

March 25, 2015

# Sinopharm Group

## 2H14 NDR Takeaways: Margin Expansion to Continue

Industry View	Stock Rating	Price Target
<b>Attractive</b>	<b>Overweight</b>	<b>HK\$34.00</b>

Sinopharm's solid sales growth and operating leverage are likely to continue in 2015, despite the uncertain policy outlook for the Healthcare industry. We find the stock attractive at 18x our revised 2015e EPS. Reiterate OW.

**Healthy 2015 sales outlook:** Given decelerating GDP growth expected in 2015, mgmt looks for growth of the end-user market to slow to 12%, and for the distribution industry to grow 14-15%. Management remains confident about achieving its sales target of 3-5% above the market average.

**Margin improvement to continue in 2015, ...** This is the first quarter that Sinopharm has recorded faster profit growth than sales growth, mainly due to: 1) internal integration; 2) economies of scale; 3) optimizing customer mix (more direct sales to hospitals), and 4) more focus on the quality of growth. Management aims to maintain the gross margin in 2015, despite potential headwinds from drug tenders, but sees room for the operating margin and net margin to improve further, thanks to strict cost controls.

**... driven by:** 1) sales from centralized procurement, which accounted for less than 10% of total sales -- Sinopharm intends to build a centralized platform at the provincial instead of national level, which mgmt believes should improve efficiency and logistics; 2) reducing operating costs via increased use of the Internet and other technology; 3) new businesses with high margins, including financial leasing, which has significant potential in the Healthcare industry.

**More flexible instruments to ease finance burden:** In 2014, the finance cost ratio increased, due to faster growth of the hospital segment, which has higher AR days. Sinopharm plans to impose more internal controls on AR and use more financial instruments such as short-term commercial paper (SCP) to lower costs. Thus, we expect the ratio to be relatively stable in 2015.

**SOE reform in progress, but no clear time line:** Sinopharm's parent group aims to become a modernized enterprise with mixed ownership of the listco. The group is working on a detailed management incentive plan.

**We raise our 2015-17 EPS estimates by 2-8% to reflect better gross margin and SG&A ratio:** We project 18% sales growth and 22% net profit growth in 2015. In 2014, organic sales growth was 17.5% while M&A contributed 2.5% growth. We expect the gross margin to decline slightly, but this should be offset by a declining SG&A cost ratio. *With the publication of this report, Yolanda Hu is assuming lead coverage of Sinopharm.*

MORGAN STANLEY ASIA LIMITED+

**Yolanda Hu**

Yolanda.Hu@morganstanley.com

+852 2848-5649

**Bin Li**

Bin.Li@morganstanley.com

+852 2239-7596

**Isabella Zhao**

Isabella.Zhao@morganstanley.com

+852 2848-5887

## Sinopharm Group ( 1099.HK , 1099 HK )

China Healthcare / China

**Stock Rating****Overweight****Industry View****Attractive**

Price target	HK\$34.00
Up/downside to price target (%)	15
Shr price, close (Mar 24, 2015)	HK\$29.50
52-Week Range	HK\$34.50-19.72
Sh out, dil, curr (mn)	2,568
Mkt cap, curr (mn)	Rmb60,695
EV, curr (mn)	Rmb78,243
Avg daily trading value (mn)	HK\$133

Fiscal Year Ending	12/14	12/15e	12/16e	12/17e
ModelWare EPS (Rmb)	1.11	1.32	1.51	1.70
Prior ModelWare EPS (Rmb)	1.10	1.29	1.44	1.58
Consensus EPS (Rmb)\$	1.10	1.30	1.55	1.50
Revenue, net (Rmb mn)	200,131	235,469	272,701	313,245
EBITDA (Rmb mn)	8,697	10,106	11,795	13,657
ModelWare net inc (Rmb mn)	2,875	3,504	4,131	4,799
P/E	19.8	18.0	15.7	13.9
P/BV	2.1	2.1	2.0	1.8
RNOA (%)	16.4	15.7	15.2	14.9
ROE (%)	13.2	12.8	13.8	14.7
EV/EBITDA	8.5	8.4	7.8	7.4
Div yld (%)	1.5	1.7	1.9	2.1
FCF yld ratio (%)	4.4	(4.4)	(3.6)	(5.1)
Leverage (EOP) (%)	36.1	51.3	62.7	74.9

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework  
\$ = Consensus data is provided by Thomson Reuters Estimates  
e = Morgan Stanley Research estimates

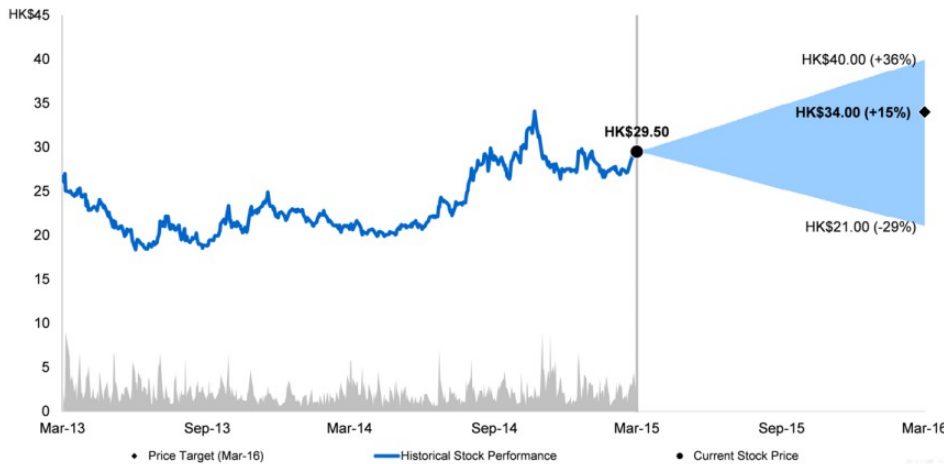
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Risk Reward

Top Distribution Brand, Commanding Market Leadership; Attractive P/E



Source: Thomson Reuters, Morgan Stanley Research

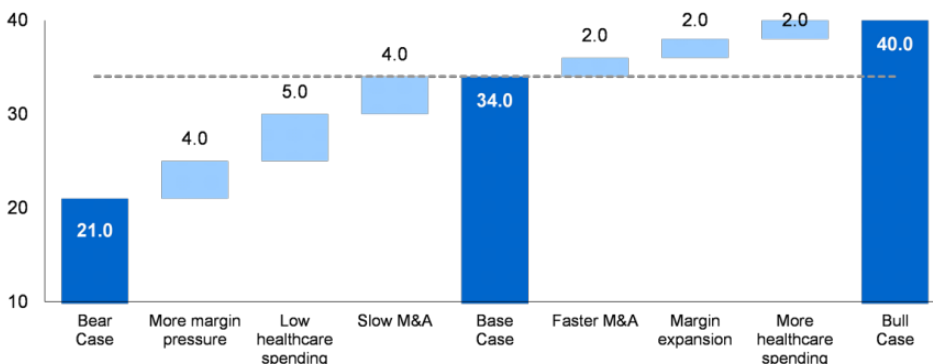
**Price Target HK\$34.0** Derived from base-case scenario, DCF analysis.

**Bull HK\$40.0**  
22.1x Bull Case 2015e EPS  
**Further cements its position as industry leader:** Consolidation accelerates and accretive M&A achieved. Higher healthcare expenditure driven by the government, leading to faster-than-expected industry growth. Margin continues to rise beyond five years. Faster penetration in hospitals and/or rural areas.

**Base HK\$34.0**  
20.7x Base Case 2015e EPS of Rmb1.32  
**Leading position and growth sustained:** Maintains its healthy growth amid reforms. M&A adds to top-line growth. Net margin stabilizes over 2015-17. Market share in hospitals and drugstores increases modestly.

**Bear HK\$21.0**  
14.2x Bear Case 2015e EPS  
**More competitive atmosphere with tougher policies from the government:** Further drug price cuts by the government drag down margins. Slow M&A and industry growth, leading to sales pressure. Slower-than-expected hospital penetration.

Exhibit 1: Bear to Bull: Driven by M&A and Industry Growth



Source: Thomson Reuters, Morgan Stanley Research

Investment Thesis

- No. 1 drug distributor with unmatched network.
- SOE status a distinct advantage: only drug distributor owned by the Central Government – a robust safety net.
- Experienced management with solid track record.
- One of the best-known names in Chinese healthcare, with an easy-to-understand business model vs. drug/device companies.
- Valuation undemanding at 18x our revised 2015 EPS estimate.

Key Value Drivers

- Healthcare expenditure and related impact on drug sales.
- M&A to spur growth.
- Continued margin improvement.

Potential Catalysts

- Margin expansion: More price cuts could weaken smaller competitors.
- Announcement of next M&A deal.
- Government release of healthcare and drug distribution data.
- Upcoming government tenders for drug procurement that favor SOEs.

Risks to Achieving Price Target

- Healthcare reform driving up spending (+) or not panning out (-).
- Hospital and drugstore penetration higher/lower than expected (+ or -).
- M&A delivering higher synergies (+) or being more dilutive (-).
- More drug price cuts by the government, reducing margins (-) but squeezing out smaller competitors (+).
- More intense competition.
- High finance costs due to tight macroeconomic conditions.

## Analysis

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**Testing the Waters for eCommerce:** Although healthcare-related eCommerce almost doubled last year, Sinopharm management remains cautious on the outlook for eCommerce business in the near term due to policy uncertainties. Regulators have not yet opened the door for online sales of prescription drugs, as expected earlier. Notably, 80% of drug consumption occurs after patients reach 60 years of age, while drugs for young people are usually for emergency use and low-priced, which does not fit the nature of eCommerce. Also, it is difficult for Internet companies to develop their own logistics and distribution centers, which usually require heavy assets. Going forward, Sinopharm may leverage its clear advantages in drug distribution and collaborate with technology companies on developing its eCommerce business, including strategic co-operation. It plans to focus on drugs for chronic disease, given stable patient group and demand, and relatively higher prices.

By using the Internet, Sinopharm is also building an internal interconnected platform to transform its traditional business into modernized healthcare services, which is one of the most important keys to its transformation. In the future, this platform could further extend into hospitals and provide them with more services.

**Drug tenders unlikely to affect margins:** Due to rising insurance coverage, some local governments have run deficits in their public medical insurance schemes. Hence, governments plan to: 1) encourage the use of commercial medical insurance and 2) cut drug prices more. However, the impact on drug distributors is likely to be neutralized, as drug manufacturers will probably compensate for the distributors' losses due to price cuts by paying Sinopharm back the same amount of money.

**New sales and promotion model with MNCs:** Sinopharm maintained a successful partnership with AstraZeneca last year. In 2015, it has done more deals with multinational corporations (MNCs). However, sales from MNCs as a percentage of the total have declined over time. This is because domestic suppliers' tender prices are lower, which increases their prospects of winning tenders and achieving faster growth.

## Valuation

### Our Key DCF Assumptions

Our primary valuation method is discounted cash flow (DCF) analysis. We cross-check our valuation with a comparison of price to earnings ratios. We believe that Sinopharm, with its dominant market position and sustainable competitive advantages, deserves to trade at a premium to its peers.

We use a cost of equity of 9.3% (unchanged), which is derived from a capital asset pricing model (CAPM) calculation of the required return on equity with a market risk premium of 4.5%, a risk-free rate of 3.31% and a beta of 0.881 (from Bloomberg). The assumed perpetual growth rate is 4%.

Other key assumptions include: 1) an optimal capital structure with 80% long-term debt and 2) a long-term corporate tax rate of 25%.

#### Exhibit 2: Sinopharm: DCF Analysis

Cost of equity	9.3%	<b>Price</b>		<b>29.25</b>			
Long-term ROE on new investments	10.0%	<b>IV Per Share (12 Month), Ex. Div</b>		<b>Mar-16 34.01</b>			
Years to reach steady-state growth	10	Expected share price return		16.27%			
Steady-state revenue growth rate (%)	4%	Expected dividend yield		0.33 1.35%			
Shares Outstanding	2,568	<b>Expected total return</b>		<b>17.62%</b>			
Steady-state borrowing cost (net of tax)	5.0%	WACC		9.2%			
Steady-state leverage (Net debt/Equity)	80%	Long-term RNOA on new investments		7.8%			
Price target horizon (months)	12	Explicit forecast period (years)		6			
Conv. factor - Model to traded Ccy	1.25	Fiscal Year Ending		12			
Decimals	2						
	F2015e	F2016e	F2017e	F2018e	F2019e	F2020e	F2021e
<b>Operating Level</b>							
Operating revenue	235,469	272,701	313,245	356,724	402,797	447,379	488,991
Operating revenue growth		15.8%	14.9%	13.9%	12.9%	11.1%	9.3%
Operating asset turnover	5.23	5.02	4.89	4.69	4.66	4.45	4.38
NOPAT	7,071	8,251	9,551	10,831	12,141	13,567	14,764
NOPAT margin	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Net operating assets	54,296	64,097	75,988	86,452	100,474	111,723	120,203
RNOA	15.7%	15.2%	14.9%	14.3%	14.0%	13.5%	13.2%
FCFO	(2,208)	(1,550)	(2,339)	367	(1,881)	2,318	6,285
PVFCFO	(2,021)	(1,299)	(1,794)	257	(1,209)	1,364	3,384
Residual income (operating)	2,909.48	3,231.70	3,625.45	3,805.93	4,148.12	4,278.34	4,435.30
PVRI (operating)	2,663	2,708	2,781	2,672	2,666	2,517	2,388
<b>Financing and Other</b>							
Net financial expense (income)	1,865	2,148	2,446	2,758	3,107	3,498	2,087
Other nonoperating expense (income)	1,702	1,973	2,306	2,627	2,944	3,286	3,286
Net debt (cash)	15,320	20,546	27,035	31,302	38,336	41,747	45,269
Other nonoperating liabilities (assets) (ONOLA)	9,138	10,809	12,836	15,204	17,909	20,978	20,978
Leverage EOP (net debt/equity)	51%	63%	75%	78%	87%	85%	84%
<b>Equity Level</b>							
Net income	3,504	4,131	4,799	5,447	6,090	6,784	9,391
Equity	29,838	32,742	36,117	39,946	44,228	48,998	53,956
ROE	12.8%	13.8%	14.7%	15.1%	15.2%	15.3%	19.2%
Dividends and net rep	1,049	1,226	1,425	1,617	1,808	2,014	4,434
PV div and net rep	960	1,027	1,092	1,134	1,160	1,183	2,383
Residual income	964.77	1,363.84	1,762.45	2,096.86	2,385.21	2,682.11	4,846.97
PVRI	883	1,142	1,351	1,471	1,531	1,575	2,605

Source: Morgan Stanley Research

#### Exhibit 3: Sinopharm: DCF Sensitivity Analysis

COE	Perpetual Growth		
	3%	4%	5%
8.3%	35.42	33.61	30.82
9.3%	35.84	34.01	31.18
10.3%	36.26	34.41	31.55

Source: Morgan Stanley Research

## Potential Risks to Our Price Target

Margin squeeze due to increased competition and price cuts.

M&A becoming dilutive.

Government policy restricting or significantly lowering drug prices, or preventing too much power from being consolidated in any one company.

More intense competition from both local players and MNCs.

High finance costs due to tight macroeconomic conditions.

## Exhibit 4: Sinopharm: Change to Our Model

RMB ('000)	New		Old		Delta		New		Old		Delta	
	2015E	2015E	Absolute	%	2016E	2016E	Absolute	%	2017E	2017E	Absolute	%
Pharmaceutical distribution	224,290,387	224,290,387	-	0%	260,176,848	260,176,848	-	0%	299,203,376	299,203,376	-	0%
Retail pharmacy	7,082,250	6,900,769	181,481	3%	8,427,878	8,004,892	422,986	5%	9,944,895	9,205,625	739,270	8%
Other business operations	4,096,328	4,862,373	(766,045)	-16%	4,096,328	5,348,610	(1,252,282)	-23%	4,096,328	5,883,471	(1,787,143)	-30%
<b>Net sales</b>	<b>235,468,965</b>	<b>236,053,528</b>	<b>(584,564)</b>	<b>0%</b>	<b>272,701,054</b>	<b>273,530,350</b>	<b>(829,296)</b>	<b>0%</b>	<b>313,244,599</b>	<b>314,292,472</b>	<b>(1,047,873)</b>	<b>0%</b>
COGS	(216,385,948)	(217,016,373)	630,426	0%	(250,792,013)	(251,685,182)	893,169	0%	(288,246,162)	(289,486,061)	1,239,899	0%
<b>Gross profit</b>	<b>19,083,017</b>	<b>19,037,155</b>	<b>45,862</b>	<b>0%</b>	<b>21,909,041</b>	<b>21,845,168</b>	<b>63,873</b>	<b>0%</b>	<b>24,998,437</b>	<b>24,806,411</b>	<b>192,026</b>	<b>1%</b>
Other income	204,021	250,000	(45,979)	-18%	204,021	250,000	(45,979)	-18%	204,021	250,000	(45,979)	-18%
Distribution and selling expenses	(5,814,434)	(5,993,737)	179,304	-3%	(6,541,238)	(6,832,861)	291,623	-4%	(7,326,186)	(7,789,461)	463,275	-6%
General and Administrative	(4,044,114)	(4,231,079)	186,966	-4%	(4,569,848)	(4,823,430)	253,582	-5%	(5,141,079)	(5,498,710)	357,631	-7%
<b>Operating income</b>	<b>9,428,491</b>	<b>9,062,338</b>	<b>366,152</b>	<b>4%</b>	<b>11,001,976</b>	<b>10,438,878</b>	<b>563,098</b>	<b>5%</b>	<b>12,735,192</b>	<b>11,768,240</b>	<b>966,953</b>	<b>8%</b>
Other gains / (loss) net	38,730	30,000	8,730	29%	38,730	30,000	8,730	29%	38,730	30,000	8,730	29%
Finance income	200,000	250,000	(50,000)	-20%	200,000	250,000	(50,000)	-20%	200,000	250,000	(50,000)	-20%
Finance costs	(2,687,258)	(2,698,192)	10,934	0%	(3,063,474)	(3,048,957)	(14,517)	0%	(3,461,726)	(3,414,832)	(46,894)	1%
Share of results of associates	187,038	167,897	19,141	11%	205,742	184,687	21,055	11%	226,316	203,156	23,161	11%
<b>Pretax income</b>	<b>7,167,001</b>	<b>6,812,043</b>	<b>354,957</b>	<b>5%</b>	<b>8,382,974</b>	<b>7,854,607</b>	<b>528,366</b>	<b>7%</b>	<b>9,738,513</b>	<b>8,836,563</b>	<b>901,949</b>	<b>10%</b>
Taxes	(1,648,410)	(1,566,770)	(81,640)	5%	(1,928,084)	(1,806,560)	(121,524)	7%	(2,239,858)	(2,032,410)	(207,448)	10%
Tax rate	23.0%	23.0%	0.0%		23.0%	23.0%	0.0%		23.0%	23.0%	0.0%	
Net income	5,518,590	5,245,273	273,317	5%	6,454,890	6,048,048	406,842	7%	7,498,655	6,804,154	694,501	10%
<b>Net income to common</b>	<b>3,504,305</b>	<b>3,409,428</b>	<b>94,877</b>	<b>3%</b>	<b>4,131,129</b>	<b>3,931,231</b>	<b>199,898</b>	<b>5%</b>	<b>4,799,139</b>	<b>4,422,700</b>	<b>376,439</b>	<b>9%</b>
Minority Interest	2,014,286	1,835,846	178,440	10%	2,323,760	2,116,817	206,944	10%	2,699,516	2,381,454	318,062	13%
<b>DILUTED EPS (RMB)</b>	<b>1.32</b>	<b>1.29</b>	<b>0.03</b>	<b>2%</b>	<b>1.51</b>	<b>1.44</b>	<b>0.06</b>	<b>4%</b>	<b>1.70</b>	<b>1.58</b>	<b>0.12</b>	<b>8%</b>
Diluted shares outstanding	2,662,733	2,645,342	17,391	1%	2,742,615	2,724,702	17,913	1%	2,824,894	2,806,443	18,450	1%
<b>Margin Analysis</b>	<b>New</b>	<b>Old</b>	<b>Absolute</b>		<b>New</b>	<b>Old</b>	<b>Absolute</b>		<b>New</b>	<b>Old</b>	<b>Absolute</b>	
<b>Gross margin</b>	<b>8.10%</b>	<b>8.06%</b>	<b>4</b>		<b>8.03%</b>	<b>7.99%</b>	<b>5</b>		<b>7.98%</b>	<b>7.89%</b>	<b>9</b>	
Distribution and selling expenses	2.47%	2.54%	(7)		2.40%	2.50%	(10)		2.34%	2.48%	(14)	
General and Administrative	1.72%	1.79%	(7)		1.68%	1.76%	(9)		1.64%	1.75%	(11)	
<b>Operating margin</b>	<b>4.00%</b>	<b>3.84%</b>	<b>17</b>		<b>4.03%</b>	<b>3.82%</b>	<b>22</b>		<b>4.07%</b>	<b>3.74%</b>	<b>32</b>	
Finance costs (as % of sales)	1.06%	1.04%	2		1.05%	1.02%	3		1.04%	1.01%	3	
Pretax margin	3.04%	2.89%	16		3.07%	2.87%	20		3.11%	2.81%	30	
Minority Interest (as % of NI)	36.50%	35.00%	150		36.00%	35.00%	100		36.00%	35.00%	100	
<b>Net margin</b>	<b>1.49%</b>	<b>1.44%</b>	<b>4</b>		<b>1.51%</b>	<b>1.44%</b>	<b>8</b>		<b>1.53%</b>	<b>1.41%</b>	<b>12</b>	
<b>% YOY Change</b>	<b>New</b>	<b>Old</b>	<b>Absolute</b>		<b>New</b>	<b>Old</b>	<b>Absolute</b>		<b>New</b>	<b>Old</b>	<b>Absolute</b>	
<b>Net sales</b>	<b>18%</b>	<b>19%</b>	<b>-1%</b>		<b>16%</b>	<b>16%</b>	<b>0%</b>		<b>15%</b>	<b>15%</b>	<b>0%</b>	
COGS	18%	19%	-1%		16%	16%	0%		15%	15%	0%	
Gross profit	17%	17%	0%		15%	15%	0%		14%	14%	1%	
Distribution and selling expenses	14%	15%	-2%		13%	14%	-2%		12%	14%	-2%	
General and Administrative	14%	15%	-1%		13%	14%	-1%		13%	14%	-2%	
<b>Operating income</b>	<b>20%</b>	<b>17%</b>	<b>3%</b>		<b>17%</b>	<b>15%</b>	<b>1%</b>		<b>16%</b>	<b>13%</b>	<b>3%</b>	
Pretax income	21%	17%	3%		17%	15%	2%		16%	13%	4%	
Net income	22%	21%	1%		18%	15%	3%		16%	13%	4%	
<b>Diluted EPS</b>	<b>18%</b>	<b>18%</b>	<b>1%</b>		<b>14%</b>	<b>12%</b>	<b>3%</b>		<b>13%</b>	<b>9%</b>	<b>4%</b>	
Diluted shares outstanding	3%	3%	0%		3%	3%	0%		3%	3%	0%	

Source: Morgan Stanley Research

**Exhibit 5: Sinopharm: Annual Income Statement**

RMB ('000)	2010A	2011A	2012A	2013A	2014A	2015E	2016E	2017E
Pharmaceutical distribution	64,800,811	95,489,133	128,142,982	157,864,297	190,133,058	224,290,387	260,176,848	299,203,376
Retail pharmacy	1,714,955	3,044,869	4,113,602	4,833,148	5,901,875	7,082,250	8,427,878	9,944,895
Other business operations	2,717,903	3,690,805	4,245,076	4,168,701	4,096,328	4,096,328	4,096,328	4,096,328
<b>Net sales</b>	<b>69,233,669</b>	<b>102,224,807</b>	<b>136,501,660</b>	<b>166,866,146</b>	<b>200,131,261</b>	<b>235,468,965</b>	<b>272,701,054</b>	<b>313,244,599</b>
COGS	(63,397,799)	(93,870,110)	(125,514,036)	(153,487,630)	(183,803,043)	(216,385,948)	(250,792,013)	(288,246,162)
<b>Gross profit</b>	<b>5,835,870</b>	<b>8,354,697</b>	<b>10,987,624</b>	<b>13,378,516</b>	<b>16,328,218</b>	<b>19,083,017</b>	<b>21,909,041</b>	<b>24,998,437</b>
Other income	77,370	168,941	218,899	288,941	204,021	204,021	204,021	204,021
Distribution and selling expenses	(1,960,018)	(2,922,793)	(3,750,408)	(4,473,773)	(5,122,849)	(5,814,434)	(6,541,238)	(7,326,186)
General and Administrative	(1,544,407)	(1,964,629)	(2,587,211)	(3,091,764)	(3,547,468)	(4,044,114)	(4,569,848)	(5,141,079)
<b>Operating income</b>	<b>2,408,815</b>	<b>3,636,216</b>	<b>4,868,904</b>	<b>6,101,920</b>	<b>7,861,922</b>	<b>9,428,491</b>	<b>11,001,976</b>	<b>12,735,192</b>
Other gains / (loss) net	171,381	201,987	286,707	40,196	38,730	38,730	38,730	38,730
Finance income	76,388	115,493	151,591	174,387	187,911	200,000	200,000	200,000
Finance costs	(348,640)	(933,498)	(1,420,729)	(1,834,756)	(2,316,602)	(2,687,258)	(3,063,474)	(3,461,726)
Share of results of associates	90,008	107,402	135,718	138,758	162,642	187,038	205,742	226,316
<b>Pretax income</b>	<b>2,397,952</b>	<b>3,127,600</b>	<b>4,022,191</b>	<b>4,620,505</b>	<b>5,934,603</b>	<b>7,167,001</b>	<b>8,382,974</b>	<b>9,738,513</b>
Taxes	(567,595)	(725,050)	(936,497)	(1,040,793)	(1,383,030)	(1,648,410)	(1,928,084)	(2,239,858)
Tax rate	23.7%	23.2%	23.3%	22.5%	23.3%	23.0%	23.0%	23.0%
Net income	1,830,357	2,402,550	3,085,694	3,579,712	4,551,573	5,518,590	6,454,890	7,498,655
<b>Net income to common</b>	<b>1,208,751</b>	<b>1,560,606</b>	<b>1,979,381</b>	<b>2,250,002</b>	<b>2,874,823</b>	<b>3,504,305</b>	<b>4,131,129</b>	<b>4,799,139</b>
Minority Interest	621,606	841,944	1,106,313	1,329,710	1,676,750	2,014,286	2,323,760	2,699,516
<b>DILUTED EPS (RMB)</b>	<b>0.53</b>	<b>0.66</b>	<b>0.82</b>	<b>0.89</b>	<b>1.11</b>	<b>1.32</b>	<b>1.51</b>	<b>1.70</b>
Diluted shares outstanding	2,264,568	2,356,102	2,402,625	2,523,359	2,585,178	2,662,733	2,742,615	2,824,894
<b>Margin Analysis</b>	<b>2010A</b>	<b>2011A</b>	<b>2012A</b>	<b>2013A</b>	<b>2014A</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
<b>Gross margin</b>	<b>8.43%</b>	<b>8.17%</b>	<b>8.05%</b>	<b>8.02%</b>	<b>8.16%</b>	<b>8.10%</b>	<b>8.03%</b>	<b>7.98%</b>
Distribution and selling expenses	2.83%	2.86%	2.75%	2.68%	2.56%	2.47%	2.40%	2.34%
General and Administrative	2.23%	1.92%	1.90%	1.85%	1.77%	1.72%	1.68%	1.64%
<b>Operating margin</b>	<b>3.48%</b>	<b>3.56%</b>	<b>3.57%</b>	<b>3.66%</b>	<b>3.93%</b>	<b>4.00%</b>	<b>4.03%</b>	<b>4.07%</b>
Pretax margin	3.46%	3.06%	2.95%	2.77%	2.97%	3.04%	3.07%	3.11%
<b>Net margin</b>	<b>1.75%</b>	<b>1.53%</b>	<b>1.45%</b>	<b>1.35%</b>	<b>1.44%</b>	<b>1.49%</b>	<b>1.51%</b>	<b>1.53%</b>
<b>% YOY Change</b>	<b>2010A</b>	<b>2011A</b>	<b>2012A</b>	<b>2013A</b>	<b>2014A</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
<b>Net sales</b>	<b>31%</b>	<b>48%</b>	<b>34%</b>	<b>22%</b>	<b>20%</b>	<b>18%</b>	<b>16%</b>	<b>15%</b>
COGS	31%	48%	34%	22%	20%	18%	16%	15%
Gross profit	32%	43%	32%	22%	22%	17%	15%	14%
Distribution and selling expenses	40%	49%	28%	19%	15%	14%	13%	12%
General and Administrative	32%	27%	32%	20%	15%	14%	13%	13%
Other operating income (expenses)	42%	18%	42%	-86%	-4%	0%	0%	0%
<b>Operating income</b>	<b>27%</b>	<b>51%</b>	<b>34%</b>	<b>25%</b>	<b>29%</b>	<b>20%</b>	<b>17%</b>	<b>16%</b>
Pretax income	26%	30%	29%	15%	28%	21%	17%	16%
Net income	25%	29%	27%	14%	28%	22%	18%	16%
<b>Diluted EPS</b>	<b>0%</b>	<b>24%</b>	<b>24%</b>	<b>8%</b>	<b>25%</b>	<b>18%</b>	<b>14%</b>	<b>13%</b>
Diluted shares outstanding	25%	4%	2%	5%	2%	3%	3%	3%

Source: Morgan Stanley Research

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	COUNT	% OF TOTAL	COUNT	% OF TOTAL	% OF RATING IBC CATEGORY
Overweight/Buy	1161	35%	321	41%	28%
Equal-weight/Hold	1459	44%	370	47%	25%
Not-Rated/Hold	101	3%	10	1%	10%
Underweight/Sell	609	18%	88	11%	14%
<b>TOTAL</b>	<b>3,330</b>		<b>789</b>		

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### Stock Price, Price Target and Rating History (See Rating Definitions)



Stock Rating History: 3/1/12 : O/NR; 1/13/14 : O/A

Price Target History: 8/26/11 : 30; 4/11/14 : 28; 9/16/14 : 34

Source: Morgan Stanley Research      Date Format: MM/DD/YY      Price Target ---      No Price Target Assigned (NA)  
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —  
 Stock and Industry Ratings (abbreviations below) appear as + Stock Ratings/Industry View  
 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)  
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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#### INDUSTRY COVERAGE: China Healthcare

COMPANY (TICKER)	RATING (AS OF)	PRICE* (03/17/2015)
<b>Hu, Yolanda</b>		
China Biologic Products (CBPO.O)	O (07/08/2014)	US\$87.97
<b>Li, Bin</b>		
Beijing Tongrentang (600085.SS)	U (11/03/2014)	Rmb26.29
Biosensors International (BIOS.SI)	U (04/11/2014)	\$S0.78
China Medical System (0867.HK)	O (01/27/2014)	HK\$12.42
China Nepstar Chain Drugstore Inc. (NPD.N)	U (08/22/2013)	US\$1.77
China Shineway Pharmaceutical (2877.HK)	U (08/22/2013)	HK\$11.46
Concord Medical Services Holdings Ltd (CCMN)	U (04/11/2014)	US\$6.28
Consun Pharma (1681.HK)	O (05/07/2014)	HK\$5.02
CSPC Pharmaceutical Group (1093.HK)	O (08/15/2012)	HK\$6.33
Fosun Pharmaceutical (2196.HK)	O (12/12/2014)	HK\$26.45
Fosun Pharmaceutical (600196.SS)	O (12/12/2014)	Rmb24.80
Jiangsu Hengrui (600276.SS)	E (08/22/2013)	Rmb43.71
Lee's Pharmaceutical (0950.HK)	O (01/27/2011)	HK\$11.28
Lijun International (2005.HK)	O (10/20/2014)	HK\$3.55
MicroPort Scientific Corp. (0853.HK)	U (08/22/2013)	HK\$3.57
Mndray (MR.N)	U (12/12/2014)	US\$26.94
PW Medtech (1358.HK)	O (12/12/2013)	HK\$2.88
Shandong Weigao (1066.HK)	++	HK\$6.47
Shanghai Pharmaceutical (601607.SS)	E (06/05/2012)	Rmb22.40
Shanghai Pharmaceutical (2607.HK)	E (06/05/2012)	HK\$18.92
Sihuan Pharmaceutical Holdings Group Ltd (0460.HK)	O (12/08/2010)	HK\$4.41
Sino Biopharmaceutical (1177.HK)	O (05/14/2010)	HK\$7.45
Sinopharm Group (1099.HK)	O (01/05/2010)	HK\$29.50
Tasly Pharmaceutical Group Co. Ltd (600535.SS)	O (11/28/2012)	Rmb46.53
WuXi Pharmatech (WX.N)	O (09/15/2008)	US\$37.15
Yunnan Baiyao Group (000538.SZ)	O (04/11/2014)	Rmb68.15
<b>Zhao, Isabella</b>		
Beijing Tongrentang Chinese Medicine (8138.HK)	O (01/14/2015)	HK\$10.94
China Traditional Chinese Medicine (0570.HK)	O (03/17/2015)	HK\$4.78
Guangzhou Pharma (0874.HK)	O (09/25/2013)	HK\$25.05
Guangzhou Pharma (600332.SS)	E (05/14/2012)	Rmb31.85
Jintian Pharma Group (2211.HK)	O (03/19/2015)	HK\$2.89
Sinovac Biotech Ltd. (SVA.O)	O (03/20/2014)	US\$4.98
The United Laboratories (3933.HK)	E (04/04/2014)	HK\$3.73
Tongrentang Technologies (1666.HK)	E (04/11/2014)	HK\$10.30

Stock Ratings are subject to change. Please see latest research for each company.

\* Historical prices are not split adjusted.

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