

2 February 2018

Outperform Upgrade

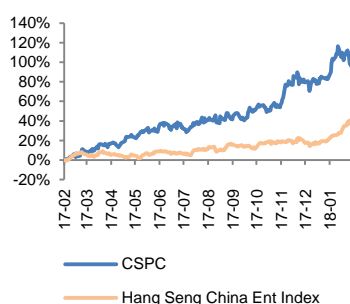
Strong pipeline

CSPC PHARMACEUTICAL GROUP (1093:HK)

Market Data: February, 1

Closing Price (HK\$)	17.06
Price Target (HK\$)	19.50
HSCEI	13,434
HSCCI	4,809
52-week High/Low (HK\$)	18.70/8.51
Market Cap (US\$m)	13,622
Market Cap (HK\$m)	106,506
Shares Outstanding (m)	6,243
Exchange Rate (Rmb-HK\$)	1.24

Price Performance Chart:



Source: Bloomberg

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Related Reports

"Antibody acquisition-CSPC Pharmaceutical Group (1093:HK)" January 11, 2018

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Financial summary and valuation

	2015	2016	2017E	2018E	2019E
Revenue (HK\$ m)	11,393.73	12,369.04	15,066.55	17,749.45	20,858.82
YoY (%)	4.00	8.56	21.81	17.81	17.52
Net income (HK\$ m)	1,665.27	2,100.85	2,745.30	3,463.93	4,458.72
YoY (%)	31.28	26.16	30.68	26.18	28.72
EPS (HK\$)	0.28	0.35	0.44	0.55	0.71
Diluted EPS (HK\$)	0.28	0.35	0.44	0.55	0.71
ROE (%)	19.80	22.30	22.55	22.55	24.86
Debt/asset (%)	34.91	30.95	23.06	20.90	18.92
Dividend Yield (%)	0.64	0.70	0.90	1.14	1.47
PE (x)	60.53	48.40	38.80	30.75	23.89
PB (x)	11.44	9.98	7.43	6.42	5.46
EV/Ebitda (x)	36.62	31.36	24.74	20.19	16.12

Note: Diluted EPS is calculated as if all outstanding convertible securities, such as convertible preferred shares, convertible debentures, stock options and warrants, were exercised.

Considering the strong growth momentum of CSPC Pharmaceutical Group's oncology drugs and the upcoming launch of new products, we maintain our diluted EPS forecasts of HK\$0.44 in 17E (+26% YoY) and HK\$0.55 in 18E (+25% YoY), and revise up our forecast from HK\$0.66 to HK\$0.71 in 19E (+29% YoY). Given the improved outlook for new drug launches, we raise our target price from HK\$16.50 to HK\$19.50, representing 35x 18E PE and 27x 19E PE. With 14% upside, we upgrade our rating from Hold to Outperform.

Sustainable growth for NBP. We note sales of *NBP* (butylphthalide), indicated for the treatment of acute ischemic stroke, face pressure in large hospitals due to limitations on basic medical insurance expenditure. Nevertheless, we think penetration of lower-tier markets will continue to drive the growth of *NBP*. To date, *NBP* capsules are distributed in about 220 cities (c.70% of Chinese cities) and 426 counties (c.15% of all counties), while *NBP* injection is distributed in about 160 cities (c.50% of all cities) and 280 counties (c.10% of all counties). This indicates that *NBP* still has substantial expansion potential in lower-tier markets. In terms of sales in sample hospitals, *NBP* ranks seventh among best-selling nervous system drugs. Its main competing drugs are recognised as adjuvant drugs by Chinese authorities due to their unclear clinical benefits. We expect *NBP* to gain market share from adjuvant drugs. As such, we forecast sales of *NBP* to grow at a 30% Cagr in 2017-19E.

Strong momentum for oncology drugs. *Jinyouli* (PEG-rhG-CSF injection) was added to China's new national reimbursement drug list (NRDL) in 2017, which we believe will significantly stimulate its sales growth. In Chinese sample hospitals, long-acting G-CSF products only represented 32% of the market in 9M17, indicating significant room for market share gain. We forecast sales of *Jinyouli* to increase at a 90% Cagr in 2017-19E, and reach HK\$1.0bn in 19E. Looking at sales in sample hospitals, CSPC occupied a 58% share in the doxorubicin liposome market in 9M17. As it gains market share, we expect *Duomeisu* to grow at a 41% Cagr in 2017-19E, and reach HK\$1.0bn in 19E. In addition, CSPC's albumin-bound form of paclitaxel injection may obtain China Food and Drug Administration's (CFDA) approval in 1Q18, becoming the first-to-market albumin-bound paclitaxel generic in China. We think peak sales of CSPC's albumin-bound paclitaxel will reach c.Rmb1.6bn by 2024E.

Upcoming generic drug approvals. We expect CSPC to receive CFDA's approval for nine generic drugs in 18E, including albumin-bound paclitaxel injection, bortezomib injection, sunitinib capsule, dasatinib tablet, dronedarone tablet, ticagrelor tablet, clopidogrel tablet, pramipexole tablet, and metformin sustained release tablet.

Upgrade to Outperform. Considering the strong growth of CSPC's oncology drugs and the launch of new products, we maintain our diluted EPS forecasts of HK\$0.44 in 17E (+26% YoY) and HK\$0.55 in 18E (+25% YoY), and revise up our forecast from HK\$0.66 to HK\$0.71 in 19E (+29% YoY). Given the improved outlook for new product launches, we raise our target price from HK\$16.50 to HK\$19.50 (35x 18E PE and 27x 19E PE). With 14% upside, we upgrade our rating from Hold to Outperform.

投资要点：

恩必普维持高速增长。我们认为受医保控费的影响，恩必普在个别规模较大医院的销售或将面临压力。然而，基层市场渗透率的提升将进一步拉动恩必普销售额的高速增长。目前，恩必普胶囊的销售渠道覆盖了约 220 个地级市（约占全国地级市总体数量的 70%），以及 426 个县（约占全国县镇数量的 15%）。此外，恩必普注射剂的销售渠道覆盖了约 160 个地级市（约占全国地级市总体数量的 50%）和 280 个县（约占全国县镇数量的 10%）。我们认为，未来恩必普向基层市场渗透的空间很大。样本医院数据显示，目前恩必普是神经科第七大西药品种，其竞争品种大多为辅助用药。我们认为，未来恩必普将会进一步抢夺辅助用药的市场份额。我们预计恩必普的销售额于 17-19 年实现 30% 的复合增长。

抗肿瘤药强势崛起。津优力（聚乙二醇化重组人粒细胞刺激因子）被纳入 2017 版国家医保目录，将显著提升该产品的销售增长。国内样本医院数据显示，17 年前三季度，长效粒细胞刺激因子占整体粒细胞刺激因子的市场份额仅为 32%，显示未来长效产品的份额提升空间较大。我们预计津优力的销售额于 17-19 年的复合增速达到 90%，或将于 2019 年达到 10 亿港币销售额。样本医院数据显示，17 年前三季度，多美素在多柔比星脂质体的市场份额为 58%。我们预计多美素未来将继续抢夺竞争对手的市场份额，其销售额有望于 17-19 年达到 41% 的复合增速，有望于 2019 年实现 10 亿港币销售额。此外，我们预计公司的注射用紫杉醇（白蛋白结合型）或将于今年一季度获得 CFDA 的上市批准，成为国内首仿产品。我们预计，公司的注射用紫杉醇（白蛋白结合型）有望于 2024 年达到峰值销售额 16 亿元。

众多仿制药即将获批。9 个仿制药或将于 18 年获批上市，包括注射用紫杉醇（白蛋白结合型）、硼替佐米注射液、舒尼替尼胶囊、达沙替尼片、决奈达隆片、替格瑞洛片、氯吡格雷片、普拉克索片和二甲双胍缓释片。

上调评级至增持。考虑到肿瘤药销售额的强劲增长以及新产品上市的正面影响，我们维持 17 年稀释每股盈利为 0.44 港币（同比增长 26%），18 年稀释每股盈利 0.55 港币（同比增长 25%），将 19 年稀释每股盈利从 0.66 港币上调至 0.71 港币（同比增长 29%）。考虑到新产品上市的正面影响，我们将目标价从 16.50 港币上调至 19.50 港币，对应 35 倍 18 年市盈率和 27 倍 19 年市盈率。目标价对应 14% 的上涨空间，我们将评级由中性上调至增持。

Sustainable growth for *NBP*

NBP (butylphthalide) is CSPC’s flagship drug, mainly used for the treatment of acute ischemic stroke. Sales of *NBP* increased 33% YoY in 9M17, with the soft capsule formulation growing 26% YoY and the injection formulation increasing 41% YoY. In 9M17, the injection formulation accounted for 49% of total *NBP* sales.

NBP soft capsule was included in the NRDL as a type-2 drug in 2009, while *NBP* injection was added to the new NRDL in 2017. According to our checks, to date, 28 out of the 31 provinces have already implemented the new NRDL. We expect expansion in reimbursement coverage to further stimulate sales of *NBP* injection from 4Q17 on.

Looking at sample hospitals, sales of *NBP* grew 15% YoY in 9M17. We note sales of *NBP* face pressure in large hospitals due to limitations on basic medical insurance expenditure. Nevertheless, we think penetration of lower-tier markets will continue to drive the growth of *NBP*. To date, *NBP* capsules are distributed in about 220 cities (c.70% of China’s cities) and 426 counties (c.15% of all counties), while *NBP* injection is distributed in about 160 cities (c.50% of all cities) and 280 counties (c.10% of all counties). In addition, *NBP* capsule has entered c.2,000 hospitals, while *NBP* injection has penetrated into c.1,000 hospitals. As of 2016, China had a total of 2,232 class-3 hospitals, 7,944 class-2 hospitals, and 9,282 class-1 hospitals. This indicates that *NBP* still has substantial expansion potential in lower-tier markets.

In terms of sales in sample hospitals, *NBP* ranks seventh among best-selling nervous system drugs. Its main competing drugs are recognised as adjuvant drugs by Chinese authorities due to their unclear clinical benefits. We expect *NBP* to gain market share from adjuvant drugs. *NBP*’s market share in sample hospitals climbed from 2.2% in 2012 to 4.9% in 9M17.

Fig 1: Market share of nervous system drugs in sample hospitals (2012-9M17)

	2012	2013	2014	2015	2016	9M17
Monosialotetrahexosyl ganglioside sodium 单唾液酸四己糖神经节苷脂	14.3%	13.6%	13.0%	12.5%	11.2%	9.7%
Oxiracetam 奥拉西坦	10.3%	10.0%	9.8%	10.0%	9.5%	8.4%
Dezocine 地佐辛	2.8%	3.8%	4.5%	5.3%	6.2%	7.5%
Mouse nerve growth factor 鼠神经生长因子	5.1%	5.1%	5.6%	6.1%	6.5%	6.0%
Edaravone 依达拉奉	6.0%	5.3%	5.2%	5.1%	5.4%	5.4%
Deproteinized hemoderivative of calf blood 小牛血去蛋白提取物	8.9%	9.4%	9.2%	7.6%	5.8%	5.2%
Butylphthalide 丁苯酞	2.2%	2.6%	3.1%	3.6%	4.3%	4.9%
Ginkgo leaves injection 银杏叶	8.9%	7.6%	6.7%	5.5%	4.9%	4.5%
Cattle encephalon glycoside and ignotin 脑苷肌肽	3.3%	4.7%	5.2%	5.0%	4.9%	4.4%
Vinpocetine 长春西汀	4.5%	4.0%	3.7%	3.5%	3.4%	3.2%

Source: Pharma Database, SWS Research

Tender prices for *NBP* injection have remained stable. *NBP* injection was subject to an 8% price cut in tenders in Shanxi and Hubei, a 6% price cut in Kweichow, and a 5% price cut in Inner Mongolia. In addition, *NBP* soft capsule was subject to a 10-20% price cut in seven regions, including Heilongjiang, Jiangsu, Hubei, and Ningxia. Since most provinces have completed their new tenders in 2017, we see less than 5% downside in *NBP*’s average selling price in 18E.

Fig 2: Tender prices for *NBP* injection (25mg per bottle, 2011-present)

	2011	2012	2013	2014	2015	2016	2017	% Change
Shanxi	312						285	-8%
Hubei			310				285	-8%
Kweichow	305						287	-6%
Inner Mongolia	305					291		-5%
Shandong	298					294		-1%

Source: Yaozh.com, SWS Research

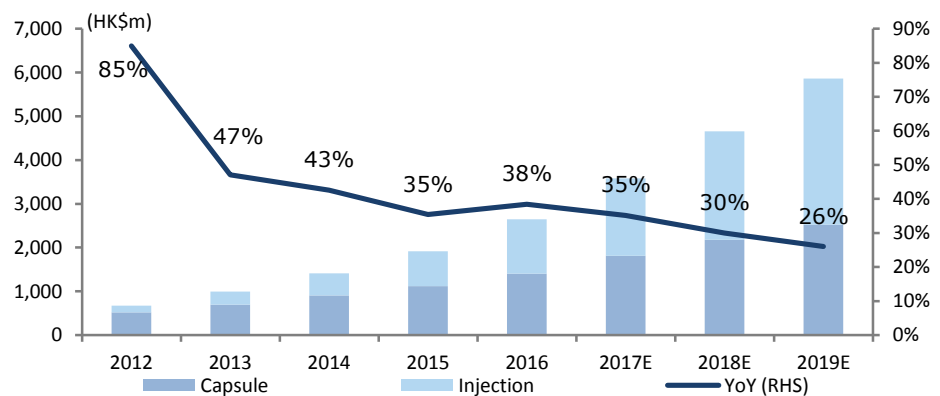
Fig 3: Tender prices for *NBP* soft capsule (100mg*24, 2008-present)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	% Change
Heilongjiang	239									188	-21%
Jiangsu			219							186	-15%
Hubei								217		186	-14%
Ningxia								216		186	-14%
Tianjin						216				186	-14%
Guangdong									213	190	-11%
Inner Mongolia				236						211	-10%
Shandong				217						199	-8%
Fujian								198		184	-7%
Jiangxi			230							217	-6%
Guangxi				224						217	-3%
Shanghai									199	198	-1%
Zhejiang								186		186	0%
Sichuan								207		207	0%

Source: Yaozh.com, SWS Research

Thanks to its distribution in lower-tier markets, reimbursement expansion for *NBP* injection, and steady selling prices, we forecast sales of *NBP* to grow at a 30% Cagr in 2017-19E.

Fig 4: Sales of *NBP* (2012-2018E)



Source: Company data, SWS Research

Strong momentum for oncology drugs

CSPC's oncology drug portfolio mainly includes *Duomeisu* (doxorubicin hydrochloride liposome), *Jinyouli* (PEG-rhG-CSF injection), *Ailineng* (elemene injection), and *Nuolining* (imatinib mesylate tablet). Oncology drug sales rallied by 73% YoY to HK\$713m in 9M17, mainly driven by *Jinyouli* (168% YoY growth) and *Duomeisu* (44% YoY growth).

Jinyouli (PEG-rhG-CSF injection) is the first-to-market long-acting granulocyte colony-stimulating factor (G-CSF) in China, which is used for the prevention of leucopenia and infection induced by chemotherapy. *Jinyouli* was added to the new NRDL in 2017, which will significantly stimulate its sales growth. We note only two domestic pharmaceutical manufacturers have launched long-acting G-CSF, namely CSPC and Qilu Pharma. We believe competition remains mild in that segment.

The global G-CSF market is largely dominated by long-acting products, accounting for c.84% of the market in 2016. However, in Chinese sample hospitals, long-acting G-CSF products only represented 32% of the market in 9M17, indicating significant room for market share gain. We forecast sales of *Jinyouli* to increase at a 90% Cagr in 2017-19E and reach HK\$1.0bn in 19E.

Fig 5: Global G-CSF market breakdown (2016)

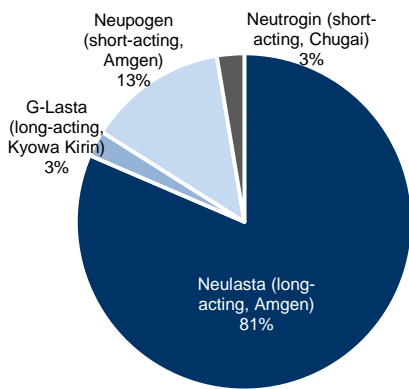
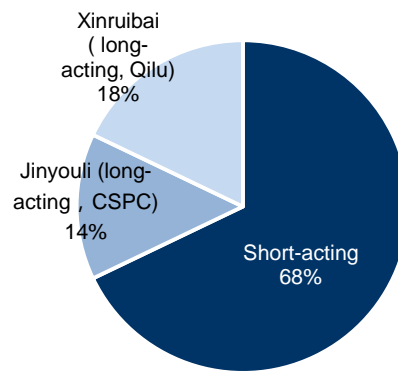


Fig 6: G-CSF sales in sample hospitals (9M17)

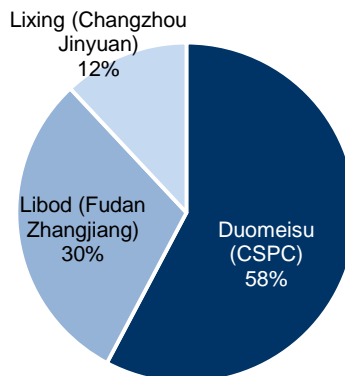


Source: Pharma Database, SWS Research

Source: Pharma Database, SWS Research

According to sales in sample hospitals, CSPC occupied a 58% share in the Chinese doxorubicin liposome market in 9M17. In December 2017, Shanghai Fudan-Zhangjiang Bio-Pharmaceutical (1349:HK – N-R) terminated its distribution agreement for *Libod* with China NT Pharma Group (1011:HK – N-R). As it will take time for Fudan Zhangjiang to build its sales team for *Libod*, we see a good opportunity for CSPC to further expand *Duomeisu's* share in the Chinese doxorubicin liposome market. We expect sales of *Duomeisu* to increase at a 41% Cagr in 2017-19E, and reach HK\$1.0bn in 19E.

Fig 7: Market share of doxorubicin liposome (9M17)



Source: Pharma database, SWS Research

In addition, CSPC’s albumin-bound form of paclitaxel injection is pending CFDA’s final approval. We expect the drug to obtain CFDA’s approval in 1Q18, becoming the first-to-market albumin-bound paclitaxel generic in China. Another four domestic players have filed abbreviated new drug applications (ANDAs) to the CFDA, namely Jiangsu Hengrui Medicine (600276:CH – BUY), Qilu Pharma, Yangtze River Pharma, and Jiangsu Kanghe Biologics.

Abraxane, the original drug developed by Celgene (CELG:US), was approved by the CFDA for the treatment of metastatic breast cancer after failure of combination chemotherapy or relapsed breast cancer within six months of adjuvant chemotherapy. The US FDA also approved *Abraxane* for the treatment of locally advanced or metastatic non-small cell lung cancer (NSCLC), as first-line treatment in combination with carboplatin, in patients who are not candidates for curative surgery or radiation therapy, and metastatic adenocarcinoma of the pancreas as first-line treatment, in combination with gemcitabine.

There are four types of paclitaxel products, including conventional paclitaxel, docetaxel, paclitaxel liposome, and albumin-bound paclitaxel. *Abraxane* is superior to other forms of paclitaxel products due to much lower incidence of hypersensitivity reactions, while other paclitaxel products require premedication in order to prevent hypersensitivity reactions. However, the treatment cost for *Abraxane* is relatively expensive (c.Rmb23,000 per treatment cycle vs Rmb7,328 per treatment cycle on average for paclitaxel liposome).

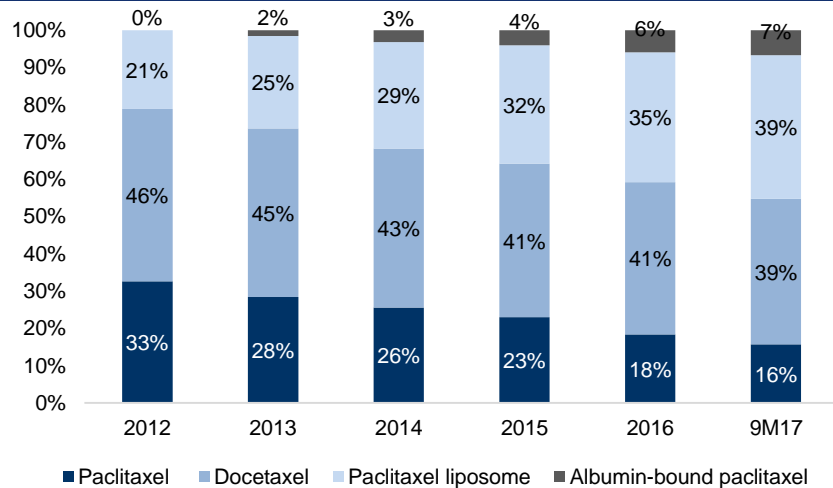
Fig 8: Comparison of paclitaxel products in China

Generic name	Brand name	Manufacturer	Status	Year of CFDA approval	Indication	Average tender price (Rmb per dose)	Cost per treatment cycle	Reimbursement coverage	Comments
Paclitaxel	Taxol	BMS	Original drug	2002	Ovarian cancer, breast cancer, NSCLC	Rmb839 per 30mg	Rmb7,551	NRDL Type 1	Complicated premedication due to high incidence of hypersensitivity reactions, other side effects such as peripheral neuropathy, arthralgias, myalgias and neutropenia, prepared and infused using non-PVC infusion consumables, 3 hour infusion
	Fuwang	Yangtze River Pharma	Generic	2005		Rmb176 per 30mg	Rmb1,584		
Docetaxel	Taxotere	Sanofi	Original drug	1998	Breast cancer, NSCLC	Rmb1,445 per 20mg	Rmb8,670	NRDL Type 2	Premedication needed 12 hours before administration due to high incidence of hypersensitivity reactions, 1 hour infusion
	Aisu	Jiangsu Hengrui	Generic	2002		Rmb364 per 20mg	Rmb2,184		
Paclitaxel liposome	Lipusu	Luye Pharma	Patent drug	2003	Ovarian cancer, breast cancer, NSCLC	Rmb916 per 30mg	Rmb7,328	26 PRDLs	Simple premedication, low incidence of hypersensitivity reactions, selective accumulation in tumours, long duration, 3 hour infusion
Albumin-bound paclitaxel	Abraxane	Celgene	Original drug	2009	Breast cancer	Rmb5,739 per 100mg	Rmb22,956	2 PRDLs (limited to metastatic or relapsed breast cancer)	No premedication needed, selective accumulation in tumours, 30 minutes infusion

Source: Yaozh, Pharma Database, SWS Research

Abraxane has gained market share from conventional paclitaxel products since 2012, with market share by revenue in sample hospitals rising from 0% in 2012 to 7% in 9M17. In terms of market share by volume in sample hospitals, *Abraxane* occupied c.1% as of 9M17, indicating substantial potential for market share gain in the future.

Fig 9: Market share by revenue of paclitaxel products (2012-9M17)



Source: Pharma database, SWS Research

We think albumin-bound paclitaxel will be used off-label for the treatment of NSCLC as this indication is approved by the US FDA. According to a research article, “Cancer statistics in China, 2015”, China’s new incidence of breast cancer reached c.272,400 in 2015, and c.733,300 for lung cancer. Assuming the penetration rate of albumin-bound paclitaxel among late-stage breast cancer patients and NSCLC patients reaches 15% and 12%, respectively, and CSPC takes a 30% market share in the Chinese albumin-bound paclitaxel market, we expect peak sales of CSPC’s albumin-bound paclitaxel to reach c.Rmb1.6bn by 2024E.

Fig 10: Sales projection for CSPC’s albumin-bound paclitaxel

	2018E	2019E	2020E	2021E	2022E	2023E	2024E
Incidence of breast cancer in China (ppl)	272,400	280,572	288,989	297,659	306,589	315,786	325,260
Metastatic or relapsed breast cancer as % of total breast cancer	35.00%	35.00%	35.00%	35.00%	35.00%	35.00%	35.00%
Penetration rate of albumin-bound paclitaxel among metastatic or relapsed breast cancer patients	3.00%	6.00%	11.00%	13.00%	14.00%	14.50%	15.00%
Incidence of lung cancer in China (ppl)	730,000	751,900	774,457	797,691	821,621	846,270	871,658
NSCLC as % of total lung cancer	85.00%	85.00%	85.00%	85.00%	85.00%	85.00%	85.00%
Stage III & IV patients as % of total NSCLC	70.00%	70.00%	70.00%	70.00%	70.00%	70.00%	70.00%
Penetration rate of albumin-bound paclitaxel among stage III & IV NSCLC patients	2.00%	5.00%	8.00%	10.00%	11.00%	11.50%	12.00%
Number of patients receiving albumin-bound paclitaxel (ppl)	11,547	28,261	47,990	61,006	68,798	73,932	79,313
Yearly treatment cost of receiving albumin-bound paclitaxel (Rmb)	96,415	93,523	90,717	87,996	85,356	82,795	80,311
CSPC’s market share in Chinese albumin-bound paclitaxel market	20.00%	23.0%	26.00%	27.00%	28.00%	29.00%	30.00%
Annual net sales of albumin-bound paclitaxel (Rmbm)	190	520	967	1,239	1,405	1,517	1,633

Source: Company data, SWS Research

We forecast sales of CSPC’s oncology drugs to grow at a 71% Cagr in 2017-19E, and reach HK\$2.8bn in 19E.

Strong R&D pipeline

CSPC has around 170 drugs under development, including 18 class-1 drugs (ie, patent drugs) and 18 drugs pending ANDA review by the US FDA.

We expect CSPC to receive CFDA’s approval for nine generic drugs in 18E, including albumin-bound paclitaxel injection, bortezomib injection, sunitinib capsule, dasatinib tablet, dronedarone tablet, ticagrelor tablet, clopidogrel tablet, pramipexole tablet, and metformin sustained release tablet.

Fig 11: Selected drug pipeline

Generic name	Generic name in Chinese	Status	Indication	Expected time of approval	Comments
Oncology					
Paclitaxel injection (albumin-bound)	注射用紫杉醇 (白蛋白结合型)	First-to-market generic	Breast cancer	1Q18	Fast track (优先审评)
Bortezomib injection	硼替佐米注射剂	Generic	Multiple myeloma	End-18	
Sunitinib malate capsule	苹果酸舒尼替尼胶囊	First-to-market generic	Gastrointestinal stromal tumor, Renal cell carcinoma	2018	
Dasatinib tablet	达沙替尼片	Generic	Philadelphia chromosome positive chronic myelogenous leukemia	End-18	
CCV					
Dronedrone hydrochloride tablet	盐酸决奈达隆片	First-to-market generic	Anti-arrhythmia	End-18	Fast track (优先审评); National Major Scientific and Technological Project for New Drugs Development (重大专项)
Ticagrelor tablet	替格瑞洛片	Generic	Acute coronary syndrome	2018	
Clopidogrel hydrogen sulphate tablet	硫酸氢氯吡格雷片	Generic	Anti-thrombus	2018	Fast track (优先审评)
CNS					
Pramipexole Dihydrochloride tablet	盐酸普拉克索片	Generic	Parkinson's disease	2018	
Diabetes					
Metformin hydrochloride sustained-release tablet	盐酸二甲双胍缓释片	Generic	Diabetes	2018	Fast track (优先审评)

Source: Company data, SWS Research

CSPC plans to conduct bioequivalence tests for c.44 drugs, including 32 essential drugs and 12 non-essential drugs. To date, CSPC has already submitted equivalence evaluation applications to the CFDA for four generics, including azithromycin tablet, tramadol hydrochloride tablet, captopril tablet, and enalapril maleate tablet.

Fig 12: Equivalence evaluation of CSPC's generic drugs

Generic name	Generic name in Chinese	Indication	Progress	Expected time of approval for equivalence evaluation	Total sales in sample hospitals (9M17)
Azithromycin tablet	阿奇霉素片	Infection	Supplementary materials required	1H18	Rmb344m
Tramadol hydrochloride tablet	盐酸曲马多片	Cancer pain, post-operation pain, etc.	Supplementary materials required	1H18	Rmb48m
Captopril tablet	卡托普利片	Hypertension, heart failure	Supplementary materials required	1H18	Rmb5m
Enalapril maleate tablet	马来酸依那普利片	Hypertension, heart failure	Under review	2H18	Rmb11m

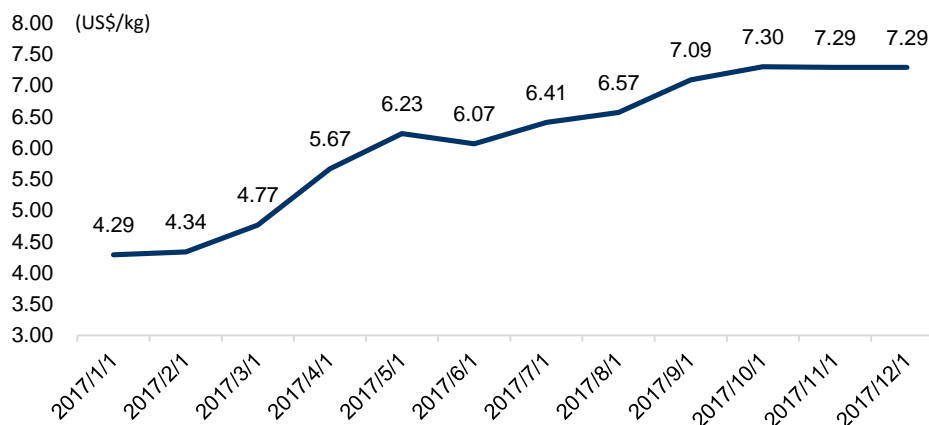
Source: Company data, SWS Research

In addition, as we expect CSPC to carry out more clinical trials for new drug developments and invest more in equivalence evaluation for generic drugs, we forecast its research and development (R&D) expense to sales ratio to increase from 3.3% in 16A to 5.3% in 17E, 6.8% in 18E, and 6.7% in 19E.

Vitamin C business

According to data from Healthoo.com, the average export price of vitamin C rose from US\$4.3/kg in January 2017 to US\$7.3/kg in December 2017. CSPC is the largest vitamin C supplier in China with annual capacity of c.45,000t. Other major domestic vitamin C producers include Shandong Luwei Pharma, DSM Jiangshan Pharmaceutical, Northeast Pharmaceutical Group (000597:CH – N-R), and Shandong Tianli Pharma (a subsidiary of Shandong Lianmeng Chemical Group).

Fig 13: Average export price of vitamin C



Source: Healthoo.com, SWS Research

Due to margin recovery in 2017, we expect increasing competition from new entrants in the future. Anhui Tiger Biotech has 33,000t of vitamin C capacity under construction and its new capacity may commence operation in 1H18. According to our calculation, the new capacity under construction represents c.40% of China’s existing capacity.

Fig 14: Supply of vitamin C

Company name	Capacity (tons, estimated)	As % of total existing capacity
Existing capacity	185,000	100%
CSPC	45,000	24%
Shandong Luwei Pharmaceutical	30,000	16%
DSM Jiangshan Pharmaceutical	25,000	14%
Northeast Pharmaceutical (000597:CH)	20,000	11%
Shandong Tianli Pharma	15,000	8%
Others	50,000	27%
New capacity	67,800	37%
Anhui Tiger Biotech	33,000	18%
Qiyuan Pharmaceutical	9,800	5%
Lvyuan Pharmaceutical	15,000	8%
Zhengzhou Tuoyang Pharmaceutical	10,000	5%

Source: Healthoo.com, Company data, SWS Research

The operating profit of CSPC’s vitamin C business surged from HK\$3.5m in 9M16 to HK\$408m in 9M17. Considering the expansion in supply, we expect the spot price of vitamin C to slightly retreat in 18E. Nevertheless, we think the price for long-term orders, which account for c.40% of total sales volume, will remain at c.US\$6.5/kg in 18E. Therefore, we forecast the operating profit of the vitamin C business to reach HK\$523m in 17E, HK\$537m in 18E, and HK\$476m in 19E.

Solid earnings outlook

Considering the strong growth momentum of CSPC Pharmaceutical Group’s oncology drugs and the upcoming launch of new products, we maintain our diluted EPS forecasts of HK\$0.44 in 17E (+26% YoY) and HK\$0.55 in 18E (+25% YoY), and revise up our forecast from HK\$0.66 to HK\$0.71 in 19E (+29% YoY). Given the improved outlook for new drug launches, we raise our target price from HK\$16.50 to HK\$19.50, representing 35x 18E PE and 27x 19E PE. With 14% upside, we upgrade our rating from Hold to Outperform.

APPENDIX

Consolidated Income Statement					
(HK\$m)	2015	2016	2017E	2018E	2019E
Revenue	11,394	12,369	15,067	17,749	20,859
Cost of Sales	(6,173)	(6,060)	(6,144)	(6,745)	(7,509)
Gross Profit	5,221	6,309	8,922	11,005	13,350
Other Income	87	107	100	118	138
Selling/General/Admin. Expenses	(2,802)	(3,342)	(4,705)	(5,485)	(6,383)
EBITDA	2,772	3,237	4,102	5,028	6,296
EBIT	2,166	2,649	3,490	4,395	5,645
Finance Costs	(56)	(42)	(36)	(29)	(22)
Profit before tax	2,112	2,635	3,464	4,376	5,633
Income tax expense	(432)	(522)	(706)	(897)	(1,155)
Minority interests	(14)	(12)	(12)	(15)	(19)
Profit for the year	1,665	2,101	2,745	3,464	4,459

Source: Company data, SWS Research

Consolidated Cash Flow Statement					
(HK\$m)	2015	2016	2017E	2018E	2019E
Profit before taxation	2,112	2,635	3,464	4,376	5,633
Plus : Depr. and amortisation	605	588	613	633	651
Finance cost	56	42	36	29	22
Losses from investments	0	0	0	0	0
Change in working capital	(46)	219	(955)	(575)	(673)
Others	(478)	(567)	(743)	(926)	(1,177)
CF from operating activities	2,249	2,916	2,415	3,536	4,455
CAPEX	(758)	(1,090)	(800)	(800)	(800)
Other CF from investing activities	35	(242)	0	0	0
CF from investing activities	(723)	(1,332)	(800)	(800)	(800)
Equity financing	0	0	2,345	0	0
Net change in liabilities	263	(283)	(200)	(200)	(200)
Dividend and interest paid	(591)	(650)	(961)	(1,212)	(1,561)
Other CF from financing activities	(265)	481	0	0	0
CF from financing activities	(592)	(452)	1,184	(1,412)	(1,761)
Net cash flow	934	1,132	2,799	1,324	1,895
FCFF	1,535	1,844	1,641	2,756	3,668
FCFE	1,742	1,519	1,405	2,526	3,445

Source: Company data, SWS Research

Consolidated Balance Sheet					
(HK\$m)	2015	2016	2017E	2018E	2019E
Current Assets	7,648	8,428	12,109	14,298	17,236
Bank balances and cash	2,299	3,235	6,034	7,357	9,252
Trade and other receivables	1,878	1,835	2,477	2,918	3,429
Inventories	1,819	1,933	1,936	2,088	2,304
Other current assets	1,651	1,425	1,663	1,935	2,250
Long-term investment	28	172	172	172	172
PP&E	5,143	5,415	5,638	5,840	6,021
Intangible and other assets	722	746	710	676	644
Total Assets	13,540	14,760	18,629	20,986	24,072
Current Liabilities	3,484	4,085	3,812	3,902	4,071
Borrowings	452	898	698	498	298
Trade and other payables	2,489	2,938	2,862	3,141	3,497
Other current liabilities	544	249	253	263	276
Long-term liabilities	1,243	484	484	484	484
Total Liabilities	4,727	4,569	4,296	4,386	4,555
Minority Interests	75	84	96	111	130
Shareholder Equity	8,738	10,108	14,237	16,489	19,387
Share Capital	9,835	10,570	12,915	12,915	12,915
Reserves	(1,097)	(462)	1,322	3,574	6,472
Total Equity	8,813	10,191	14,333	16,599	19,517
Total Liabilities and equity	13,540	14,760	18,629	20,986	24,072

Source: Company data, SWS Research

Key Financial Ratios					
	2015	2016	2017E	2018E	2019E
Ratios per share (HK\$)					
Earnings per share	0.28	0.35	0.44	0.55	0.71
Diluted EPS	0.28	0.35	0.44	0.55	0.71
Operating CF per share	0.38	0.49	0.39	0.57	0.71
Dividend per share	0.11	0.12	0.15	0.19	0.25
Net assets per share	1.49	1.71	2.30	2.66	3.13
Key Operating Ratios(%)					
ROIC	15.81	17.54	17.14	19.01	21.11
ROE	19.80	22.30	22.55	22.55	24.86
Gross profit margin	45.82	51.00	59.22	62.00	64.00
EBITDA Margin	24.33	26.17	27.23	28.33	30.18
EBIT Margin	19.01	21.42	23.16	24.76	27.06
Growth rate of Revenue(YoY)	4.00	8.56	21.81	17.81	17.52
Growth rate of Profit(YoY)	31.28	26.16	30.68	26.18	28.72
Debt-to-asset ratio	34.91	30.95	23.06	20.90	18.92
Turnover rate of net assets	1.29	1.21	1.05	1.07	1.07
Turnover rate of total assets	0.84	0.84	0.81	0.85	0.87
Effective tax rate (%)	20.49	20.02	20.45	20.55	20.54
Dividend yield (%)	0.64	0.70	0.90	1.14	1.47
Valuation Ratios (X)					
P/E	60.53	48.40	38.80	30.75	23.89
P/B	11.44	9.98	7.43	6.42	5.46
EV/Sale	8.91	8.21	6.74	5.72	4.87

Source: Company data, SWS Research

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