

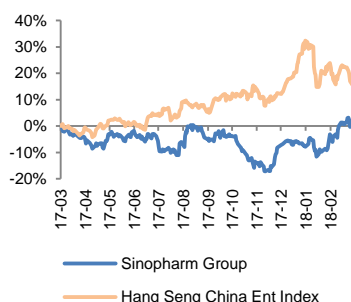
27 March 2018

Outperform Upgrade

Market Data: 26 March

Closing Price (HK\$)	37.60
Price Target (HK\$)	44.00
HSCEI	12,198
HSCCI	4,420
52-week High/Low (HK\$)	38.50/29.85
Market Cap (US\$m)	13,255
Market Cap (HK\$m)	104,043
Shares Outstanding (m)	2,767
Exchange Rate (Rmb-HK\$)	1.25

Price Performance Chart:



Source: Bloomberg

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Related Reports

"Patient for recovery—Sinopharm Group (1099:HK)" October 31, 2017

"Cash outflow—Sinopharm Group (1099:HK)" August 29, 2017

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两票制正面影响开始体现

SINOPHARM GROUP (1099:HK)

Financial summary and valuation

	2016	2017	2018E	2019E	2020E
Revenue (Rmb m)	258,387.69	277,717.02	301,092.06	332,133.43	372,569.57
YoY (%)	12.99	7.48	8.42	10.31	12.17
Net income (Rmb m)	4,647.34	5,283.09	5,812.43	6,824.78	7,971.71
YoY (%)	23.20	13.68	10.02	17.42	16.81
EPS (Rmb)	1.68	1.91	2.10	2.47	2.88
Diluted EPS (Rmb)	1.68	1.91	2.10	2.47	2.88
ROE (%)	15.01	15.75	15.59	16.36	17.00
Debt/asset (%)	71.76	69.76	68.32	67.18	66.28
Dividend Yield (%)	1.67	1.90	2.10	2.46	2.87
PE (x)	17.86	15.72	14.32	12.19	10.44
PB (x)	1.86	1.62	1.45	1.28	1.13
EV/Ebitda (x)	8.08	6.95	6.11	5.35	4.60

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

公司 2017 年收入增长 7.5% 至 2,780 亿元，归属股东净利润同比上升 14% 至 52.8 亿元，高于我们预期的 50.1 亿元。2017 年核心净利润（扣除政府补贴，资产处置损益等）同比增长 14%。

最坏时期已经过去。分销收入的增速从 2016 年的 13.3% 下降至 2017 年的 7.3%。分销收入增速放缓主要由于销售到第三方商业公司的调拨业务将因不符合“两票制”的要求而下滑。目前国内大多数地区已经执行“两票制”。因此，调拨业务占公司整体分销收入的比重从 2016 年的 21.2% 下降至 2017 年的 17.9%。我们认为“两票制”的施行将有助于大型医药流通企业进一步扩张市场份额。因此，我们预计公司分销收入的增速将从 17 年的 7.3%，提升至 18 年的 8%，19 年达到 10% 和 20 年达到 12%。

剥离融资租赁，有效去杠杆。经营活动现金净流入从 2016 年的 93 亿元下降至 2017 年的 17 亿元，同比下降 82%，主要由于公司融资租赁业务导致约 46 亿元经营现金流出，以及应收账款天数延长。公司于 2017 年底剥离了融资租赁业务，将显著改善现金流压力。此外，大多数公立医院已经于 2017 年实施药品“零加成”政策，我们认为“零加成”政策造成付款天数延长的负面影响，已经基本在 2017 年反映。然而，由于纯销业务的应收账款天数通常比调拨业务更长，随着纯销业务占比的提升，我们认为公司整体的应收账款天数将继续延长。

利润率提升。17 年毛利率同比上升 0.31 个百分点至 8.31%，主要由于纯销业务占比的提升，纯销的毛利率显著高于调拨业务。此外，医疗器械分销业务的毛利率高于药品分销，2017 年医疗器械分销业务收入实现了超过 30% 的高速增长。我们认为随着收入结构的改善，公司整体毛利率水平将持续提升。

财务费用上升。17 年财务费用率上升 0.75 个百分点至 0.91%。我们注意到 2017 年初以来，国内企业的融资成本逐渐上升。因此，我们预计财务费用比率将于 18 年上升至 1.06%，19 年达到 1.07%，20 年为 1.00%。

上调评级至增持。我们将 2018 年的稀释每股盈利从 1.97 元上调至 2.10 元（同比增长 10%），2019 年的稀释每股盈利从 2.17 元上调至 2.47 元（同比增长 18%），预计 2020 年的稀释每股盈利为 2.88 元（同比增长 17%）。我们将目标价从 36.5 港币上调至 44.0 港币，对应 17 倍 18 年市盈率。目标价对应 17% 的上涨空间，上调至增持评级。

Investment Highlights:

Sinopharm reported 2017 net revenue of Rmb278bn (+7.5% YoY) and net profit of Rmb5.3bn (+14% YoY), beating our estimate of Rmb5.0bn (+8% YoY). Core net profit (excluding one-off items, such as government subsidies and disposal gains) increased 14% YoY in 2017. We revise up our diluted EPS forecasts from Rmb1.97 to Rmb2.10 in 18E (+10% YoY) and from Rmb2.17 to Rmb2.47 in 19E (+18% YoY), and forecast Rmb2.88 in 20E (+17% YoY). We lift our target price from HK\$36.50 to HK\$44.00, representing 17x 18E PE, and, with 17% upside, we upgrade our rating from Hold to Outperform.

Sales growth recovery. Pharmaceutical distribution sales growth slowed down from 13.3% YoY in 16A to 7.3% in 17A. This was mainly due to the decrease in sales to third-party distributors, impacted by the “two invoice scheme”. To date, most regions in China have already carried out the “two invoice scheme”. As a result, Sino Biopharm’s proportion of distribution sales to third parties dropped from 21.2% in 16A to 17.9% in 17A. Nevertheless, we believe that the implementation of the two invoice scheme will help large players such as Sinopharm to consolidate market share. Hence, we expect Sinopharm’s pharmaceutical distribution sales growth to accelerate from 7.3% YoY in 17A to 8% YoY in 18E, 10% YoY in 19E and 12% YoY in 20E.

Deleveraging efforts. Operating cash inflows decreased from Rmb9.3bn in 16A to Rmb1.7bn in 17A (-82% YoY). This was mainly due to the expansion of financial leasing business and the extended receivable days. The company spun off its financial leasing business in end-2017 while this business led to c.Rmb4.6bn operating cash outflows in 17A. In addition, as most public hospitals have already cancelled drug markups in 2017, we think the extension in receivable days caused by the “zero markup” policy was largely reflected in 2017, while the overall receivable days may continue to rise because direct sales will account for a higher proportion of total sales.

Margin expansion. In 2017, gross margin improved by 0.31ppts YoY to 8.31%. This was mainly due to a higher proportion of direct sales which has higher gross margin than sales to third party distributors. In addition, medical device distribution sales, which had higher margin than drug distribution sales, grew more than 30% YoY in 17A. We think Sinopharm’s gross margin will continue to improve because the mix change will continue in coming years.

Rising financial costs. Net interest expense ratio increased from 0.75% in 16A to 0.91% in 17A. We notice that the overall borrowing costs for Chinese enterprises have been rising from 2017. Considering rising financial costs, we expect the firm’s financing expense ratio to reach 1.06% in 18E, 1.07% in 19E and 1.00% in 20E.

Upgrade to Outperform. We revise up our diluted EPS forecasts from Rmb1.97 to Rmb2.10 in 18E (+10% YoY) and from Rmb2.17 to Rmb2.47 in 19E (+18% YoY), and forecast Rmb2.88 in 20E (+17% YoY). We lift our target price from HK\$36.50 to HK\$44.00, representing 17x 18E PE and, with 17% upside, we upgrade our rating from Hold to Outperform.

APPENDIX

Consolidated Income Statement

(Rmbm)	2016	2017	2018E	2019E	2020E
Revenue	258,388	277,717	301,092	332,133	372,570
Cost of Sales	(237,717)	(254,640)	(274,012)	(301,262)	(337,567)
Gross Profit	20,671	23,077	27,080	30,871	35,003
Other Income	272	400	250	250	250
Selling/General/Admin. Expenses	(10,729)	(11,570)	(13,399)	(14,913)	(16,691)
EBITDA	11,281	12,921	15,097	17,458	19,889
EBIT	10,214	11,906	13,932	16,208	18,562
Finance Costs	(1,932)	(2,534)	(3,197)	(3,546)	(3,714)
Profit before tax	8,925	10,173	11,199	13,149	15,359
Income tax expense	(2,033)	(2,305)	(2,542)	(2,985)	(3,486)
Minority interests	(2,244)	(2,585)	(2,844)	(3,339)	(3,901)
Profit for the year	4,647	5,283	5,812	6,825	7,972

Source: Company data, SWS Research

Consolidated Cash Flow Statement

(Rmbm)	2016	2017	2018E	2019E	2020E
Profit before taxation	8,925	10,173	11,199	13,149	15,359
Plus : Depr. and amortisation	1,068	1,015	1,166	1,250	1,327
Finance cost	1,971	2,855	3,556	3,885	4,057
Losses from investments	(0)	0	0	0	0
Change in working capital	(128)	(6,943)	(7,384)	(7,660)	(5,709)
Others	(2,578)	(5,433)	(3,006)	(3,472)	(3,997)
CF from operating activities	9,258	1,667	5,531	7,153	11,037
CAPEX	(1,310)	(2,747)	(2,300)	(2,300)	(2,300)
Other CF from investing activities	(297)	199	209	220	231
CF from investing activities	(1,606)	(2,547)	(2,091)	(2,080)	(2,069)
Equity financing	0	0	0	0	0
Net change in liabilities	2,325	5,000	0	0	0
Dividend and interest paid	(3,607)	(4,822)	(5,799)	(6,365)	(6,969)
Other CF from financing activities	(745)	4,124	0	0	0
CF from financing activities	(2,027)	4,302	(5,799)	(6,365)	(6,969)
Net cash flow	5,625	3,422	(2,358)	(1,292)	1,999
FCFF	7,811	927	2,871	4,513	8,394
FCFE	8,165	3,072	(685)	628	4,336

Source: Company data, SWS Research

Consolidated Balance Sheet

(Rmbm)	2016	2017	2018E	2019E	2020E
Current Assets	132,760	144,843	155,500	170,362	189,385
Bank balances and cash	25,573	29,011	26,653	25,361	27,360
Trade and other receivables	74,923	84,204	95,217	110,015	123,409
Inventories	25,760	26,769	28,771	30,126	33,757
Other current assets	6,504	4,859	4,859	4,859	4,859
Long-term investment	3,328	5,051	5,305	5,572	5,852
PP&E	6,752	7,796	8,460	9,065	9,616
Intangible and other assets	14,871	11,849	12,319	12,764	13,186
Total Assets	157,712	169,539	181,584	197,763	218,039
Current Liabilities	99,737	110,876	116,674	125,471	137,131
Borrowings	22,363	30,163	30,163	30,163	30,163
Trade and other payables	76,425	79,773	85,404	93,897	105,213
Other current liabilities	949	941	1,107	1,411	1,755
Long-term liabilities	13,442	7,393	7,393	7,393	7,393
Total Liabilities	113,179	118,269	124,067	132,864	144,524
Minority Interests	12,722	16,012	18,191	20,795	23,831
Shareholder Equity	31,811	35,258	39,326	44,104	49,684
Share Capital	2,767	2,767	2,767	2,767	2,767
Reserves	29,044	32,684	36,752	41,530	47,110
Total Equity	44,532	51,270	57,517	64,898	73,515
Total Liabilities and equity	157,712	169,539	181,584	197,763	218,039

Source: Company data, SWS Research

Key Financial Ratios

	2016	2017	2018E	2019E	2020E
Ratios per share (Rmb)					
Earnings per share	1.68	1.91	2.10	2.47	2.88
Diluted EPS	1.68	1.91	2.10	2.47	2.88
Operating CF per share	3.35	0.60	2.00	2.58	3.99
Dividend per share	0.50	0.57	0.63	0.74	0.86
Net assets per share	16.14	18.57	20.79	23.45	26.57
Key Operating Ratios(%)					
ROIC	10.11	10.60	11.56	12.47	13.15
ROE	15.01	15.75	15.59	16.36	17.00
Gross profit margin	8.00	8.31	8.99	9.29	9.39
EBITDA Margin	4.37	4.65	5.01	5.26	5.34
EBIT Margin	3.95	4.29	4.63	4.88	4.98
Growth rate of Revenue(YoY)	12.99	7.48	8.42	10.31	12.17
Growth rate of Profit(YoY)	23.20	13.68	10.02	17.42	16.81
Debt-to-asset ratio	71.76	69.76	68.32	67.18	66.28
Turnover rate of net assets	5.80	5.42	5.23	5.12	5.07
Turnover rate of total assets	1.64	1.64	1.66	1.68	1.71
Effective tax rate (%)	22.78	22.66	22.70	22.70	22.70
Dividend yield (%)	1.67	1.90	2.10	2.46	2.87
Valuation Ratios (X)					
P/E	17.86	15.72	14.32	12.19	10.44
P/B	1.86	1.62	1.45	1.28	1.13
EV/Sale	0.35	0.32	0.31	0.28	0.25

Source: Company data, SWS Research

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BUY: Share price performance is expected to generate more than 20% upside over a 12-month period.

Outperform: Share price performance is expected to generate between 10-20% upside over a 12-month period.

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