



Rating
Buy

Asia
China

Health Care
Pharmaceuticals /
Biotechnology

Company
Hengrui Medicine

Reuters 600276.SS Bloomberg 600276 CH Exchange SHH Ticker 600276

Date
13 August 2018

Results

Price at 10 Aug 2018 (CNY)	70.06
Price target - 12mth (CNY)	85.50
52-week range (CNY)	101.50 - 53.17
Shanghai Composite	2,795

Expect growth acceleration ahead

Solid quarter; the beat, inline and the miss

Hengrui registered sales/core profit of RMB3.9bn/924m in 2Q18, representing YoY growth of 23%/21%. This suggests acceleration from 22%/12% growth achieved in 1Q18. Core profit would reach RMB2.0bn with 29% YoY growth (apple to apple comparison) in 1H18, if we were to exclude stock compensation expense and investment income from financial products. The company indicated 15-20%, 30%, 21% and stable growth for oncology, anesthetics, contrast agents and export business respectively for 1H18.

- **What's beat?** GM improved to 86.7% from 86.4%, which is partially due to VAT reduction. We do not think this will continue for 2H18 as price cut may offset this.
- **What are inline?** revenue growth, SBC and OPM are largely inline.
- **What missed?** We estimate apatinib sales were around RMB830m, representing 16% YoY growth which is below street expectation of 40-50% growth, and 45% growth per Rx data.
- **What's ahead of us in 2H18?** 1) SBC (stock based compensation) expense was RMB161m in 1H18 while full year budget is 187m, as such NP shall have a better base for 2H18; 2) apatinib weakness should have been reflected in consensus due to NRDL inclusion of Avastin and anlotinib launch. We expect downward adjustment of peak sales estimate of consensus; 3) significant GM expansion is unlikely until after multiple new drug launches in 2019, as price cuts of oncology drugs may offset the upside.

Adjust target price to RMB85.5 from RMB85.8; risks

We believe recent stock weakness represents an enhanced opportunity to buy, as the gap between Hengrui and other bellwethers has become wider based on recent pipeline progress, in our view. Our PT is based on 64x 2019E EPS. We believe Hengrui deserves a premium on the multiple given the superior value of its products and its strong pipeline, and its A-share peers are trading at 31x 2019E EPS with 19% growth in 2020 (vs. 25% we model for Hengrui). Key risks include regulatory delays, setback in gastric and ESCC for PD-1, as well as price cut and competition.

Valuation & Risks

Jack Hu, Ph.D.

Research Analyst

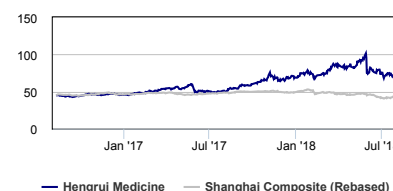
+852-2203 6208

Key changes

TP	85.80 to 85.50	↓	-0.3%
Sales (FYE)	17,254 to 17,230	↓	-0.1%
Op prof margin (FYE)	25.9 to 25.5	↓	-1.3%
Net profit (FYE)	3,957.2 to 3,934.5	↓	-0.6%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-3.9	-23.5	33.3
Shanghai Composite	-1.1	-12.0	-14.3

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	22.9
Net debt/equity (%)	-31.6
Book value/share (CNY)	5.18
Price/book (x)	13.5
Net interest cover (x)	-
Operating profit margin (%)	25.5

Source: Deutsche Bank

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Apatinib sales might have missed DBe and consensus

Management did not offer color on apatinib sales. Our current estimate of RMB830m is lower than RMB1.2bn modelled previously for 1H18. This represents 16% YoY growth only. As we believe volume growth shall accelerate after NRDL inclusion, three negative elements also worked simultaneously, including 36% price cut, the NRDL inclusion of Avastin and the launch of anlotinib.

Apatinib sales number is **an important data point with multiple complications.**

First, the data point itself is a stock driver, even the significance is decreasing as multiple new drugs would be launched soon. However we believe consensus expected 40-50% YoY growth as Rx data indicated 45-50% growth in 5mYTD18; secondly, if sales were below expectation, this would lead to another question why. The most rational explanation could be **a smaller-than-expected near-term addressable market vs. consensus** in our view, if we would exclude other elements (such as capacity issues, inventory stocking, destocking etc) which the street has no visibility with.

As we ponder the most pertinent counter-argument whether peak sales of apatinib should be revised down, we construe it would be slow implementation of NRDL and potential longer than expected duration of NRDL benefit. However both elements remain uncertain to us, while missing our/consensus expectation already occurred.



Model updated: 12 August 2018

Running the numbers

Asia

China

Pharmaceuticals / Biotechnology

Hengrui Medicine

Reuters: 600276.SS Bloomberg: 600276 CH

Buy

Price (10 Aug 18) CNY 70.06

Target Price CNY 85.50

52 Week range CNY 53.17 - 101.50

Market cap (m) CNYm 197,364
USDm 28,790

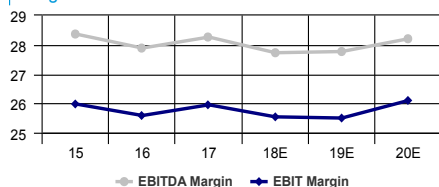
Company Profile

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.

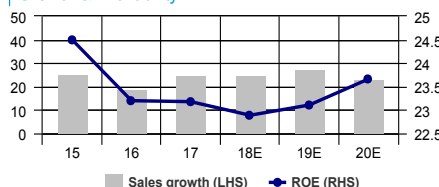
Price Performance



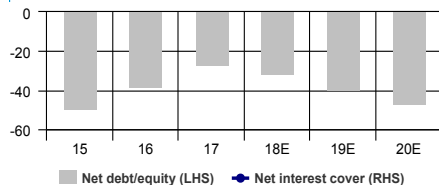
Margin Trends



Growth & Profitability



Solvency



Jack Hu, Ph.D.

+852 2203 6208

jack.hu@db.com

Fiscal year end 31-Dec

Financial Summary

	2015	2016	2017	2018E	2019E	2020E
DB EPS (CNY)	0.77	0.92	1.16	1.03	1.34	1.70
Reported EPS (CNY)	0.77	0.92	1.14	1.05	1.34	1.70
DPS (CNY)	0.05	0.07	0.11	0.07	0.09	0.12
BVPS (CNY)	3.5	4.4	5.5	5.2	6.4	8.0
Weighted average shares (m)	2,817	2,814	2,817	3,673	3,682	3,682
Average market cap (CNYm)	121,009	127,361	157,894	197,364	197,364	197,364
Enterprise value (CNYm)	116,224	122,854	154,085	191,697	188,389	183,907

Valuation Metrics

P/E (DB) (x)	55.8	49.2	48.5	68.1	52.4	41.1
P/E (Reported) (x)	55.7	49.3	49.1	66.7	52.4	41.1
P/BV (x)	13.90	10.34	12.64	13.53	10.94	8.77
FCF Yield (%)	1.6	1.2	1.4	0.9	1.5	1.9
Dividend Yield (%)	0.1	0.2	0.2	0.1	0.1	0.2
EV/Sales (x)	12.5	11.1	11.1	11.1	8.6	6.8
EV/EBITDA (x)	44.0	39.7	39.4	40.1	30.8	24.0
EV/EBIT (x)	48.0	43.3	42.9	43.6	33.5	25.9

Income Statement (CNYm)

Sales revenue	9,316	11,094	13,836	17,230	22,026	27,155
Gross profit	7,944	9,659	11,986	14,960	19,295	23,978
EBITDA	2,643	3,094	3,911	4,778	6,117	7,659
Depreciation	218	248	311	370	493	565
Amortisation	4	7	9	7	7	7
EBIT	2,420	2,838	3,591	4,401	5,617	7,087
Net interest income/(expense)	148	166	37	119	155	240
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinary	-7	5	-15	-3	0	0
Other pre-tax income/(expense)	1	4	147	145	35	43
Profit before tax	2,562	3,013	3,759	4,661	5,807	7,371
Income tax expense	338	379	466	636	795	1,009
Minorities	52	45	76	91	91	91
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	2,172	2,589	3,217	3,935	4,922	6,272
DB adjustments (including dilution)	-1	1	40	-82	0	0
DB Net profit	2,171	2,590	3,257	3,853	4,922	6,272

Cash Flow (CNYm)

Cash flow from operations	2,277	2,593	2,547	3,257	4,624	5,826
Net Capex	-394	-1,110	-379	-1,034	-881	-815
Free cash flow	1,883	1,482	2,169	2,223	3,743	5,011
Equity raised/(bought back)	19	14	14	0	0	0
Dividends paid	-150	-196	-317	-275	-345	-439
Net inc/(dec) in borrowings	0	-10	0	0	0	0
Other investing/financing cash flows	-67	-1,512	-3,039	0	0	0
Net cash flow	1,684	-221	-1,173	1,948	3,399	4,572
Change in working capital	-169	-259	-1,044	-1,131	-888	-1,109

Balance Sheet (CNYm)

Cash and other liquid assets	5,133	4,912	4,267	6,215	9,614	14,186
Tangible fixed assets	1,770	2,474	3,079	3,742	4,130	4,380
Goodwill/intangible assets	196	285	279	272	265	258
Associates/investments	79	81	118	118	118	118
Other assets	4,319	6,578	10,297	12,058	13,341	15,208
Total assets	11,497	14,330	18,039	22,406	27,468	34,149
Interest bearing debt	0	0	0	0	0	0
Other liabilities	1,139	1,456	2,096	2,727	3,122	3,879
Total liabilities	1,139	1,456	2,096	2,727	3,122	3,879
Shareholders' equity	9,931	12,388	15,368	19,012	23,590	29,423
Minorities	426	486	575	666	757	847
Total shareholders' equity	10,358	12,874	15,943	19,678	24,346	30,270
Net debt	-5,133	-4,912	-4,267	-6,215	-9,614	-14,186

Key Company Metrics

Sales growth (%)	25.0	19.1	24.7	24.5	27.8	23.3
DB EPS growth (%)	44.5	19.3	25.8	-11.0	29.9	27.4
EBITDA Margin (%)	28.4	27.9	28.3	27.7	27.8	28.2
EBIT Margin (%)	26.0	25.6	26.0	25.5	25.5	26.1
Payout ratio (%)	6.9	7.5	9.9	7.0	7.0	7.0
ROE (%)	24.5	23.2	23.2	22.9	23.1	23.7
Capex/sales (%)	4.2	10.0	2.7	6.0	4.0	3.0
Capex/depreciation (x)	1.8	4.4	1.2	2.7	1.8	1.4
Net debt/equity (%)	-49.6	-38.2	-26.8	-31.6	-39.5	-46.9
Net interest cover (x)	nm	nm	nm	nm	nm	nm

Source: Company data, Deutsche Bank estimates



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
Hengrui Medicine	600276.SS	70.06 (CNY) 10 Aug 2018	NA

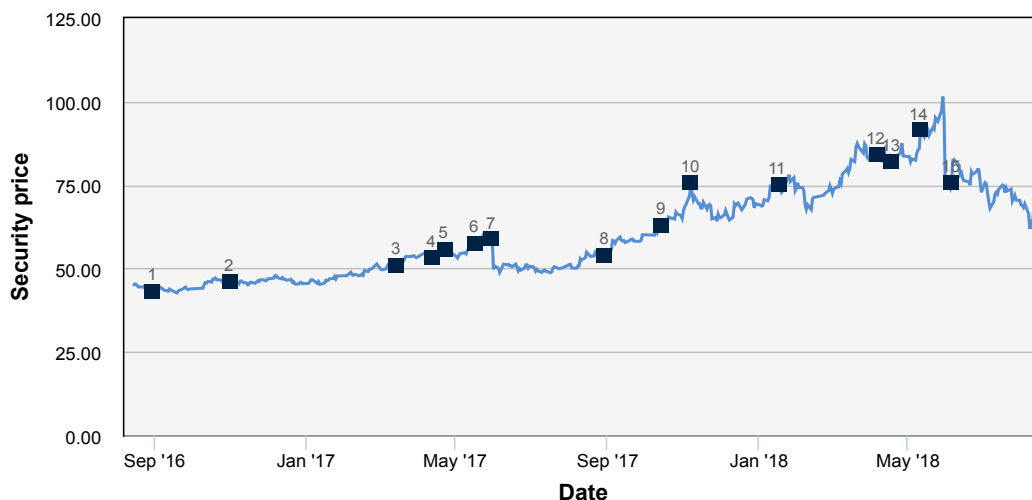
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Historical recommendations and target price. Hengrui Medicine (600276.SS)

(as of 08/10/2018)



Current Recommendations

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

** Analyst is no longer at Deutsche Bank

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2.	11/01/2016	Buy, Target Price Change CNY 55.00	Jack Hu, Ph.D.	10.	11/07/2017	Buy, Target Price Change CNY 78.10	Jack Hu, Ph.D.
3.	03/15/2017	Buy, Target Price Change CNY 60.00	Jack Hu, Ph.D.	11.	01/17/2018	Buy, Target Price Change CNY 82.20	Jack Hu, Ph.D.
4.	04/13/2017	Buy, Target Price Change CNY 63.50	Jack Hu, Ph.D.	12.	04/06/2018	Buy, Target Price Change CNY 94.10	Jack Hu, Ph.D.
5.	04/23/2017	Buy, Target Price Change CNY 65.00	Jack Hu, Ph.D.	13.	04/18/2018	Buy, Target Price Change CNY 92.80	Jack Hu, Ph.D.
6.	05/18/2017	Buy, Target Price Change CNY 70.00	Jack Hu, Ph.D.	14.	05/11/2018	Buy, Target Price Change CNY 104.10	Jack Hu, Ph.D.
7.	05/31/2017	Buy, Target Price Change CNY 58.50	Jack Hu, Ph.D.	15.	06/05/2018	Buy, Target Price Change CNY 85.80	Jack Hu, Ph.D.
8.	08/30/2017	Buy, Target Price Change CNY 60.50	Jack Hu, Ph.D.				



Equity Rating Key

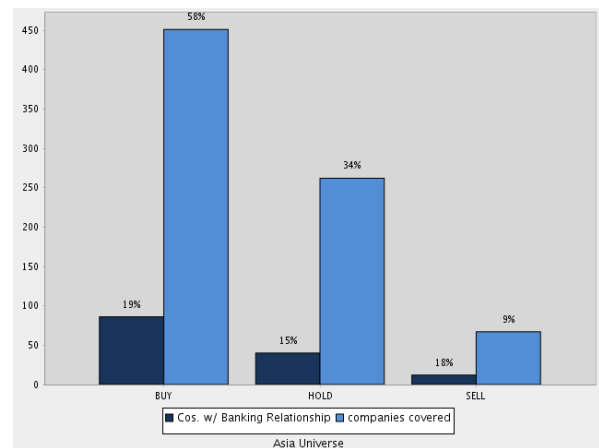
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Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

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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David Folkerts-Landau

Group Chief Economist and Global Head of Research

Pam Finelli
Global Chief Operating Officer
Research

Michael Spencer
Head of APAC Research
Global Head of Economics

Steve Pollard
Head of Americas Research
Global Head of Equity Research

Anthony Klarman
Global Head of
Debt Research

Kinner Lakhani
Head of EMEA
Equity Research

Dave Clark
Head of APAC
Equity Research

Andreas Neubauer
Head of Research - Germany

Spyros Mesomeris
Global Head of Quantitative
and QIS Research

International Production Locations

Deutsche Bank AG

Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG

Mainzer Landstrasse 11-17
60329 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG

Filiale Hongkong
International Commerce Centre,
1 Austin Road West, Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.

2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank AG London

1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank Securities Inc.

60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500
