

Fosun Pharmaceutical - H

FY14 solid with strong contribution from medical devices; Hospital services remain a key focus

Fosun recorded robust FY14 results, with sales up 20.3% Y/Y and recurring profit up 29.8%. While drug manufacturing showed weakness with sales up 11.3% Y/Y and segment profit down 8.2%, segment profit for both hospital services and medical device segments more than doubled. With Sinopharm performing and these two segments contributing, we think Fosun's diversified healthcare holdings make it attractive in 2015 given the expected difficulties facing drug manufacturing companies. We reiterate OW on Fosun.

- **FY14 overview:** Total sales were Rmb11.9bn (+20.3%) and net profit was Rmb2,123mn (+33.5%), with marked to market gain on Sinopharm holding excluded from both 2013 and 2014. Core net profit was Rmb1,331mn (+29.8%). While sales of drugs increased by only 11.3% due to weakness from Jinzhou Aohong, hospital services' revenue and medical device sales rose by 150% and 37%, respectively. This highlights the strength of Fosun.
- **Margin trend:** GM was down 0.4ppt Y/Y to 43.7% due to lower than overall growth of high GM drug sales. SG&A/sales was 29.0%, up 0.52ppt from 2013 level. Fosun spent 4.7% of revenue on R&D (4.4% in 2013). It spent 6.16% of manufacturing revenue on drug R&D, up from 5.5% in 2013.
- **Other updates:** While Fosun made no hospital acquisition in 2014, it has a pipeline of hospitals for acquisition. It entered an agreement with Taizhou government to set up greenfield hospitals and later announced a tentative agreement to develop a high-end hospital in Qiqihar and set up for procurement JV. Fosun will help develop United Family hospitals as a major shareholder of privatized CHINDEX. Fosun guided for attaining manufacturing business growth in line with industry growth of low teens organically plus 5-10% growth through acquisitions, including Erye Pharma. We expect Fosun to pursue M&A in the medical devices and diagnostic equipment area.

Overweight

2196.HK, 2196 HK

Price: HK\$26.20

Price Target: HK\$35.80

China

Healthcare

Sean Wu ^{AC}

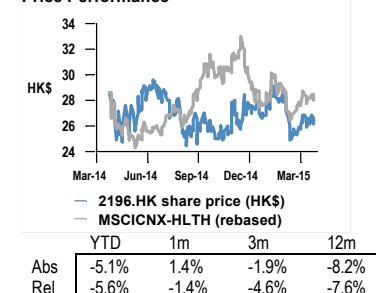
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Price Performance



Fosun Pharmaceutical - H (Reuters: 2196.HK, Bloomberg: 2196 HK)

Rmb in mn, year-end Dec	FY12A	FY13A	FY14A	FY15E	FY16E
Revenue (Rmb mn)	7,278	9,161	11,523	13,746	16,037
Net Profit (Rmb mn)	1,564	1,754	1,957	2,061	2,322
EPS (Rmb)	0.80	0.78	0.87	0.92	1.04
DPS (Rmb)	0.24	0.21	0.23	0.24	0.27
Revenue growth (%)	13.1%	25.9%	25.8%	19.3%	16.7%
EPS growth (%)	30.3%	(1.8%)	11.5%	5.3%	12.7%
ROCE	2.9%	3.9%	4.6%	4.9%	5.3%
ROE	13.5%	12.4%	12.6%	12.1%	12.4%
P/E (x)	26.3	26.8	24.0	22.8	20.2
P/BV (x)	3.5	3.2	2.9	2.6	2.4
EV/EBITDA (x)	34.1	24.2	19.5	17.8	16.2
Dividend Yield	1.1%	1.0%	1.1%	1.2%	1.3%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Shares O/S (mn)	1,904
Market Cap (Rmb mn)	39,919
Market Cap (\$ mn)	6,433
Price (HK\$)	26.20
Date Of Price	25 Mar 15
Free Float(%)	100.0%
3M - Avg daily vol (mn)	1.96
3M - Avg daily val (HK\$ mn)	52.76
3M - Avg daily val (\$ mn)	6.8
MSCI CNX-HLTH	151.54
Exchange Rate	7.76
Price Target End Date	31-Dec-15
Price Target (HK\$)	35.80

See page 8 for analyst certification and important disclosures, including non-US analyst disclosures.

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Key catalysts for the stock price:	Upside risks to our view:	Downside risks to our view:
<ul style="list-style-type: none"> Quarterly earnings beat Winning tenders in major provinces for key drugs and sales ramp up of new products Approval and launch of human insulin Major M&A in the hospital services sector 	<ul style="list-style-type: none"> Unexpected early approval of human insulin Better penetration in China market of Alma products Hospital services acquisition yields more synergies than expected Much better than expected sales performance from products due to tenders. 	<ul style="list-style-type: none"> Unfavorable government policies on prices of healthcare products and services. Failure to gain from any future M&A in terms of yield synergies and growth. Difficulty in exiting minority investments due to unfavorable market conditions.

Key financial metrics	FY13A	FY14A	FY15E	FY16E
Revenues (LC)	9,921	11,938	13,309	16,389
Revenue growth (%)	36.3%	20.3%	11.5%	23.1%
EBITDA (LC)	1,707	1,963	2,405	2,877
EBITDA margin (%)	17.2%	16.4%	18.1%	17.6%
Tax rate (%)	15.5%	12.8%	17.5%	16.5%
Net profit (LC)	1,583	2,113	2,184	2,620
EPS (LC)	0.71	0.92	0.94	1.13
EPS growth (%)	-11.5%	30.3%	2.6%	20.0%
DPS (LC)	0.27	0.28	0.29	0.34
BVPS (LC)	6.8	7.2	7.9	8.7
Operating cash flow (LC mn)	1,012	1,200	1,806	1,302
Free cash flow (LC mn)	(1,645)	(146)	1,084	505
Interest cover (x)	4.9	4.7	4.5	5.1
Net margin (%)	16.0%	17.7%	16.4%	16.0%
Sales/assets (X)	0.4	0.4	0.4	0.4
Debt/equity (%)	31.9%	46.2%	47.0%	42.3%
Net debt/equity (%)	14.5%	26.8%	27.5%	25.4%
ROE (%)	11.0%	13.4%	12.6%	13.7%

Key model assumptions	FY13A	FY14A	FY15E	FY16E
Hospitals acquired		5	5	5
ASP cut for drugs		5%	5%	5%
Manufacturing segment margin		15.2%	15.4%	15.6%

Source: Company and J.P. Morgan estimates.

Sensitivity analysis	EBITDA		EPS	
Sensitivity to	FY15E	FY16E	FY15E	FY16E
1ppt increase in GM	2.8%	3.8%	2.5%	3.0%
0.5ppt increase in selling cost	-3.9%	-9.1%	-3.5%	-7.0%
5% change in investment gain	0.0%	1.6%	0.0%	1.6%
5% increase in Sinopharm profit	0.0%	1.6%	0.0%	1.5%

Source: J.P. Morgan estimates.

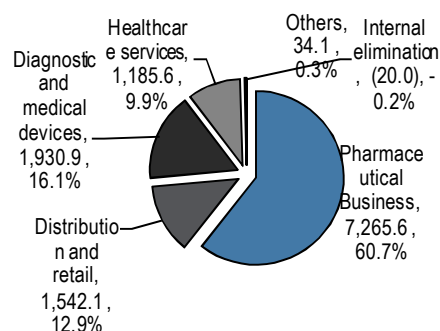
Comparative metrics	CMP	Mkt Cap	P/E (x)		EV/EBITDA (x)		P/BV (x)		YTD
	LC	\$Mn	FY14E	FY15E	FY14E	FY15E	FY14E	FY15E	Stock perf.
FOSUN PHARMA-H (OW)	26.2	9,142	19.0	16.4	28.7	23.1	9.1	9.1	(6.1)
SHANGHAI FOSUN-A (NC)	25.33	9,142	21.6	18.2	28.8	24.2	10.0	10.0	20.0
AIER EYE HSPTL-A (NC)	36.21	3,808	76.2	57.7	40.0	31.7	3.7	3.7	31.4
BAIYUNSHAN PH-H (NC)	25.75	6,556	19.8	16.3	20.8	17.2	9.3	9.3	9.8
GUANGZHOU BAIY-A (OW)	6.4	4,876	22.5	17.8	14.4	11.8	1.8	1.8	(6.4)
CSPC PHARMACEUTI (NC)	13.14	1,413	35.7	27.8	23.1	17.2	2.7	2.7	(8.1)
PHOENIXHEALTH (NC)	21.78	8,618	23.4	20.5	13.7	12.0	11.2	11.2	32.0
SHANG PHARM -A (N)	19	8,618	16.5	14.6	14.0	12.5	11.1	11.1	8.6
SHANGHAI PHARM-H (NC)	33.78	6,556	29.0	23.7	22.8	19.8	9.2	9.2	
SINO BIOPHARM (N)	7.49	4,773	26.9	23.1	14.6	12.3	1.7	1.7	6.5

Source: Bloomberg, Bloomberg consensus for stocks Not Covered, J.P. Morgan; Price as of 03/25/2015

Valuation and price target basis

Our Dec-15 price target of HK\$35.80 for Fosun H shares is based on sum-of-parts methodology.

Revenue mix in 2015E



Source: J.P. Morgan estimates.

JPM vs. consensus, change in estimates

EPS (LC)	FY15E	FY16E
JPM old	0.946	1.111
JPM new	0.921	0.945
% chg	-2.6%	-15.0%
Consensus	1.106	1.283

Source: Bloomberg, J.P. Morgan estimates.

Earnings Review

Table 1: Fosun: FY2014 Variance Analysis

Year to Dec (Rmb 'mn)	FY13A	FY14A	FY014E	Growth	Variance	Consensus	Variance
Pharmaceutical Business	6,526	7,266	7,505	11.3%	-3.2%		
Distribution and retail	1,502	1,542	1,607	2.7%	-4.0%		
Diagnostic and medical devices	1,407	1,931	1,872	37.2%	3.2%		
Healthcare services	475	1,186	1,150	149.8%	3.1%		
Turnover	9,921	11,938	12,142	20.3%	-1.7%	12,060	-1.0%
Gross profit	4,378	5,220	5,058	19.2%	3.2%		
GPM	44.1%	43.7%	41.7%	-0.4 ppt	2.1 ppt		
EBIT	1,114	1,192	1,428	7.0%	-16.5%	1,262	-5.5%
Net profit	1,583	2,113	1,999	33.5%	5.7%	2,137	-1.1%
EPS (Rmb)	0.706	0.921	0.872	30.3%	5.6%	0.953	-3.4%

Source: J.P. Morgan estimates, Bloomberg, Company data.

Pharma and manufacturing and R&D

- This segment saw revenue of Rmb7,26 mn which is 11.36% increase from last year and a net profit of Rmb1,095 mn, -25.5% Y/Y.
- Net profit of this segment increased by +7.45% excluding effect of disposal of Rmb45 mn equity interest of Tongjitang Chinese Medicines Company.
- 86 patents were applied (6 in US and 3 under Patent Cooperation Treaty) in pharma manufacturing and R&D. This segment also obtained 36 licensed patents with 35 invention patents (17 in US, Japan and Europe). R&D expense of the segment was RMB 452 mn, which is 6.2% of the segment's revenue.

Table 2: Fosun: Performance of key categories of products

Drug categories	2014 sales (Rmb 'mn)	2013 sales (Rmb 'mn)	2012 sales (Rmb 'mn)	FY14 Y/Y growth (%)	FY13 Y/Y growth (%)
Cardiovascular	654	522	399	25.3	31.1
CNS	892	838	441	6.4	89.9
Blood system	246.00	278	202	(11.5)	37.8
Metabolism and alimentary tract	1516	1,292	1,117	17.3	15.6
Anti-infective	1100	844	574	30.3	47.0
APIs and intermediate	148	42		252.4	

Source: J.P. Morgan, Company data. Fosun had 15 products with sales above Rmb100mn in 2014, compared to 15 in 2013 and 11 in 2012.

Pharma distribution and retail

- This business realized revenue of Rmb1,542 mn, +2.66% Y/Y.

- Fosun has entered equity transfer agreement with Sinopharm to sell its stakes in two drugstore chains in Shanghai and Beijing to this associated company. Hence, we have removed all forecasts of drugstore sales.

Healthcare services business

- Healthcare services revenue went up by 150% to Rmb1,186mn. The segment was Rmb229mn, +159%. Net profit was Rmb118 mn, +165%.
- Total number of beds across different hospitals reached 2,770

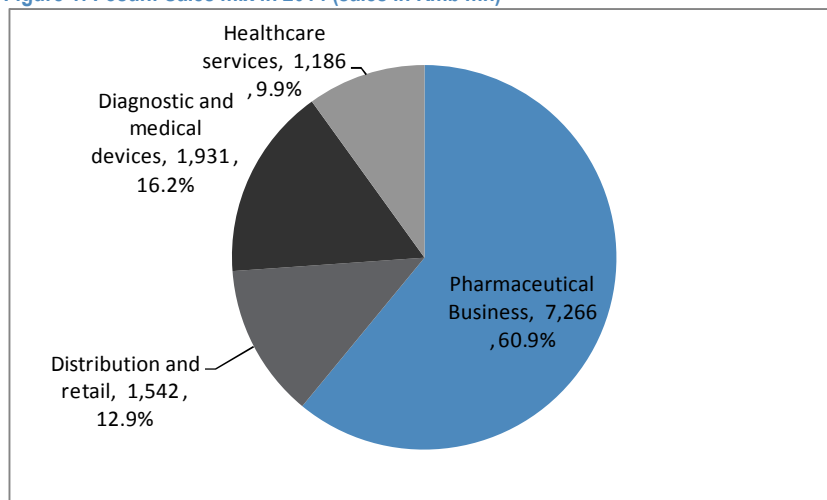
Medical Diagnostics and Medical Devices:

- Fosun actively pursued international investments and entered agreements with companies like miacom Diagnostics GmbH (37% equity interest) and Genefirst Limited (35.23% equity interest)
- Fosun recorded sales of Rmb1,496mn from the manufacturing of medical diagnosis and medical devices segment, +38.39% Y/Y. Excluding the impact of Alma Lasers, the organic growth was 16.51% in 2014.
- Alma Lasers performed well in markets like China and India and it recorded revenue of Rmb621mn, +13.40%.
- Five products (including 1,470 nano surgical lasers) were approved by EU CE markings and three products got U.S. FDA approval
- Medical device distribution sales grew by 33.4%Y/Y to reach Rmb435mn.

Balance sheet and cash flow analysis

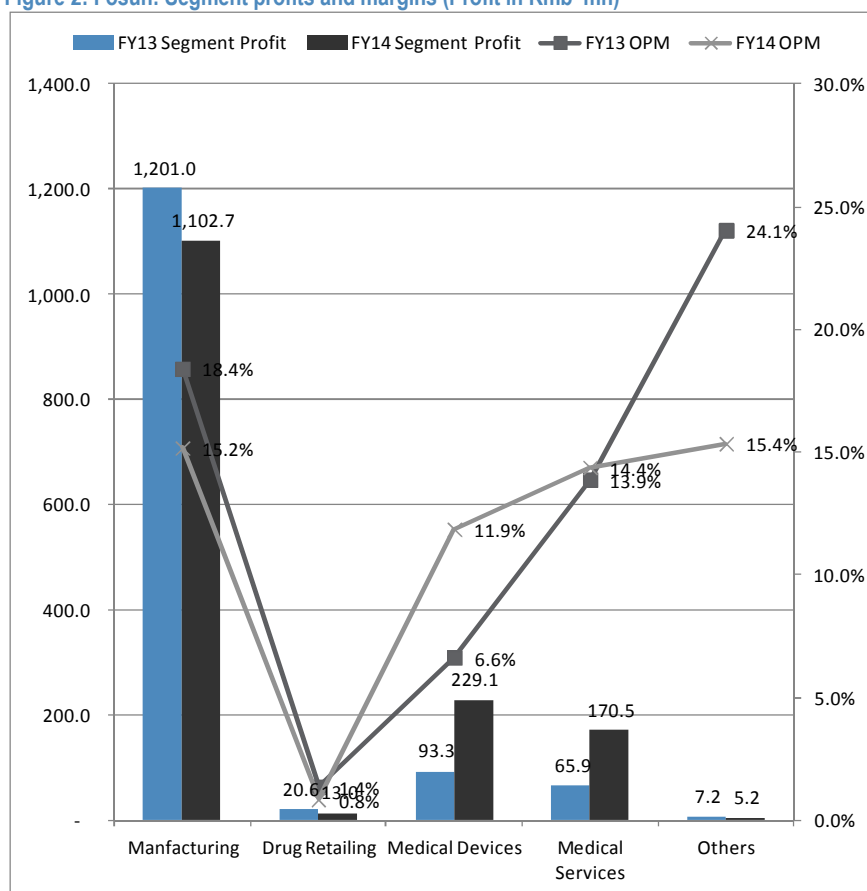
As of Dec. 31, 2014, Fosun had cash and equivalents of Rmb3,695mn, up from Rmb3,607mn as of YE2013. Net operating cash flow from operating activities was Rmb1,200m, up +18.6% Y/Y. In 2014, Fosun incurred capital expenditures of Rmb1,276mn and had a total cash outflow related to investing activities of around Rmb2,478mn. Fosun's debt ratio was 45.9%, up from 40% as of YE2013 and net gearing increased from 19% to 24.9%. The company's account receivable days increased slightly from 52 to 55, while inventory days improved from 87.4 to 95.1 and account payable days decreased from 67.2 to 55.5 as of YE2014. The company's cash conversion cycle increased from 80 days to 87 days.

Figure 1: Fosun: Sales mix in 2014 (sales in Rmb'mn)



Source: Company reports.

Figure 2: Fosun: Segment profits and margins (Profit in Rmb 'mn)



Source: Company reports.

Model revisions

We are adjusting our model to reflect the disposal of retail drugstores to Sinopharm. We have also tweaked around selling expenses and administrative expenses to account for increasing R&D efforts. Our changes are summarized below.

Table 2: Model revisions

Year to Dec (Rmb 'mn)	New		Old		Change	
	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
Turnover	13,309	16,389	14,758	17,396	-9.8%	-5.8%
Gross profit	6,224	7,869	6,341	7,803	-1.9%	0.9%
EBIT	1,594	1,986	1,832	2,283	-13.0%	-13.0%
Net profit	2,184	2,620	2,186	2,569	-0.1%	2.0%
EPS (Rmb)	0.945	1.133	0.946	1.111	-0.1%	2.0%
Gross margin	46.8%	48.0%	43.0%	44.9%	3.8%	3.2%

Source: J.P. Morgan estimates

Investment Thesis, Valuation and Risks

Fosun Pharmaceutical - H (Overweight; Price Target: HK\$35.80)

Investment Thesis

Fosun is a leading Chinese healthcare company with business operations covering most of the important segments in the healthcare industry value chain. The Group has expanded rapidly through organic growth, M&A and strategic investments. The company owns about 30% of Sinopharm, which forms part of Fosun's core valuation. It has recently vastly expanded its manufacturing operations through aggressive acquisitions, including Jinzhou Aohong, which produces Aodejin, a top-5 best selling prescription drug in China. It has also aggressively been amassing hospital services assets, which allows the company to participate in a potentially very lucrative space.

Valuation

Our Dec-15 price target is HK\$35.8 implies a P/E multiple of 31x on 2015e EPS. To determine Dec-15 PT, we use a sum-of-the-parts analysis to value Fosun because of its complicated corporate structure. We segregate Fosun into three different groups of value-generating businesses: 1) its core businesses covering all its manufacturing and retailing businesses, mainly contributed by its majority-owned companies; 2) its associated companies in which Fosun owns a 25-50% stake with results not consolidated but the profit contribution showing up as associated income on the balance sheet; and 3) securities held for sale. We value these three parts quite differently.

	Per share
Core Businesses	22.2
Other Associated	10.6
Available-for-sale financial assets	2.6
Total SOTP Value	35.8

Source: J.P. Morgan estimates.

Risks to Rating and Price Target

Key risks to our rating and PT include 1) unfavourable government policies on prices of healthcare products and services, 2) failure to gain from any future M&A transactions in terms of yield synergies and growth, 3) difficulty in exiting minority investments due to unfavorable market conditions, 4) unexpected further delays in the launch of human insulin, and 5) penetrating private healthcare services and realizing target returns proving exceedingly difficult.

Fosun Pharmaceutical - H: Summary of Financials

Income Statement					Cash flow statement				
Rmb in millions, year end Dec	FY13	FY14	FY15E	FY16E	Rmb in millions, year end Dec	FY13	FY14	FY15E	FY16E
Revenues	9,161	11,523	13,746	16,037	EBIT	968	1,252	1,529	1,784
% change Y/Y	25.9%	25.8%	19.3%	16.7%	Depr. & amortization	606	768	727	785
Gross Profit	3,940	4,922	5,960	7,204	Change in working capital	(166)	(382)	(347)	(713)
% change Y/Y	25.0%	24.9%	21.1%	20.9%	Taxes	(53)	(431)	(519)	(636)
EBITDA	1,574	2,020	2,256	2,569	Cash flow from operations	1,150	963	1,110	901
% change Y/Y	55.6%	28.4%	11.7%	13.9%	Capex	(4,366)	(1,969)	(1,412)	(1,862)
EBIT	968	1,252	1,529	1,784	Net Interest	(360)	(395)	(458)	(489)
% change Y/Y	63.0%	29.4%	22.1%	16.7%	Other	325	409	437	509
EBIT Margin	10.6%	10.9%	11.1%	11.1%	Free cash flow	(2,928)	(693)	56	(573)
Net Interest	(360)	(395)	(458)	(489)	Equity raised/(repaid)	0	0	0	0
Earnings before tax	2,599	2,872	3,100	3,441	Debt raised/(repaid)	218	0	1,029	0
% change Y/Y	22.4%	10.5%	7.9%	11.0%	Other	0	941	0	(15)
Tax	(514)	(597)	(675)	(715)	Dividends paid	(201)	(321)	(413)	(577)
as % of EBT	19.8%	20.8%	21.8%	20.8%	Beginning cash	4,973	2,098	2,121	2,872
Net income (reported)	1,754	1,957	2,061	2,322	Ending cash	2,098	2,121	2,872	1,829
% change Y/Y	12.2%	11.5%	5.3%	12.7%	DPS	0.21	0.23	0.24	0.27
Shares outstanding	2,240	2,240	2,240	2,240					
EPS (reported)	0.78	0.87	0.92	1.04					
% change Y/Y	(1.8%)	11.5%	5.3%	12.7%					
Balance sheet					Ratio Analysis				
Rmb in millions, year end Dec	FY13	FY14	FY15E	FY16E	Rmb in millions, year end Dec	FY13	FY14	FY15E	FY16E
Cash and cash equivalents	2,098	2,121	2,872	1,829	Gross margin	43.0%	42.7%	43.4%	44.9%
Accounts receivable	1,168	1,268	1,350	1,425	EBITDA margin	17.2%	17.5%	16.4%	16.0%
Inventories	1,383	1,502	1,599	1,688	Operating margin	10.6%	10.9%	11.1%	11.1%
Others	2,935	4,240	5,580	7,565	Net margin	19.2%	17.0%	15.0%	14.5%
Current assets	7,584	9,131	11,400	12,506	Sales per share growth	10.1%	25.8%	19.3%	16.7%
LT investments	4,722	5,491	5,903	6,364	Sales growth	25.9%	25.8%	19.3%	16.7%
Net fixed assets	5,126	5,849	6,468	7,487	Net profit growth	12.2%	11.5%	5.3%	12.7%
Total Assets	28,200	31,198	34,458	37,006	EPS growth	(1.8%)	11.5%	5.3%	12.7%
Liabilities					Interest coverage (x)	4.4	5.1	4.9	5.3
Short-term loans	1,370	1,575	1,769	1,730	Net debt to equity	21.7%	24.8%	23.7%	26.0%
Payables	996	1,125	1,233	1,336	Working Capital to Sales	0.3	0.3	0.4	0.4
Others	2,440	2,555	2,768	3,045	Sales/assets	0.3	0.4	0.4	0.4
Total current liabilities	4,806	5,254	5,770	6,111	Assets/equity	1.9	1.9	1.9	1.9
Long-term debt	4,385	5,180	5,986	6,025	ROE	12.4%	12.6%	12.1%	12.4%
Other liabilities	2,147	2,088	2,118	2,103	ROCE	3.9%	4.6%	4.9%	5.3%
Total Liabilities	11,338	12,523	13,874	14,239					
Shareholders' equity	14,786	16,281	17,826	19,605					
BVPS	6.60	7.27	7.96	8.75					

Source: Company reports and J.P. Morgan estimates.

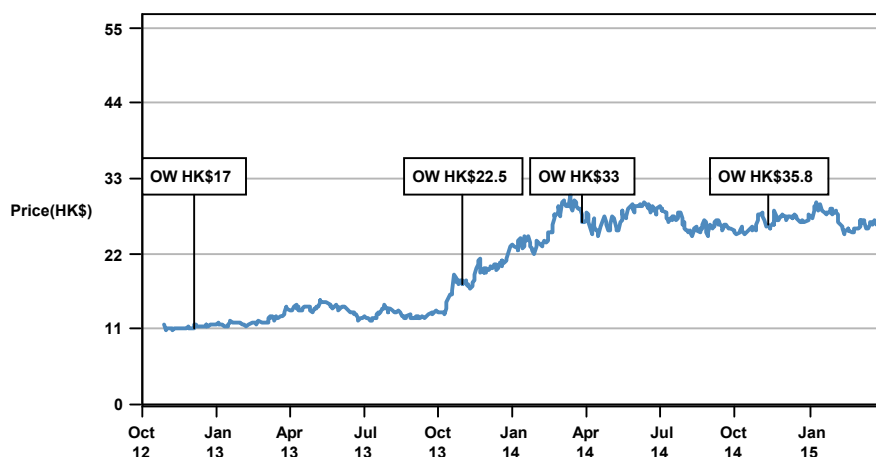
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Fosun Pharmaceutical - H (2196.HK, 2196 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
03-Dec-12	OW	11.20	17.00
31-Oct-13	OW	17.54	22.50
27-Mar-14	OW	26.70	33.00
10-Nov-14	OW	26.45	35.80

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Dec 03, 2012.

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