



Rating
Buy

Asia
China

Health Care
Pharmaceuticals /
Biotechnology

Company
Hengrui Medicine

Reuters 600276.SS Bloomberg 600276 CH Exchange SHH Ticker 600276

Date
31 August 2017

Results

Price at 30 Aug 2017 (CNY)	53.99
Price target - 12mth (CNY)	60.50
52-week range (CNY)	60.22 - 42.67
Shanghai Composite	3,366

Expecting growth acceleration in 2018

Solid growth delivered in 2Q17

Hengrui registered sales/core profit of RMB3.2bn/766m in 2Q17, representing YoY growth of 22%/21%. This suggests mild acceleration from 19%/17% growth achieved in 1Q17. Export growth was below 20% in 2Q17, according to the management. We highlight the near-term catalysts for Hengrui: 1) export growth acceleration in 2H17/2018, driven by new products launches in the US; 2) we expect apatinib to add another leg of growth following NRDL implementation, starting from 3Q17 and 3) three potential blockbuster launches in 2019, including 19K, pyrotinib and nab-paclitaxel. We reiterate Buy on rich pipeline and earnings growth visibility.

Domestic growth in line with expectation; ASP erosion

Growth in the oncology/anesthetics/contrast agents segments stood at sub-20%/20%+/30%+ in 1H17 vs. 36%/19%/30% in 2016. We attribute the solid performance to fast ramp-up of contrast agents loversol/Iodixanol, while cancer drugs recorded growth moderation due to tender ASP pressure and law of large numbers. Management indicated that price renegotiation at the hospital level affected 1H17 results.

On margins and pipeline progress

GM came in at 86.4% in 2Q17, down from 87.7% in 2Q16, primarily due to ASP pressure in drug tenders. Nevertheless, OPM expansion was recorded despite the GM contraction, from 26.6% in 2Q16 to 27.6% in 2Q17. Management attributed the margin expansion to lower selling and promotion expenses and admin cost savings. R&D expenditure was 12.3% in 2Q17 vs. 9.3% in 2Q16, as more late-stage trials were initiated. Management indicated that near-term pipeline priorities are pyrotinib and camrelizumab. The majority of its potential blockbusters are in the phase 3 stage, including pyrotinib P3 for mBC, apatinib P3 for NSCLC/LC and camrelizumab for EC/LC.

Raising target price to RMB60.5 from RMB58.5; risks

Our RMB60.5 target price is based on 43x 2018E EPS vs. the 42x we used previously. We believe the multiple is justified, as its A-share peers are trading at 29x 2018E EPS, with 14% growth in 2019 (vs. the 27% we model for Hengrui). We believe the premium is justified, given the superior pipeline, upside potential from exports and potential earnings growth acceleration driven by blockbuster launches. Key risks include product launch delays and price cuts.

Valuation & Risks

Jack Hu, PhD

Research Analyst

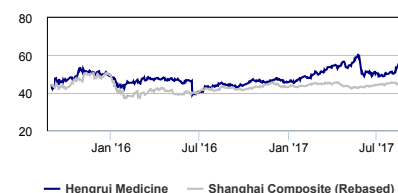
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Key changes

TP	58.50 to 60.50	↑	3.4%
Sales (FYE)	13,399 to 13,261	↓	-1.0%
Op prof margin (FYE)	-	↑	0.3%
Net profit (FYE)	3,162.0 to 3,153.5	↓	-0.3%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	6.0	-8.3	24.9
Shanghai Composite	3.4	8.2	9.4

Source: Deutsche Bank



Growth outlook

Hengrui continued solid growth in 1H17, with sub-20%/20%+/30%+ YoY growth achieved in oncology, anesthetics and contrast agents, compared to 36%/19%/30% in 2016. For 2H17, management expects the apatinib inclusion in NRDL to add another leg of growth, despite the 36% ASP cut vs. most recent tender prices. We summarize the key drivers and catalysts below:

- **Exports:** Growth in 1H17 was below 20% in 1H17, as a result of limited new product launches in overseas markets and law of large numbers for cyclophosphamide and sevoflurane. Management expects to see a growth breakout during 2018/19, as more pipeline drugs are expected to receive approval in 2H17. Going forward, the US remains the primary focus for exports, as a result of a relatively established sales/promotion model and regulatory framework. Europe and Japan would be secondary focuses for Hengrui, given limited scale of operations and barriers to entry. We forecast GM expansion from 87.4% in 2017 to 88.7% in 2020, as exports contribution increases.
- **Apatinib:** The drug achieved RMB800m in sales in 2016 vs. RMB280m in sales in 2015, translating into growth of 190% YoY and a 17% contribution to its oncology franchise. Management is optimistic on achieving its sales target for FY17, judging from the 1H17 sales performance and boost from NRDL coverage. We continue to expect indication expansion opportunities for the drug, including major cancer types, such as NSCLC and liver cancer. Hengrui is currently conducting phase 3 trials on the above two indications.
- **Pyrotinib:** Clinical application was recently filed (while phase 3 is ongoing) for breast cancer indication. We note that the application was filed based on P2 data, and could be the first Chinese anti-tumor drug approved based on P2 data. As per management, the phase 2 trial for pyrotinib demonstrated superior clinical efficacy vs. the control group, using Tykerb (lapatinib) for HER-2 positive breast cancer.
- **Re-submission of 19K and retagliptin:** 19K application was already re-submitted to CFDA under priority review track in May 2017. The company is conducting phase 3 trials for retagliptin, while guiding that the refilling timeline would be delayed. While we believe the Street still expects refilling in 2H17, we pushed back our market launch forecast of retagliptin to 2020 vs. 2018 previously. As for 19K, it is expected to contribute to the top line in 2018.
- **Clinical trial update:** Management indicated that near-term priorities would be pyrotinib and PD-1 camrelizumab. The majority of its potential blockbusters are in the phase 3 stage, including pyrotinib P3 for BC, apatinib P3 for NSCLC/LC and camrelizumab for EC/LC.



Figure 1: Income statement

Income Statement (RMB m)	2014	2015	2016	1H17	2H17E	2017E	2018E	2019E	2020E
Export	51	356	432	382	133	515	679	863	1,094
Oncology drugs	3,001	3,541	4,830	2,835	3,035	5,870	7,253	9,415	12,105
Contrast agents	753	1,006	1,308	775	910	1,685	2,095	2,522	2,919
Muscle relaxation and anesthetics	2,098	2,524	3,007	1,604	1,884	3,488	4,030	4,607	5,209
Anti-infective	306	326	300	144	169	313	324	335	346
Electrolyte injection	294	305	303	149	175	325	347	372	398
Others - including diabetes	948	1,259	914	454	610	1,130	1,824	2,891	4,006
Revenue	7,452	9,316	11,094	6,345	6,916	13,261	16,551	21,005	26,076
Cost of sales	(1,313)	(1,372)	(1,435)	(852)	(823)	(1,675)	(1,970)	(2,458)	(2,947)
Gross profit	6,139	7,944	9,659	5,493	6,093	11,586	14,582	18,547	23,129
Revenue tax and others	(133)	(156)	(203)	(118)	(119)	(238)	(288)	(365)	(454)
Research and development costs	(652)	(892)	(1,184)	(782)	(747)	(1,529)	(1,842)	(2,374)	(2,947)
Total administrative expenses (including R&D)	(1,464)	(1,843)	(2,266)	(1,287)	(1,397)	(2,684)	(3,530)	(4,537)	(5,632)
Distribution costs	(2,844)	(3,525)	(4,352)	(2,279)	(2,839)	(5,118)	(6,323)	(8,024)	(9,961)
EBIT - core	1,699	2,420	2,838	1,808	1,738	3,546	4,441	5,621	7,082
EBITDA - core	1,912	2,643	3,094	1,961	1,883	3,844	4,874	6,153	7,669
Other non-recurring items	19	1	(1)	2		2	-	-	-
Other income	41	28	32	11	21	31	50	63	78
Other expense	(14)	(25)	(43)	(9)	(9)	(18)	(17)	(29)	(37)
Impairment loss of assets	(7)	(7)	5	(8)		(8)	-	-	-
Investment income	0	(3)	15	31		31	-	-	-
Gain/loss on fair value changes				-					
Finance costs - net	81	148	166	40	69	138	185	253	293
Interest income	81	126	126	49		138	185	253	293
Others, including FX gain and interest expenses	(1)	22	40	(10)		-	-	-	-
Profit before taxation - reported	1,800	2,562	3,013	1,872	1,818	3,720	4,658	5,908	7,417
Taxation	(227)	(338)	(379)	(278)	(228)	(507)	(635)	(805)	(1,011)
Tax rate	13%	13%	13%	14.9%	12.6%	13.6%	13.6%	13.6%	13.6%
Net profit - reported	1,573	2,224	2,634	1,594	1,590	3,184	4,024	5,103	6,406
Non-controlling interests	(57)	(52)	(45)	(20)	(39)	(59)	(59)	(59)	(59)
Net income attributable to Equity holders - reported	1,516	2,172	2,589	1,573	1,551	3,124	3,964	5,043	6,347
Net income attributable to Equity holders - core	1,497	2,171	2,590	1,572	1,551	3,122	3,964	5,043	6,347
Common shares									
EPS: Basic (RMB) - Reported	0.540	0.771	0.920	0.559	0.551	1.109	1.407	1.790	2.253
EPS: Diluted (RMB) - Reported	0.540	0.771	0.919	0.559	0.551	1.109	1.407	1.790	2.253
EPS: Basic (RMB) - core	0.533	0.771	0.920	0.558	0.551	1.108	1.407	1.790	2.253
EPS: Diluted (RMB) - core	0.533	0.770	0.919	0.558	0.551	1.108	1.407	1.790	2.253

Source: Deutsche Bank estimates, company data



Model updated: 30 August 2017

Running the numbers

Asia
China
Pharmaceuticals / Biotechnology

Hengrui Medicine

Reuters: 600276.SS Bloomberg: 600276 CH

Buy

Price (30 Aug 17) CNY 53.99

Target Price CNY 60.50

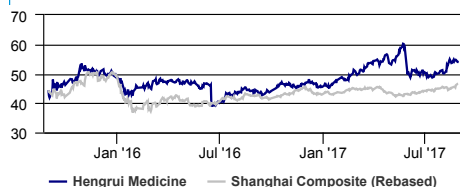
52 Week range CNY 42.67 - 60.22

Market cap (m) CNYm 152,093
USDm 23,042

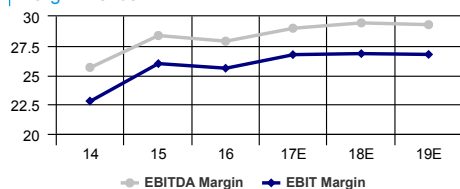
Company Profile

Jiangsu Hengrui Medicine Co. Ltd. was established in 1970 and its headquarters is in Lianyungang, Jiangsu province. The company is primarily involved in the manufacture and R&D of drugs, including those for oncology, muscle relaxation and anesthetics, contrast agents, electrolytes, and anti-infective drugs. Apart from its domestic business, Hengrui exports drugs to the US, Europe, and other countries.

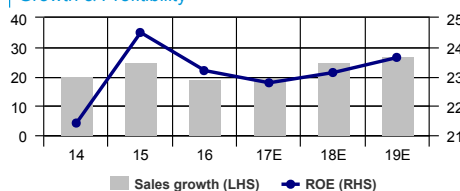
Price Performance



Margin Trends



Growth & Profitability



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Fiscal year end 31-Dec 2014 2015 2016 2017E 2018E 2019E

Financial Summary

DB EPS (CNY)	0.53	0.77	0.92	1.12	1.41	1.79
Reported EPS (CNY)	0.54	0.77	0.92	1.12	1.41	1.79
DPS (CNY)	0.04	0.05	0.07	0.08	0.10	0.13
BVPS (CNY)	2.8	3.5	4.4	5.4	6.7	8.4
Weighted average shares (m)	2,806	2,817	2,814	2,817	2,817	2,817
Average market cap (CNYm)	73,425	121,009	127,361	152,093	152,093	152,093
Enterprise value (CNYm)	70,340	116,224	122,854	146,191	144,181	140,946

Valuation Metrics

P/E (DB) (x)	49.1	55.8	49.2	48.1	38.4	30.2
P/E (Reported) (x)	48.4	55.7	49.3	48.2	38.4	30.2
P/BV (x)	10.36	13.90	10.34	9.94	8.01	6.42
FCF Yield (%)	1.7	1.6	1.2	1.1	1.5	2.4
Dividend Yield (%)	0.2	0.1	0.2	0.1	0.2	0.2
EV/Sales (x)	9.4	12.5	11.1	11.0	8.7	6.7
EV/EBITDA (x)	36.8	44.0	39.7	38.0	29.6	22.9
EV/EBIT (x)	41.4	48.0	43.3	41.2	32.5	25.1

Income Statement (CNYm)

Sales revenue	7,452	9,316	11,094	13,261	16,551	21,005
Gross profit	6,139	7,944	9,659	11,586	14,582	18,547
EBITDA	1,912	2,643	3,094	3,844	4,874	6,153
Depreciation	209	218	248	292	426	525
Amortisation	4	4	7	6	7	7
EBIT	1,699	2,420	2,838	3,546	4,441	5,621
Net interest income(expense)	81	148	166	138	185	253
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinary	-7	-7	5	-8	0	0
Other pre-tax income/(expense)	27	1	4	44	33	34
Profit before tax	1,800	2,562	3,013	3,720	4,658	5,908
Income tax expense	227	338	379	507	635	805
Minorities	57	52	45	59	59	59
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	1,516	2,172	2,589	3,154	3,964	5,043
DB adjustments (including dilution)	-19	-1	1	8	0	0
DB Net profit	1,497	2,171	2,590	3,162	3,964	5,043

Cash Flow (CNYm)

Cash flow from operations	1,574	2,277	2,593	2,735	3,340	4,487
Net Capex	-298	-394	-1,110	-1,061	-993	-840
Free cash flow	1,276	1,883	1,482	1,674	2,347	3,647
Equity raised/(bought back)	136	19	14	0	0	0
Dividends paid	-122	-150	-196	-219	-278	-353
Net inc/(dec) in borrowings	-10	0	-10	0	0	0
Other investing/financing cash flows	1	-67	-1,512	0	0	0
Net cash flow	1,280	1,684	-221	1,455	2,069	3,294
Change in working capital	-198	-169	-259	-747	-1,117	-1,147

Balance Sheet (CNYm)

Cash and other liquid assets	3,449	5,133	4,912	6,367	8,437	11,731
Tangible fixed assets	1,624	1,770	2,474	3,243	3,810	4,125
Goodwill/intangible assets	200	196	285	279	272	265
Associates/investments	1	79	81	81	81	81
Other assets	3,812	4,319	6,578	7,360	8,923	10,367
Total assets	9,087	11,497	14,330	17,330	21,523	26,569
Interest bearing debt	10	0	0	0	0	0
Other liabilities	923	1,139	1,456	1,491	1,937	2,234
Total liabilities	933	1,139	1,456	1,491	1,937	2,234
Shareholders' equity	7,798	9,931	12,388	15,294	18,980	23,671
Minorities	355	426	486	546	605	664
Total shareholders' equity	8,154	10,358	12,874	15,839	19,585	24,335
Net debt	-3,439	-5,133	-4,912	-6,367	-8,437	-11,731

Key Company Metrics

Sales growth (%)	20.1	25.0	19.1	19.5	24.8	26.9
DB EPS growth (%)	23.4	44.5	19.3	22.1	25.4	27.2
EBITDA Margin (%)	25.7	28.4	27.9	29.0	29.4	29.3
EBIT Margin (%)	22.8	26.0	25.6	26.7	26.8	26.8
Payout ratio (%)	8.1	6.9	7.5	6.9	7.0	7.0
ROE (%)	21.4	24.5	23.2	22.8	23.1	23.6
Capex/sales (%)	4.0	4.2	10.0	8.0	6.0	4.0
Capex/depreciation (x)	1.4	1.8	4.4	3.6	2.3	1.6
Net debt/equity (%)	-42.2	-49.6	-38.2	-40.2	-43.1	-48.2
Net interest cover (x)	nm	nm	nm	nm	nm	nm

Source: Company data, Deutsche Securities estimates



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Hengrui Medicine	600276.SS	53.99 (CNY) 30 Aug 2017	NA

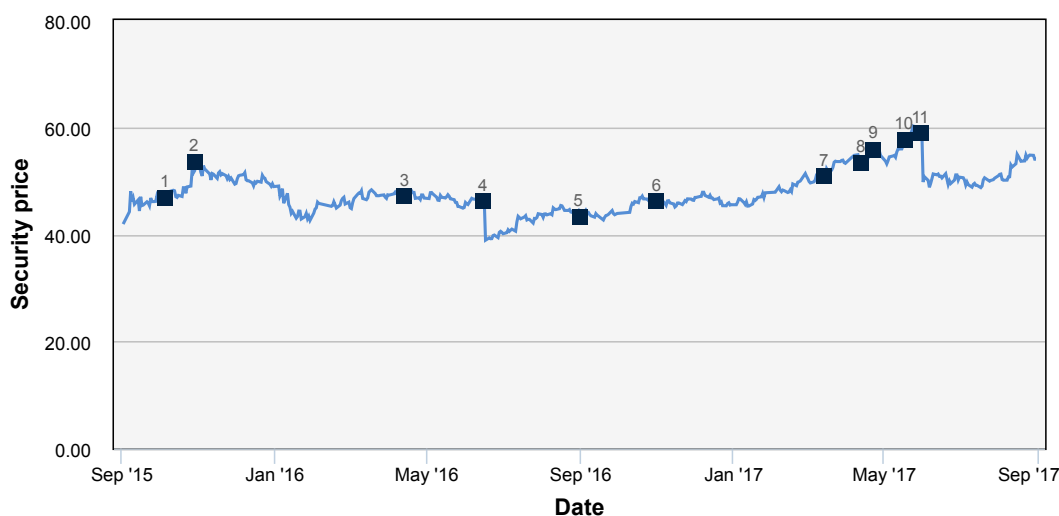
*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg, and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr>. Aside from within this report, important conflict disclosures can also be found at <https://gm/db.com/equities> under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

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The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Jack Hu

Historical recommendations and target price. Hengrui Medicine (600276.SS)

(as of 08/30/2017)



Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

** Analyst is no longer at Deutsche Bank

1.	10/06/2015	Buy, Target Price Change CNY 55,00	Jack Hu, Ph.D	7.	03/15/2017	Buy, Target Price Change CNY 60,00	Jack Hu, Ph.D
2.	10/30/2015	Buy, Target Price Change CNY 60,00	Jack Hu, Ph.D	8.	04/13/2017	Buy, Target Price Change CNY 63,50	Jack Hu, Ph.D
3.	04/14/2016	Buy, Target Price Change CNY 59,50	Jack Hu, Ph.D	9.	04/23/2017	Buy, Target Price Change CNY 65,00	Jack Hu, Ph.D
4.	06/16/2016	Buy, Target Price Change CNY 49,50	Jack Hu, Ph.D	10.	05/18/2017	Buy, Target Price Change CNY 70,00	Jack Hu, Ph.D
5.	08/31/2016	Buy, Target Price Change CNY 50,00	Jack Hu, Ph.D	11.	05/31/2017	Buy, Target Price Change CNY 58,50	Jack Hu, Ph.D
6.	11/01/2016	Buy, Target Price Change CNY 55,00	Jack Hu, Ph.D				



Equity Rating Key

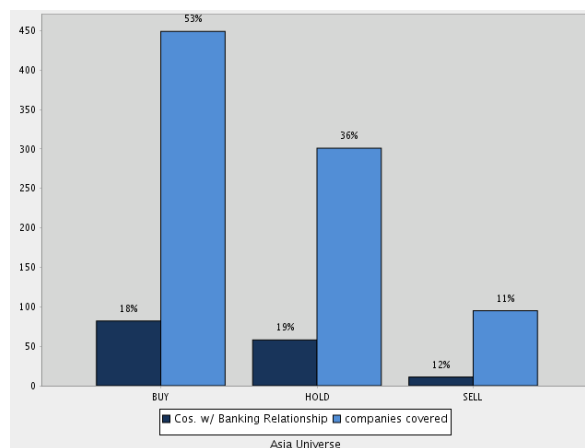
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

Equity rating dispersion and banking relationships





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Macroeconomic fluctuations often account for most of the risks associated with exposures to instruments that promise to pay fixed or variable interest rates. For an investor who is long fixed rate instruments (thus receiving these cash flows), increases in interest rates naturally lift the discount factors applied to the expected cash flows and thus cause a loss. The longer the maturity of a certain cash flow and the higher the move in the discount factor, the higher will be the loss. Upside surprises in inflation, fiscal funding needs, and FX depreciation rates are among the most common adverse macroeconomic shocks to receivers. But counterparty exposure, issuer creditworthiness, client segmentation, regulation (including changes in assets holding limits for different types of investors), changes in tax policies, currency convertibility (which may constrain currency conversion, repatriation of profits and/or the liquidation of positions), and settlement issues related to local clearing houses are also important risk factors to be considered. The sensitivity of fixed income instruments to macroeconomic shocks may be mitigated by indexing the contracted cash flows to inflation, to FX depreciation, or to specified interest rates – these are common in emerging markets. It is important to note that the index fixings may -- by construction -- lag or mis-measure the actual move in the underlying variables they are intended to track. The choice of the proper fixing (or metric) is particularly important in swaps markets, where floating coupon rates (i.e., coupons indexed to a typically short-dated interest rate reference index) are exchanged for fixed coupons. It is also important to acknowledge that funding in a currency that differs from the currency in which coupons are denominated carries FX risk. Naturally, options on swaps (swaptions) also bear the risks typical to options in addition to the risks related to rates movements.

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