

Dedicated to health

14 Jul 2015

Investment Highlights

- ❖ **A prescription drug maker with an abundant range of products.** Lionco is primarily engaged in the R&D, manufacturing and sales of prescription drugs. As of end-Jan 2015, Lionco has obtained production licenses for 180 drugs under 84 major categories (preparations), underscoring its abundant range of products. CAGR of Lionco's revenue and net profit (attributable to the parent company) over the past three years were 10.7% and 25.7% respectively. A number of Lionco's major products are ranked amongst the top 3 (in terms of market shares) in China.
- ❖ **Strong growth momentum stemming from its product differentiation strategy and agency sales model.** Lionco focuses on differentiation and scarcity for its product line-up. Meanwhile, it also adopts an agency model (consolidating quality distributors) for its sales process, which enjoys advantages of: (i) avoiding intense competition that results in price wars and ensuring high profit margins on major products; (ii) a more flexible sales process by expertly consolidating its distributors. Not only does this boost Lionco's sales capability, it also shortens the time required to develop distribution channels after products are launched into the market; (iii) removing the earlier limitations of applications (for disease treatment) in Lionco's new product development, allowing the Company to dig deep into higher margin products which enjoy vast potential but less competition. This flexible sales mechanism facilitates Lionco in seizing opportunities in the rapidly growing domestic pharmaceuticals market, giving impetus to its future growth.
- ❖ **Major products are top ranked in the domestic market, expansion of the grassroots healthcare market to bring about rapid growth.** Currently, Lionco's products are divided into three major categories: (i) parenteral nutrition; (ii) anti-infective drugs; (iii) digestive medicine. Among which, its alanyl-glutamine and potassium sodium dehydroandrographolide succinate injections both hold second largest shares in their respective markets in China, while its omeprazole sodium injection commands the third largest market share. As its alanyl-glutamine and omeprazole sodium injections are manufactured using Lionco's core patents, these two products enjoy outstanding competitiveness and pricing power overall. Currently, 13 of Lionco's drugs are included in the National Essential Drugs Catalogue. Following expansion to the grassroots healthcare market on the back of policy rollouts (including graded diagnosis and treatment), a large number of Lionco's essential drugs (such as omeprazole sodium injection) will embrace fast growth, which catapults the Company's earnings onto the rapid growth track.



OVERWEIGHT

(Initial Coverage)

Current price: Rmb26.96

Target price: Rmb31.50

CITICS Research

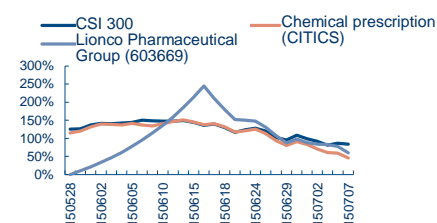
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Performance relative to the index



Source: CITICS Quantitative Investment Analysis System

Main data

CSI 300	3928
Total equity/shares o/s (mn)	260/65
LTM High/low (Rmb)	58.17/16.85
1-month absolute gain	-25.36%
6-month absolute gain	%
YTD Absolute gain	%
LTM Average daily turnover (Rmb mn)	246.87

- ❖ **Starting to reap dividends from its products in the pipeline, expected to witness a surge in sales over the coming years.** Lionco is currently applying for approvals of clinical trial or mass production for ~27 new drugs as well as 117 generic drugs. Lionco expects to progressively launch a number of high quality differentiated products over the next two years including acetylcysteine injection. We forecast these new products will boost Lionco's annual sales revenue by Rmb400mn-plus in the next five years. Meanwhile, leveraging on its core technology and patents in superfine crushing and development of new crystal forms, Lionco has developed a number of blockbuster drugs (such as prasugrel tablets/capsules) and these drugs will have market size of Rmb1.0bn-plus in the future. We anticipate that Lionco will start to reap dividends from the progressive launch of these new products over the next 3-5 years, which translates into steady growth for the Company.
- ❖ **Risks associated with investing in the Company:** (i) cuts to drug prices; (ii) fluctuations in raw material prices; (iii) new product launches falling short of expectations.
- ❖ **Earnings forecast, valuation and investment rating:** we are upbeat on the Lionco's model of competing with differentiated products in the generic preparations market and forecast its 2015-17E EPS to be Rmb0.75/0.94/1.16. Taking into account: (i) comparable are trading at average valuation of 38x prospective 2015E PER; (ii) competitive advantage stemming from product differentiation; (iii) vast market potential for its products in the pipelines, we apply a target price of Rmb31.50 (42x prospective 2015E PER) and initiate coverage with an OVERWEIGHT rating

Item/Year	2013	2014	2015E	2016E	2017E
Turnover (Rmb mn)	494	576	668	812	1019
Growth rate (YoY, %)	6	17	16	22	25
Net profit (Rmb mn)	115	150	194	244	301
Growth rate (YoY, %)	21	31	30	26	23
EPS (Rmb)	0.44	0.58	0.75	0.94	1.16
Gross margin (%)	59	61	60	60	60
ROE (%)	33	40	16	18	19
PE (x)	60	46	36	28	23
P/B(x)	15	14	6	5	4
EV/EBITDA(x)	47	37	30	25	18

Source: CITICS Quantitative Investment Analysis System

Note: Closing price as of 09 Jul 2015

Income Statement

(Rmb mn)

Indicator	2013	2014	2015E	2016E	2017E
Turnover	494	576	668	812	1,019
Operating cost	202	225	268	323	405
Gross margin	59.1%	60.9%	59.8%	60.2%	60.2%
Business tax & surcharge	5	7	8	10	12
Selling expense	69	79	93	113	142
Selling expense ratio	13.99%	13.71%	13.90%	13.90%	13.90%
Administrative expense	89	101	120	146	183
Administrative expense ratio	17.91%	17.49%	18.00%	18.00%	18.00%
Financial expense	-1	-2	-16	-30	-36
Financial expense ratio	-0.21%	-0.34%	-2.35%	-3.66%	-3.52%
Investment revenue	1	1	0	0	0
Operating profit	130	164	195	249	312
Operating profit margin	26.30%	28.44%	29.12%	30.70%	30.61%
Non-operating income	24	23	20	20	20
Non-operating expenditure	1	1	1	1	1
Total profit	153	185	214	268	331
Income tax	38	35	19	24	30
Income tax rate	25.0%	19.0%	9.0%	9.0%	9.0%
Minority interests	0	0	0	0	0
Net profit attributable to shareholders	115	150	194	244	301
Net margin	23.23%	26.00%	29.08%	30.06%	29.55%
EPS (Rmb, diluted)	0.44	0.58	0.75	0.94	1.16

Cash Flow Statement

(Rmb mn)

Indicator	2013	2014	2015E	2016E	2017E
Net profit	115	150	194	244	301
Minority interests	0	0	0	0	0
Depreciation & amortization	20	28	36	36	60
Change in working capital	26	2	-17	0	14
Others	0	2	-16	-29	-35
Operating cash flow	161	181	197	251	339
CAPEX	-104	-117	-109	-139	-3
Investment revenue	1	1	0	0	0
Disposal of assets	146	306	0	0	0
Others	-158	-281	0	0	0
Investing cash flow	-115	-90	-109	-139	-3
Stock issuance	0	0	687	0	0
Change in liabilities	0	3	0	0	0
Dividend paid	0	0	-58	-73	-90
Others	0	-133	16	30	36
Financing cash flow	0	-130	645	-44	-54
Net increase in cash and equivalent	46	-39	733	68	282

Balance Sheet

(Rmb mn)

Indicator	2013	2014	2015E	2016E	2017E
Cash and cash equivalent	151	82	815	883	1,165
Inventory	75	79	94	113	142
Accounts receivable	3	5	6	7	9
Other current assets	40	19	37	54	64
Current assets	270	184	952	1,058	1,381
Fixed assets	253	256	235	210	394
Long-term equity investment	0	0	0	0	0
Intangible assets	28	47	44	41	38
Other long-term assets	31	72	170	302	64
Non-current assets	313	376	449	552	496
Total assets	582	560	1,401	1,610	1,876
Short-term borrowing	0	0	0	0	0
Accounts payable	63	51	60	72	91
Other current liabilities	153	117	125	151	188
Current liabilities	215	168	185	224	279
long-term liabilities	0	0	0	0	0
Other long-term liabilities	16	18	18	18	18
Non-current liabilities	16	18	18	18	18
Total liabilities	231	186	203	241	297
Share capital	195	195	260	260	260
Capital reserve	9	9	632	632	632
Owner's equity	351	374	1,198	1,369	1,579
Minority interests	0	0	0	0	0
Liabilities & owner's equity	582	560	1,401	1,610	1,876

Indicator	2013	2014	2015E	2016E	2017E
Growth rate (%)					
Turnover	5.54	16.62	15.90	21.58	25.45
Operating profit	4.66	26.08	18.68	28.19	25.10
Net profit	20.62	30.54	29.65	25.68	23.32
Margin (%)					
Gross margin	59.11	60.89	59.83	60.18	60.25
EBIT Margin	26.12	28.53	26.76	27.11	27.18
EBITDA Margin	30.14	33.43	32.09	31.54	33.03
Net margin	23.23	26.00	29.08	30.06	29.55
Return (%)					
ROE	32.70	40.06	16.22	17.84	19.07
ROA	19.72	26.77	13.87	15.17	16.05
Others (%)					
Liability/asset ratio	39.70	33.17	14.50	15.00	15.83
Income tax rate	24.97	19.01	9.00	9.00	9.00
Dividend payout ratio	0.00	0.00	30.00	30.00	30.00

Source: CITICS Quantitative Investment Analysis System

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		HOLD	Increase relative to market representative index between -10% and 5%
		SELL	Decrease relative to market representative index over 10%
	Industry ratings	OUTPERFORM	Increase relative to market representative index over 10%
		NEUTRAL	Increase relative to market representative index between -10% and 10%
		UNDERPERFORM	Decrease relative to market representative index over 10%

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