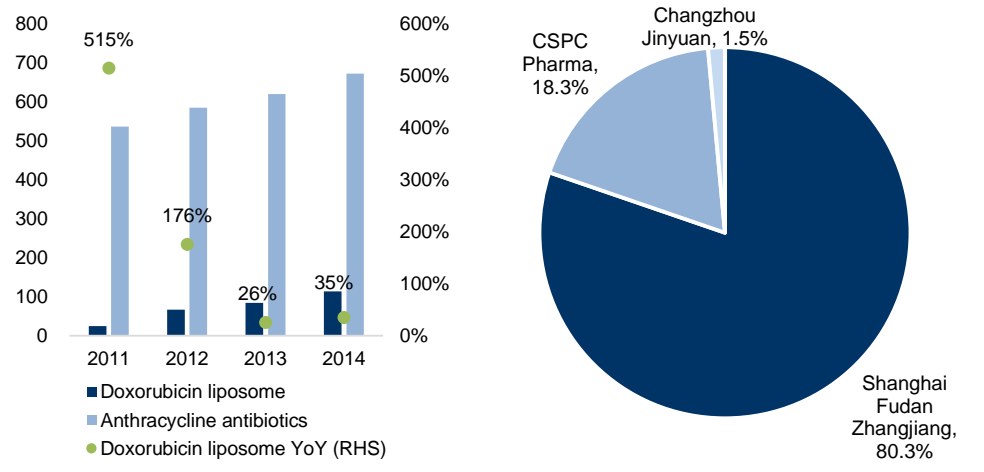
Source: Pharma database, SWS Research

However, traditional anthracycline antibiotics' main adverse effect is cardiotoxicity, which considerably limits their usefulness. The liposomal formulations of anthracycline antibiotics are less toxic to cardiac tissue than the non-liposomal form because a lower proportion of drug administered in the liposome form is delivered to the heart. Hence, we expect *Libod* and other liposomal formulations of anthracycline antibiotics to substitute the traditional non-liposomal formulations.

**Libod to take market share from traditional anthracycline antibiotics.** In China's sample hospital market, growth in doxorubicin liposome (67% Cagr) outpaced traditional anthracycline drugs (3% Cagr) during 2011 and 2014. As a result, percentage of doxorubicin liposome sales among anthracycline antibiotics increased from 4.5% in 2011 to 16.8% in 2014. We believe the strong growth in doxorubicin liposome will continue due to its superior safety and effectiveness.

**High market consolidation indicates sustainable margins.** *Libod* is the largest player in China's doxorubicin liposome market. Its market share amounts to 80% in 2014 in terms of sales in sample hospitals. There are merely three players in the market. The other two are CSPC Pharmaceutical Group (1093:HK, 18% share) and Changzhou Jinyuan (1.5% share). Hence, we expect benign pricing competition given the high market consolidation.

**Figure 16: Doxorubicin liposome outpaced other anthracycline antibiotics** **Figure 17: Market share split of doxorubicin liposome (2014)**



Source: Pharma Database, SWS Research

Source: Pharma database, SWS Research

**More tender wins to drive the growth.** In February 2015, *Libod* became the only doxorubicin hydrochloride liposome injection that won the bid for insured critical illness in Zhejiang Province. Thus, sales volume of *Libod* in Zhejiang Province may triple from c.5000 units in 2014 to c.15,000 units in 2015. We expect *Libod* to win more tenders in 2015 which may drive its sales volume to grow by c.55% YoY to 95,000 units. Figuring in 5% decrease in the average price of *Libod*, we expect revenue of *Libod* to grow by 50% YoY in 2015.



Figure 18: Highlights of doxorubicin hydrochloride liposome products

Brand name	Manufacturer	Year of launch	Average selling price (in Rmb/unit)	Tenders	Reimbursement
Libod	Shanghai Fudan Zhangjiang (1349:HK)	2009	5,282	24 Provinces	3 PRDL
Duomeisu	CSPC Pharmaceutical Group (1093:HK)	2012	5,105	14 Provinces	2 PRDL
Lixing	Changzhou Jinyuan	2013	5,279	3 Provinces	2 PRDL

Source: Yaozh.com, SWS Research

Figure 19: Revenue of Libod

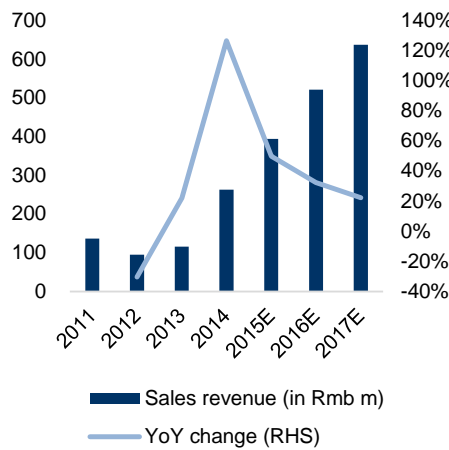
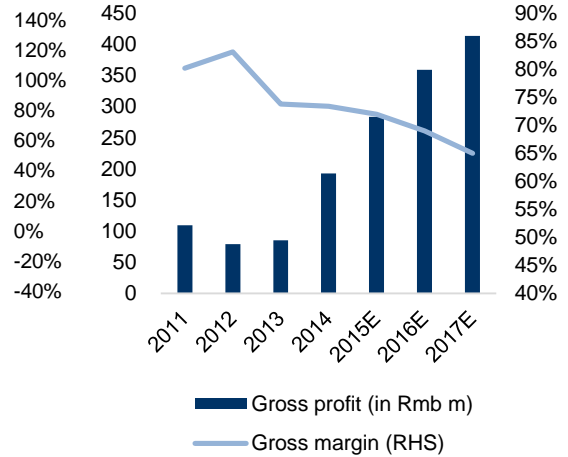


Figure 20: Gross profit of Libod



Source: Company data, SWS Research

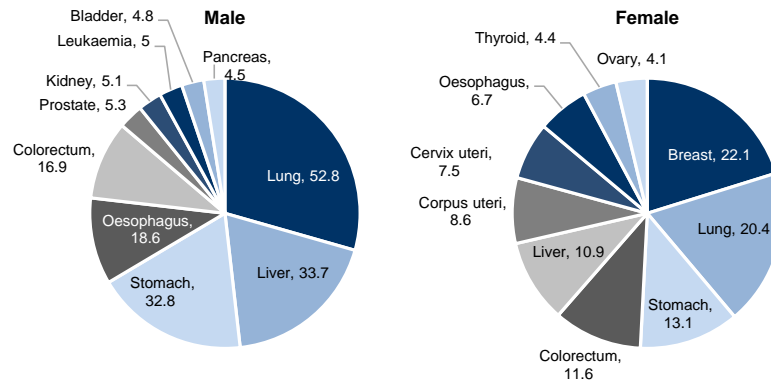
Source: Company data, SWS Research

## Xi Di Ke, a trump card

**Xi Di Ke, a class 1 new anti-cancer drug.** In May 2013, NT Pharma acquired *Xi Di Ke* (uroacitides injection) from Hefei Yongsheng Pharmaceutical Company with a consideration of Rmb30.5m. *Xi Di Ke* is a class 1 new drug approved by China Food and Drug Administration (CFDA) with patent expiry in 2024. *Xi Di Ke* is now used in the combined chemotherapy in the treatment of advanced breast cancer and non-small cell lung cancer. In January 2014, CFDA approved the phase II clinical trial for myelodysplastic syndromes (MDS), a new indication for *Xi Di Ke*. MDS is now globally considered as an incurable disease. Hence, it is likely that CFDA will speed up the approval process of the new indication. On April 1, 2015, company announced that the research project on the MDS indication for *Xi Di Ke* was admitted to the “Major New Drugs Innovation and Development” projects shortlist of the National Ministry of Science and Technology. The approval may be granted in end-2016.

**Large market potential for *Xi Di Ke*.** The approved indications of *Xi Di Ke*, non-small cell lung cancer and advanced breast cancer, are the most common cancers in China. Data from NCCR shows that lung cancer has the highest incidence among Chinese men while breast cancer has the highest incidence among Chinese women.

**Figure 21: Top 10 cancers in China by sex (age-standardised incidence per 100,000 population, 2012)**



Source: International Agency for Research on Cancer, SWS Research

Data from “China cancer annual report (2012)” shows that the new incidence of non-small lung cancer, breast cancer and MDS are 640,000, 230,000 and 39,000 per annum, respectively. Considering that *Xi Di Ke* is not a first-line drug in treating non-small lung cancer and breast cancer, we estimate the penetration rates of *Xi Di Ke* can reach 0.6% and 1.5% in these two markets, respectively. Nevertheless, given *Xi Di Ke* may be one of the few drugs that can treat MDS in the future, we believe *Xi Di Ke* can achieve 40% penetration in the MDS market. Hence, we estimate the peak sales volume of *Xi Di Ke* can reach 1.6m units per annum.

We think NT Pharma may entrust the distribution of *Xi Di Ke* to Sihuan Pharmaceutical Holdings (460:HK) given its long-term strategic cooperation with Sihuan. We estimate the retail price of *Xi Di Ke* to be Rmb1,000 per unit while the ex-factory price (including tax) to be Rmb250 per unit. We expect c.90% gross margin from *Xi Di Ke*. We believe the sales of *Xi Di Ke* will ramp up quickly thanks to the strong sales and marketing capability of Sihuan Pharmaceutical Holdings. Under our base case scenario, *Xi Di Ke* will contribute Rmb22m and Rmb108m revenue in 2015 and 2016, respectively. Our base case scenario indicates that the peak sales of *Xi Di Ke* can reach Rmb300m.

**Figure 22: Peak sales forecast of *Xi Di Ke***

Indication	Treatment protocol	Usage amount per patient (in units)	Ex-factory price (in Rmb/unit, excl. tax)	No. of patients	Penetration rate of <i>Xi Di Ke</i>	Annual sales volume (in '000 units)
Non-small cell lung cancer	300ml/day (or 3 units); 7 days per course; 2 courses per person	42	215	640,000	0.6%	161
Breast cancer	300ml/day (or 3 units); 7 days per course; 2 courses per person	42	215	230,000	1.5%	145
MDS	300ml/day (or 3 units); 14 days per course; 2-3 courses per person	84	215	39,000	40.0%	1,310
<b>Total</b>						<b>1,617</b>

Source: China cancer annual report (2012), Company data, SWS Research

**Figure 23: Scenario analysis of Xi Di Ke**

	2015E	2016E	2017E	2018E	2019E	2020E
<b>Bull case scenario</b>						
Volume ('000 units)	150	600	1,100	1,400	1,650	1,900
ASP (in Rmb per unit)	215	215	215	209	198	178
Sales (in Rmb m)	32	129	237	292	327	339
<b>Base case scenario</b>						
Volume ('000 units)	100	500	800	1,100	1,400	1,600
ASP (in Rmb per unit)	215	215	215	209	198	188
Sales (in Rmb m)	22	108	172	229	277	301
<b>Bear case scenario</b>						
Volume ('000 units)	80	400	700	950	1,150	1,300
ASP (in Rmb per unit)	215	215	215	209	198	182
Sales (in Rmb m)	17	86	151	198	228	237

Source: SWS Research

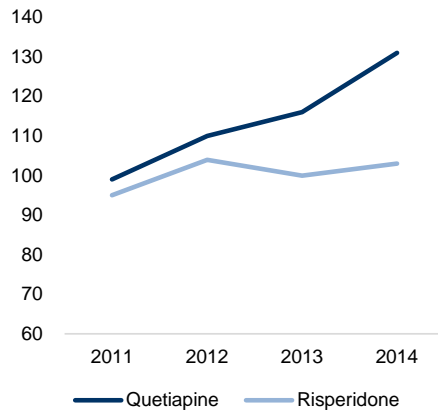
## New growth from an old drug (*Shusi*)

**New indication approval drives the growth.** *Shusi* (quetiapine fumarate tablets) is sold by the company. Its indications include schizophrenia and bipolar affective disorder (newly approved by CFDA in December 2013). Data from Decision Resources indicate that around 15m Chinese people suffer from affective disorder diseases. However, due to the low awareness of mental illness, merely c.30% Chinese patients get diagnosed. We believe the consultation rates of bipolar affective disorder will rise thanks to increasing awareness of the disease among Chinese people.

**Expect *Shusi* to gain market share.** Risperidone is another drug treating schizophrenia. However, this drug has many side effects like insomnia, anxiety, headache, etc. Given that quetiapine is safer than risperidone, it has been taking market share from risperidone in past 3 years. According to data from sample hospitals, quetiapine sales grew at 9.8% cagr during 2011 and 2014 while sales of risperidone recorded 2.7% cagr during the same period. Now the market size of risperidone is around 80% of that of quetiapine, indicating large upside of quetiapine sales in the future.

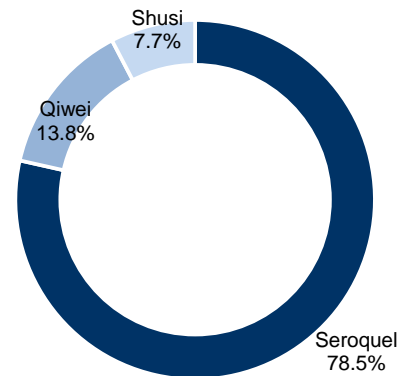
There are three players in China's quetiapine fumarate tablet market, including *Seroquel* (the original drug) by AstraZeneca, *Qiwei* by Hunan Dongting Pharm and *Shusi* by NT Pharma. According to data from sample hospitals, *Shusi* has 7.7% market share in 2014 while *Qiwei* and *Seroquel* take 13.8% and 78.5% share, respectively. As the selling price of *Seroquel* is now c.2x higher than that of *Shusi* and *Qiwei*, we expect *Seroquel* to be substituted by the domestic generic drugs. In addition, we believe *Seroquel* will face large price downside as the Chinese authorities are cutting the prices of expensive drugs. It is likely that *Seroquel* will quit the Chinese market given the ominous outlook of its volume and pricing. We expect the YoY growth in the revenue of *Shusi* to achieve 60% in 2015 vs. 43% in 2014.

**Figure 24: Sales of Quetiapine and Risperidone in China's sample hospitals (in Rmb m)**



Source: Pharma Database, SWS Research

**Figure 25: Market share split of quetiapine fumarate tablets in China's sample hospitals (2014)**



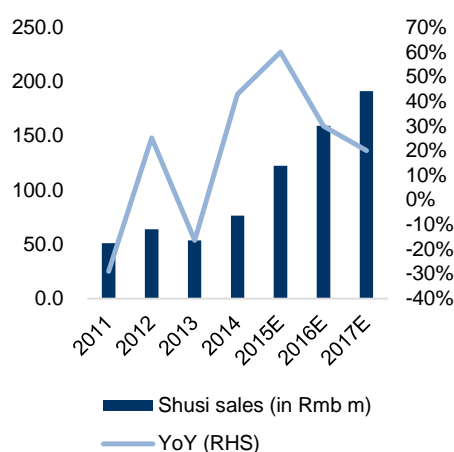
Source: Pharma database, SWS Research

**Figure 26: Highlights of quetiapine fumarate tablets**

Brand name	Manufacturer	Year of launch	Selling price (in Rmb)	Unit price (in Rmb per mg)	Tenders	Reimbursement
Seroquel	AstraZeneca	2000	217.4 (200mg * 20 tablets)	0.054	21 Provinces	NRDL (Type II)
Qiwei	Hunan Dongting Pharm	2003	51.0 (100mg * 30 tablets)	0.017	26 Provinces	NRDL (Type II)
Shusi	NT Pharma	2007	50.5 (100mg * 30 tablets)	0.017	26 Provinces	NRDL (Type II)

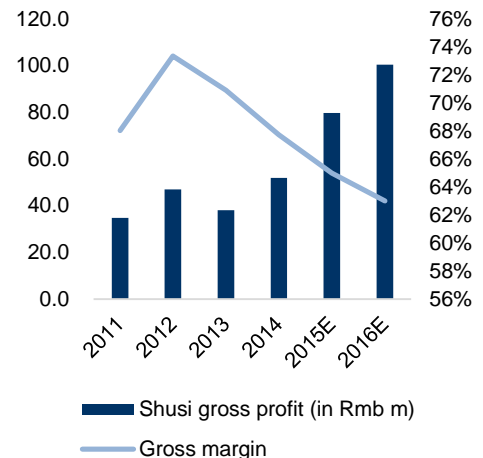
Source: yaozhi.com, SWS Research

**Figure 27: Sales of Shusi**



Source: Company data, SWS Research

**Figure 28: Gross profit of Shusi**

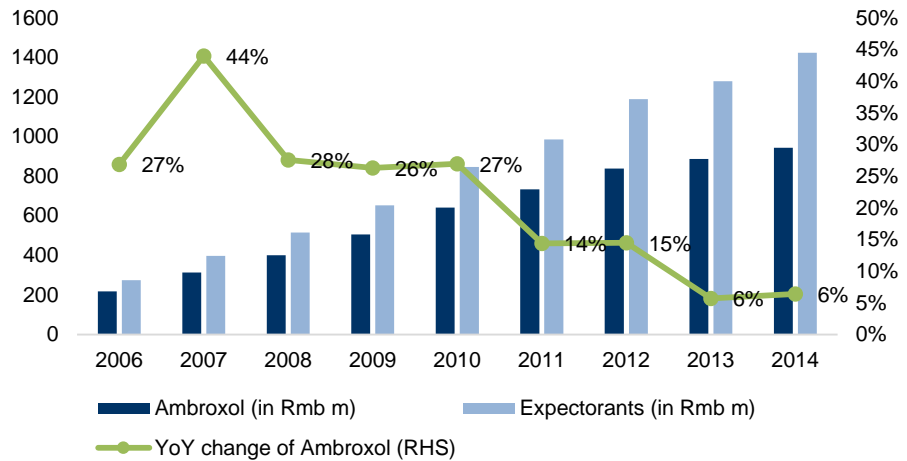


Source: Company data, SWS Research

## Zhuo'ao, steady sales

**Ambroxol, a widely used expectorant drug.** Zhuo'ao (ambroxol hydrochloride injection) takes 66% share in the expectorant drug market of China's sample hospitals in 2014. However, its growth has decelerated from 15% YoY in 2012 to 6% YoY in 2014. We expect the demand in ambroxol to continue growing steadily as the incidence of respiratory diseases may climb due to the serious air pollution in China.

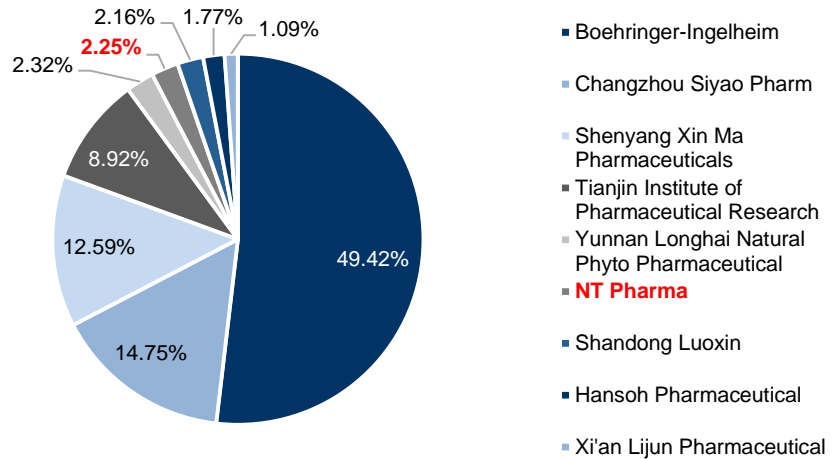
Figure 29: Steady growth in ambroxol sales



Source: Pharma Database, SWS Research

**Growth capped by capacity and competition.** There are more than 60 players manufacturing ambroxol in China. NT Pharma only has 2.25% share in China's sample hospital market, making it the sixth largest player in the market. We believe the pricing of ambroxol will gradually decrease due to its fragmented competition landscape. Moreover, the production lines of *Zhuo'ao* was running at almost full capacity in 2014. Company plans to lift the annual capacity of *Zhuo'ao* from 40m units in 2014 to c.50m units in 2015. Hence, we expect sales of *Zhuo'ao* to pick up from 2.4% YoY in 2014 to 15% YoY in 2015.

Figure 30: Fragmented market of ambroxol



Source: Pharma Database, SWS Research

Figure 31: Sales of Zhuo'ao

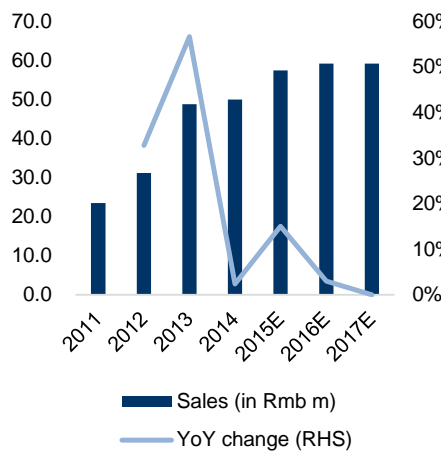
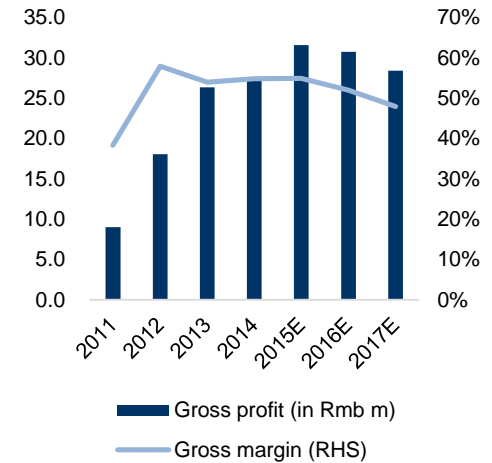


Figure 32: Gross profit of Zhuo'ao



Source: Company data, SWS Research

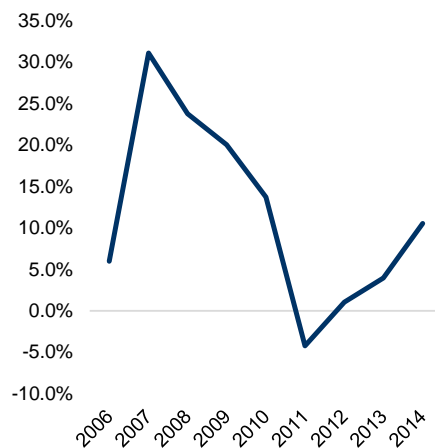
Source: Company data, SWS Research

## Fortum, not main focus

**Sales in antibiotic drugs to stabilize after 4 years of restrictive policies.** In May 2011, then Ministry of Health of PRC initiated a 3-year campaign to crack down the abuse of antibiotics. As a result, in China's sample hospitals, percentage of sales from antibiotic drugs decreased notably from 23.2% in 2010 to 15.6% in 2014. We believe China's antibiotic consumption will stabilize from 2015 as the impact from restrictive policies has been fading. In China's sample hospitals, sales of antibiotics has recovered from -4.2% YoY in 2011 to 10.5% YoY in 2014.

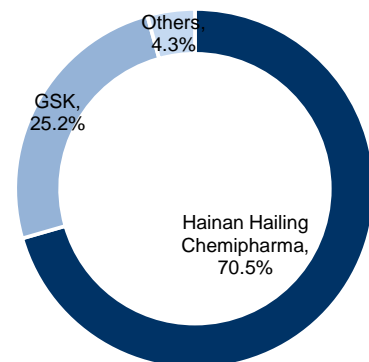
**NT Pharma to quit the sales of Fortum given its unattractive profitability.** NT Pharma is the sole distributor of Fortum (ceftazidime injection) by GSK in China. As of 2014, Fortum takes 25% share in the ceftazidime market of China's sample hospitals. As the gross margin of Fortum was as low as 30% in 2014, we believe the drug has limited contribution to the bottom line. NT Pharma may quit the sales of Fortum in May 2015 and focus its efforts on selling innovative drugs. We estimate Fortum to contribute c.Rmb100m revenue and c.Rmb30m gross profit in 1H15.

Figure 33: YoY change in antibiotic drug sales in sample hospitals



Source: Pharma Database, SWS Research

Figure 34: Market share split of ceftazidime in sample hospitals



Source: Company data, SWS Research

Figure 35: Sales of Fortum

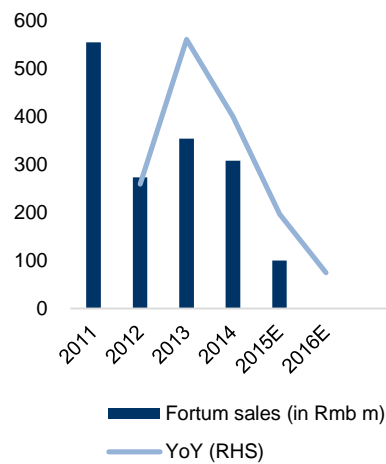
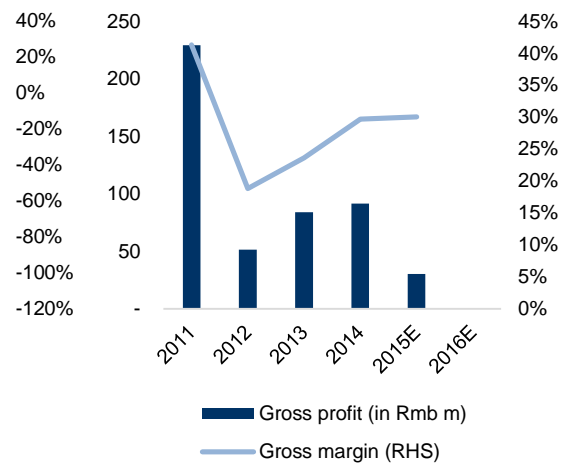


Figure 36: Gross profit of Fortum



Source: Company data, SWS Research

Source: Company data, SWS Research

## Joint hands with Sinopharm

**Aiming to become a leader in 3<sup>rd</sup> party drug promotion industry.** In February 2015, company announced to establish a new JV with Sinopharm Nutraceuticals, a subsidiary of Sinopharm (1099:HK). Sinopharm and NT Pharma will hold 60% and 30% stake in the JV, respectively, while the remaining 10% stake will be owned by the JV's management team. The registered capital of the JV is Rmb20m. NT Pharma and Sinopharm aims to develop the JV into a leader in the third party drug promotion industry. Sinopharm is the largest pharmaceutical distributor in China with 15-20% market share. By leveraging the well established distribution network of Sinopharm and the abundant experiences of NT Pharma in promoting innovative drugs, the JV will quickly ramp up its third-party drug promotion business, in our view. Moreover, we believe the JV will also expand its drug portfolio through acquisitions.

Figure 37: Highlights of the new JV with Sinopharm

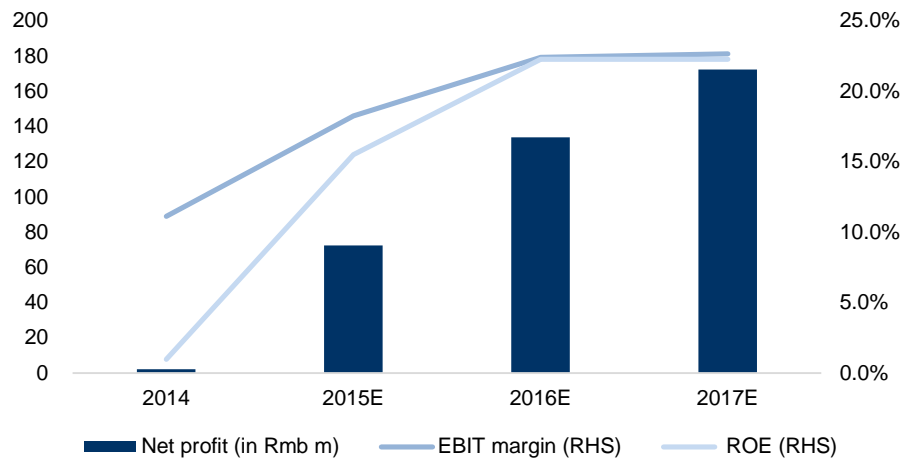
Date of announcement	Event	Shareholding structure	Investment	Business focus
2015/2/4	Company to establish a JV with Sinopharm Nutraceuticals (subsidiary of Sinopharm)	60% stake owned by Sinopharm Nutraceuticals, 30% by NT Pharma and 10% by management	Rmb20m registered capital	Aiming to become a leader in China's 3rd-party drug promotion industry

Source: Company information, SWS Research

## Earnings recovery to fuel the re-rating

**We forecast earnings to rebound from Rmb2.1m in 2014 to Rmb72.5m in 2015.** Growth will be mainly driven by the strong sales in *Libod*, *Shusi* and *Xi Di Ke*. Excluding the impact from terminating the sales of *Fortum*, the topline may increase by 28% YoY in 2015, in our view. As innovative drugs may outgrow generic drugs, we expect margins to improve thanks to the mix upgrade. We estimate operating margin to increase from 0.24% in 2014 to 8.93% in 2015. As a result, ROE may improve from 1.0% in 2014 to 15.5% in 2015.

**Figure 38: Profitability of NT Pharma**



Source: Company data, SWS Research

**Re-rating to be driven by earnings recovery.** NT Pharma is trading at 31x 15E PE and 17x 16E PE while its Chinese peers, on average, are trading at 29x 15E PE and 21x 16E PE. Our target price is HK\$2.8, implying 40x 15E PE and 22x 16E PE. We think the stock deserves a valuation premium given its strong earnings growth momentum. We believe the stock is a BUY and expect 28% upside from the current share price.

**Figure 39: Comparable peers of NT Pharma**

Company name	Ticker	Rating	Market cap (in US\$ m)	15E PE	16E PE	15E PB	15E EPS growth	16E EPS growth	15E ROE
China Nt Pharma Group Co Ltd	1011 HK	BUY	365.2	31.2	16.9	4.9	3372.6	84.7	15.5
China Medical System Holding	867 HK	N/R	4,299.8	24.2	19.2	5.7	32.5	25.8	23.5
China Pioneer Pharma Holding	1345 HK	N/R	1,114.8	18.6	15.4	4.8	39.5	21.1	27.4
Harbin Gloria Pharmaceutical-A	002437 CH	N/R	4,048.5	42.4	32.3	7.1	28.6	31.2	17.4
Yifan Xinfu Pharmaceutical-A	002019 CH	N/R	2,411.5	29.4	23.2	4.7	32.8	26.8	14.3
<b>Average</b>				<b>29.2</b>	<b>21.4</b>	<b>5.4</b>	<b>701.2</b>	<b>37.9</b>	<b>19.6</b>

Source: Bloomberg, SWS Research Note: We use Bloomberg consensus for non-rated stocks

## Catalysts and risks

Positive near-term catalysts are likely to be strong 1H15 results, the approval of the production of Xi Di Ke in mid-2015, and the positive progresses of its JV with Sinopharm.

We see risks of the stock primarily in larger-than-expected price cut in provincial drug tenders and slower-than-expected progresses of its JV with Sinopharm.



## Appendix

### Consolidated Income Statement

million yuan	2013	2014	2015E	2016E	2017E
<b>Revenue</b>	754	865	811	951	1,167
<b>Cost of Sales</b>	(465)	(473)	(341)	(363)	(453)
<b>Gross Profit</b>	289	391	470	589	714
<b>Other Income</b>	7	51	0	0	0
Selling/General/Admin. Expenses	(467)	(346)	(322)	(376)	(449)
EBITDA	(551)	119	174	239	290
EBIT	(578)	96	148	213	264
Finance Costs	(75)	(79)	(51)	(35)	(35)
<b>Profit before tax</b>	(653)	17	97	178	230
Income tax expense	(21)	(15)	(24)	(45)	(57)
Minority interests	0	0	0	0	0
<b>Profit for the year</b>	(673)	2	72	134	172

Source: Company data, SWS Research

### Consolidated Cash Flow Statement

million yuan	2013	2014	2015E	2016E	2017E
<b>Profit before taxation</b>	(653)	17	97	178	230
Plus : Depr. and amortisation	27	23	26	26	26
Finance cost	75	79	51	35	35
Losses from investments	403	0	0	0	0
Change in working capital	103	(14)	(32)	(44)	17
Others	6	(34)	(43)	(64)	(76)
<b>CF from operating activities</b>	(38)	71	98	131	231
CAPEX	(0)	(105)	(10)	(40)	(70)
Other CF from investing activities	(125)	169	19	19	(31)
<b>CF from investing activities</b>	(125)	64	9	(21)	(101)
Equity financing	0	0	182	0	0
Net change in liabilities	48	60	(300)	0	0
Dividend and interest paid	(46)	(79)	(51)	(35)	(35)
Other CF from financing activities	147	0	0	0	0
<b>CF from financing activities</b>	149	(18)	(170)	(35)	(35)
<b>Net cash flow</b>	(15)	117	(62)	76	95
FCFF	(427)	16	156	200	295
FCFE	(455)	(3)	(196)	165	260

Source: Company data, SWS Research

**Consolidated Balance Sheet**

million yuan	2013	2014	2015E	2016E	2017E
<b>Current Assets</b>	1,067	1,048	925	1,084	1,346
Bank balances and cash	489	557	495	570	716
Trade and other receivables	298	404	333	391	480
Inventories	132	84	84	99	118
Other current assets	147	3	13	23	33
Long-term investment	126	96	96	96	96
PP&E	189	264	260	285	311
Intangible and other assets	60	77	66	55	73
<b>Total Assets</b>	1,442	1,485	1,347	1,520	1,826
<b>Current Liabilities</b>	922	1,130	727	756	880
Borrowings	315	544	244	244	244
Trade and other payables	576	570	468	497	621
Other current liabilities	(372)	(759)	(92)	23	81
Long-term liabilities	311	143	143	143	143
<b>Total Liabilities</b>	1,233	1,272	870	899	1,023
Minority Interests	0	0	0	0	0
<b>Shareholder Equity</b>	209	213	467	601	773
Share Capital	0	0	182	182	182
Reserves	209	213	285	419	592
<b>Total Equity</b>	209	213	467	601	773
<b>Total Liabilities and equity</b>	1,442	1,485	1,337	1,500	1,796

Source: Company data, SWS Research

**Key Financial Ratios**

	2013	2014	2015E	2016E	2017E
<b>Ratios per share (yuan)</b>					
Earnings per share	(0.62)	0.00	0.06	0.10	0.13
Diluted EPS	(0.62)	0.00	0.06	0.10	0.13
Operating CF per share	(0.04)	0.07	0.08	0.10	0.18
Dividend per share	0.00	0.00	0.00	0.00	0.00
Net assets per share	0.19	0.20	0.36	0.46	0.60
<b>Key Operating Ratios(%)</b>					
ROIC	(98.56)	2.18	20.27	26.38	29.03
ROE	(322.54)	0.98	15.51	22.27	22.28
Gross profit margin	38.32	45.26	57.92	61.90	61.15
EBITDA Margin	(73.01)	13.79	21.43	25.11	24.86
EBIT Margin	(76.60)	11.11	18.25	22.40	22.65
Growth rate of Revenue(YoY)	2.03	14.65	(6.18)	17.29	22.64
Growth rate of Profit(YoY)	NA	NA	3372.58	84.72	28.70
Debt-to-asset ratio	85.52	85.66	64.57	59.13	56.01
Turnover rate of net assets	3.61	4.06	1.74	1.58	1.51
Turnover rate of total assets	0.52	0.58	0.60	0.63	0.64
Effective tax rate (%)	(3.16)	87.96	25.00	25.00	25.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
<b>Valuation Ratios (X)</b>					
P/E	(2.80)	904.14	31.24	16.91	13.14
P/B	9.04	8.86	4.85	3.77	2.93
EV/Sale	3.53	2.99	2.89	2.38	1.86

Source: Company data, SWS Research

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Hold: Share price performance is expected to generate between 10% downside to 10% upside over a 12-month period.

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