



Company Report: Sihuan Pharmaceutical (00460 HK)

公司报告: 四环医药 (00460 HK)

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Despite Unfavorable Policies in 2018, New Opportunities Showing Up, "Accumulate"

新机会出现, 尽管2018年政策不利, “收集”

- **2017 shareholders' profit slumped by 15.2% YoY to RMB1,449 million.** Dragged by destocking of sales channels and the inclusion of key CCV products into Key Monitored Drug Lists, revenue dropped by 13.8% YoY to RMB2,746 million in 2017. Despite a 3.6 ppt improvement in GM, surging R&D expenses and distribution costs depressed bottom-line performance.
- **Although unfavorable policies continue to depress the Company's performance in 2018, bottom-line growth is expected to rebound.** Challenges have not vanished, as 1) major CCV products are expected to be continuously hit by policies related to reimbursement; 2) destocking will last to 2018; and 3) soaring expenses are expected to assist the Company in fitting into the current regulatory system and to support sustainable growth. However, new opportunities are showing up, such as new products with potential peak sales of over RMB1 billion, namely Huineng/ Mainuokang/ Roxatidine are expected to deliver robust growth and to support rebound of the bottom line. The return to double-digit top-line growth may have to wait until 2021, when innovative drugs with potential peak sales of over RMB1 billion (Birociclib and Janagliflozin) and multiple generics are expected to launch. **We forecast 2018-2020 EPS to grow by 1.8% YoY/ 8.5% YoY/ 8.0% YoY to RMB0.155/ RMB0.169/ RMB0.182, respectively.** Moreover, sitting on a big pile of cash, the Company is expected to seek M&As to strengthen its portfolio before launch of its new innovative products.
- **Investment rating of "Accumulate" is set for Sihuan Pharma; TP is HK\$2.30, representing 12.0x/ 11.1x 2018/ 2019 PER.** A valuation discount over its peers is to reflect bigger policy risk exposure for its products, below-industry-average growth and moderate R&D capability.
- **2017 年股东净利下跌 15.2%至人民币 14.49 亿。** 受销售渠道去库存以及重点心脑血管产品被纳入重点监控目录影响, 2017 年收入同比倒退 13.8%至人民币 27.46 亿。尽管毛利率同比增长 3.6 个百分点, 激增的研发费用以及分销成本令股东净利承压。
- **尽管不利政策在 2018 年将继续压抑公司表现, 股东净利增速预计将会反弹。** 挑战仍未消除, 因为 1) 主要心脑血管产品预计将继续受到与医保相关的政策打击; 2) 去库存将延续至 2018; 以及 3) 费用预计将会激增, 以帮助公司适应当前监管体系并支持公司实现可持续发展。然而, 新机会出现: 人民币 10 亿级新产品如回能/ 迈诺康/ 罗沙替丁预计将快速增长并支持利润反弹。收入或需待 2021 年才能重回双位数增长: 彼时预计将有两个人人民币 10 亿级创新药 (吡罗西尼与加格列净) 以及多个仿制药上市。**我们预测 2018-2020 年每股净利将分别同比增 1.8%/ 8.5%/ 8.0% 至人民币 0.155/人民币 0.169/人民币 0.182。** 另外, 坐拥大量现金, 公司有望在新的创新产品上市前寻求并购机会以增强其产品组合。
- **我们给予四环医药“收集”的投资评级, 目标价为 2.30 港币, 对应 12.0 倍/ 11.1 倍 2018 年/ 2019 年的市盈率。** 为反映四环医药产品更大的政策风险敞口、低于行业平均的增速以及中等的研发能力, 我们给予公司相比其同行更低的估值。

Rating:

Accumulate
Initial

评级:

收集 (首次覆盖)

6-18m TP 目标价:

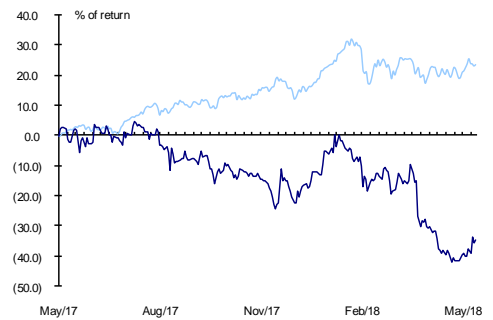
HK\$2.30

Share price 股价:

HK\$2.110

Stock performance

股价表现



Change in Share Price	1 M	3 M	1 Y
股价变动	1 个月	3 个月	1 年
Abs. % 绝对变动 %	6.0	(23.8)	(36.0)
Rel. % to HS Index 相对恒指变动 %	3.5	(23.6)	(59.5)
Avg. share price (HK\$) 平均股价 (港元)	2.0	2.4	2.8

Source: Bloomberg, Guotai Junan International.

Year End	Turnover	Net Profit	EPS	EPS	PER	BPS	PBR	DPS	Yield	ROE
年结	收入	股东净利	每股净利	每股净利变动	市盈率	每股净资产	市净率	每股股息	股息率	净资产收益率
12/31	(RMB m)	(RMB m)	(RMB)	(Δ %)	(x)	(RMB)	(x)	(RMB)	(%)	(%)
2016A	3,186	1,708	0.169	(15.3)	11.2	1.075	1.8	0.107	5.7	15.5
2017A	2,746	1,449	0.153	(9.3)	11.2	1.166	1.5	0.031	1.8	13.2
2018F	2,955	1,472	0.155	1.8	11.0	1.299	1.3	0.031	1.8	12.6
2019F	3,236	1,598	0.169	8.5	10.1	1.436	1.2	0.034	2.0	12.3
2020F	3,546	1,725	0.182	8.0	9.4	1.583	1.1	0.036	2.1	12.1
Shares in issue (m) 总股数 (m)				9,471.1	Major shareholder 大股东				Dr. Che Fengsheng 62.4%	
Market cap. (HK\$ m) 市值 (HK\$ m)				19,984.0	Free float (%) 自由流通比率 (%)					37.6
3 month average vol. 3 个月平均成交股数 ('000)				22,154.9	FY18 Net gearing (%) FY18 净负债/股东资金 (%)					Net cash
52 Weeks high/low (HK\$) 52 周高/低 (HK\$)				3.534 / 1.850	FY18 Est. NAV (HK\$) FY18 每股估值 (港元)					2.8

Source: the Company, Guotai Junan International.

2017 Results Review

Sihuan Pharmaceutical Holdings Group Ltd. ("Sihuan Pharma" or the "Company") reported revenue/ net profit of RMB2,746 million/ RMB1,449 million in 2017, representing growth of -13.8% YoY/ -15.2% YoY. We attribute the decline in revenue mainly to 1) destocking of third-party agents triggered by the two-invoice system (the Company adopts an indirect sales model), which posed detrimental impact on 2H17 performance of Sihuan Pharma (revenue/ shareholders' profit was down by 27.4%/ 37.6%, respectively); 2) entrance of key CCV products into the mature stage of the product cycle and inclusion into Key Monitored Drug Lists ("KMDLs") in multiple regions; 3) intensified competition of non-exclusive products; and 4) the disposal of Beijing Boren Hospital. The shrinking of net profit was also driven by 1) rising R&D expenses (up 4.1 ppts to 8.5% of total revenue), induced by progression of clinical trials and increased resource allocation for the development of innovative drugs and 2) expanding distribution costs caused by an increase in academic promotion activities and an upgrades within the sales team to adapt to the two-invoice system, regardless of 3.6 ppts improvement in gross margin (which was attributed to the implementation of the two-invoice system and an increased proportion of exclusive products in product mix). EPS fell by 9.3% YoY in 2017, with 115.6 million shares repurchased (representing 1.21% of the total number of shares before the repurchases in 2017) during the year.

Best-selling CCV products continued to face the burden of sales growth in 2017, while new products maintained strong growth momentum. Major CCV products, namely Kelinao/ Anjieli, Chuanqing, Qu'Ao, Aogan, Oudimei/ Aofutai/ Weitong, Yuanzhijiu/ Xingwei, Yimaining/ Yikangning, Yeduoja and Wei'ao recorded gloomy YoY revenue growth of -21.2%, -35.3%, -36.4%, -20.2%, -15.9%, -5.6%, -12.5%, -14.3% and -2.6% in 2017, respectively. Nonetheless, newly-launched non-CCV products, Roxatidine and Huineng, continued to deliver splendid performance in 2017, with top-line growth of over 64.0% YoY and 139.5% YoY.

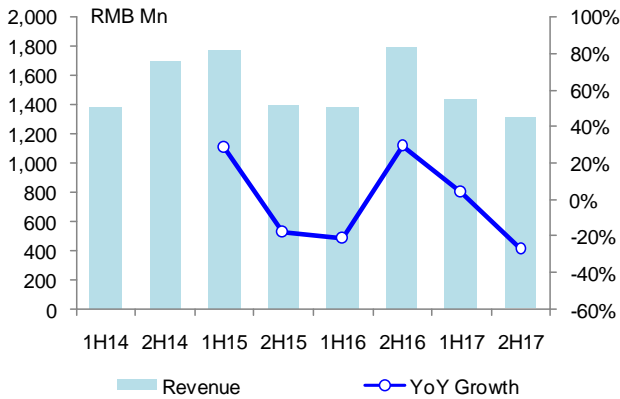
Hospital purchases indicated that top-line performance was significantly affected by destocking in sales channels, and we think hospital purchases could better reveal the real performance of the Company's products. According to IMS, YoY growth rates of hospital purchases in 2017 of Kelinao/ Anjieli, Chuanqing, Qu'Ao, Aogan, Oudimei/ Aofutai/ Weitong, Yuanzhijiu/ Xingwei, Yimaining/ Yikangning and Wei'ao were -1.8%, -4.5%, -6.0%, -0.1%, -6.4%, -2.2%, -3.5% and -18.0%, respectively. Chuanqing and Qu'ao witnessed a reduction in the decline in growth of hospital purchases in 2017, on the back of price cuts in exchange for bigger market share. Considering that statistics provided by IMS are primarily sourced from hospitals with over 100 beds, and that the Company has already penetrated into more small-sized and medium-sized hospitals in low-end markets, we estimate that the real growth rate of hospital purchases of the Company's products may be a bit better than the numbers disclosed by IMS to a certain extent.

Table-1: Sihuan Pharma's 2017 Results Review

RMB million	2016	2017	YoY	2H16	2H17	YoY
Revenue	3,186	2,746	-13.8%	1,798	1,305	-27.4%
- CCV drugs	3,006	2,583	-14.1%	1,694	1,226	-27.7%
- Non-CCV drugs	180	163	-9.3%	104	80	-23.2%
Gross profit	2,189	1,987	-9.2%	1,262	968	-23.2%
Distribution costs	(146)	(228)	56.2%	(90)	(157)	74.2%
Admin expenses	(540)	(629)	16.4%	(324)	(360)	11.2%
R&D expenses	141	233	65.7%	n.a.	n.a.	n.a.
Operating profit	2,131	1,688	-20.8%	1,253	720	-42.5%
Finance costs	(0)	(0)	-78.1%	(0)	(0)	-56.2%
Share of profit of associates&JV	22	41	89.0%	9	12	32.8%
Profit After Tax	1,680	1,479	-12.0%	962	638	-33.6%
Shareholder's Profit	1,708	1,449	-15.2%	972	606	-37.6%
EPS (RMB cent)	16.85	15.28	-9.3%	9.75	6.41	-34.3%
Gross Margin	68.7%	72.4%	3.6 ppts	70.2%	74.2%	4.0 ppts
Operating Margin	66.9%	61.5%	-5.4 ppt	69.7%	55.2%	-14.5 ppt
Net Profit Margin	53.6%	52.8%	-0.9 ppt	54.1%	46.5%	-7.6 ppt

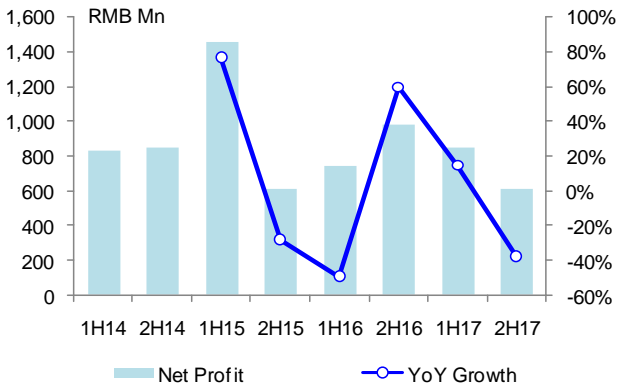
Source: the Company, GuotaiJunan International.

Figure-1: Sihuan Pharma's Revenue and Growth



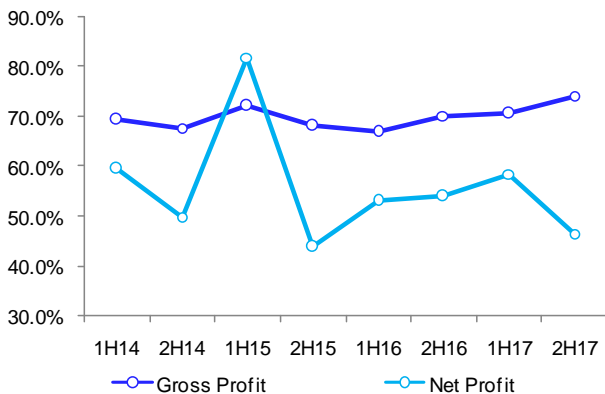
Source: the Company, Guotai Junan International.

Figure-2: Sihuan Pharma's Net Profit and Growth



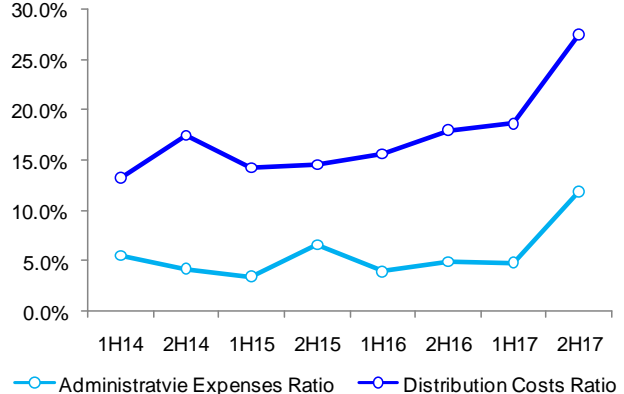
Source: the Company, Guotai Junan International.

Figure-3: Sihuan Pharma's Margins



Source: the Company, Guotai Junan International.

Figure-4: Sihuan Pharma's Expenses Ratios



Source: the Company, Guotai Junan International.

Table-2: Review of Sihuan Pharma's Product Portfolio

Generic Name	Trade Name/ Trademark	Form	Launch	Direct Competitors	Reimbursement	Minimum Tender Price YoY	KMDL	Sales Growth (%)		Hospital Purchase Growth (%)	Proportion in Sales (%)
								2016	2017		
CCV drugs:											
Cinepazide Maleate Injection	Kelinao/ Anjieti	Injection	2003/2006	5	NRDL B/ NRDL B w/ 1 limits	~	Yes	(18.6)	(21.2)	(1.8)	14.8
Ligustrazine Hydrochloride for Injection	Chuanqing	Injection	2003	>10	NRDL B/ NRDL B	↓	Yes	(18.6)	(35.3)	(4.5)	1.8
Cerebroprotein Hydrolysate	Qu'ao	Injection	2005	>10	18 PRDL/ 15 PRDL	↓↓↓	Yes	14.0	(36.4)	(6.0)	3.1
Monosialotetradecyl Oxytetracycline sodium injection	Aogan/ GM1	Injection	2008	6	18 PRDL/ 18 PRDL	~	Yes	2.8	(20.2)	(0.1)	5.5
Cerebroside-kinin Injection	Oudimei/ Aofutai/ Weitong	Injection	2010	Exclusive	23 PRDL/ 22 PRDL	↑	Yes	12.0	(15.9)	(6.4)	27.3
Troxerutin and Cerebroproteine Hydrolysate Injection	Yuanzhijiu/ Xingwei	Injection	2011	Exclusive	23 PRDL/ 22 PRDL	↓	Yes	8.6	(5.6)	(2.2)	15.5
Alprostadiil Lipid Emulsion Injection	Yimaining/ Yikangning	Injection	2010	>10	NRDL B/ NRDL B w/ 1 limits	-	Yes	1.7	(12.5)	(3.5)	7.8
Compound Trivitamin B for Injection (II)	Yeduojia	Injection	2011	Exclusive	16 PRDL/ 15 PRDL	-	Yes	26.7	(14.3)	n.a	4.8
Salviae Miltiorrhizae and Ligustrazine Hydrochloride Injection	Wei'ao	Injection	2011	1	22 PRDL/ 24 PRDL	~	Yes	1.9	(2.6)	(18.0)	6.1
Brevescapine Sodium Chloride Injection		Injection	2011	>10	5 PRDL/ NRDL B	↓	Yes	3.7	28.6		0.1
Floium Ginkgo Extract and Tertram Ethypyrazine Sodium Chloride Injection	Mainuokang	Injection	2015	Exclusive	9 PRDL/ 11 PRDL	-	No	n.a.	n.a.		1.4
Others								(44.8)	459.7		6.0
Sum								0.2	(14.1)		94.2
Non-CCV drugs:											
Oxcarbazepine	Ren'ao	Tablets	2005	1	NRDL B/ NRDL B	~	No	24.9	(1.2)		0.9
Roxatidine	Jie'ao	Injection	2013	1	2 PRDL/ 5 PRDL	-	No	136.7	64.0		1.2
Monoammonium Glycyrhizinate and Cysteine and Sodium Chloride Injection	Huineng	Injection	2014	Exclusive	9 PRDL/ 11 PRDL	-	No	237.6	139.5		0.7
Others								21.7	61.0		0.7
Sum								7.9	(9.3)		5.8

Source: the Company, IMS, Guotai Junan International.

Note:
1. KMDL stands for Key Monitored Drug List in prefecture-level cities.
2. For Minimum Tender Price YoY, "-" represents no changes; "~" represents a change of less than 2.5%; "↓" represents a decrease of less than 5% but more than 2.5%; "↓↓↓" represents a decrease of less than 10% but more than 5%; "↓↓↓" represents a decrease of more than 10%; "↑" represents an increase of less than 5% but more than 2.5%; "↑↑" represents an increase of less than 10% but more than 5%; "↑↑↑" represents an increase of more than 10%; "↕" indicates fluctuations in tender prices through various provinces.

Outlook

Major CCV products (most are included in KMDLs) will continue to be hit by policies related to healthcare reform, especially the reimbursement. According to the new Provincial Reimbursement Drug Lists ("PRDLs") already released, drugs in KMDLs have barely phased out in most provinces. However, a few provinces have raised the out-of-pocket proportion for drugs in KMDLs. We expect more provinces to follow this path in the near term, therefore depressing the sales of most of the Company's CCV products. Moreover, single-disease paying model, a heavy weapon to facilitate rational drug-use and to reduce drug costs, has been tried out in more than two thirds of provinces in China as at February 2018. With the release of the Catalogue of Recommended for Single-disease Paying Model by the Ministry of Human Resources and Social Security ("MOHRSS") in late February, applicable regions of the single-disease paying model are expected to rapidly expand afterwards, posing a long-term challenge to Sihuan Pharma's CCV major products which are regarded as adjuvant drugs in some regions. We expect that the single-disease paying model will be implemented nationwide and DRGs will be carried out in most regions by the end of 2020. In addition, the management indicated that the negative impact induced by the destocking of sales channel will last to the end of 2018.

Some short-term opportunities have emerged, as new products with potential peak terminal sales of over RMB1,000 million, namely Huineng, Roxatidine as well as Mainuokang and Quetiapine produced by PharmaDax Foshan, are expected to deliver robust growth. 1) Roxatidine is expected to achieve a CAGR of over 60% in 2017-2020, with the expectation that it will be included into more PRDLs in 2018, on the back of a better curative effect than other H2-receptor antagonists and reimbursement restrictions on rival products (namely proton pump inhibitors) in the newly-revised NRDL. The market size of drugs used in antiacid and peptic ulcer disease in China is very big, amounting to over RMB5 billion. 2) With less adverse effects, but with broader indications than Magnesium Isoglycyrrhizinate and compound Glycyrrhizin, Huineng (Monoammonium Glycyrrhizinate and Cysteine and Sodium Chloride injection) is expected to be added into more PRDLs and thus speedily grab a bigger share of the RMB3 billion glycyrrhizin market in China; we expect Huineng to grow at a CAGR of over 80% in 2017-2020. 3) The investment in PharmaDax (FoShan) Co., Ltd ("PharmaDax Foshan"; the Company currently possesses 19.99% share in PharmaDax Foshan but is entitled to increase its share to 51% under certain conditions), which focuses on the manufacturing of generic drugs of extended release ("ER") formulation with a production line obtaining U.S. FDA certification, not only offers the Company two generics approved by the U.S. FDA (Quetiapine Fumarate ER tablet and Glyburide tablet, of which Quetiapine has been selected in to Priority Review by the CFDA) as well as one pending approval (Metoprolol Succinate ER tablet), but also accelerate the Company's generics applications in China and promote their international development through the injection of products developed by the Company into the production line of PharmaDax Foshan and simultaneous applications in both China and overseas.

Table-3: Comparison of H2-receptor Antagonists

H2 antagonists	1st Generation	2nd Generation	3rd Generation		4th Generation	
	Cimetidine	Ranitidine	Nizatidine	Famotidine	Roxatidine	Lafutidine
Effectiveness of acid reduction	Medium	Medium high	High	Medium high	High	Medium high
Bioavailability (%)	60-80	50-60	90-95	40-50	>95	n.a.
Half life (h)	2.0	2-2.5	1.6	3-3.5	4-8	1-3
Anti-androgenic effect	Yes	Weak	No	No	No	n.a.
P450 inhibitor	Yes	No	No	No	No	Yes
Gastric mucosal protection	No	No	No	No	Yes	Yes

Source: the Company, Guotai Junan International.

Table-4: Review of Products Produced by PharmaDax Foshan Approved by the U.S. FDA

Generic Name	Indication	Reimbursement	Comment
Quetiapine Fumarate ER Tablet	Atypical antipsychotic	Newly included into NRDL B	<p>Quetiapine Fumarate ER Tablet is expected to be a RMB500 million product (referring to terminal sales). Quetiapine, believed to work by blocking serotonin and dopamine receptors, is a second-generation antipsychotic used as the first-line treatment of schizophrenia and a choice to treat bipolar disorder. At present, there are two dosage forms on the market, namely tablet and ER tablet, both of which were developed firstly by AstraZeneca. Estimated by Menet, the market size of chemical drugs used in the treatment of schizophrenia is about RMB7.33 billion in 2016 with growth rate of 9.67%, and Quetiapine is the third best-selling chemical drugs, with a market share of 13.35% in 2016. According to Chinese Center For Disease Control And Prevention, there are about 10 million schizophrenics in China, less than half of whom have accepted treatments. However, the Chinese government plans to increase the treatment rate to over 80% by the end 2020, indicating that the market size of chemical drugs used in the treatment of schizophrenia will expand by about 50% by the end of 2020 and reach over RMB10 billion. We estimate the market size of Quetiapine will achieve RMB1.5 billion in 2020. We are positive on the outlook of the ER tablet form in view of its newly inclusion into NRDL and its improvement of patient compliance. Currently, there are more than 5 companies developing generics of Quetiapine Fumarate ER Tablet. We believe PharmaDax Foshan will launch the FTM generic in 2018 for its product has been selected into priority review by CFDA.</p>
Glyburide Tablet	Anti-diabetic	NRDL A	<p>Glyburide is an anti-diabetic drug in a class of medications known as sulfonylureas and is used in the treatment of type 2 diabetes. According to Menet, the market size of anti-diabetic used in public hospitals exceeded RMB41 billion in 2016 with growth rate of 9.04%. However, Glyburide obtained only less than 0.1% market share which was shared by over 50 competitors. Despite a competitive landscape and not a very big market size, we expect the product of PharmaDax Foshan to be one of the first ones to pass Consistency Evaluation.</p>

Source: the Company, Guotai Junan International.

In the pipeline, the Company has been focusing on the development of 8 Class 1 innovative drugs. **The Company expects the launch of two key products in 2021, Janagliflozin (SGLT2 inhibitor) and Birociclib (CDK4/6 inhibitor), each of which has peak sales potential of over RMB1,000 million (referring to terminal sales).** However, as no innovative drugs are likely to be launched before 2021, we believe that generics, or even products obtained through M&As (the management indicated the Company will continuously seek for potential targets), would be the near-term focuses for the Company. As for generic drugs, the Company currently has over 67 generic drugs under development, and 15 pending for manufacturing approval. We highlight that three key projects (Bolutinum toxin, Ambroxol and Hyaluronic acid) are in Phase III clinical trials and will be launched to market in 2-3 years. As for the progress of Consistency Evaluation, bioequivalence test of metformin was completed in 2017 and the CFDA accepted the Company's application in March 2018, indicating that Sihuan Pharma has the fastest progress within common tablets. Moreover, Azithromycin capsule and Oxcarbazepine tablet are expected to become the first few products to pass bioequivalent tests.

Table-5: Review on Sihuan Pharma's Key Innovative Drugs

Project	Classification	Therapeutic Area	Mechanism	Status
First Tier:				
Janagliflozin	Chemical 1.1	Diabetes	SGLT2 inhibitor	Phase I clinical trials
Birociclib	Chemical 1.1	Oncology	CDK4/6 inhibitor	Obtained approval for Phase I-III clinical trials
Benapenem	Chemical 1.1	Anti-infective	Carbapenem	Phase I clinical trials completed; Phase II clinical trial about to commence
Second Tier:				
Pirotinib	Chemical 1.1	Oncology	EGFR-TKI	Phase I clinical trials in the U.S. completed; Phase I clinical trials in China ongoing
Anaprazole Sodium	Chemical 1.1	Gastrointestinal disease	PPI	Phase I clinical trials completed
Tylerdipine	Chemical 1.1	CCV	L/T-type calcium channels inhibitor	Phase I clinical trials completed
XZP-3621-1001	Chemical 1.1	Oncology	ALK inhibitor	IND
Fadanafil	Chemical 1.1	BPH- LUTS,ED	PDE5 inhibitor	Phase I clinical trials
Insulin analogue	Therapeutic Biologics 7	Diabetes	-	IND

Source: the Company, Guotai Junan International.

We expect SGLT2 inhibitors to obtain increasing share of the diabetes medicine market and Janagliflozin to be one of the first three domestic SGLT2 inhibitors introduced to the market. Janagliflozin is an innovative anti-diabetic drug which inhibits sodium-glucose co-transporter 2 ("SGLT2"), intended for the treatment of type 2 diabetes. SGLT2 is currently the new target for treating type 2 diabetes globally. SGLT2 inhibitors lead to the blockage of glucose re-absorption in the kidney, and increases glucose excretion through urine, helping to effectively lower blood glucose levels. Therefore, side effects of traditional oral hypoglycemic drugs such as weight gain and low blood glucose levels are seldom reported. In addition, SGLT2 inhibitors are the only class of anti-diabetic drugs with clinically proven cardio-protective effects to diabetics. It is recommended as the

1st/2nd line of treatment for diabetes in both domestic and foreign markets. According to Menet, the diabetes medicine market in China reached RMB40 billion in 2016, with YoY growth of 9.04%. Currently, it is dominated by insulin, Metformin and Acarbose. We expect SGLT2 inhibitors, DPP4 inhibitors and GLP1 agonists to obtain increasing market share in the future, in view of international market trends (together took up about 45% global market share in 2017), drug efficacy and toxicity, and clinical guidelines. At the end of 2017, the CFDA approved the launch of three imported SGLT2 inhibitors. Considering that the price of imported drugs is expensive and they will not be included into PRDLs speedily, Janagliflozin, together with other potential domestic products (of which Hengrui Medicine's (600276 CH) SGLT2 inhibitor is in the fastest progress and is undergoing Phase III clinical trial), will have a chance to grab a bigger share.

Sound market prospects in China are expected for CDK4/6 inhibitors, as 1) the addition of CDK4/6 inhibitors to hormone therapy has been proven to largely improve the PFS of patients with HR/HER- breast cancer by multiple cases of international clinical research; 2) CDK4/6 inhibitors may be used in combination with multiple other targeted treatments such as PD-1; 3) according to the *Chinese Journal of Clinical Oncology*, new cases of breast cancer in China amounted to 269,000 in 2015, with HR/HER- accounting for about 48.6%; and 4) global sales of CDK4/6 inhibitors exceeded US\$3,000 million in 2017. Currently, there is no CDK4/6 inhibitor approved in China and Pfizer's Palbociclib is expected to launch in 2018. More than 20 domestic pharmaceutical manufacturers are working on the development of innovative CDK4/6 inhibitors, of which Hengrui Medicine's (600276 CH) SHR-6390 has the fastest progress and is about to conduct Phase II clinical trials. The second fastest product is Sihuan Pharma's Birociclib, which is in Phase I clinical trials. **We expect Birociclib to be one of the first three domestic CDK4/6 inhibitors introduced to the market.**

Earnings Forecasts & Valuation

Considering that major CCV products are expected to be continuously hit by policies, we forecast 2017-2020 revenue CAGR of CCV products to be 5.1% YoY. Driven by robust growth of Huineng and Roxatidine, revenue of non-CCV products is expected increase by a CAGR of 49.9% YoY during 2017-2020. **Therefore, we forecast 2018/ 2019/ 2020 revenue to grow by 7.6% YoY/ 9.5% YoY and 9.6% YoY to RMB2,955 million, RMB3,236 million and RMB3,546 million, respectively.**

Gross margin is expected to step up through product mix optimization and a change of sales model for new products. However, soaring selling costs are expected to assist the Company in fitting into the current regulatory system, especially the two-invoice system, and in building self-owned sales teams for new products. Moreover, we expect that the Company will continue to deliver increasing resources in R&D projects in order to ensure its sustainable development, and thus R&D expenses are expected to hike in the coming years. All in all, the operating margin and net profit margin are expected to decline progressively in the coming years. **We forecast shareholders' profit to grow YoY by 1.6%, 8.5% and 8.0% to RMB1,472 million, RMB1,598 million and RMB1,725 million in 2018-2020, respectively. EPS is estimated to be RMB0.155/ RMB0.169/ RMB0.182 in 2018-2020, respectively.**

Table-6: Key Earnings Estimates of for Sihuan Pharma

RMB million	2017	2018	2019	2020	2017-2020 CAGR
Revenue	2,746	2,955	3,236	3,546	8.9%
- CCV products	2,583	2,701	2,849	2,997	5.1%
- Non-CCV products	163	254	387	549	49.9%
Gross profit	1,987	2,216	2,424	2,652	10.1%
Distribution costs	(228)	(256)	(294)	(338)	14.1%
Admin expenses	(629)	(713)	(800)	(907)	13.0%
R&D expenses	(233)	(339)	(374)	(426)	22.2%
Operating profit	1,688	1,735	1,889	2,049	6.7%
Profit After Tax	1,479	1,503	1,631	1,761	6.0%
Shareholder's Profit	1,449	1,472	1,598	1,725	6.0%
Basic EPS (cent)	15.28	15.55	16.87	18.22	6.0%
Gross Margin	72.4%	75.0%	74.9%	74.8%	
Operating Margin	61.5%	58.7%	58.4%	57.8%	
Net Profit Margin	52.8%	49.8%	49.4%	48.7%	

Source: Guotai Junan International.

Investment rating of "Accumulate" is set for Sihuan Pharma; TP is HK\$2.30, representing 12.0x/ 11.1x 2018/ 2019 PER. Currently, Sihuan Pharma's HK listed peers are trading at 34.5x/ 28.7x 2018/ 2019 PER. A valuation discount over its peers is to reflect bigger policy risk exposure for Sihuan Pharma's products, below-industry-average growth and moderate R&D capability.

Risks

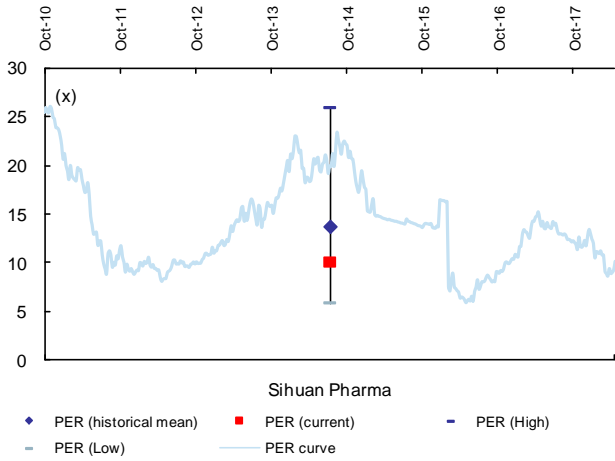
- 1) Government policy risks;
- 2) Margin erosion triggered by further price cuts in key products;
- 3) Slower-than-expected tender progress;
- 4) Delays in the Company's pipeline.

Table-7: Peers Group Comparison of Sihuan Pharma

Company	Stock Code	Currency	Last price	Market Cap HKD mil	PE (fiscal year)				PB (fiscal year)				PEG	ROE (%)	ROA (%)	EV/EBITDA		
					17A	18F	19F	20F	17A	18F	19F	20F		18F	18F	17A	18F	19F
HK - Listed Peers																		
Sihuan Pharma	460 HK	HKD	1.99	19,984	11.9	9.7	10.6	9.4	1.5	1.2	1.1	1.0	1.2	13.0	10.1	9.9	6.6	5.3
Sino Biopharma	1177 HK	HKD	15.68	161,090	56.5	46.0	38.9	32.5	12.8	8.6	6.8	5.5	2.3	24.5	13.8	22.6	23.3	18.7
Fosun Pharma-H	2196 HK	HKD	43.75	128,076	30.6	24.0	20.0	17.2	3.7	3.2	2.9	2.6	1.1	14.0	5.2	31.0	28.1	23.0
Luye Pharma	2186 HK	HKD	8.24	31,702	27.8	22.6	19.8	16.8	3.9	3.2	2.8	2.4	1.2	14.9	9.8	11.9	16.9	14.6
Livzon Pharma-H	1513 HK	HKD	63.10	43,891	6.6	25.8	21.7	18.9	2.6	2.5	2.3	2.1	n.a.	9.8	6.8	18.3	n.a.	n.a.
United Lab	3933 HK	HKD	7.69	15,130	160.1	25.4	20.5	17.0	2.3	2.3	2.0	1.8	0.2	9.0	3.7	11.8	8.7	7.6
Fudan Zhangjiang	1349 HK	HKD	3.77	3,563	41.0	20.6	12.1	14.0	3.4	2.7	2.1	n.a.	0.5	15.4	12.1	27.1	11.1	5.7
CSPC Pharma	1093 HK	HKD	20.30	148,272	52.2	41.0	32.8	26.0	9.7	8.7	7.7	6.0	1.6	22.4	16.2	22.5	27.0	21.8
Simple Average					48.4	26.9	22.1	19.0	5.0	4.0	3.5	3.1	1.2	15.4	9.7	19.4	17.4	13.8
Weighted Average					44.9	34.5	28.7	23.8	7.8	6.1	5.2	4.3	1.6	18.9	11.2	22.8	24.0	19.5
China - Listed Peers																		
Hengrui Medicine	600276 CH	CNY	82.04	321,900	75.3	66.3	52.3	41.6	16.8	13.5	10.9	8.7	3.0	21.2	19.0	45.7	51.7	39.9
Fosun Pharma-A	600196 CH	CNY	37.71	128,074	33.8	28.0	23.6	20.2	4.2	3.8	3.3	3.0	1.5	13.7	6.5	31.0	24.6	20.7
Kelun Pharma	002422 CH	CNY	29.55	60,004	65.1	48.3	36.8	24.2	4.1	3.8	3.4	2.9	1.2	8.6	4.1	25.8	n.a.	n.a.
Livzon Pharma-A	000513 CH	CNY	70.79	43,890	8.9	35.0	29.6	25.6	3.7	3.5	3.2	2.8	n.a.	10.2	7.2	18.3	n.a.	n.a.
Shyndec Pharma	600420 CH	CNY	11.33	16,649	26.2	14.7	12.8	n.a.	2.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	8.9	n.a.	n.a.
Zhejiang Medicine	600216 CH	CNY	14.24	18,935	59.0	12.3	13.4	12.7	2.1	1.8	1.7	1.5	0.2	15.3	12.5	18.0	n.a.	n.a.
Hisun Pharma	600267 CH	CNY	15.26	19,456	1,636.0	n.a.	n.a.	n.a.	2.3	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	20.0	n.a.	n.a.
Lukang Pharma	600789 CH	CNY	9.79	9,349	56.1	n.a.	n.a.	n.a.	3.3	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Haisco Pharma	002653 CH	CNY	12.11	18,495	63.2	n.a.	n.a.	n.a.	7.6	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	42.1	n.a.	n.a.
Huadong Medicine	000963 CH	CNY	65.99	88,989	40.6	32.5	26.3	21.4	8.6	7.1	5.9	4.8	1.4	22.2	12.3	19.5	n.a.	n.a.
North China Pharma	600812 CH	CNY	4.45	9,883	410.0	n.a.	n.a.	n.a.	1.5	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	18.5	n.a.	n.a.
Northeast Pharma	000597 CH	CNY	9.59	7,647	43.6	n.a.	n.a.	n.a.	2.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	15.5	n.a.	n.a.
Salubris Pharm	002294 CH	CNY	39.73	54,113	30.2	25.7	21.6	19.5	7.3	5.9	4.9	4.3	1.6	22.8	20.4	25.5	19.5	15.9
Simple Average					196.0	32.9	27.1	23.6	5.1	5.6	4.8	4.0	1.5	16.3	11.7	24.1	31.9	25.5
Weighted Average					97.3	46.6	37.3	30.4	9.8	8.7	7.1	5.8	2.2	18.2	13.9	33.1	41.4	32.4

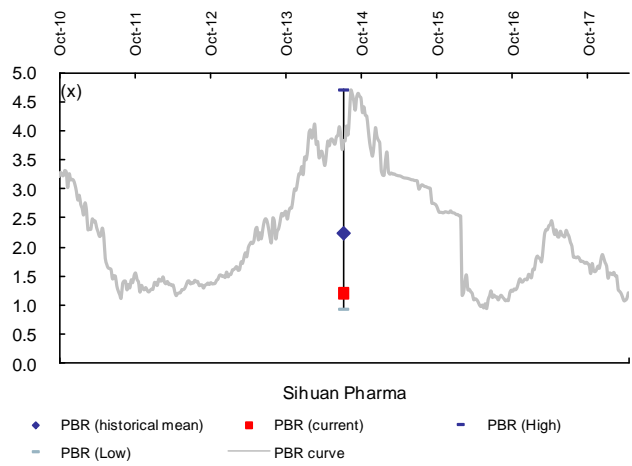
Source: Bloomberg, Guotai Junan International.

Figure-5: Forward PE Band of Sihuan Pharma



Source: Bloomberg, Guotai Junan International.

Figure-6: Forward PB Band of Sihuan Pharma



Source: Bloomberg, Guotai Junan International.

Financial Statements and Ratios

Income Statement						Balance Sheet					
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F	Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F
Total Revenue	3,186	2,746	2,955	3,236	3,546	PPE	2,104	2,454	2,564	2,726	2,899
Cost of Sales	(997)	(759)	(739)	(812)	(893)	Goodwill	2,248	2,844	2,844	2,844	2,844
Gross Profit	2,189	1,987	2,216	2,424	2,652	Intangible Assets	579	1,338	1,213	1,111	1,032
Other Income	166	137	147	188	235	Other Non-current Assets	2,062	2,182	2,157	2,175	2,198
Other Gains-Net	491	440	358	391	427	Total Non-current Assets	6,993	8,818	8,777	8,856	8,973
Distribution Costs	(146)	(228)	(256)	(294)	(338)	Cash & Cash Equivalents	2,407	832	1,172	2,255	3,401
Administrative Expenses	(540)	(629)	(713)	(800)	(907)	Inventories	201	228	266	300	331
Other Expenses	(29)	(18)	(19)	(19)	(20)	Trade and Other Receivables	877	747	901	1,003	1,117
Operating Profit	2,131	1,688	1,735	1,889	2,049	Other Current Assets	1,710	2,967	3,006	3,006	3,006
Finance Costs	(0)	(0)	0	0	0	Total Current Assets	5,195	4,774	5,346	6,565	7,854
Share of Profit of Associates & JV	22	41	38	41	41	Total Assets	12,188	13,592	14,122	15,421	16,828
Profit Before Tax	2,153	1,729	1,773	1,930	2,090	Short-term Borrowings	8	0	0	0	0
Income Tax	(473)	(250)	(270)	(299)	(329)	Trade and Other Payables	827	1,805	1,142	1,197	1,256
profit After Tax	1,680	1,479	1,503	1,631	1,761	Others Current Liabilities	203	99	94	94	94
Non-controlling Interest	28	(30)	(30)	(33)	(36)	Total Current Liabilities	1,038	1,903	1,236	1,291	1,350
Shareholders' Profit / Loss	1,708	1,449	1,472	1,598	1,725	Long-term Borrowings	0	0	0	0	0
Basic EPS	0.169	0.153	0.155	0.169	0.182	Others Non-current Liabilities	178	352	274	189	105
						Total Non-current Liabilities	178	352	274	189	105
						Total Liabilities	1,217	2,256	1,509	1,480	1,454
						Total Shareholders' Equity	10,901	11,057	12,303	13,598	14,995
						Minority Interest	70	279	310	343	378
						Total Equity	10,971	11,336	12,613	13,941	15,373

Cash Flow Statement					
Year end 31 Dec (RMB m)	2016A	2017A	2018F	2019F	2020F
PBT	2,153	1,729	1,773	1,930	2,090
D&A	291	297	363	353	351
Other Adjustments	(96)	(252)	(147)	(188)	(234)
Changes in WC	266	585	(855)	(81)	(85)
Income tax paid	(596)	(442)	(372)	(405)	(439)
Cash from Operating Activities	2,018	1,918	761	1,609	1,683
Capital Expenditure	(365)	(487)	(331)	(397)	(430)
Others	365	(1,610)	136	175	220
Cash from Investing Activities	0	(2,097)	(195)	(222)	(209)
Issues of Shares	0	0	0	0	0
Repurchase of Shares	(1,237)	(252)	0	0	0
Debt Paid/Raised	0	(4)	0	0	0
Dividends Paid	(607)	(1,144)	(226)	(303)	(329)
Others	(50)	4	0	0	0
Cash from Financing Activities	(1,894)	(1,396)	(226)	(303)	(329)
Net Changes in Cash	125	(1,575)	340	1,083	1,145
Cash at Beg of Year	2,282	2,407	832	1,172	2,255
Cash at End of Year	2,407	832	1,172	2,255	3,401

Financial Ratios					
	2016A	2017A	2018F	2019F	2020F
Growth and Profitability					
Revenue	0.6%	-13.8%	7.6%	9.5%	9.6%
EBITDA	-21.3%	-17.1%	5.4%	6.9%	6.9%
Operating profit	-20.9%	-20.8%	2.7%	8.9%	8.4%
Net Profit	-17.2%	-15.2%	1.6%	8.5%	8.0%
ROE	15.5%	13.2%	12.6%	12.3%	12.1%
ROA	13.7%	11.5%	10.8%	11.0%	10.9%
ROIC	19.6%	14.1%	13.1%	14.0%	14.7%
Margins and Liquidity					
Gross margin	68.7%	72.4%	75.0%	74.9%	74.8%
EBITDA margin	76.7%	73.8%	72.3%	70.6%	68.8%
Operating margin	66.9%	61.5%	58.7%	58.4%	57.8%
Net Profit margin	53.6%	52.8%	49.8%	49.4%	48.7%
Dividend Payout Ratio	60.0%	20.3%	20.0%	20.0%	20.0%
Net Debt/Equity	Net cash	Net cash	Net cash	Net cash	Net cash
Liabilities/Assets	10.0%	16.6%	10.7%	9.6%	8.6%
Current ratio	5.0x	2.5x	4.3x	5.1x	5.8x
Quick ratio	4.8x	2.4x	4.1x	4.9x	5.6x
Dupont Analysis					
Leverage	1.1x	1.2x	1.2x	1.1x	1.1x
Asset turnover	0.3	0.2	0.2	0.2	0.2
EBIT margin	67.6%	63.0%	60.0%	59.6%	58.9%
Interest burden	100.0%	100.0%	100.0%	100.0%	100.0%
Tax burden	78.0%	85.5%	84.8%	84.5%	84.3%
Shareholders' profit/PAT	101.7%	98.0%	98.0%	98.0%	98.0%
ROE	15.5%	13.2%	12.6%	12.3%	12.1%

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance > 15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance < -15%; or the fundamental outlook of the company or sector is unfavorable.

Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance > 5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance < -5%; Or the fundamental outlook of the sector is unfavorable.

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