

Company Report

China Merchants Securities (HK) Co., Ltd.
Hong Kong Equity Research

Shanghai Pharma (2607 HK)

Acquiring majority control of Techpool

■ SH Pharma acquired 26.3% stake in Techpool from Takeda (ticker: 4502 JP) and now owns 67.1% of the target; Techpool is a leading urine protein pharma with strong specialty drugs research and A&E drugs marketing capabilities; the deal valued the target at 19/16x 2018/19E PER in our estimates

■ We think that the stronger control of Techpool would help SH Pharma build out its specialty drug marketing capabilities; this in turn should underpin SH Pharma's investment case as one of the leading marketers of MNC's new drugs in China; Company is valued at 15/12x 18/19 PER, with good risk/reward

Techpool has an interesting specialty drugs portfolio and strong A&E marketing capabilities

Techpool mainly markets two products: 1) ulinastatin, a drug to treat acute and chronic pancreatitis and acute circulatory failure, and 2) urinary kallidinogenase, a drug to treat moderate and acute thrombotic cerebral infarction. Both are clinically necessary drugs used mainly in A&E or ICU. Noteworthy is Techpool's specialty drug marketing capabilities – its sales team generated RMB2.6mn per head sales which is ahead of domestic peers' and on par with MNC's peers (RMB2.5-3mn per head).

The deal is with good strategic merits

Techpool delivered RMB1.1bn revenue and RMB80mn NP in 2017, both down from the previous year due to the two-invoice reform, the government price negotiation and its distributors' inventory adjustment. We expect that the sales and NP to recover gradually from 2018, thanks to the stronger support from SH Pharma's distribution network. Financially we calculate that the deal would only add 0.2%/0.5% to FY18/19E EPS - consequently we leave our estimates unchanged for now. Strategically, we think that SH Pharma can better tap into Techpool's valuable A&E/ICU marketing capabilities with greater stake in the group. Such capabilities will be crucial to underpin SH Pharma's MNC drugs' leading marketer story over long run, in our view.

Financials

RMB mn	2015	2016	2017	2018E	2019E
Revenue	105,517	120,765	130,847	161,072	174,737
Growth (%)	18.4%	14.5%	8.3%	23.1%	8.5%
Net profit	2,649	3,064	3,075	3,602	4,548
Growth (%)	27.5%	15.6%	0.4%	17.1%	26.3%
EPS (RMB)	0.99	1.14	1.14	1.27	1.60
DPS (RMB)	0.38	0.43	0.46	0.41	0.51
P/E (x)	19.3	17.5	16.4	14.7	11.7
P/B (x)	1.7	1.7	1.5	1.3	1.2
ROE (%)	8.5%	8.7%	8.9%	8.4%	9.6%

Sources: Company data, CMS (HK) estimates

Su Zhang Hayden Zhang
+852 3189 6357 +852 3189 6354
suzhang@cmschina.com.hk haydenzhang@cmschina.com.hk

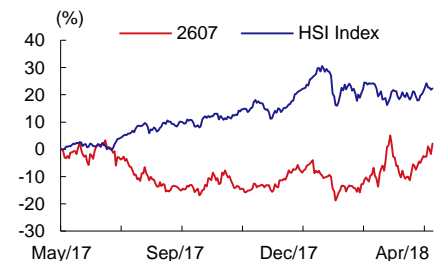
WHAT'S NEW

M&A news

BUY

Previous	BUY
Price	HK\$23.3
12-month Target Price (Potential up/downside)	HK\$28.1 (+21%)
Previous	HK\$28.1

Price Performance



Source: Bigdata

%	1m	6m	12m
2607 HK	12.0	20.5	8.4
HSI	2.5	6.3	23.5

Sector: Pharmaceutical & Healthcare

Hang Seng Index	31048
HSCEI	12355

Key Data

52-week range (HK\$)	18.2-24.25
Market cap (HK\$ mn)	21414
Avg. daily volume (mn)	4.59
BVPS (HK\$)	11.76

Shareholding Structure

Shanghai SASAC	33.6%
Shanghai Guosheng	1.2%
Shenergy Group	0.9%

Free float	66.4%
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Related Research

1. Shanghai Pharma (2607 HK) - Solid 1Q; riding the wave of MNC's new drug launches (BUY), 2018/04/30
2. Shanghai Pharma (2607 HK) - Potentially high growth delta in 18/19 (BUY), 2018/03/26
3. Shanghai Pharma (2607 HK) - Cash replenished after buying out a competitor (BUY), 2018/02/12
4. China Pharmaceutical & Healthcare – CMS China healthcare sector outlook 2018 (OVERWEIGHT), 2018/01/05
5. Shanghai Pharma (2607 HK) - Adding buffer, narrowing gap (BUY), 2017/08/30
6. Shanghai Pharma (2607 HK) - Serious consolidation contender with proven track record (BUY), 2016/12/14

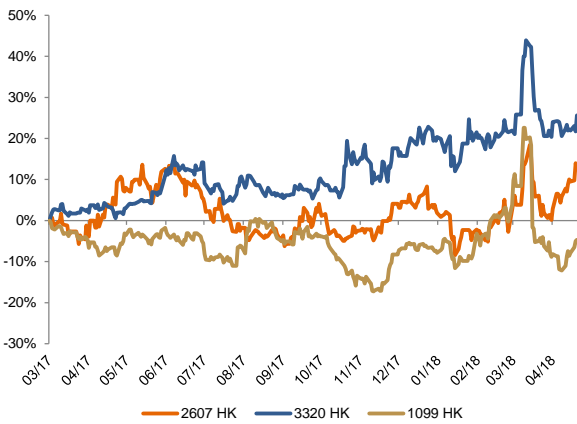
Focus charts

Figure 1: Stock performance



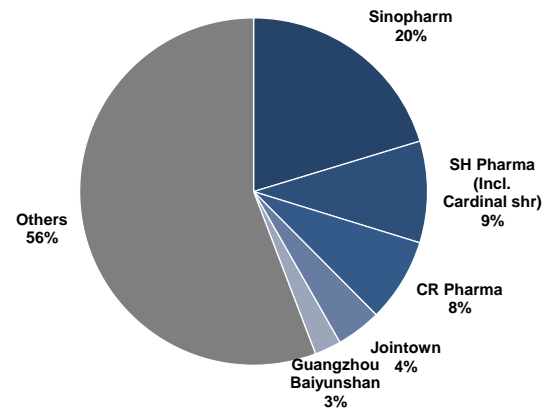
Sources: Company data, CMS (HK)

Figure 2: 12m performance of SH Pharm (2607 HK), CR Pharm (3320 HK) and Sinopharm (1099 HK)



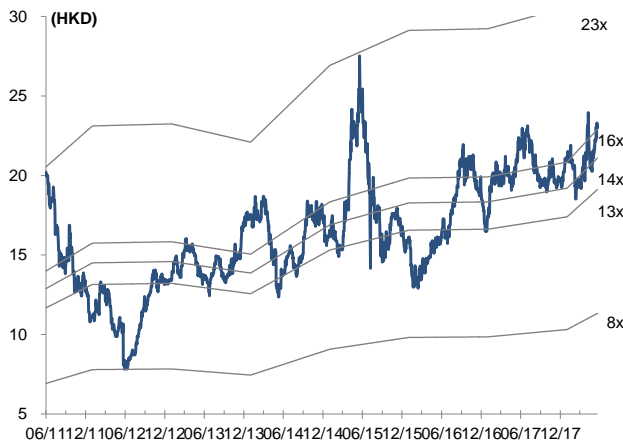
Sources: Company data, CMS (HK)

Figure 3: Chinese distributors' market share in FY16 (after combining SHP and Cardinal)



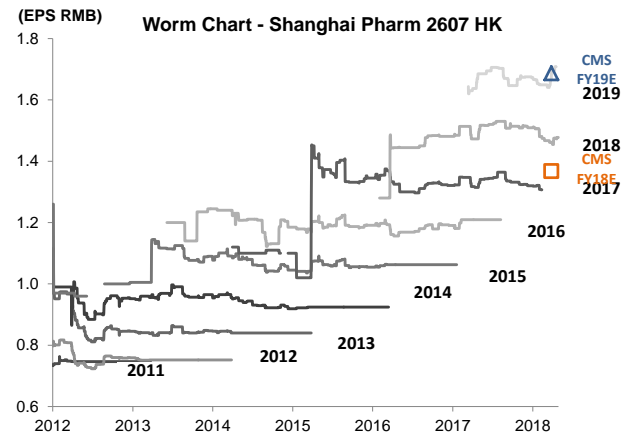
Sources: Bloomberg, CMS (HK)

Figure 4: PER band



Sources: Company data, CMS (HK)

Figure 5: Consensus worm chart



Sources: Bloomberg, CMS (HK)

Figure 6: Techpools' financials forecasts and valuation

	2015	2016	2017	2018E	2019E	2020E
Financials (RMB)						
Revenue	1,384	1,453	1,108	1,233	1,372	1,476
YoY change		5%	-24%	11%	11%	8%
OW: Tianpu Luoan (ulinastatin)	1,064	1,098	812	893	983	1,032
OW: Kailikang (urinary kallidinogenase)	310	342	276	317	365	420
Others	10	13	20	22	24	25
Net profit	244	236	80	185	219	236
YoY change		-3%	-66%	132%	19%	8%
NPM	18%	16%	7%	15%	16%	16%
Valuation (x)						
PER	14.2	14.7	43.6	18.8	15.8	14.7
PBR	n.a.	3.0	3.1	n.a.	n.a.	n.a.
PSR	2.5	2.4	3.1	2.8	2.5	2.4

Sources: Company data, CMS (HK)

Financial Summary

Balance Sheet

RMB million	2015	2016	2017	2018E	2019E
Cash and ST investments	12,039	11,967	14,842	9,415	5,554
Inventories	15,091	16,416	17,270	20,613	22,155
Other current assets	28,456	31,884	36,530	41,482	45,480
Total current assets	55,585	60,267	68,642	71,510	73,189
Property, plant & equipment	6,317	7,201	9,386	12,878	14,226
Other assets	5,570	6,590	6,940	6,940	6,940
Intangible assets	6,872	8,685	9,376	10,888	10,600
Total non-current asset	18,759	22,476	25,702	30,707	31,766
Total assets	74,344	82,743	94,345	102,216	104,955
Accounts payable	28,562	30,670	34,790	40,462	43,079
ST bank loans	10,399	9,641	13,792	9,792	5,792
Income taxes payable	398	341	722	455	494
Other current liabilities	67	462	327	327	327
Total current liabilities	39,427	41,113	49,632	51,037	49,692
Long term debt	93	2,836	2,959	2,959	2,959
Deferred taxes	392	492	620	620	620
Other liabilities	624	1,467	1,382	1,382	1,382
Total non-current liabilities	1,110	4,795	5,037	5,037	5,037
Total liabilities	40,536	45,908	54,669	56,073	54,729
Minority interest	3,878	5,212	5,645	6,212	6,921
Common equity	29,930	31,623	34,031	39,930	43,305
Total equity	33,808	36,834	39,676	46,143	50,227

Cash Flow Statement

RMB million	2015	2016	2017	2018E	2019E
PBT	4,172	4,639	5,205	5,672	7,090
Depreciation and amortization	746	824	922	1,084	1,387
Operating profit before change in WC	4,765	5,270	5,938	7,514	9,185
Funds from other operating activities	-2,704	-2,488	-2,547	-2,890	-2,885
Cash from operating activities	611	1,218	1,641	2,271	3,860
Capital expenditure	-1,214	-1,875	-1,874	-2,255	-2,446
Interest received	140	172	161	246	172
Cash from investing activities	-1,769	-2,718	-2,194	-5,741	-2,274
Long term borrowings	93	2,836	2,959	2,959	2,959
Common dividends (cash)	-1,030	-1,156	-1,245	-1,157	-1,446
Cash from financing activities	1,235	1,204	3,161	-1,957	-5,446
Effect of FX rate changes	11	-3	-19	0	0
Net change in cash	77	-295	2,608	-5,427	-3,860
Net cash - beginning balance	11,190	11,278	10,980	13,569	8,142
Net cash - ending balance	11,278	10,980	13,569	8,142	4,282

Sources: Company data, CMS (HK) estimates

Profit & Loss Statement

RMB million	2015	2016	2017	2018E	2019E
Revenue	105,517	120,765	130,847	161,072	174,737
Cost of sales	-92,979	-106,868	-114,661	-139,327	-149,749
Gross profit	12,538	13,897	16,187	21,745	24,987
SG&A expenses	-8,906	-10,112	-11,509	-16,429	-18,522
Operating profit	3,836	4,078	4,875	5,559	6,729
Interest income	139	172	161	246	172
Interest expense	-647	-697	-830	-1,106	-880
PBT	4,172	4,639	5,205	5,672	7,090
Income tax	-807	-809	-1,147	-1,248	-1,560
Minority interest	-487	-633	-537	-567	-709
Net profit	2,649	3,064	3,075	3,602	4,548
EPS - Diluted (RMB)	0.99	1.14	1.14	1.27	1.60
DPS (RMB)	0.38	0.43	0.46	0.41	0.51
Dividend yield	2.5%	2.7%	3.1%	2.7%	3.4%

Ratio

	2015	2016	2017	2018E	2019E
Growth (YoY)					
Revenue	18.4%	14.5%	8.3%	23.1%	8.5%
Gross profit	12.2%	10.8%	16.5%	34.3%	14.9%
Operating profit	17.3%	6.3%	19.5%	14.0%	21.1%
Net profit	27.5%	15.6%	0.4%	17.1%	26.3%
Margin					
Gross margin	11.9%	11.5%	12.4%	13.5%	14.3%
EBITDA margin	4.3%	4.1%	4.4%	4.1%	4.6%
Operating margin	3.6%	3.4%	3.7%	3.5%	3.9%
Adj. net profit margin	2.5%	2.5%	2.3%	2.2%	2.6%
Efficiency					
Inventory days	55	54	54	54	54
Trade receivable days	91	91	95	94	95
Account payable days	102	101	104	106	105
Financial ratios					
Current ratio (x)	1.4	1.5	1.4	1.4	1.5
Quick ratio (x)	1.0	1.1	1.0	1.0	1.0
ROA	3.9%	3.9%	3.7%	3.8%	4.6%
ROE	8.5%	8.7%	8.9%	8.4%	9.6%
Net gearing	-2.3%	4.1%	8.0%	10.0%	8.9%

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
NEUTRAL	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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China Merchants Securities (HK) Co., Ltd.

Address: 48/F, One Exchange Square, Central, Hong Kong

Tel: +852 3189 6888 Fax: +852 3101 0828