Deutsche Bank
Research

Rating
Buy

Asia
China

Health Care
Pharmaceuticals / Biotechnology

Company
Hengrui Medicine

Reuters	Bloomberg	Exchange	Ticker
600276.SS	600276 CH	SHH	600276

Date
22 October 2018

Forecast Change

Price at 18 Oct 2018 (CNY)	55.44
Price target - 12mth (CNY)	73.90
52-week range (CNY)	101.50 - 55.40
Shanghai Composite	2,550

Deep dive into flagship drugs

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A market leader for almost all flagship drugs

We analyzed competitive landscape of Hengrui's top 10 drugs including Aitan (apatinib), Aibeining, Aisu, and atracurium series. All together, they took in 66% of total revenue in 1H18 by Rx data. Hengrui maintained its No. 1 rank in many of the chemical classes in the past 4.5 years. Also, most of the 10 drugs experienced single-digit price cuts during the period, except for Aitan, whose ASP was slashed 37% in 1H18 upon NRDL entry. We now model 21% and 27% growth for net income in 2018 and 2019, respectively.

Expect limited impact from BE drug tender; 3 drugs involved

We expect limited impact on Hengrui from the drug tender in 11 large cities. Related products include dexmedetomidine, irbesartan, and nab paclitaxel, which accounted for 11%, 1%, and 0% of revenue in 1H18, respectively, per Rx data. Whether dexmedetomidine can pass BE before this tender remains uncertain now. No matter whether Hengrui wins or loses the tender, we estimate the impact on total revenue would be from -1.5% to -1% in 11 cities only, while blended impact would be no more than 0.5% in absolute value. Going forward, we believe Hengrui holds a relatively robust franchise with more focus on innovative drugs vs. competitors.

Model revisions, including minor changes to historical data

The largest challenge for modeling Hengrui is the lack of sales data, as the company does not report individual drug revenue at all. While Hengrui primarily replies upon its direct sales force, public data also indicates Hengrui used third party CSOs (contract sales organizations), which explains the discrepancy between Rx data and reported revenues on specific therapeutic classes. We took time to reconcile these and believe our present model properly reflects Rx trends.

Decrease price target to RMB73.9 from RMB85.5; risks

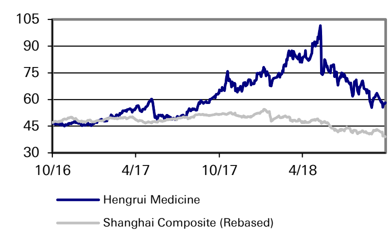
We decrease our PT mainly due to sector re-rating. Our PT is based on 55x 2019E EPS, vs. 64x previously. We believe Hengrui deserves a premium in the multiple given the superior value of its products and its strong pipeline; its A-share peers are trading at 29x 2019E EPS with 20% growth in 2020 (vs. 27% we model for Hengrui). Key risks include regulatory delays, setback in gastric and ESCC for PD-1, as well as price cut and competition.

Key changes

TP	85.50 to 73.90	↓	-13.6%
Sales (FYE)	17,230 to 17,143	↓	-0.5%
Op prof margin (FYE)	-	↑	0.0%
Net profit (FYE)	3,934.5 to 3,916.2	↓	-0.5%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-3.5	-25.3	-12.9
Shanghai Composite	-7.9	-10.8	-26.5

Source: Deutsche Bank

Deutsche Bank AG/Hong Kong

Distributed on: 22/10/2018 00:51:32 GMT

Model updated:20 October 2018

Running the numbers

Asia

China

Pharmaceuticals / Biotechnology

Hengrui Medicine

Reuters: 600276.SS Bloomberg: 600276 CH

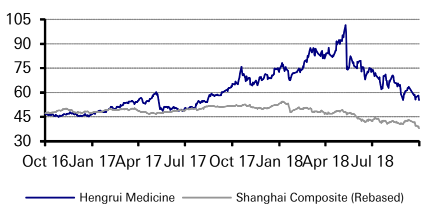
Buy

Price (18 Oct 18)	CNY 55.44
Target Price	CNY 73.90
52 Week range	CNY 55.40 - 101.50
Market Cap (m)	CNYm 156,178
	USDm 22,526

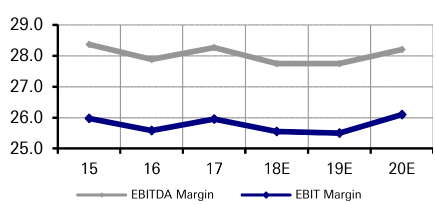
Company Profile

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.

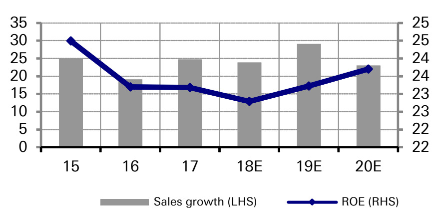
Price Performance



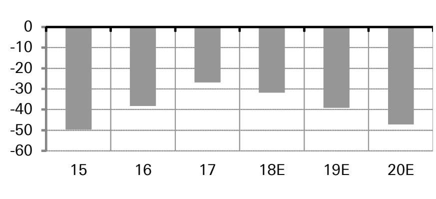
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 31-Dec	2015	2016	2017	2018E	2019E	2020E
Financial Summary						
DB EPS (CNY)	0.77	0.92	1.16	1.02	1.34	1.71
Reported EPS (CNY)	0.77	0.92	1.14	1.05	1.34	1.71
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	156,178	156,178	156,178
Enterprise value (CNYm)	116,224	122,854	154,085	150,479	147,300	142,633
Valuation Metrics						
P/E (DB) (x)	55.8	49.2	48.5	54.1	41.3	32.5
P/E (Reported) (x)	55.7	49.3	49.1	53.0	41.3	32.5
P/BV (x)	13.90	10.34	12.64	10.72	8.65	6.93
FCF Yield (%)	1.6	1.2	1.4	1.1	1.8	2.5
Dividend Yield (%)	0.1	0.2	0.2	0.1	0.2	0.2
EV/Sales (x)	12.5	11.1	11.1	8.8	6.7	5.2
EV/EBITDA (x)	44.0	39.7	39.4	31.6	24.0	18.6
EV/EBIT (x)	48.0	43.3	42.9	34.4	26.1	20.1
Income Statement (CNYm)						
Sales revenue	9,316	11,094	13,836	17,143	22,130	27,221
Gross profit	7,944	9,659	11,986	14,884	19,386	24,037
EBITDA	2,643	3,094	3,911	4,757	6,142	7,677
Depreciation	218	248	311	370	492	565
Amortisation	4	7	9	7	7	7
EBIT	2,420	2,838	3,591	4,380	5,643	7,105
Net interest income(expense)	148	166	37	119	156	238
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	-7	5	-15	-3	0	0
Other pre-tax income/(expense)	1	4	147	145	35	44
Profit before tax	2,562	3,013	3,759	4,640	5,835	7,386
Income tax expense	338	379	466	633	799	1,011
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	3,916	4,945	6,285
DB adjustments (including dilution)	-1	1	40	-82	0	0
DB Net profit	2,171	2,590	3,257	3,834	4,945	6,285
Cash Flow (CNYm)						
Cash flow from operations	2,277	2,593	2,547	3,283	4,501	6,015
Net Capex	-394	-1,110	-379	-1,029	-885	-817
Free cash flow	1,883	1,482	2,169	2,254	3,615	5,198
Equity raised/(bought back)	19	14	14	0	0	0
Dividends paid	-150	-196	-317	-274	-346	-440
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	1,981	3,269	4,758
Change in working capital	*-169*	*-259*	*-1,044*	*-1,086*	*-1,034*	*-932*
Balance Sheet (CNYm)						
Cash and other liquid assets	5,133	4,912	4,267	6,248	9,517	14,275
Tangible fixed assets	1,770	2,474	3,079	3,737	4,130	4,382
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	11,998	13,471	15,125
Total assets	11,497	14,330	18,039	22,372	27,501	34,158
Interest bearing debt	0	0	0	0	0	0
Other liabilities	1,139	1,456	2,096	2,711	3,150	3,871
Total liabilities	1,139	1,456	2,096	2,711	3,150	3,871
Shareholders' equity	9,931	12,388	15,368	18,995	23,595	29,439
Minorities	426	486	575	666	757	847
Total shareholders' equity	10,358	12,874	15,943	19,661	24,351	30,286
Net debt	*-5,133*	*-4,912*	*-4,267*	*-6,248*	*-9,517*	*-14,275*
Key Company Metrics						
Sales growth (%)	25.0	19.1	24.7	23.9	29.1	23.0
DB EPS growth (%)	44.5	19.3	25.8	-11.4	31.2	27.1
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	22.8	23.2	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	-31.8	-39.1	-47.1
Net interest cover (x)	nm	nm	nm	nm	nm	nm

Source: Company data, Deutsche Bank estimates

Summary

DB analysis for top 10 drugs

We picked top 10 drugs according to Rx data and evaluated competitive landscape for each drug. In our calculation, we standardized all dosages/formulations. We also use 3M rolling average for market share and ASP data. Our key takeaways include the following:

- Most of the top 10 drugs delivered healthy growth in 1H18, while Aiheng lagged.
- Out of top 10, Hengrui has a dominant position for 9 drugs in terms of market share.
- Despite the threats of potential new rivals in each generic class, for instance, iodixanol, sevoflurane and irinotecan, we believe Hengrui is able to manage the risks well, supported by strong marketing, high-quality products, and abundant pipeline.

Figure 1: Summary of top 10 drugs

Drug name	Generic name	Drug sales in 1H18 (RMB, m)	Drug sales growth in 1H18	% of total revenue in 1H18	Market share nationwide in 1H18	No of domestic competitors	Potential new player
Aisu	Docetaxel	851	23%	11%	55%	More than 10	
Aibeining	Dexmedetomidine	847	14%	11%	78%	7	
Cisatracurium besylate for injection	Cisatracurium besylate	651	12%	8%	69%	3	
Atracurium besilate for injection	Atracurium	16	-11%	0%	100%	0	
Ioversol injection	Ioversol	650	13%	8%	94%	0	
Iodixanol injection	Iodixanol	641	64%	8%	57%	3	Starry Pharm
Kaiteli	Sevoflurane	604	9%	8%	69%	2	Haixi Lianhe Pharma
Aili	Irinotecan	402	29%	5%	70%	4	Sichuan Huiyu Pharma
Aiheng	Oxaliplatin	322	2%	4%	32%	More than 10	
Aitan	Apatinib	290	77%	4%	100%	0	

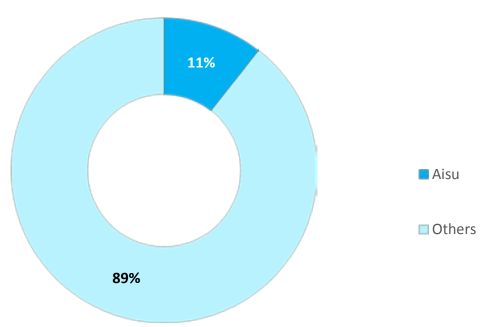
Source: Deutsche Bank, CPA, CFDA, yaozh.com

Deep dive into flagship drugs

Aisu (docetaxel)

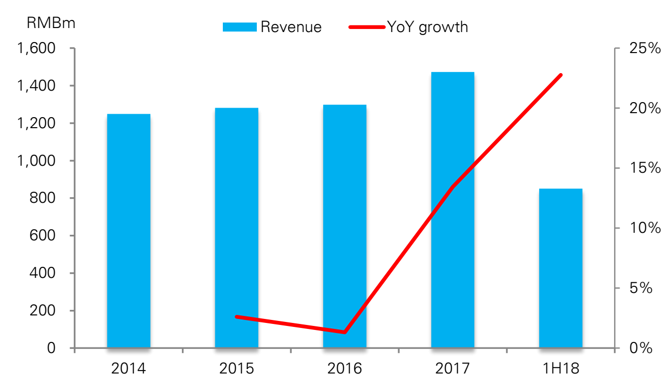
- Sales growth of Aisu improved to 23% in 1H18, vs. 13%/1% in 2017/2016, respectively. In our view, this is partly related to removal of restrictions to 2nd line treatment in national reimbursement last year.
- Aisu was also taking more market share from early 2017 with relatively small price cut (4% in 1H18).

Figure 2: Sales of Aisu accounted for 11% of total revenue in 1H18



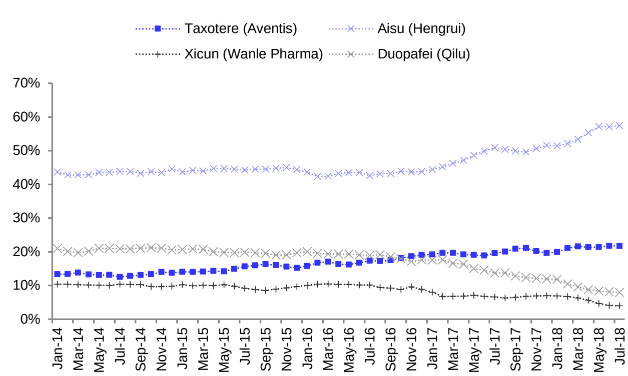
Source: Deutsche Bank, Chinese Pharmaceutical Association (CPA)

Figure 3: Growth acceleration of Aisu revenue since 2016



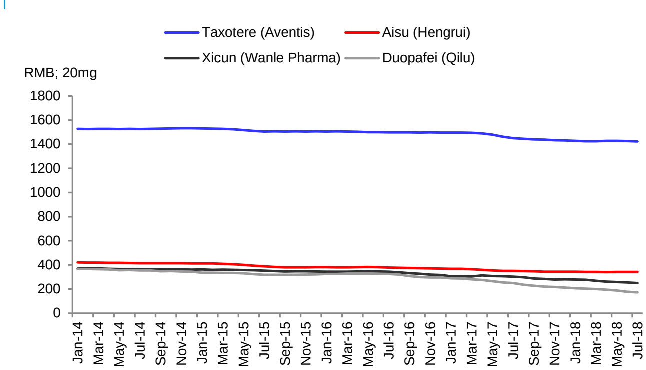
Source: Deutsche Bank, CPA

Figure 4: Market share of major docetaxel players by revenue



Source: Deutsche Bank, CPA

Figure 5: ASP of docetaxel

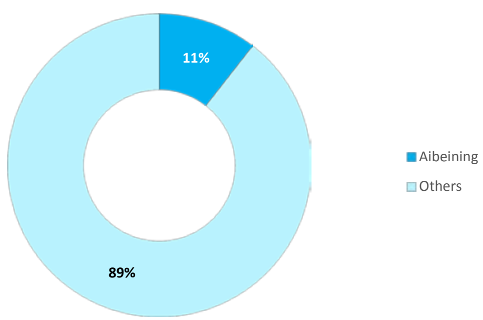


Source: Deutsche Bank, CPA

Aibeining (dexmedetomidine)

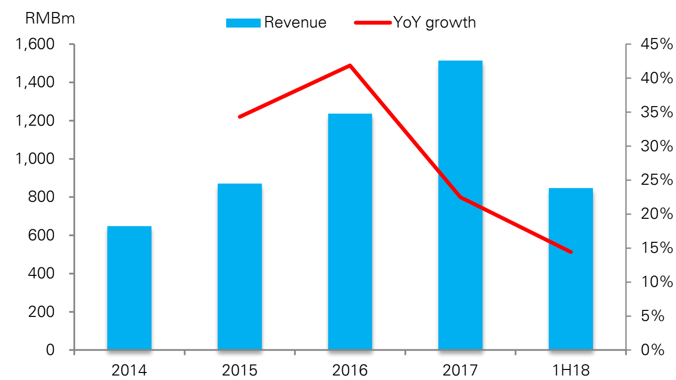
- Aibeining is the largest drug of Hengrui by our estimate and holds the majority of dexmedetomidine market in China.
- According to Rx data, this drug accounted for 11% of total revenue in 1H18, and it grew 14% YoY during the period. We also highlight the magnitude of price cut increased to 7% in 1H18 from 2% in 2016, which we believe was due to intensified competition.

Figure 6: Sales of Aibeining accounted for 11% of total revenue in 1H18



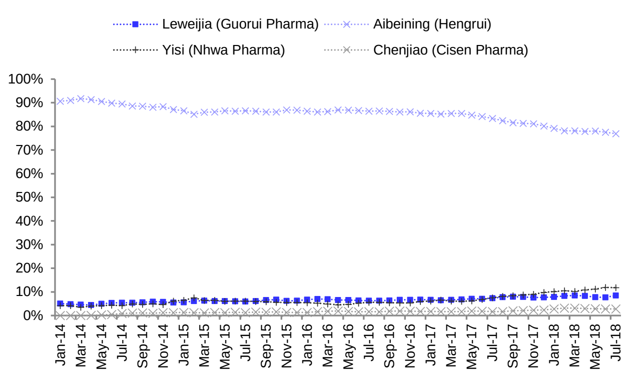
Source: Deutsche Bank, CPA

Figure 7: Revenue growth of Aibeining remained solid



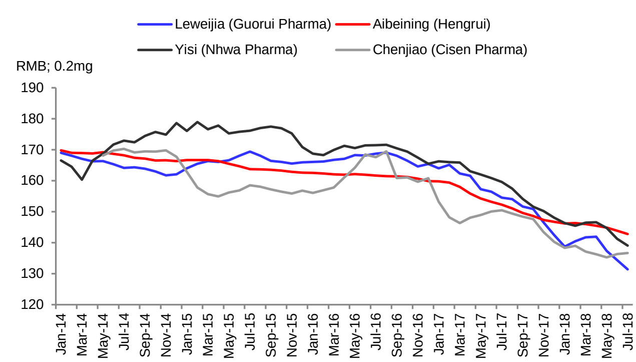
Source: Deutsche Bank, CPA

Figure 8: Market share of major dexmedetomidine players by revenue



Source: Deutsche Bank, CPA

Figure 9: ASP of dexmedetomidine

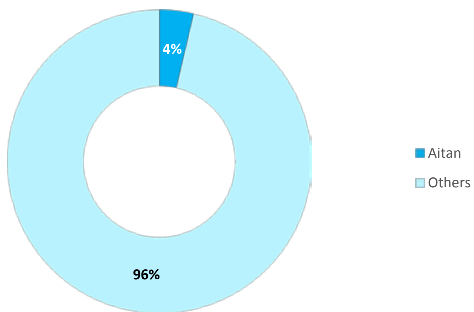


Source: Deutsche Bank, CPA

Aitan (apatinib)

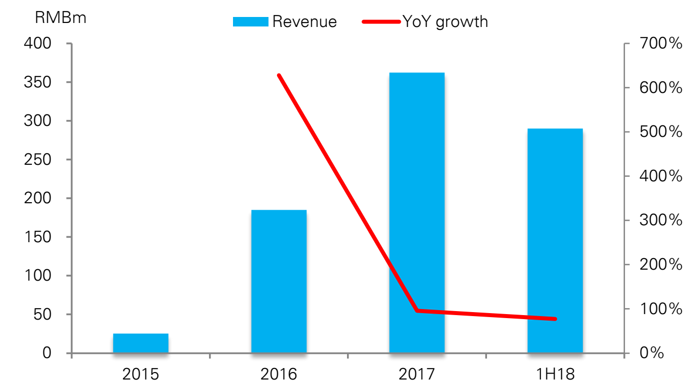
- According to Rx data, Aitan accounted for only 4% of Hengrui's total sales in 1H18, vs. 11% by DBe. We highlight that the reason behind the difference is that a large portion of Aitan is sold in drug stores.
- We continue to expect very strong growth of Aitan in the next few quarters.

Figure 10: Sales of Aitan accounted for 4% of total revenue in 1H18 by Rx data



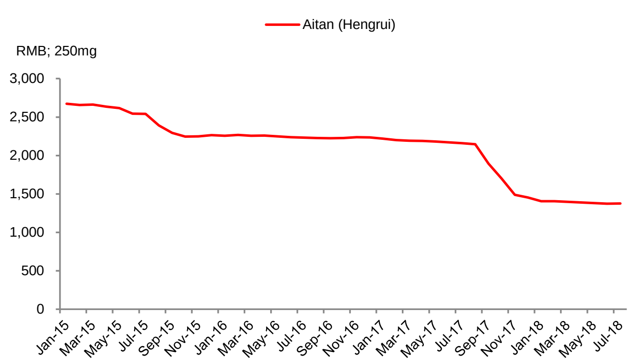
Source: Deutsche Bank, CPA

Figure 11: Robust revenue growth of Aitan continued



Source: Deutsche Bank, CPA

Figure 12: ASP of apatinib

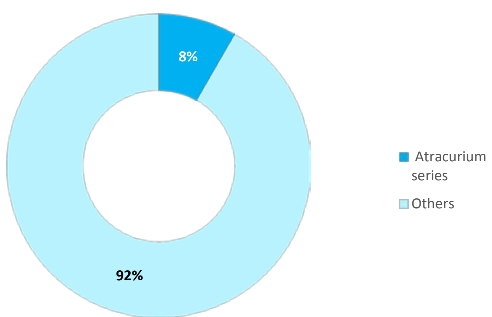


Source: Deutsche Bank, CPA

Atracurium series

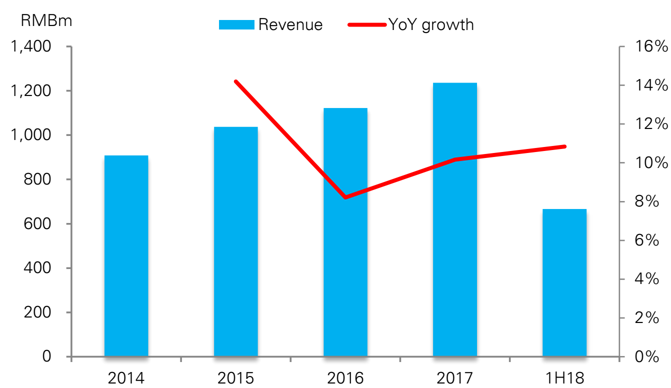
- Atracurium series includes cisatracurium besylate and atracurium besilate, and the former takes up the majority of sales by Rx data. Additionally, atracurium besilate is an exclusive drug of Hengrui.
- Growth of cisatracurium besylate remained solid, while sales of atracurium besilate shrunk during the period.
- Hengrui maintained prices quite well and experienced lower price cuts vs. major competitors. ASP of cisatracurium besylate and atracurium besilate declined moderately by 5% and 6% YoY, respectively, in 1H18.

Figure 13: Sales of Hengrui's atracurium series accounted for 8% of total revenue in 1H18



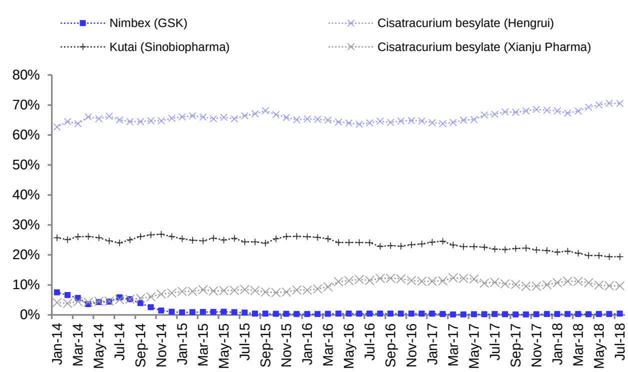
Source: Deutsche Bank, CPA

Figure 14: Healthy growth of Hengrui's atracurium series revenue



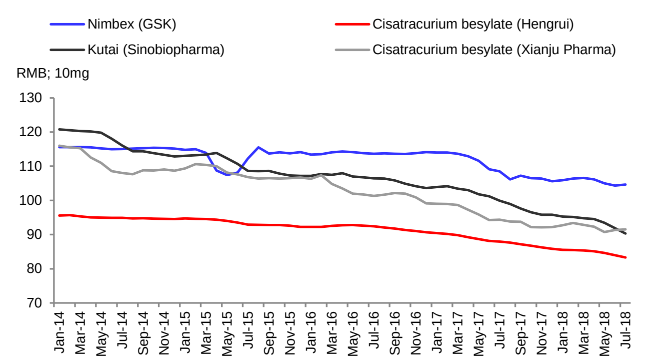
Source: Deutsche Bank, CPA

Figure 15: Market share of major cisatracurium besylate players by revenue



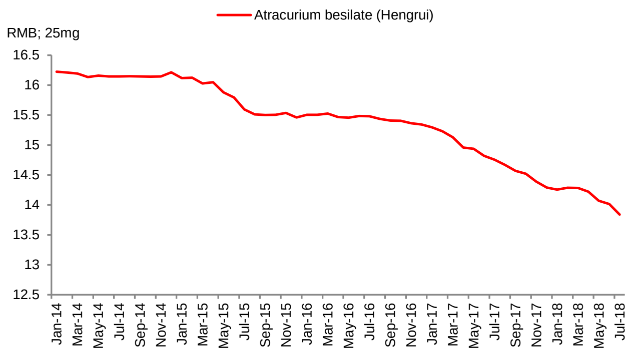
Source: Deutsche Bank, CPA

Figure 16: ASP of cisatracurium besylate



Source: Deutsche Bank, CPA

Figure 17: ASP of atracurium besilate

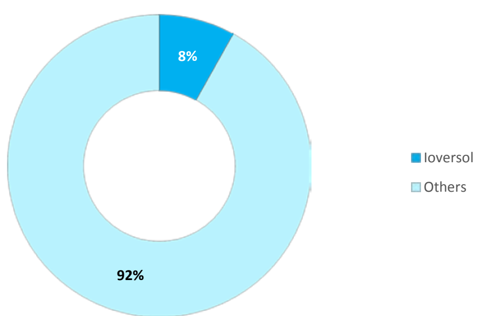


Source: Deutsche Bank, CPA

Ioversol

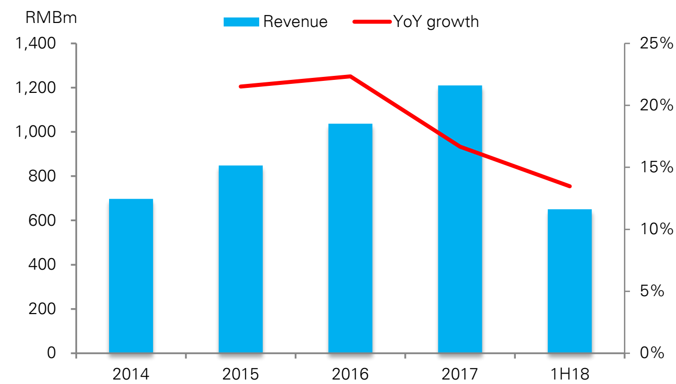
- Hengrui's ioversol was dominant in the market with 94% share in 1H18 and contributed 8% of total revenue by Rx data. This product delivered CAGR14-17 of 20%.
- We see impact of both volume and price on revenue growth deceleration, and price cut was 7% and 6% in 2017 and 1H18, respectively.

Figure 18: Sales of Hengrui's ioversol accounted for 8% of total revenue in 1H18



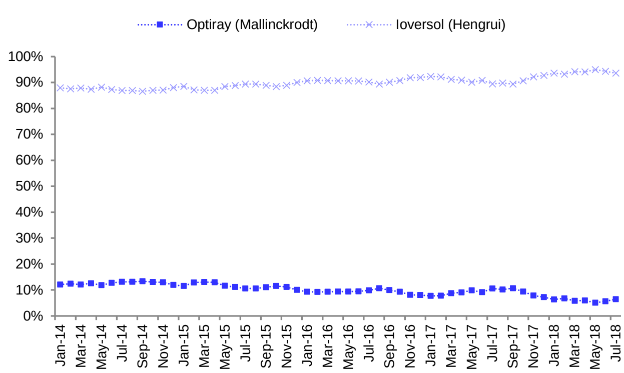
Source: Deutsche Bank, CPA

Figure 19: Revenue growth of Hengrui's ioversol



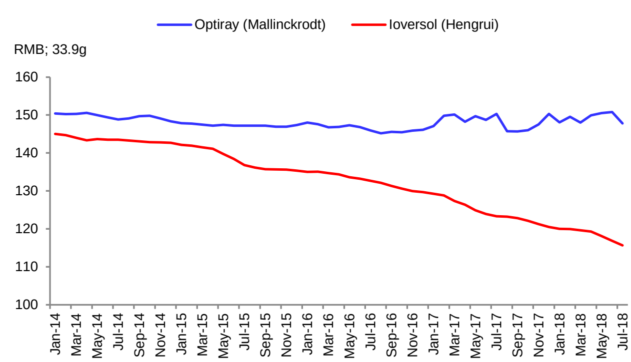
Source: Deutsche Bank, CPA

Figure 20: Market share of major ioversol players by revenue



Source: Deutsche Bank, CPA

Figure 21: ASP of ioversol

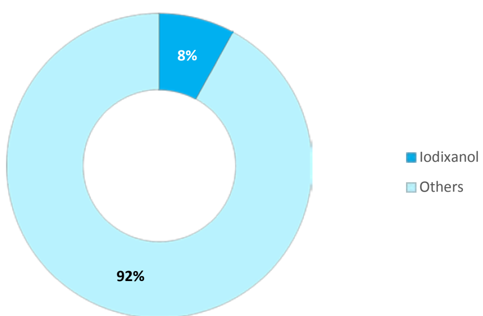


Source: Deutsche Bank, CPA

Iodixanol

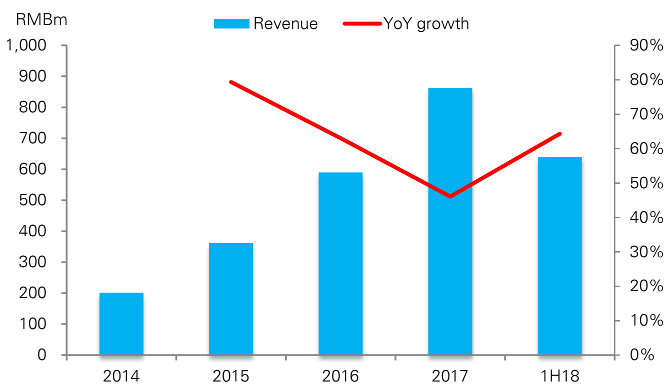
- Hengrui's iodixanol is another key drug in the contrast agents segment and accounted for 8% of total revenue in 1H18. Rx data indicated that it had been gaining market share since 2014, and charged at the lowest national price since 2015.
- Sales growth of Hengrui's iodixanol outperformed most of its flagship drugs, with CAGR14-17 of 62%. We remain optimistic on contrast agents franchise and anticipate strong growth momentum ahead.

Figure 22: Sales of Hengrui's iodixanol accounted for 8% of total revenue in 1H18



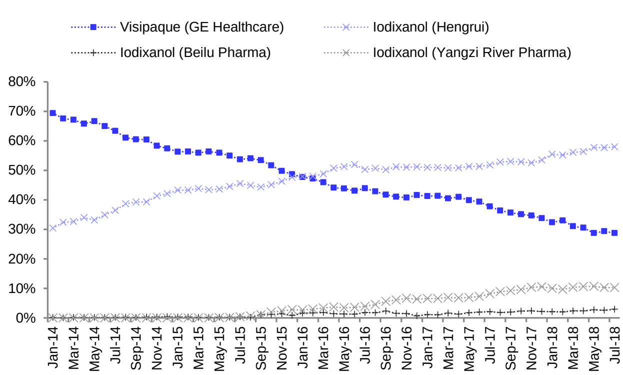
Source: Deutsche Bank, CPA

Figure 23: Revenue growth of Hengrui's iodixanol



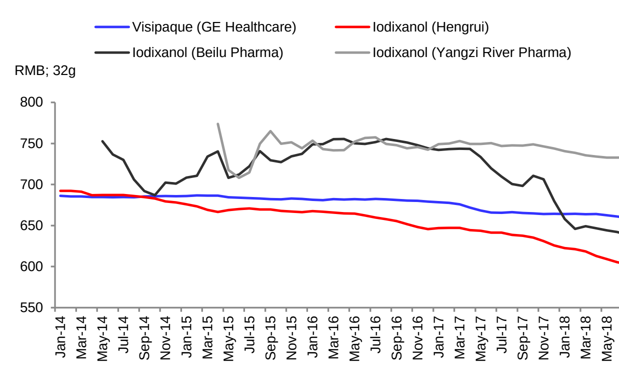
Source: Deutsche Bank, CPA

Figure 24: Market share of major iodixanol players by revenue



Source: Deutsche Bank, CPA

Figure 25: ASP of iodixanol

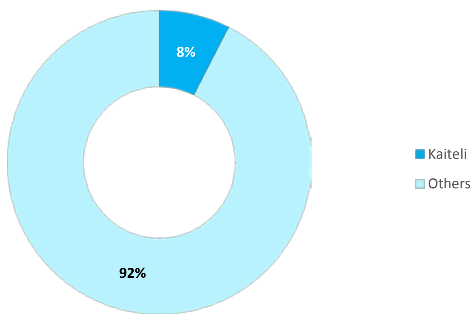


Source: Deutsche Bank, CPA

Kaiteli (sevoflurane)

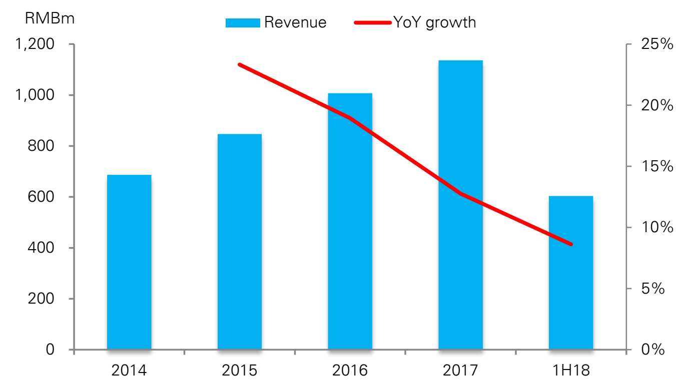
- Sales growth of Kaiteli has slowed since 2015 according to Rx data, while we believe its export revenue should have expanded rapidly.
- Hengrui continued to be the market leader in sevoflurane in China and retained over 60% market share in the past 4.5 years. We anticipate more fierce competition in the future when the third player enters the market, as Haixi Lianhe Pharma's generic is under regulatory review.

Figure 26: Sales of Kaiteli accounted for 8% of total revenue in 1H18



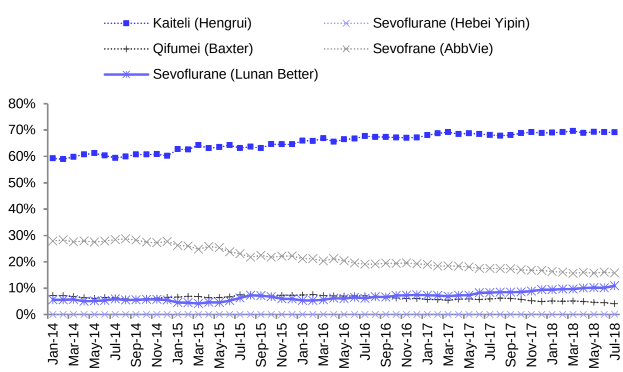
Source: Deutsche Bank, CPA

Figure 27: Revenue growth of Kaiteli decelerated since 2015



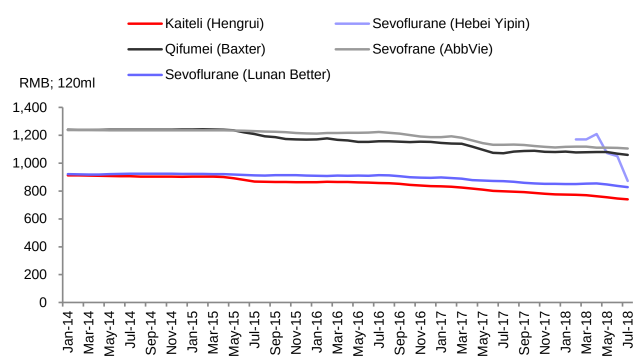
Source: Deutsche Bank, CPA

Figure 28: Market share of major sevoflurane players by revenue



Source: Deutsche Bank, CPA

Figure 29: ASP of sevoflurane

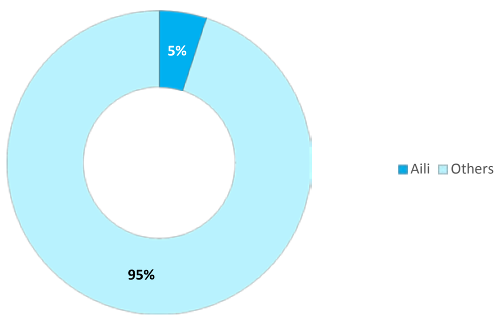


Source: Deutsche Bank, CPA

Aili (irinotecan)

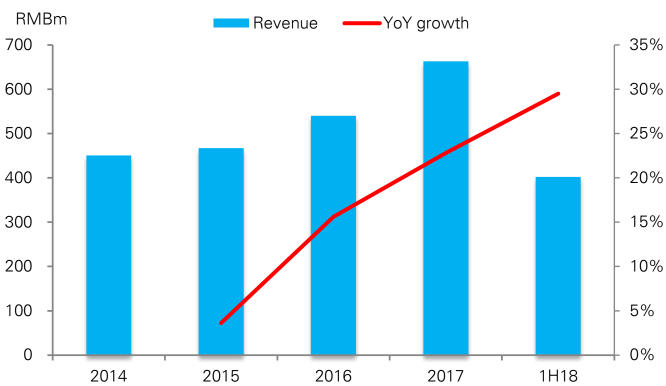
- Sales growth of Aili accelerated to 29% in 1H18 from 4% in 2015 per Rx data. This might be owing to removal of restrictions to 2nd line treatment in tier 1 and special hospital in 2017 NRDL.

Figure 30: Sales of Aili accounted for 5% of total revenue in 1H18



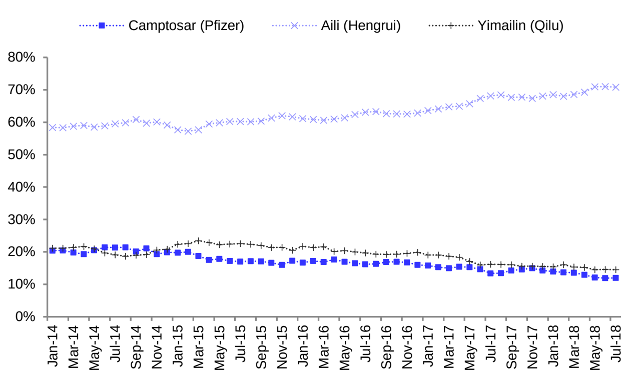
Source: Deutsche Bank, CPA

Figure 31: Revenue growth of Aili accelerated since 2015



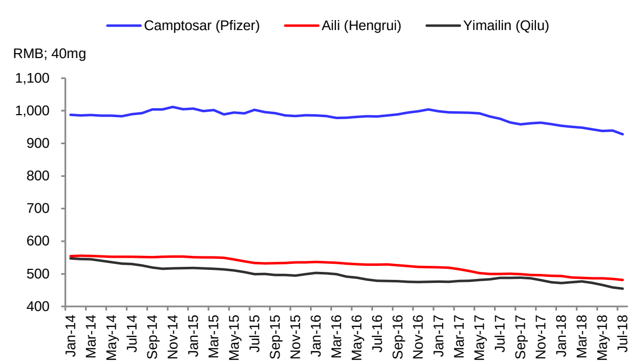
Source: Deutsche Bank, CPA

Figure 32: Market share of major irinotecan players by revenue



Source: Deutsche Bank, CPA

Figure 33: ASP of irinotecan

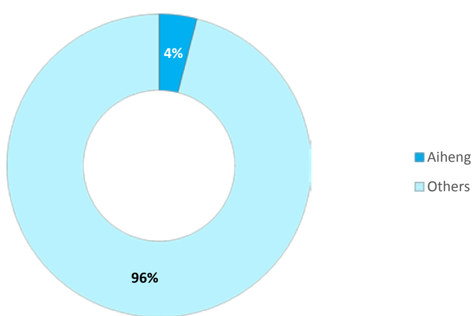


Source: Deutsche Bank, CPA

Aiheng (oxaliplatin)

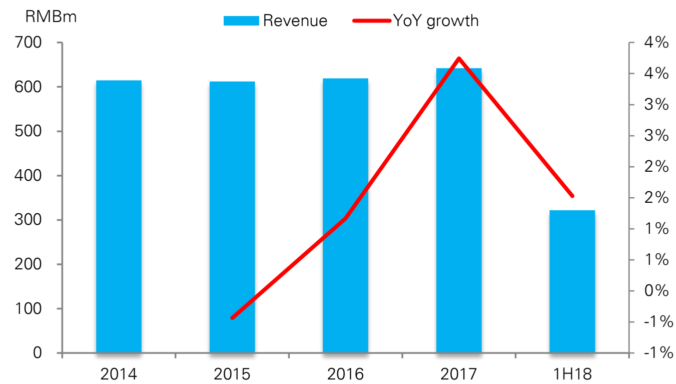
- Aiheng maintained stable growth of 0-4% each year from 2014 to 1H18.
- We are a bit surprised that Sanofi accumulated nearly 13% market share in the past 4.5 years, while Hengrui lost 4%.

Figure 34: Sales of Aiheng accounted for 4% of total revenue in 1H18



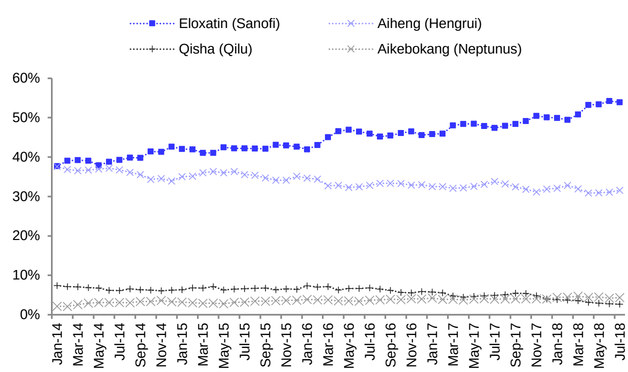
Source: Deutsche Bank, CPA

Figure 35: Revenue growth of Aiheng



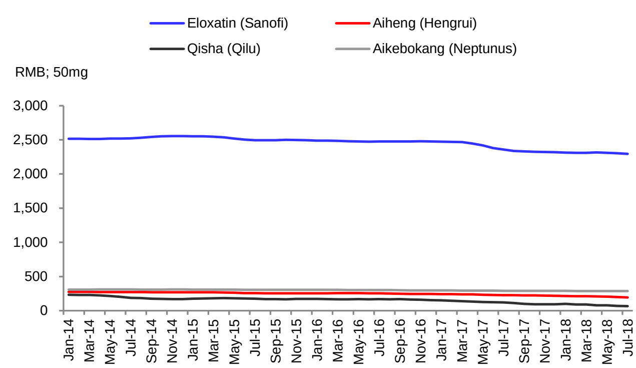
Source: Deutsche Bank, CPA

Figure 36: Market share of major oxaliplatin players by revenue



Source: Deutsche Bank, CPA

Figure 37: ASP of oxaliplatin



Source: Deutsche Bank, CPA

Appendix 1

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Company	Ticker	Recent price*	Disclosure
Hengrui Medicine	600276.SS	56.60 (CNY) 19 Oct 18	NA

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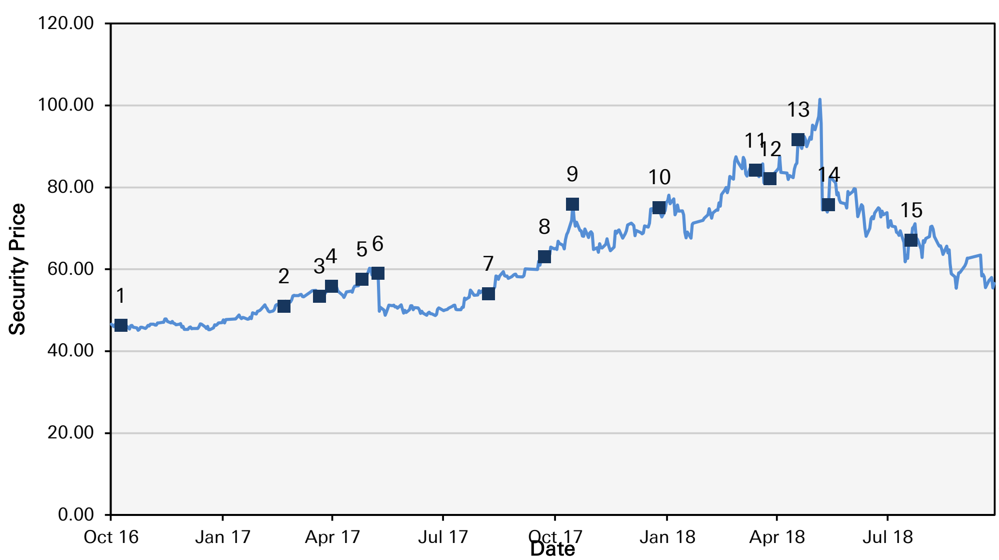
Historical recommendations and target price: Hengrui Medicine (600276.SS)

(as of 10/19/2018)



Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

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Hold
Sell
Not Rated
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4.	23/04/2017:	Buy, Target Price Change CNY65.00 Jack Hu, Ph.D.
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12.	18/04/2018:	Buy, Target Price Change CNY92.80 Jack Hu, Ph.D.
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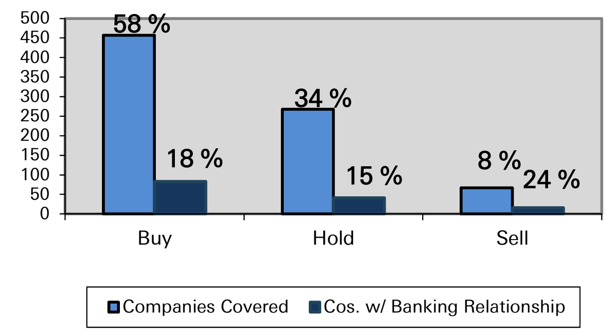
Equity rating dispersion and banking relationships



Asia-Pacific Universe

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