

23 November 2018

China

EQUITIES

AShare
Research002294 CH Outperform
Price (at 08:50, 22 Nov 2018 GMT) Rmb25.22

Valuation - NAV	Rmb	24.36
12-month target	Rmb	40.06
Upside/Downside	%	+58.8
12-month TSR	%	+62.7

GICS sector

Pharmaceuticals, Biotechnology & Life Sciences

Market cap	Rmbm	26,380
Market cap	US\$m	3,738
Free float	%	28
30-day avg turnover	US\$m	23.5
Number shares on issue	m	1,046

Investment fundamentals

Year end 31 Dec		2017A	2018E	2019E	2020E
Revenue	m	4,076.1	4,865.9	5,933.5	6,948.7
EBIT	m	1,657.8	1,905.7	2,399.4	2,864.2
EBIT growth	%	3.6	15.0	25.9	19.4
Reported profit	m	1,451.9	1,638.1	2,049.3	2,441.0
Adjusted profit	m	1,395.3	1,638.1	2,049.3	2,441.0
EPS rep	Rmb	1.39	1.57	1.96	2.33
EPS rep growth	%	4.0	12.8	25.1	19.1
EPS adj	Rmb	1.33	1.57	1.96	2.33
EPS adj growth	%	1.1	17.4	25.1	19.1
PER rep	x	18.2	16.1	12.9	10.8
PER adj	x	18.9	16.1	12.9	10.8
Total DPS	Rmb	0.80	0.90	1.00	1.10
Total div yield	%	3.2	3.6	4.0	4.4
ROA	%	24.7	26.2	29.0	29.8
ROE	%	24.5	25.4	27.7	28.2
EV/EBITDA	x	14.3	12.6	10.1	8.5
Net debt/equity	%	-26.5	-32.5	-39.2	-46.0
P/BV	x	4.4	3.8	3.3	2.8

Source: FactSet, Macquarie Research, November 2018
(all figures in Rmb unless noted, TP in CNY)SZ Salubris Pharm (A-Share) (002294 CH)
Top pick among manufacturers

Key points

- ▶ Taijia's growth to remain strong in 2019, even after factoring in price cuts.
- ▶ Expert in challenging patents and winning, enjoying extra years of profits.
- ▶ Initiate coverage as top pick, with Outperform rating and TP of Rmb40.06.

Following the successful launch of Taijia in 2000 and good execution since then, Shenzhen Salubris Pharm (SALU) enjoys one of the highest ROEs (of 24%) among peers, despite having virtually zero debt. Its generous payout ratio of 57% results in a high dividend yield of 3.6%, which we believe is a rarity among pharmaceutical companies. The stock is one of the cheapest (13x vs peers at 28x 2019E) and worst performing (down 45% vs sector median of -19% YTD) among peers. With our estimated earnings growth of 17% in 2018 and 25% in 2019 (sector at 12%), we top pick Salubris among manufacturers.

Taijia enjoying tailwinds

Sales of Taijia have more than doubled over the last five years to Rmb3bn in 2017 and we expect 15% growth in 2018 and peak sales of Rmb4bn in 2021. Gross margin is high at 90% in 2017 and should remain so even with a single-digit price decline in 2018 based on our estimate. Investors may worry about the challenges faced in the next three years: "4+7" centralized procurement, price declines and threats from existing and new competitors. Yet we believe a price cut of 25% should be enough for Taijia to win the tending offer and we believe it could gain 10% market share as well as SGA savings due to guaranteed volume.

From 1 to 4 anti-thrombotic drugs

Management has already put more products on the market and candidates under development to sustain medium-term earnings growth even in the event of Taijia sales starting to slip. Management has focused on anti-thrombotic drugs: Taijia (泰嘉), launched in 2000, Taijianing (泰加宁), launched in 2011, Taiyi (泰仪), launched in 2018, and Rivaroxaban (利伐沙班) to be launched next year. In our view, these products should help the company reduce its reliance on Taijia from 74% of revenue in 2017 to 57% in 2020E, according to our estimate.

Challenger and winner

SALU has been successful in challenging patents of brand name drugs. SALU even managed to launch Taijia in 2000 before the brand name drug Plavix entered the market in 2005 while the second generic, Lepu's Shuaitai, entered the market only in 2012 when the patent formally expired. 17 years later, SALU repeated this feat with a successful patent challenge of Taiyi (泰仪) and its ticagrelor became the first-to-market generic in August 2018. We think this management strength is unique in the market and not easily replicable by peers.

Valuation

We apply 20x PE on 2019E EPS for all therapeutical areas to arrive at our target price of Rmb40.06, implying a 62.7% TSR. We believe our multiple is justified in view of strong earnings growth (we see 17% in 2018E and 25% in 2019E).

Key risk

Concentration risk for Taijia, which could face fierce competition and price cuts.

Analysts

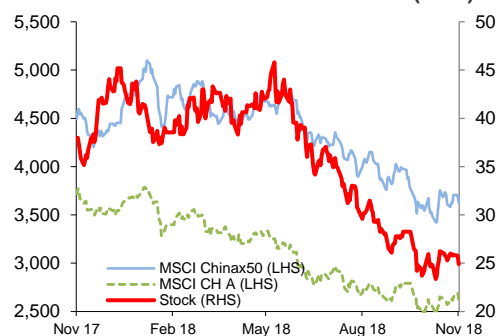
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002294-HK vs MSCI CH and MSCI CH A (Rmb)



Source: FactSet, Macquarie Research, Nov. 2018

MQ forecast vs Consensus forecast (Rmb bn)

	2015A	2016A	2017A	2018E		2019E
Revenue	3.4	3.8	4.1	MQ	4.9	5.9
				Cons	4.8	5.5
				Dif%	2%	7%
Net profit	1.25	1.38	1.40	MQ	1.64	2.05
				Cons	1.63	1.86
				Dif%	0%	10%

Source: FactSet, Macquarie Research, November 2018
MQ: Macquarie forecast, Cons: FactSet consensus

Events after listing in 2009:

A 2013 Xinlitan (Allisartan Isoproxil, 信立坦), Class 1 innovative drug, launched

B 2014 Acquired Genemen biotech (金盟) and Genekey biotech (金凯)

C 2017 Taijia (泰嘉, Clopidogrel Bisulfate) acquired first approval for bioequivalence test

D 2017 Xinlitan was admitted to NRDL (2017)

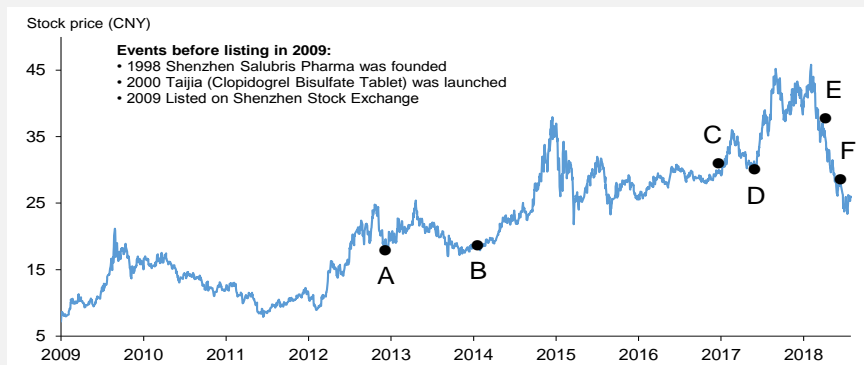
E 2018 Acquired Suzhou Huanchen Medical Technology (苏州桓晨医疗科技)

F 2018 Ticagrelor (替格瑞洛), first-to-market generic, was approved for marketing

Company profile

- Shenzhen Salubris Pharmaceutical (SALU) is a pharmaceutical company that specializes in cardiovascular drugs, among which Taijia (泰嘉, clopidogrel) is its signature product. It is the generic version of Plavix made by Sanofi and is used to inhibit aggregation of blood platelets to reduce the risks of heart disease and stroke, especially after placement of a coronary artery stent.
- Founded in 1998, SALU started off making and selling active pharmaceutical ingredients. It expanded to become a drug manufacturer in 2000 when it launched Taijia before the patent expiry of Plavix. In 2009, it was listed in Shenzhen. In 2014, it acquired Genemen Biotech and Genekey Biotech, which saw it grow to incorporate R&D in biological drugs. In 2017, Taijia received its first approval for bioequivalence test (BE) and Xinlitan, its innovative hypertension drug was listed on National Reimbursement Drug List (NRDL). In August 2018, its first-to-market generic drug ticagrelor was approved for marketing, after it successfully challenged the patent held by AstraZeneca.
- Salubris entered the medical equipment business by acquiring 100% of Suzhou Huanchen in June 2018; Suzhou Huanchen's main product, Alpha Stent, is a non-degradable heart stent. Apart from Huanchen, Salubris acquired 10%+ Mercator Med System and less than 10% of M.A.MEDALLIANCESA, through which Salubris obtained exclusive commercial rights for their products in China.
- Chairman and founder, Ye Chenghai (aged 75) graduated from Renmin University of China in 1968 with a Bachelor in International Politics. Right after graduation, he joined the government as an officer at Baoan County (currently a district of Shenzhen), and was promoted to be a member of the Shenzhen China Communist Party Standing Committee in 1979. In 1983, he became the Vice Mayor of Shenzhen and Member of Guangdong CCP Standing Committee. In 1985 he resigned from his government position and was involved in various ventures before he founded SALU in 1988. His son, Kevin Sing Ye (aged 44), General Manager, and his daughter Ye Yujun (aged 49), Executive Director, help run the company. Ye Chenghai and his family own 68% of the company, which provides strong support in market downturns.
- From 2014 to 2017, the CAGR of revenue and earnings was 12.8% and 10.5%, respectively. We estimate the cardiovascular segment will contribute 98.5% of 2019 net profits. We expect revenue and earnings to increase by 19.4% and 17.4% in 2018, due to the continuous growth of Taijia and new launch of ticagrelor (替格瑞洛) for anticoagulation in August 2018. 2019 should see the launch of teriparatide (特立帕肽) for osteoporosis, in our view.
- The company plans to expand its therapeutic reach to orthopaedics and oncology over the next five years, with a mix of chemical and biological candidates in the form of innovative and generic drugs.

Fig 1 Company History



Source: FactSet, Macquarie Research, November 2018, priced as of 22 November 2018

Top pick among manufacturers

We initiate coverage on the China healthcare manufacturing (pharma) sector with a positive view and our top pick is Shenzhen-listed Salubris Pharmaceutical (SALU). While we believe that many larger pharmaceutical companies with bigger portfolios and longer operating histories also should see strong earnings growth and have attractive valuation upside from current levels, SALU provides the above plus it has a track record of beating competitors, including foreign brands, to secure approval and launch products. It also has the highest ROE (at 24%) in the sector, despite having virtually zero debt. Its generous payout ratio of 57% results in a high dividend yield of 3.6%, which we believe is a rarity among pharmaceutical companies. Investors may worry about the challenges faced by its key revenue contributor, Taijia, in the next three years: centralized procurement, price declines and threats from existing and new competitors. However, we believe the YTD stock price correction of 45% should have factored that in already. With our estimated earnings growth of 17% in 2018 and 25% in 2019 (sector at 12%) and the stock trading at 13x PE (2019E, sector at 28x), we believe this is an attractive opportunity to bottom fish.

Financials comparison

	18E ROE	18E Div yield	19E PE adj.
SINO	13%	0.7%	26.6
CSPC	20%	1.2%	20.3
SALU	24%	3.6%	12.7
LUYE	15%	1.0%	13.0
LIVZ	11%	1.8%	13.7

Source: Macquarie Research, November 2018

Taijia enjoying tailwinds

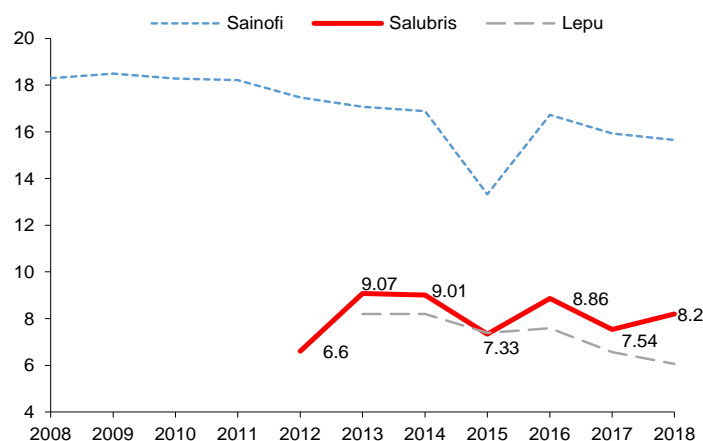
Sales of Taijia have more than doubled over the last five years to Rmb3bn in 2017 and we expect 15% growth in 2018 and peak sales of Rmb4bn in 2021. Gross margin is high at 90% in 2017 and should remain high even with single-digit price decline in 2018 according to our forecast. At a price of Rmb50-60 per box, 45% below that of brand name drug Plavix, which is sold by Sanofi, we believe its margins should be resilient in coming years even under the threat of centralized procurement. If prices drop by 20%, gross margin will drop by 1ppt; if prices drop by 50%, the impact on gross margin will be 10ppts.

However, the volume impact of centralized procurement is more difficult to predict. If we conservatively assume it adds 10% market share to Taijia from its current level of 30%, prices cannot drop more than 25% to be worthwhile for Taijia to win the tendering offer. Currently, competitor Lepu Medical Technology (A-Share) (300003 CH, Rmb29.60, Outperform, TP: Rmb52.00) sells another generic version of the clopidogrel drug, Shuaitai (帅泰), at a price 30% below that of Taijia's. If Lepu participates in the procurement process, we believe that it will likely win. However, Lepu has not completed a bioequivalence test yet.

We believe a price cut of 25% should be enough and Taijia will gain 10% additional market share

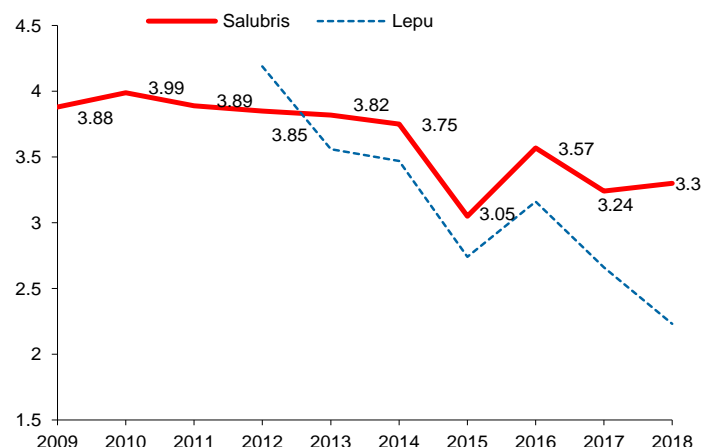
If Lepu does not participate in the centralized procurement bidding, Taijia will likely win, in our view, as Sanofi might not be willing to cut its price severely. Under the centralized procurement guidelines, the lowest bid will win if there are only two bidders but the price cut needs to be compelling enough. We believe a price cut of 25% should be enough and would see Taijia gain an additional 10% of market share. In this case, it should be a wash as SGA expenses should also drop significantly for the extra 10% market share. SGA typically accounts for 35% of revenue. If the SGA ratio drops to 20% of the revised down price, Taijia post-tax profits may actually increase by 10%. Thus, we expect the impact of centralized procurement to range from neutral to slightly positive for SALU.

Fig 2 Tendering price comparison of 75mg clopidogrel



Source: Insight DXY, Macquarie Research, November 2018 (Rmb)

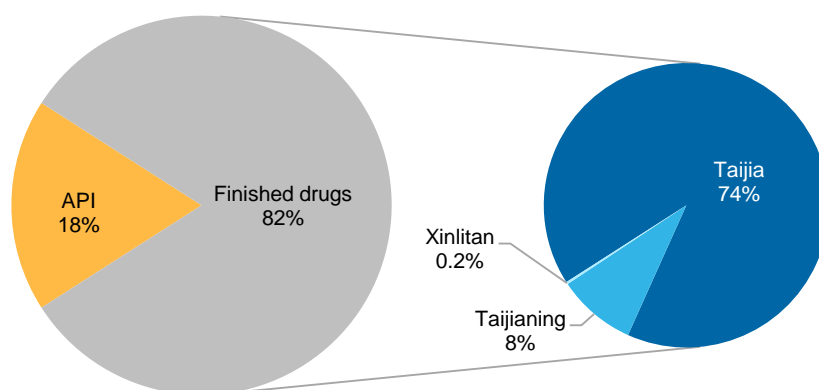
Fig 3 Tendering price comparison of 25mg clopidogrel



Source: Insight DXY, Macquarie Research, November 2018 (Rmb)

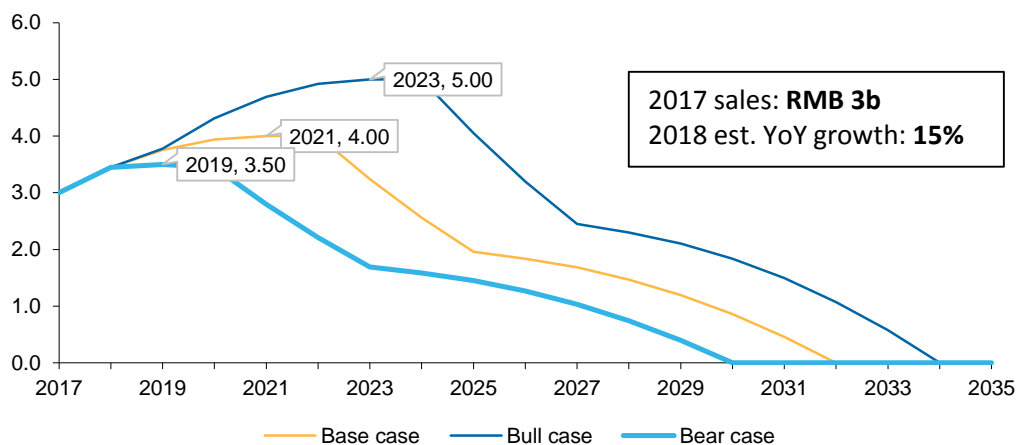
However, we see more competitors for Taijia down the road. Many generics are on the horizon, including products under development by Hengrui and CSPC. Thus, price erosion should be inevitable in the long run. SALU management's tactic is to grab more market share from Sanofi before peers jump in and to slow the price decline. Most importantly, SALU has other products on the market and in the pipeline to reduce its dependence on Taijia. Currently, Taijia offers three dosage forms (25mg, 75mg and 300mg) and the first two have passed bioequivalence tests. They account for 40% market share in volume and 30% plus in value. Plavix accounts for about 50% in volume and 60% in value but it only offers 75mg and 300mg dosages. Lepu contributes the remainder.

Fig 4 Revenue breakdown of key drugs – 2017



Source: Macquarie Research, November 2018

Fig 5 Scenario analysis of Taijia (Rmb bn)



Source: Macquarie Research, November 2018

Management has more products on the market and candidates under development

From 1 to 4 anti-thrombotic drugs

Management has already put more products on the market and candidates under development to sustain medium-term earnings growth even in the event of Taijia sales starting to slip. In contrast to peers' aggressively expanding into many therapeutic fields, SALU has been focused on the cardiovascular market. Taijia (泰嘉), launched in 2000, Taijianing (泰加宁), launched in 2011, and Taiyi (泰仪), launched in 2018, are all anti-thrombotic drugs. Another drug under development is rivaroxaban (利伐沙班), which we estimate will launch in 2019. Taijia and Taiyi are antiplatelet while Taijianing and rivaroxaban are anticoagulants. Together they help form a strong franchise for SALU in this space, in our view.

Anti-thrombotic drugs have a market size of Rmb25bn based on our estimates



There are more than 300m cardiovascular patients in China and anti-thrombotic drugs have a market size of Rmb25bn as of 2017 based on our estimates. This market has a low treatment rate at this stage but we expect this to grow quickly in the future. We believe there will be cost synergies as well as brand credibility for SALU as a leading player. The pace of sales ramp-up should be much faster due to established channels and recognition by doctors.

The company is also developing products for hypertension. Xinlitan (信立坦) is the company's first Class 1.1 innovative drug. The active drug allisartan (阿利沙坦酯) belongs to the sartan class of drugs and was launched in 2013. It is about to accelerate its growth after its inclusion in the 2017 NRDL. We estimate the hypertension market was as big as Rmb30bn in 2017 and the sartan class (angiotensin II receptor blocker) is a major component of this.

There are another couple of high-potential generics about to launch in the next three years, including rivaroxaban as an anti-coagulation drug; teriparatide for treatment of osteoporosis; and pitavastatin and rosuvastatin for treatment of hyperlipidemia. In the future, there has been work on the innovative DPP-4 drug fotaliptin for treatment of diabetes; biosimilar of denosumab for osteoporosis; and biosimilar of etanercept for autoimmune diseases.

We expect Taijia to account for 74% of revenue during 2018. Thanks to new product launches, we project its importance will drop to 57% by 2020. This should mitigate the concentration risk of the company and increase investors' confidence in the sustainability of earnings.

Taijianing (泰加宁)



Challenger and winner

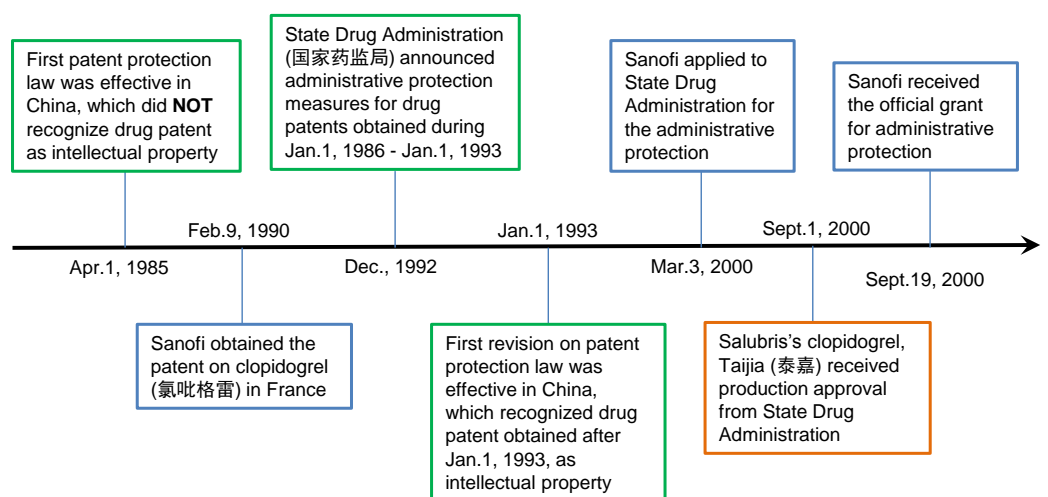
China's regulatory authorities favour the development of innovative drugs. Fast track status can be granted to drug candidates where the original brand name drug patent is about to expire in three years (for IND clinical trial applications) or one year (for NDA production applications). Salubris took a more aggressive approach to gaining approvals through which it has successfully challenged the patents of two brand name drugs.

For Taijia, SALU managed to launch as a generic in 2000 – even before the brand name drug Plavix entered the Chinese market in 2005; the second generic, Shuaitai (帅泰) by Lepu, entered the market in 2012 when the patent formally expired. Although SALU's achievement was largely attributed to incomplete patent protection practices in China, as detailed in Fig 6 below, Taijia was such a success that it brought Salubris almost two decades of unbroken profit growth.

Xinlitan (信立坦)



Fig 6 Timeline of Salubris' patent challenge for clopidogrel



Source: Company website (authorized by management), November 2018

Source: Macquarie Research, November 2018

In comparison, US generic drug company Apotex also challenged the patent but only managed to launch for a few weeks in the US in 2006 (6 years after Taijia) and then was ordered by the US court to halt sales. The CEO of Bristol-Myers Squibb, the JV partner behind Plavix, had to step down due to this incident.

Seventeen years later, with a relatively established patent protection law in China, simply taking advantage of timing is not enough to avert being convicted of breaching patent exclusivity. Thus, for ticagrelor, Salubris took its battle directly to AstraZeneca, to challenge its patent of Brilique, with active pharmaceutical ingredient (API) of ticagrelor.

- On April 27 and June 22, 2017, Salubris submitted two appeals to the National Intellectual Property Administration (NIPA, 国家知识产权局), challenging AstraZeneca's patents for the essential compound of ticagrelor and its crystal form.
- Partly due to AstraZeneca's mistake of publishing two patents for a similar compound and a similar crystal form back in 1998 and 2000, respectively, Salubris challenged AstraZeneca by accusing it of a lack of innovativeness.
- The case was settled on Nov.22, 2017, when NIPA supported Salubris' claim, stating that "AstraZeneca's patent is lack of innovative usage and effectiveness" and thus announced the ineffectiveness of AstraZeneca's patent of ticagrelor.

Thereafter, in August 2018, Salubris successfully launched its ticagrelor, Taiyi (泰仪), becoming the first-to-market generic. Where we believe it will differ from clopidogrel is that Ticagrelor should not take another ten years to ramp sales as SALU's reputation and channel were established in the anticoagulation treatment field. We see a promising sales outlook for ticagrelor, estimating it will reach Rmb0.44bn sales in 2019 and peak sales of Rmb1bn in 2025.

Fig 7 Salubris' major products

SALU drug	API	Brand drug	US approval	China approval	Patent expiry	SALU launch	BE test status	Non-SALU generic in China	Non-SALU generic overseas	# of generics in the pipeline
Taijia (泰嘉)	Clopidogrel (氯吡格雷)	Plavix (波立维) by Sanofi	1997	2005	2012	2000	Yes	Lepu Medical	Actavis, etc.	123
Taijianing (泰加宁)	Bivalirudin (比伐卢定)	Angiomax by The Medicines Company	2000	2014	2010	2011	-	Hansoh Pharma	Fresenius Kabi, etc.	19
Taiyi (泰仪)	Ticagrelor (替格瑞洛)	Brilique by AstraZeneca	2011	2012	2019	2018	Yes	-	-	39
Teriparatide	Teriparatide (特立帕肽)	Forteo/Forsteo by Eli Lilly	2002	2011	2018	2019E	-	-	Intas Pharma, etc.	15

Source: Insight DXY, Macquarie Research, November 2018

Unlike most companies that pragmatically obey the rules, Salubris' culture questions and challenges and thus – even apart from Taijia and Taiyi – Taijianing is the first-to-market generic of bivalirudin and teriparatide, which is expected to launch early next year, only one year after the patent expiry. Going forward, we believe Salubris will continue to be a pioneer in new products, adding to its current portfolio and that it will continue to win as a challenger.

Valuation, recommendation, risks

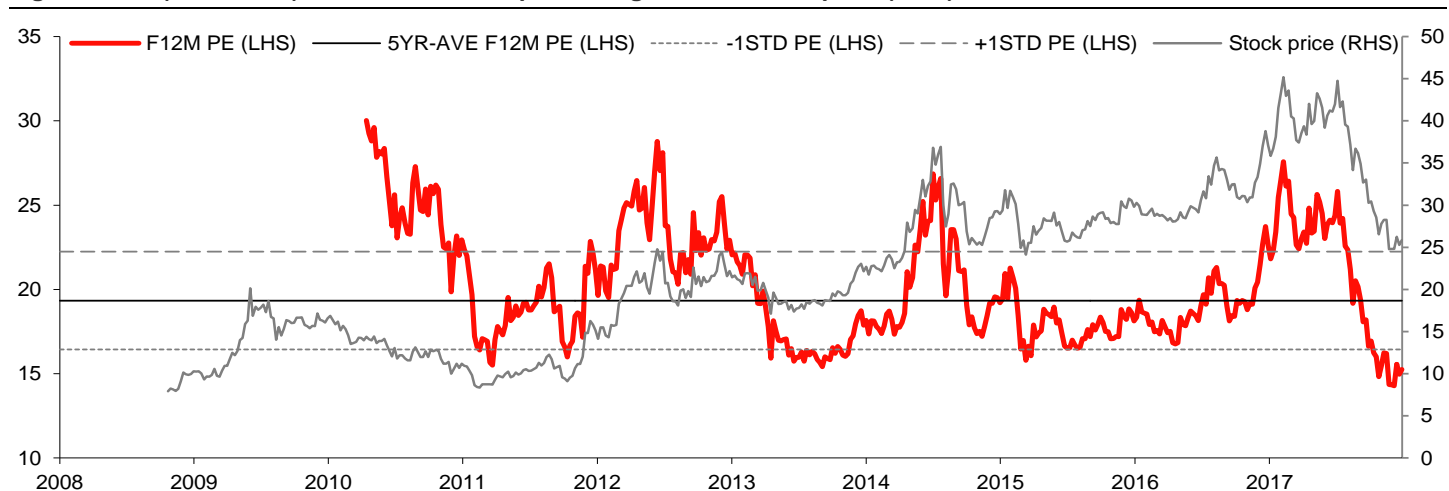
We base our target price on 2019E PE multiples but we differ from our peers in providing 1) free cash flow analysis on each product and business, 2) breakdown of revenue and earnings into individual products or subsidiaries and associates, with respective margin/SGA/tax assumptions, plus 3) major products under development, as far as into pre-clinical stage if meaningful, associated with estimated probability of each event, R&D of each stage and sales trajectory.

The discounted free cash flows will result in a gross asset value, which, after adding the net cash (or minus net debt) and working capital, will become net asset value (NAV). Currently, we use end-2019 to calculate our NAV estimates. NAV estimates are important in two important respects:

- In evaluating the present value of projects under development, which may not be able to contribute to earnings in the next three years; and
- In considering the impact on balance sheet after acquisitions and disposals, which may not be captured when just using a PE multiple to value a company.

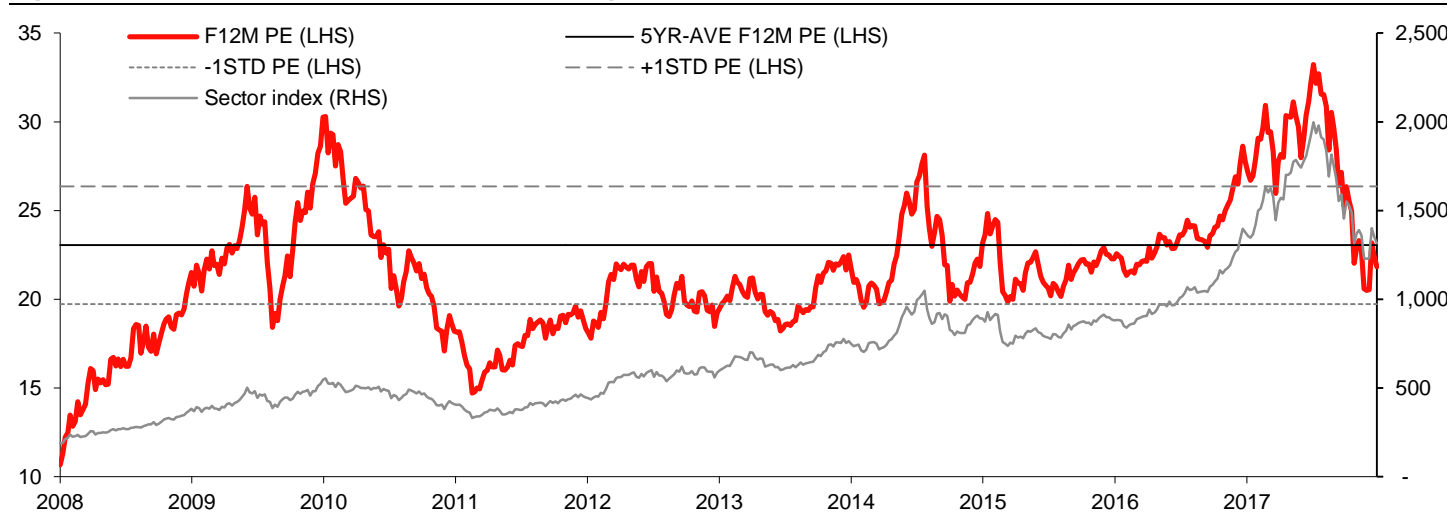
We apply 20x PE on the 2019E EPS of all therapeutical areas to arrive at our target price of Rmb40.06, implying 62.7% TSR. We believe the multiple is justified in view of the strong earnings growth (we forecast 17% growth in 2018 and 25% in 2019), versus peers trading at 27.9x (12% growth in 2019 according to consensus). SALU currently trades at 12.9x 12-month forward PE, versus historically at 19.3x.

Fig 8 SALU (002294-CH) Historical PE multiple, average PE and stock price (Rmb)



Source: Factset, Macquarie Research, November 2018, priced as of 22 November 2018

Fig 9 Sector (Pharma) Historical PE multiple, average PE and sector index



Source: Factset, Macquarie Research, November 2018, priced as of 22 November 2018

Key risks

Taijia presents product concentration risk for the company. The drug accounted for 70% of revenue in 2017 with a 90% gross profit margin. With more competitors entering this market and threats of centralized procurement and competitive tendering, the growth of Taijia should slow in a few years' time. It will be a challenge to find another product to fully replace the success of Taijia. If the initial growth of Taijianing, Xinlitan and Taiyi take longer than expected, the company's earnings growth may be at risk.

Concentration risk also applies to the therapeutic focus SALU chooses. The cardiovascular treatment field is lucrative but competition is fierce and could get worse in the future. The company has been making preparations to develop products for oncology, autoimmune diseases and metabolism diseases but earnings contribution is not prominent in the near term.

The company's first innovative drug, Xinlitan, was actually acquired from Shanghai Allist.

Management has yet to prove its in-house R&D capability to develop successful products from scratch, especially in the biological space. While its track record of developing and marketing first-to-market generics is strong, innovative drug development is to be proven.

SALU is a family-owned and family-run business. The strong family ties and history of its Chairman working in a senior position within the government may raise corporate governance risks. Listco is 65.73%-owned by Hong Kong Salubris Limited, which in turn is owned 75% by Chairman Ye Chenghai and 25% by his wife Liao Qingqing. Another 2.34% of the listco is owned by a company controlled by the Chairman's son-in-law. The Chairman's son, Kevin Sing Ye, is Director and General Manager. The Chairman's daughter, Ye Yujun, is also a Director.

Products analysis

Current drugs are mainly focused on the cerebral cardiovascular (CCV) field, especially in the anti-thrombotic field. SALU’s most successful drug to date, Taijia, recorded over Rmb3bn in sales in 2017 and has acquired over 30% market share. We believe new drugs from SALU will constitute a combination punch with Taijia in the anti-thrombotic field, including Taijianing as a thrombin inhibitor and Taiyi as an anti-platelet drug; we forecast these products will account for 7% and 5%, respectively, of revenue in 2018.

Besides anti-thrombotic drugs, there is Xinlitan, one of few innovative sartan drugs developed by a domestic pharma for the treatment of hypertension. The drug was newly listed on the 2017 NRDL and we expect sales to accelerate to a peak of Rmb1.5bn.

Salubris’ competitive edge in the anti-thrombotic field will be hard to shake, in our view, considering both Taijia and Taiyi were first-to-market generics after SALUS successfully challenged patents from innovators. Also, Xinlitan, as a Class 1.1 innovative drug, enjoys patent protection until 2026.

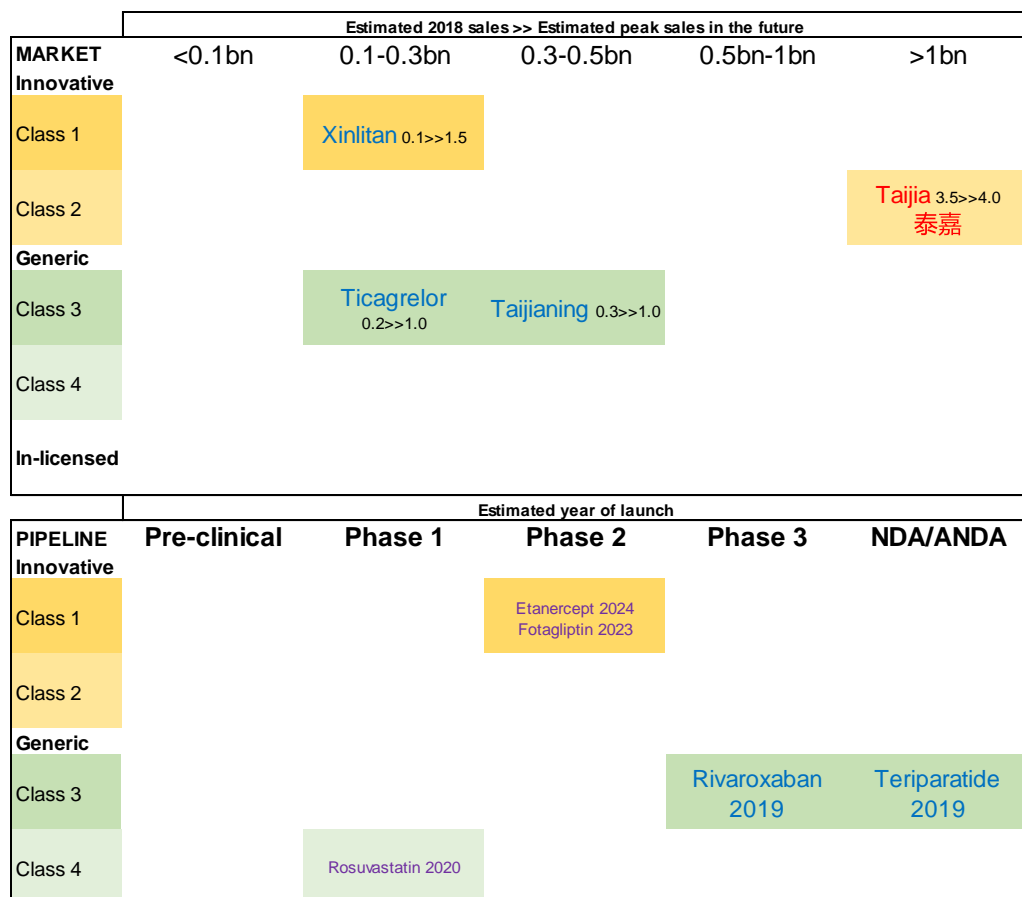
Pipelines analysis – strengthening its roots while expanding branches

In the anti-thrombotic field, another highly successful generic is rivaroxaban, which is currently in (Abbreviated New Drug Application) ANDA stage and we expect it to launch in 2019, with peak sales of Rmb1bn. We forecast it will ramp up fast and account for 4% of the total revenue in 2019.

In the hypertension field, the company has innovative compound drug sacubitril/allisartan and a generic olmesartan under development, currently in Phase I and ANDA respectively, and expected to launch in 2024 and 2019 with a combined peak sales of c. Rmb1bn, based on our forecasts.

In the hyperlipidemia field, pitavastatin is under ANDA review and we expect it to launch in 2019, with an estimated peak sales of Rmb0.5bn in 2026. A generic osteoporosis teriparatide has submitted for ANDA, and we expect it launch in 2019 with an estimated sales of Rmb1bn based on our forecast.

Fig 12 Major market and pipeline drugs with estimated launch date and peak sales (Rmb)



Source: Company data, Macquarie Research, November 2018

Fig 13 Taijia

- Sales trend: Taijia recorded sales of Rmb3bn in 2017, accounting for 74% of total revenue. We estimate it should maintain its current growth momentum and reach peak sales of c. Rmb4bn in 2021.
- Market size: there are more than 300m CCV patients in China and we estimate the market size for anti-thrombotic drugs was over Rmb25bn in 2017. Within this market, we estimate anti-platelet drugs account for c. 60%.
- Growth potential: clopidogrel is the most prescribed anti-thrombotic drug in China and has been listed on the 2009 and 2010 NRDL. In the future, major growth could come from sales penetration into low-tier cities and areas, and substitution of drugs from MNCs.

Source: Macquarie Research, November 2018

Fig 15 Taijia

- Mechanism of action (MOA): the active ingredient of Taijia is clopidogrel, classified as an antiplatelet medication within anti-thrombotic drugs. It is a prodrug, when activated after two steps, it binds to an ADP receptor called P2Y12, which plays a role in activation of platelets and the final cross-linking process by fibrin.
- History: Taijia was brought to the market in 2001 as a first-to-market generic and has been growing at a fast pace since then. What should be noted is that Taijia is the first drug of its kind to pass the BE test required by CFDA.
- Potential risk: Taijia has been on the market and listed on the NRDL for a long time, with limited upside space to ramp sales. Competition would become fiercer with more players entering this market.

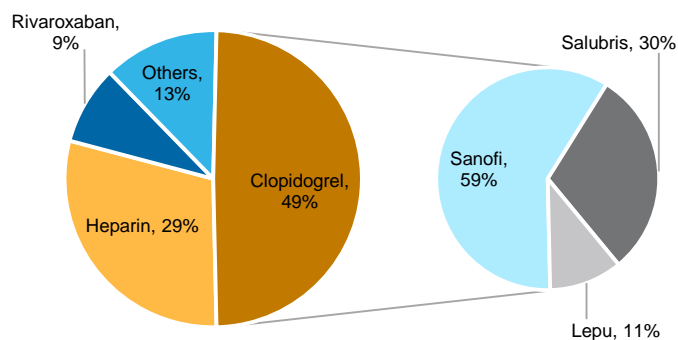
Source: Macquarie Research, November 2018

Fig 17 Xinlitan

- Sales trend: Xinlitan recorded sales of c. Rmb10m in 2017, accounting for c. 0.3% of the total revenue. Pricing change has been moderate in recent years. In the future, we believe it will maintain a moderate growth rate and achieve peak sales of Rmb1bn.
- Market size: hypertension is the No. 1 cause of cardiovascular diseases and there are c. 300m hypertension patients in China. We estimate the respective drug market was estimated to be around Rmb30bn in 2017.
- Growth potential: as a Class 1.1 innovative drug, patent protection lasts until 2026. Major growth will come from its inclusion onto the 2017 NRDL, and the growth of sartan class drugs within the hypertension drugs market.

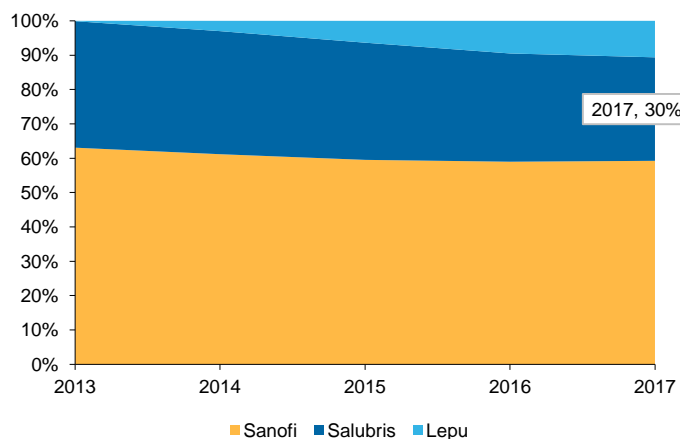
Source: Macquarie Research, November 2018

Fig 14 Market breakdown of anticoagulant drugs in 2017



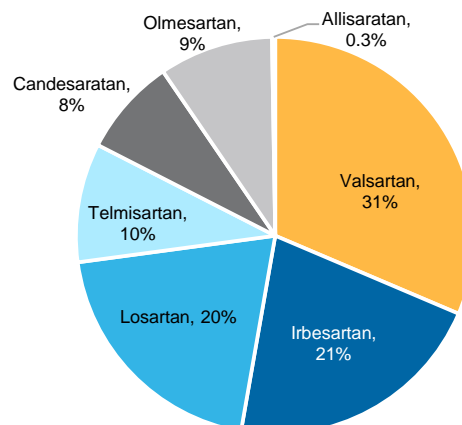
Source: Company Data, Macquarie Research, November 2018

Fig 16 Market share change of Taijia



Source: PDB, Macquarie Research, November 2018

Fig 18 Market breakdown of ARB drugs in 2017



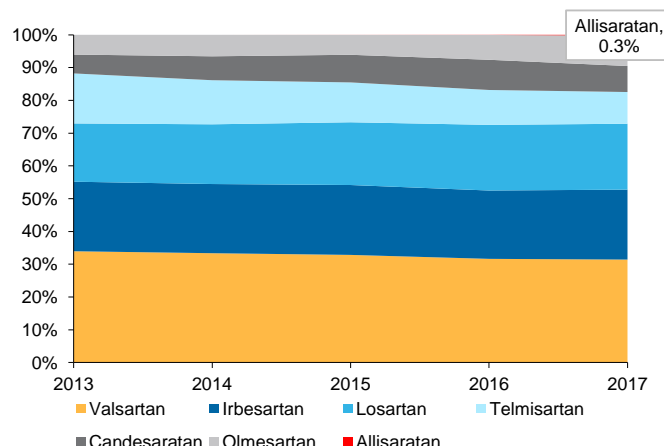
Source: Company Data, Macquarie Research, November 2018

Fig 19 Xinlitan

- **MOA:** Xinlitan belongs to the angiotensin II receptor blockers (ARBs), primarily for treatment of hypertension when patients are intolerant of ACE inhibitor therapy. They are AT1-receptor antagonists; by blocking the activation of angiotensin II AT1 receptors, they cause vasodilation, reduce secretion of vasopressin, and reduce production of aldosterone. The combined effect reduces blood pressure.
- **History:** Xinlitan was originally acquired from Shanghai Allist and launched in 2013.
- **Potential risk:** competition in the sartan class drugs is very fierce and it needs to face competition from valsartan, irbesartan and losartan, the major sartan drugs in the market, from MNCs and domestic players.

Source: Macquarie Research, November 2018

Fig 20 Market share change of Xinlitan



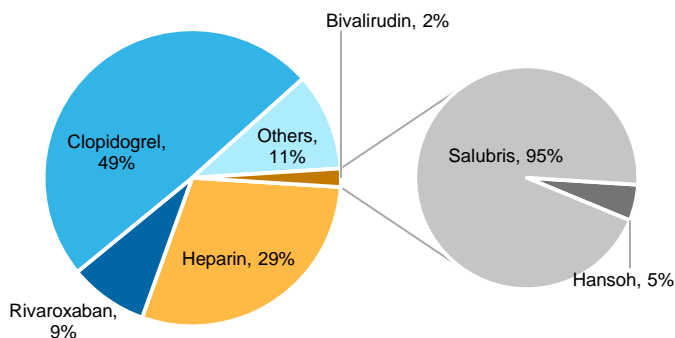
Source: PDB, Macquarie Research, November 2018

Fig 21 Taijiajing

- **Sales trend:** Taijiajing recorded sales of c. Rmb200m in 2017, accounting for c. 4.9% of total revenue. We estimate it should maintain its current growth momentum and reach peak sales of c. Rmb1bn.
- **Market size:** there are more than 300m CCV patients in China and we estimate the current market size for anti-thrombotic drugs was over Rmb25bn in 2017. Within this market, anti-coagulant drugs account for c. 30%.
- **Growth potential:** future growth should mainly come from market share acquisition within the anti-coagulant drugs market, especially from heparin drugs, expected by us to be listed onto more PRDLs and its combination effect with the highly successful Taijia.

Source: Macquarie Research, November 2018

Fig 22 Market breakdown of anticoagulant drugs in 2017



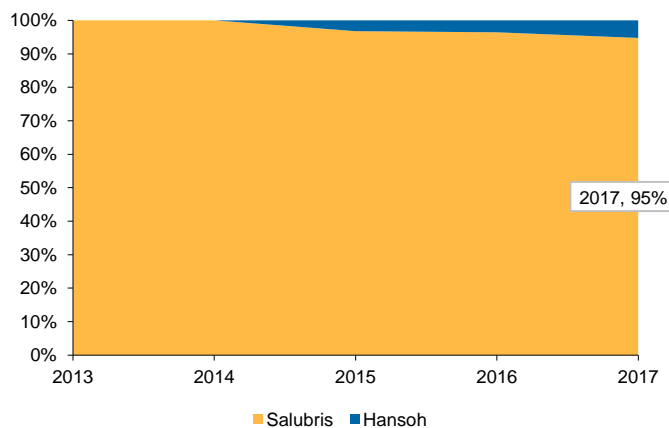
Source: Company Data, Macquarie Research, November 2018

Fig 23 Taijiajing

- **MOA:** the active ingredient of Taijiajing is bivalirudin, belonging to the rudin drug class. It is a direct thrombin inhibitor (DTI) and works by binding to the catalytic site and anion-binding exosite of thrombin. Thrombin is a serine proteinase that plays a central role in the thrombotic process; it can turn fibrinogen into fibrin monomers to form the final fibrin clot.
- **History:** Taijiajing launched in 2011, as the first-to-market generic with the innovator drug not entering the China market yet. Besides Salubris, Hansoh got approved for the same drug in 2014.
- **Potential risk:** within anti-coagulant drugs market, it might face competition from -xaban drugs; within bivalirudin, it needs to face competition from Hansoh.

Source: Macquarie Research, November 2018

Fig 24 Market share change of Taijiajing



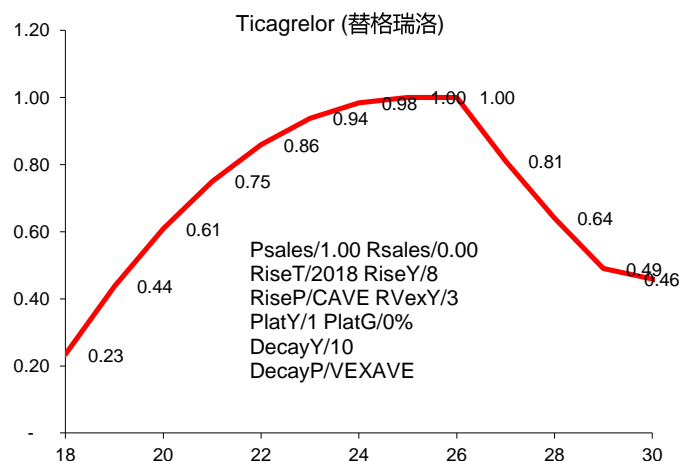
Source: PDB, Macquarie Research, November 2018

Fig 25 Ticagrelor

- Sales potential: the innovative drug ticagrelor is Brilinta/Possia, developed by AZ and approved by the EMA in 2010 and the FDA in 2011. The anti-platelet drug market in China was around Rmb15bn in 2017. As the first-to-market generic, we estimate the drug could achieve potential peak sales of Rmb1bn.
- MOA: like the thienopyridine drugs clopidogrel and prasugrel, ticagrelor blocks ADP receptors of subtype P2Y12. However, its binding is reversible and doesn't need hepatic activation. It is an allosteric antagonist, which has a binding site that is different to ADP.
- Competitive landscape: there are two ticagrelor drugs in the market, two are under NDA review and another 12 are in clinical trials.

Source: Macquarie Research, November 2018

Fig 26 Sales forecast simulation of ticagrelor (Rmb bn)



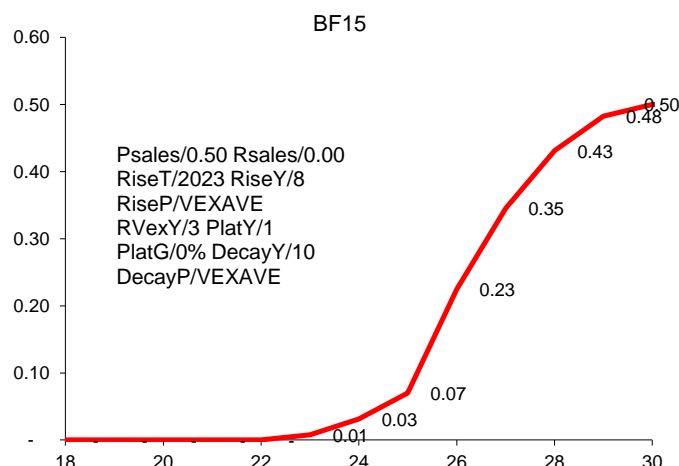
Source: Macquarie Research, November 2018

Fig 27 Fotagliptin

- Sales potential: the comparable drug of fotagliptin is sitagliptin, developed by MSD, which recorded sales of US\$3.7bn globally in 2017. The DPP-4 drugs account for c. 25% of the global diabetes drug market whereas this ratio is c. 6% in China. We estimate the potential DPP-4 drug market size is over Rmb12bn and fotagliptin could record a potential peak sales of Rmb0.5bn.
- MOA: it belongs to dipeptidyl peptidase 4 (DPP-4) inhibitors. DPP-4 is an enzyme that breaks down incretin hormones GLP-1 and GIP, which could inhibit glucagon release and increase insulin secretion.
- Competitive landscape: there are six gliptin drugs in the market, all from MNCs. Twenty-four are under the NDA review and another 73 are in clinical trials.

Source: Macquarie Research, November 2018

Fig 28 Sales forecast simulation of fotagliptin (Rmb bn)



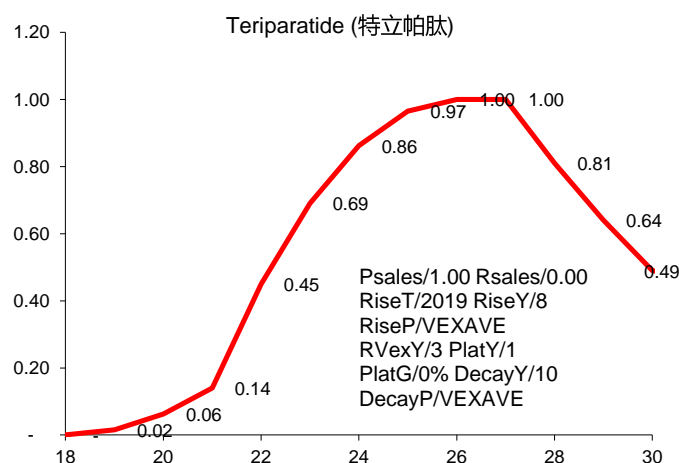
Source: Macquarie Research, November 2018

Fig 29 Teriparatide

- Sales potential: the innovative drug teriparatide is Forteo, developed by Lilly, which recorded global sales of US\$1.8bn in 2017. The current osteoporosis drug market in China is around Rmb8bn and we believe teriparatide could achieve potential sales of Rmb1bn.
- MOA: teriparatide is a portion of human parathyroid hormone (PTH). PTH is the main regulator of calcium metabolism. Chronically increased PTH could increase bone resorption, whereas intermittent increase would activate osteoblasts more. With daily injections, the net effect would stimulate bone formation.
- Competitive landscape: only the innovator drug and one generic are available in the Chinese market. Two are under NDA review and another 12 are in clinical trials.

Source: Macquarie Research, November 2018

Fig 30 Sales forecast simulation of teriparatide (Rmb bn)



Source: Macquarie Research, November 2018

Financial analysis

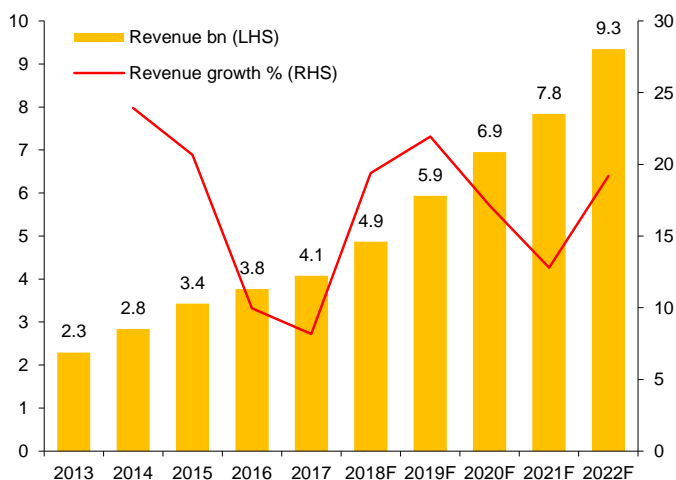
Current drugs are selling well and ticagrelor has been the surprising growth driver in 2018

SG&A ratio is much lower than the industry average, indicating significant upside potential in drug sales

Revenue growth has been slowing in recent years, from 20% in 2015 to 8% in 2017, but should pick up again in 2018 at 19%, thanks to the launch of generic ticagrelor. The product was launched in 3Q18 and we expect it to be a key driver in 2H18. The company's core EPS should almost double between 2017 and 2021, thanks to ticagrelor and bivalirudin in the anticoagulant market, the innovative sartan drug, allisartan, in the hypertension market, and other potential generics for osteoporosis and autoimmune diseases.

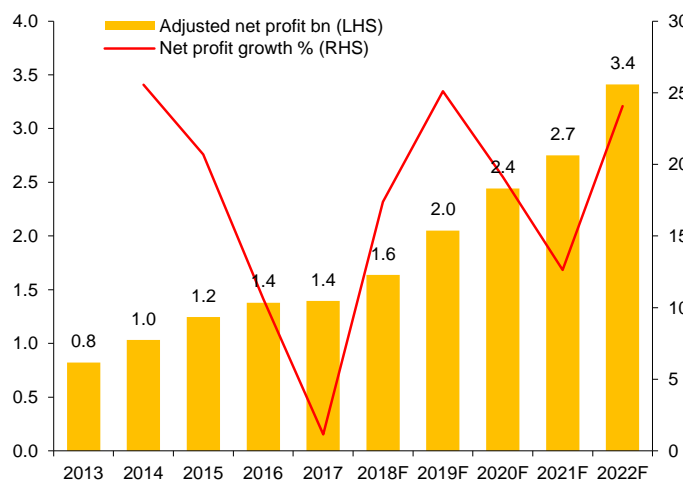
The biggest current revenue contributor is Taijia with a lucrative gross margin of 90% in 1H18. Margin should be stable in the coming years, considering new drugs and pipelines are either innovative drugs such as allisartan or early-to-market generics such as teriparatide. SG&A accounted for 34% of the revenue during the first 9 months of 2018, which was lower than industry average. With new drugs coming on board, we estimate SG&A ratio to increase mildly. Most of the new drugs are in the cardiovascular field, enjoying potential synergies with Taijia. R&D expense was 8% of revenue, higher than industry average of c. 6% and among the highest. Investors should be able to get the return of R&D soon with new major project launches next 3 years.

Fig 31 Revenue and growth of 002294-CH (Rmb bn)



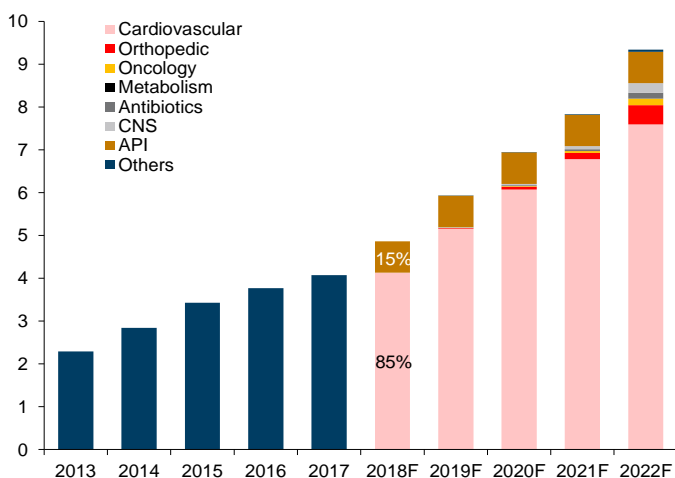
Source: Factset, Macquarie Research, November 2018

Fig 32 Net profit and growth of 002294-CH (Rmb bn)



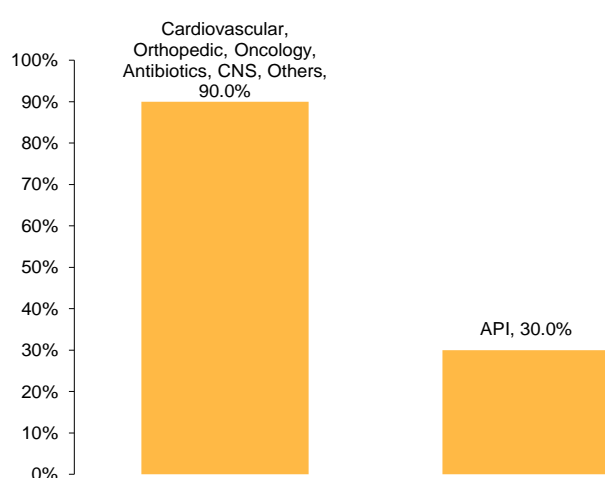
Source: Factset, Macquarie Research, November 2018

Fig 33 Revenue breakdown of 002294-CH (Rmb bn)



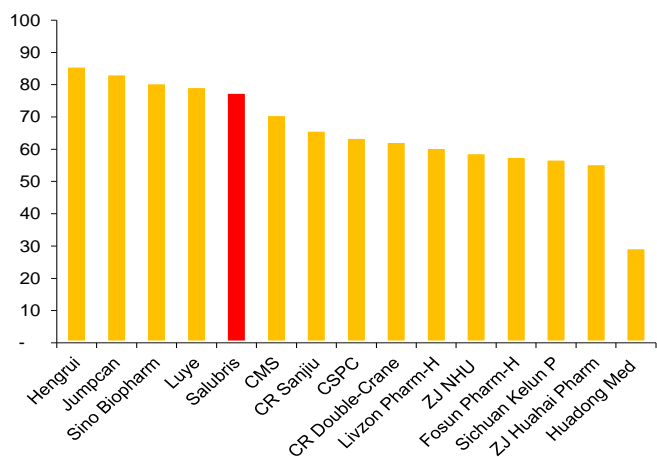
Source: Factset, Macquarie Research, November 2018

Fig 34 Gross margin breakdown 2018F of 002294-CH



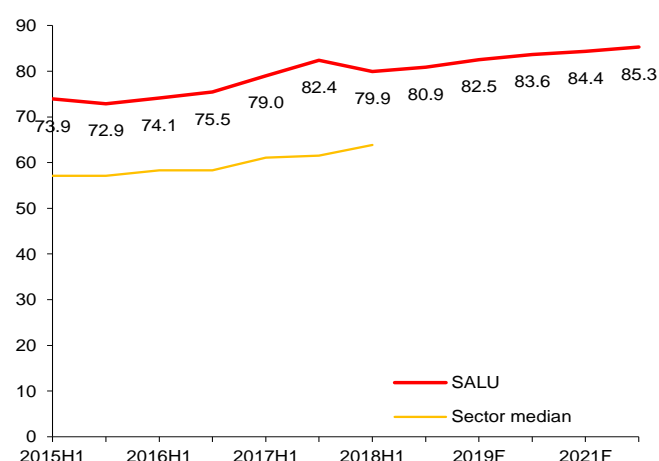
Source: Factset, Macquarie Research, November 2018

Fig 35 Gross margin of 002294-CH vs peers - 1H18 (%)



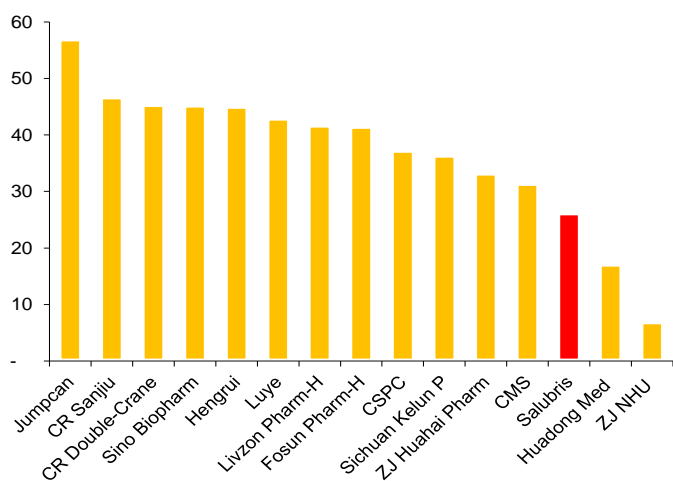
Source: Factset, Macquarie Research, November 2018

Fig 36 Gross margin trend of 002294-CH (%)



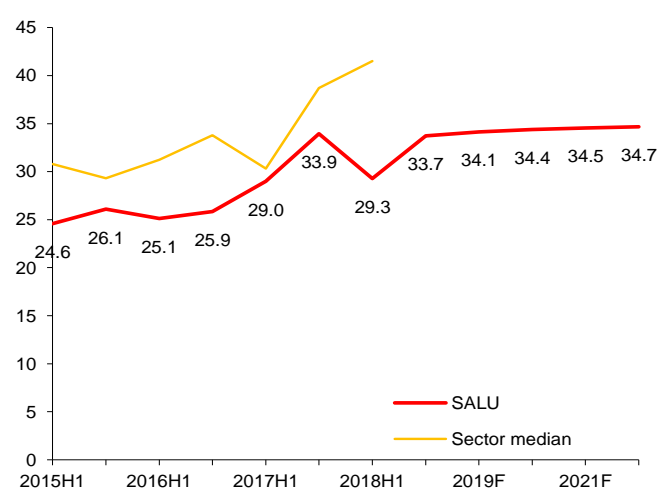
Source: Factset, Macquarie Research, November 2018

Fig 37 SGA ratio of 002294-CH vs peers - 1H18 (%)



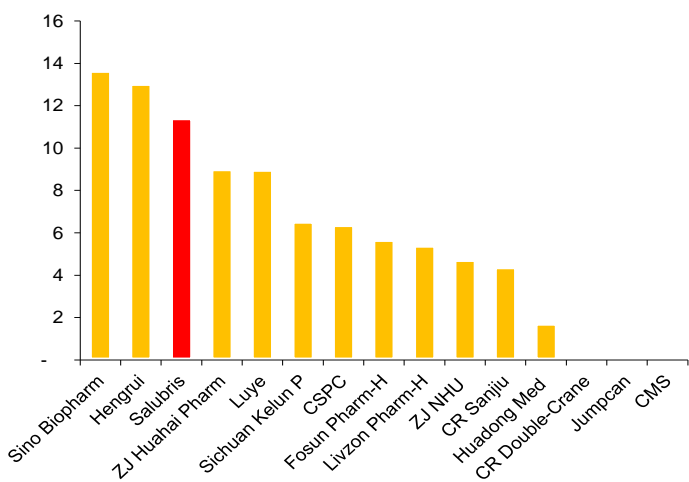
Source: Factset, Macquarie Research, November 2018

Fig 38 SGA ratio trend of 002294-CH (%)



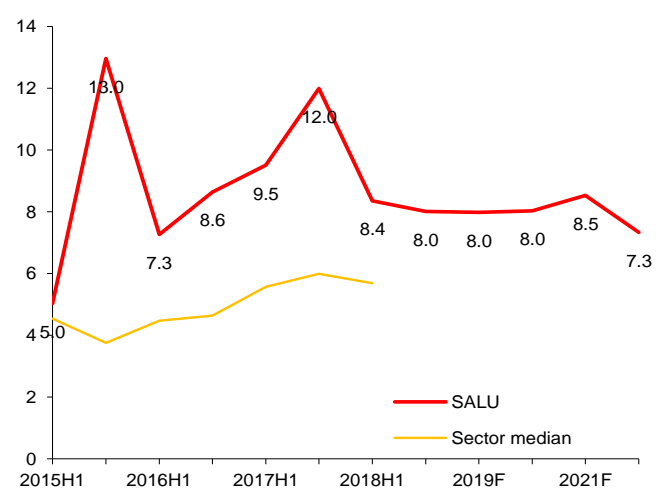
Source: Factset, Macquarie Research, November 2018

Fig 39 R&D ratio of 002294-CH vs peers - 1H18 (%)



Source: Company Data, Macquarie Research, November 2018

Fig 40 R&D ratio trend of 002294-CH (%)



Source: Company Data, Macquarie Research, November 2018

Balance sheet

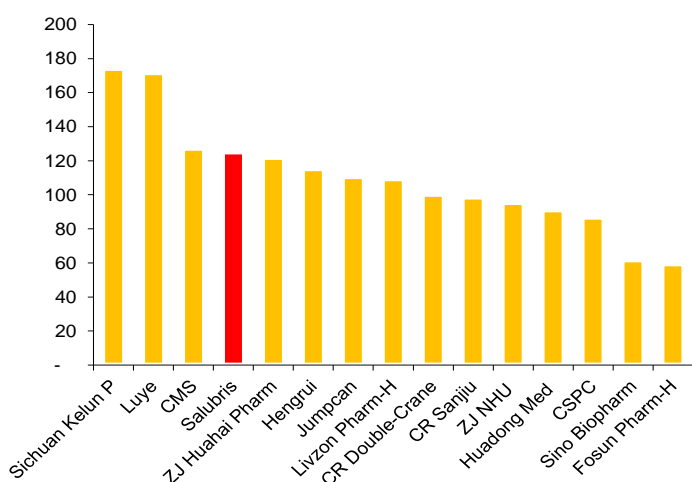
Inventory days increased sharply in 2017

Inventory days of 1H18 were 206, consistent with 2017 when there was a dramatic increase. This number is higher than the industry average of around 150 days. SALU has been doing well in the management of its receivables, with receivable days of 74 in 1H18, consistent with its historical value, which is lower than the industry average of around 100. In the future, we estimate this ratio would not change a lot without dramatic external changes.

Financial position is one of the healthiest among peers

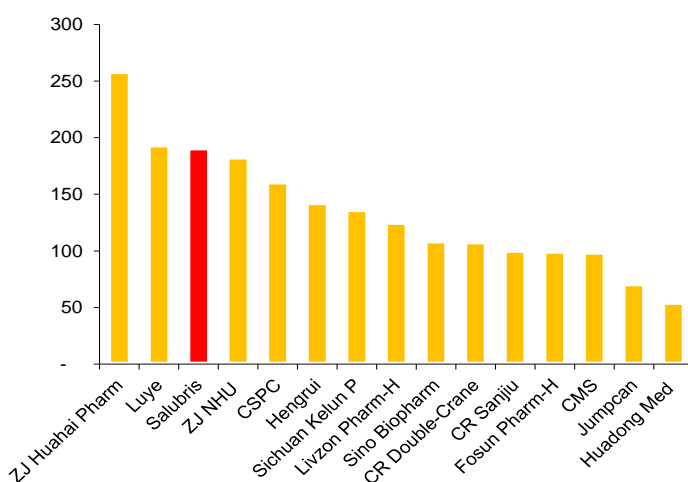
The company has been increasing its operating cash flows after including changes of working capital from Rmb1bn in 2015 to Rmb1.5bn in 2017. The company has a net cash position by 1H18. Operating cash flow has been enough to cover the investment activities of the company in the past three years and the company is generous in paying out dividends to shareholders, with a dividend payout ratio of around 50%, indicating good cash liquidity. SALU's total gearing ratio is among the lowest of peers, showing a healthy capital structure, less interest pressure and potential fund-raising capability in the future.

Fig 41 Receivables days of 002294-CH vs peers - 1H18



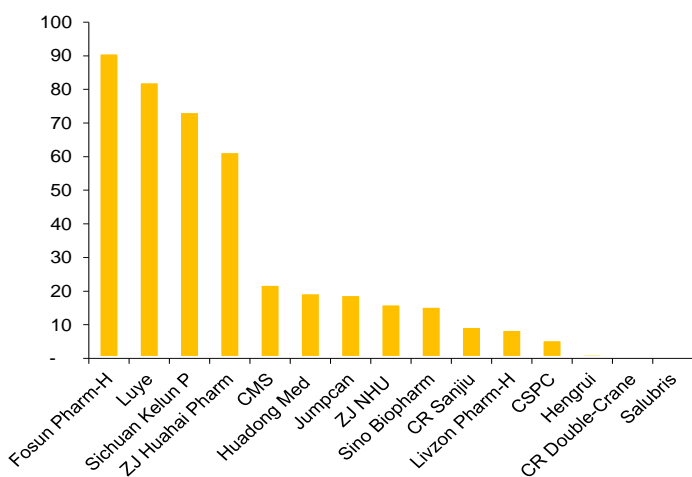
Source: Factset, Macquarie Research, November 2018

Fig 42 Inventories days of 002294-CH vs peers - 1H18



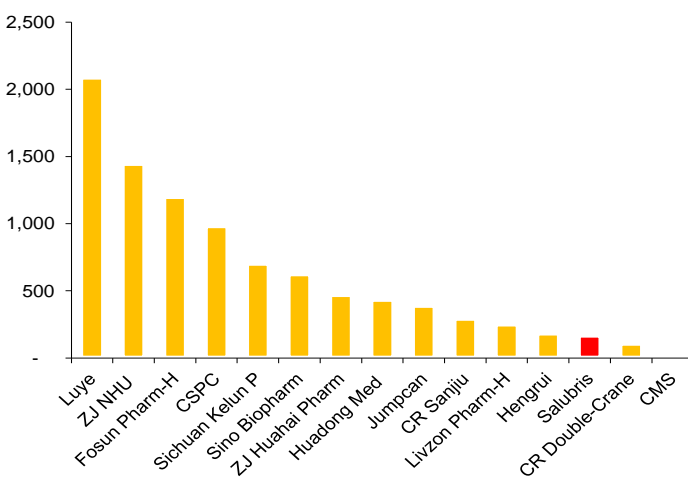
Source: Factset, Macquarie Research, November 2018

Fig 43 Total Gearing of 002294-CH vs peers - 1H18 (%)



Source: Factset, Macquarie Research, November 2018

Fig 44 Capex of 002294-CH vs peers - 1H18 (Rmb mn)



Source: Factset, Macquarie Research, November 2018

Fig 45 Income statement and balance sheet forecasts (Rmb bn)

INCOME STATEMENT	2013	2014	2015	2016	2017	2018F	2019F	2020F	2021F	2022F
Revenue	2.3	2.8	3.4	3.8	4.1	4.9	5.9	6.9	7.8	9.3
COGS	(0.6)	(0.8)	(0.9)	(0.9)	(0.8)	(0.9)	(1.0)	(1.1)	(1.2)	(1.4)
Gross profit	1.7	2.1	2.5	2.8	3.3	3.9	4.9	5.8	6.6	8.0
Gross margin	75.4%	73.1%	73.4%	74.8%	80.7%	80.9%	82.5%	83.6%	84.4%	85.3%
Selling, marketing & administrative	(0.6)	(0.8)	(0.9)	(1.0)	(1.3)	(1.6)	(2.0)	(2.4)	(2.7)	(3.2)
Research and development	(0.1)	(0.1)	(0.3)	(0.3)	(0.4)	(0.4)	(0.5)	(0.6)	(0.7)	(0.7)
Other operating income/expenses	0.0	0.0	0.1	0.0	0.1	-	-	-	-	-
Exceptional items	(0.0)	0.0	0.0	(0.0)	0.0	-	-	-	-	-
EBIT excluding exceptional	0.9	1.2	1.5	1.6	1.7	1.9	2.4	2.9	3.2	4.0
EBITDA excluding exceptional	1.0	1.2	1.5	1.7	1.8	2.0	2.5	3.0	3.4	4.2
Interest expenses	-	-	-	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Interest income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Share of results of associates	(0.0)	0.0	(0.0)	(0.0)	(0.0)	-	-	-	-	-
Other non-operating income/expenses	0.0	0.0	0.0	0.0	0.0	-	-	-	-	-
Profit before tax	1.0	1.2	1.5	1.7	1.7	1.9	2.4	2.9	3.3	4.1
Income tax	(0.1)	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)	(0.4)	(0.4)	(0.5)	(0.6)
Profit before minority interests	0.8	1.0	1.3	1.4	1.4	1.6	2.0	2.4	2.8	3.4
Minority interests	0.0	0.0	0.0	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	0.0	0.0
Net profit	0.83	1.04	1.27	1.40	1.45	1.64	2.05	2.44	2.75	3.41
Dividends	0.39	0.46	0.63	0.73	0.84	0.94	1.05	1.15	1.15	1.15
Preferred distributions	-	-	-	-	-	-	-	-	-	-
Adjusted net profit	0.82	1.03	1.25	1.38	1.40	1.64	2.05	2.44	2.75	3.41
EPS (adjusted)	0.79	0.99	1.19	1.32	1.33	1.57	1.96	2.33	2.63	3.26
DPS	0.38	0.44	0.60	0.70	0.80	0.90	1.00	1.10	1.10	1.10
Special DPS	-	-	-	-	-	-	-	-	-	-
Average basic shares	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05
Average fully-diluted shares	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05
End-of-period basic shares	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05	1.05
BALANCE SHEET										
Investment properties	-	-	-	-	-	-	-	-	-	-
Property, plant and equipment	-	-	-	-	-	-	-	-	-	-
Land bank	-	-	-	-	-	-	-	-	-	-
Interests in associates and JCEs	0.0	0.0	-	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Investments	-	-	-	-	0.3	0.3	0.3	0.3	0.3	0.3
Receivables (L/T)	-	-	-	-	-	-	-	-	-	-
Intangible assets	0.4	0.9	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.3
Deferred tax assets	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other assets (L/T)	1.0	1.0	1.3	1.6	1.5	1.5	1.5	1.5	1.5	1.5
Total non-current assets	1	2	3	3	3	3	3	3	3	3
Properties completed/under development	-	-	-	-	-	-	-	-	-	-
Inventories	0.2	0.2	0.3	0.3	0.5	0.5	0.6	0.6	0.7	0.8
Receivables (S/T)	0.7	0.8	0.8	0.8	0.8	1.0	1.2	1.4	1.6	1.9
Other assets (S/T)	0.7	0.7	0.7	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Restricted cash and investments	-	-	-	0.1	0.9	0.9	0.9	0.9	0.9	0.9
Cash and cash equivalents	0.7	0.9	1.0	1.7	0.8	1.5	2.4	3.6	5.0	7.0
Total current assets	2	3	3	4	4	5	6	7	9	11
Total assets	4	5	5	7	7	8	9	10	12	14
Deferred revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payables	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.2
Taxes payable	0.1	0.2	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.4
Other liabilities (S/T)	0.2	0.5	0.3	0.7	0.3	0.3	0.3	0.3	0.3	0.3
Bank and other borrowings (S/T)	-	0.0	-	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total current liabilities	0	1	1	1	1	1	1	1	1	1
Bank and other borrowings (L/T)	-	-	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deferred tax liabilities	-	-	-	-	-	-	-	-	-	-
Other liabilities (L/T)	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total non-current liabilities	0	0	0	0	0	0	0	0	0	0
Total liabilities	1	1	1	1	1	1	1	1	1	1
Issued capital	0.7	0.7	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Share premium and reserves	0.8	0.9	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Retained earnings	1.6	2.2	2.9	3.6	4.3	5.1	6.2	7.6	9.2	11.5
Shareholders' equities	3	4	5	5	6	7	8	9	11	13
Perpetual securities	-	-	-	-	-	-	-	-	-	-
Minority interests	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total equities	3	4	5	5	6	7	8	9	11	13
Total liabilities and equities	4	5	5	7	7	8	9	10	12	14

Source: Company data, Bloomberg, Macquarie Research, November 2018

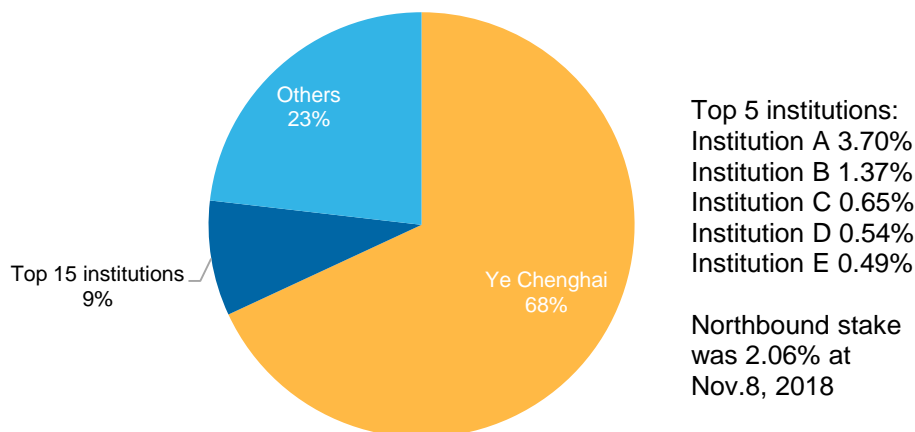
Appendices

Fig 46 Management

	Ye Chenghai (叶澄海)	Kevin Sing Ye (叶宇翔)	Ye Yuyun (叶宇筠)	Yan Jie (颜杰)	Chen Ping(陈平)
Management	<ul style="list-style-type: none"> Chairman Founder 	<ul style="list-style-type: none"> General Manager Executive Director 	<ul style="list-style-type: none"> Assistant to General Manager Executive Director 	<ul style="list-style-type: none"> Executive Vice President of Salubris R&D academy Deputy General Manager Executive Director 	<ul style="list-style-type: none"> Deputy General Manager Head of Quality Control
Age & Relationship	<ul style="list-style-type: none"> Age 75 	<ul style="list-style-type: none"> Age 44 Son of Ye Chenghai Brother of Ye Yuyun 	<ul style="list-style-type: none"> Age 49 Daughter of Ye Chenghai Sister of Kelvin Sing Ye 	<ul style="list-style-type: none"> Age 46 	<ul style="list-style-type: none"> Age 48
Scientific & Education	<ul style="list-style-type: none"> Bachelor of International Politics, Renmin University of China 	<ul style="list-style-type: none"> MBA of Yale University 	<ul style="list-style-type: none"> MBA 	<ul style="list-style-type: none"> Certified Pharmacist Professor Physician Master 	<ul style="list-style-type: none"> Master
History & Experience	<ul style="list-style-type: none"> 1968 Bachelor graduated 1968-79 Government official at Baoan County 1979-83 Member of the Shenzhen CCP Standing Committee 1983 Member of the Guangdong CCP Standing Committee, Member of the Shenzhen CCP Standing Committee & Vice Mayor of Shenzhen 1983-84 Member of the Guangdong CCP Standing Committee, Director of Guangdong Economic Working Committee & Director of Guangdong Special Economic Zone office 1984-85 Deputy Director of Binzhou Economic Committee 1985 Resigned from Gov. 1985-98 Various start-up business 1998 Founder and Chariman of Salubris 	<ul style="list-style-type: none"> 2004-07 Assistant to General Manager, Deputy General Manager and General Manager of Shenzhen Salubris 2007-now Executive Director and General Manager of Shenzhen Salubris 	<ul style="list-style-type: none"> 2000-14 CFO of Shenzhen Salubris 2014-16 Assistant to General Manager, Shenzhen Salubris 2016-now Executive Director and Assistant to General Manager, Shenzhen Salubris 	<ul style="list-style-type: none"> 2006-13 Quality Control Department of Shenzhen Salubris 2013-now Deputy General Manager, Head of Quality Control of Shenzhen Salubri 2017-now Executive Vice Director of Salubris R&D Academy 	<ul style="list-style-type: none"> 2000-07 Quality Control Manager, Vice Chief Engineer, Head of Factory and Deputy General Manager 2007-now Deputy General Manager of the Company 2015-now Head of Quality Control of the Company
Compensation & Stock position (Rmb)	<ul style="list-style-type: none"> Annual salary: 2017 0.28mn, 2016 0.28mn Largest shareholder with 67.83% holdings 	<ul style="list-style-type: none"> Annual salary: 2017 0.89mn, 2016 0.71mn 	<ul style="list-style-type: none"> Annual salary: 2017 0.73mn, 2016 0.48mn 	<ul style="list-style-type: none"> Annual salary: 2017 0.65mn, 2016 0.55mn 	<ul style="list-style-type: none"> Annual salary: 2017 0.56mn, 2016 0.58mn
Special notes	<ul style="list-style-type: none"> HK permanent resident 	<ul style="list-style-type: none"> US national 	<ul style="list-style-type: none"> HK permanent resident 		

Source: Company Data, Macquarie Research, November 2018

Fig 47 Ownership Structure



Source: FactSet, Macquarie Research, November 2018

Macquarie Quant View

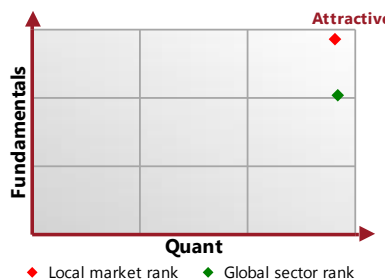
The Quant View page below has been derived from models that are developed and maintained by Sales and Trading personnel at Macquarie. The models are not a product of the Macquarie Research Department.

The quant model currently holds a strong positive view on Shenzhen Salubris Pharmaceuticals (A-Share). The strongest style exposure is Profitability, indicating this stock is efficiently converting investments to earnings; proxied by ratios like ROE or ROA. The weakest style exposure is Growth, indicating this stock has weak historic and/or forecast growth. Growth metrics focus on both top and bot...

52/948

Global rank in Pharma, Biotech & Life Sciences

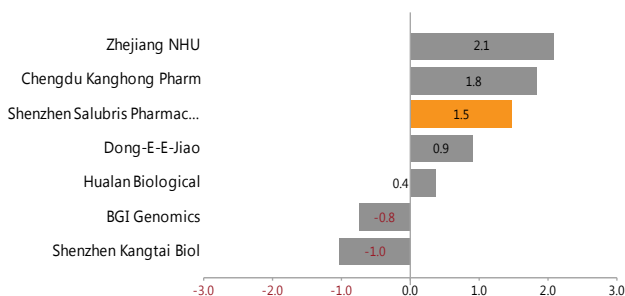
% of BUY recommendations: 100% (4/4)
 Number of Price Target downgrades: 0
 Number of Price Target upgrades: 0



Displays where the company's ranked based on the fundamental consensus Price Target and Macquarie's Quantitative Alpha model. Two rankings: Local market (China A) and Global sector (Pharma, Biotech & Life Sciences)

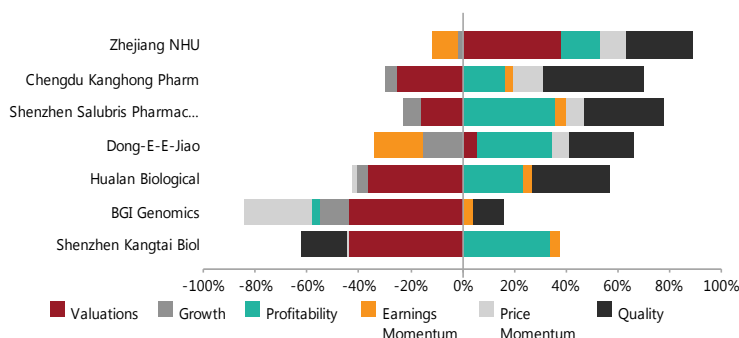
Macquarie Alpha Model ranking

A list of comparable companies and their Macquarie Alpha model score (higher is better).



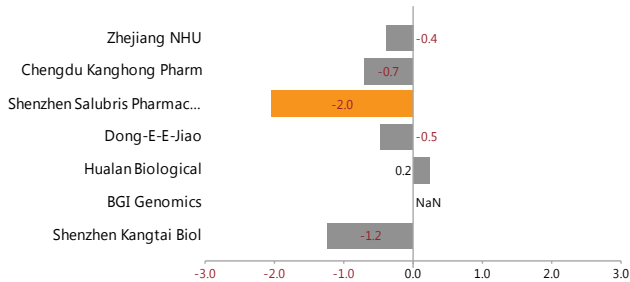
Factors driving the Alpha Model

For the comparable firms this chart shows the key underlying styles and their contribution to the current overall Alpha score.



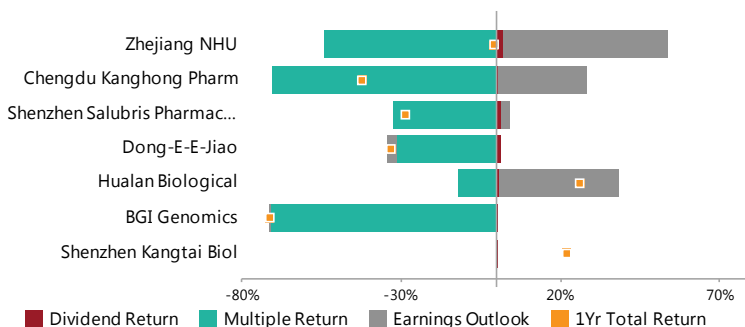
Macquarie Earnings Sentiment Indicator

The Macquarie Sentiment Indicator is an enhanced earnings revisions signal that favours analysts who have more timely and higher conviction revisions. Current score shown below.



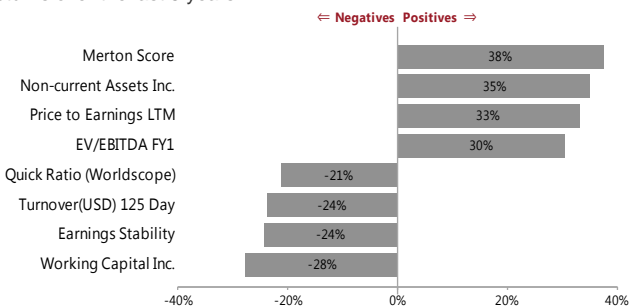
Drivers of Stock Return

Breakdown of 1 year total return (local currency) into returns from dividends, changes in forward earnings estimates and the resulting change in earnings multiple.



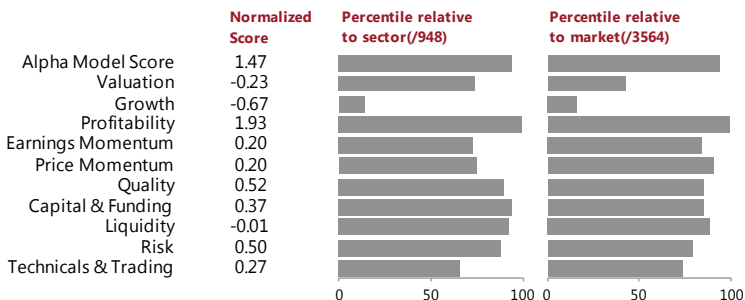
What drove this Company in the last 5 years

Which factor score has had the greatest correlation with the company's returns over the last 5 years.



How it looks on the Alpha model

A more granular view of the underlying style scores that drive the alpha (higher is better) and the percentile rank relative to the sector and market.



Source (all charts): FactSet, Thomson Reuters, and Macquarie Quant. For more details on the Macquarie Alpha model or for more customised analysis and screens, please contact the Macquarie Global Quantitative/Custom Products Group (cpq@macquarie.com)

Shenzhen Salubris Pharmaceuticals (A-Share) (002294 CH, Outperform, Target Price: Rmb40.06)

Interim Results					Profit & Loss						
		1H/18A	2H/18E	1H/19E	2H/19E		2017A	2018E	2019E	2020E	
Revenue	m	2,227	2,639	2,967	2,967	Revenue	m	4,076	4,866	5,933	6,949
Gross Profit	m	1,779	2,157	2,449	2,449	Gross Profit	m	3,291	3,937	4,898	5,811
Cost of Goods Sold	m	447	482	518	518	Cost of Goods Sold	m	785	929	1,036	1,137
EBITDA	m	1,004	1,028	1,263	1,263	EBITDA	m	1,784	2,032	2,525	2,990
Depreciation	m	85	41	63	63	Depreciation	m	126	126	126	126
Amortisation of Goodwill	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0	Other Amortisation	m	0	0	0	0
EBIT	m	919	987	1,200	1,200	EBIT	m	1,658	1,906	2,399	2,864
Net Interest Income	m	4	15	10	10	Net Interest Income	m	20	20	20	20
Associates	m	-0	0	0	0	Associates	m	-2	0	0	0
Exceptionals	m	-1	1	0	0	Exceptionals	m	12	0	0	0
Forex Gains / Losses	m	0	0	0	0	Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	8	-8	0	0	Other Pre-Tax Income	m	28	0	0	0
Pre-Tax Profit	m	930	995	1,209	1,209	Pre-Tax Profit	m	1,715	1,925	2,419	2,884
Tax Expense	m	-142	-150	-183	-186	Tax Expense	m	-278	-292	-370	-443
Net Profit	m	788	845	1,026	1,023	Net Profit	m	1,437	1,633	2,049	2,441
Minority Interests	m	2	4	0	0	Minority Interests	m	15	5	0	0
Reported Earnings	m	790	849	1,026	1,023	Reported Earnings	m	1,452	1,638	2,049	2,441
Adjusted Earnings	m	763	875	1,026	1,023	Adjusted Earnings	m	1,395	1,638	2,049	2,441
EPS (rep)		0.75	0.81	0.98	0.98	EPS (rep)		1.39	1.57	1.96	2.33
EPS (adj)		0.73	0.84	0.98	0.98	EPS (adj)		1.33	1.57	1.96	2.33
EPS Growth yoy (adj)	%	7.3	27.9	34.4	17.0	EPS Growth (adj)	%	1.1	17.4	25.1	19.1
						PE (rep)	x	18.2	16.1	12.9	10.8
						PE (adj)	x	18.9	16.1	12.9	10.8
EBITDA Margin	%	45.1	39.0	42.6	42.6	Total DPS		0.80	0.90	1.00	1.10
EBIT Margin	%	41.3	37.4	40.4	40.4	Total Div Yield	%	3.2	3.6	4.0	4.4
Earnings Split	%	46.6	53.4	50.1	49.9	Basic Shares Outstanding	m	1,046	1,046	1,046	1,046
Revenue Growth	%	11.6	26.9	33.2	12.4	Diluted Shares Outstanding	m	1,046	1,046	1,046	1,046
EBIT Growth	%	11.3	18.6	30.6	21.6						
Profit and Loss Ratios					Cashflow Analysis						
		2017A	2018E	2019E	2020E		2017A	2018E	2019E	2020E	
Revenue Growth	%	8.2	19.4	21.9	17.1	EBITDA	m	0	1,911	2,399	2,864
EBITDA Growth	%	4.1	13.9	24.3	18.4	Tax Paid	m	-885	-292	-370	-443
EBIT Growth	%	3.6	15.0	25.9	19.4	Chgs in Working Cap	m	-76	-176	-212	-202
Gross Profit Margin	%	80.7	80.9	82.5	83.6	Net Interest Paid	m	0	20	20	20
EBITDA Margin	%	43.8	41.8	42.6	43.0	Other	m	2,433	0	0	0
EBIT Margin	%	40.7	39.2	40.4	41.2	Operating Cashflow	m	1,472	1,462	1,837	2,239
Net Profit Margin	%	34.2	33.7	34.5	35.1	Acquisitions	m	0	-2	0	0
Payout Ratio	%	60.0	57.5	51.0	47.1	Capex	m	0	0	0	0
EV/EBITDA	x	14.3	12.6	10.1	8.5	Asset Sales	m	-331	0	0	0
EV/EBIT	x	15.4	13.4	10.6	8.9	Other	m	-890	0	0	0
Balance Sheet Ratios						Investing Cashflow	m	-1,221	-2	0	0
ROE	%	24.5	25.4	27.7	28.2	Dividend (Ordinary)	m	-1,157	-837	-941	-1,046
ROA	%	24.7	26.2	29.0	29.8	Equity Raised	m	16	0	0	0
ROIC	%	37.1	35.7	43.2	49.3	Debt Movements	m	-15	0	0	0
Net Debt/Equity	%	-26.5	-32.5	-39.2	-46.0	Other	m	21	10	5	-0
Interest Cover	x	nmf	nmf	nmf	nmf	Financing Cashflow	m	-1,136	-827	-936	-1,046
Price/Book	x	4.4	3.8	3.3	2.8	Net Chg in Cash/Debt	m	-885	633	901	1,193
Book Value per Share		5.8	6.6	7.6	8.9	Free Cashflow	m	1,472	1,462	1,837	2,239
						Balance Sheet		2017A	2018E	2019E	2020E
						Cash	m	1,679	2,312	3,213	4,405
						Receivables	m	835	1,000	1,219	1,428
						Inventories	m	478	509	568	623
						Investments	m	0	0	0	0
						Fixed Assets	m	0	0	0	0
						Intangibles	m	1,299	1,299	1,299	1,299
						Other Assets	m	2,573	2,575	2,575	2,575
						Total Assets	m	6,864	7,696	8,874	10,331
						Payables	m	109	120	131	142
						Short Term Debt	m	15	15	15	15
						Long Term Debt	m	30	30	30	30
						Provisions	m	193	203	257	308
						Other Liabilities	m	358	358	358	358
						Total Liabilities	m	706	726	791	853
						Shareholders' Funds	m	6,053	6,854	7,962	9,357
						Minority Interests	m	106	115	121	120
						Other	m	0	0	0	0
						Total S/H Equity	m	6,159	6,970	8,083	9,477
						Total Liab & S/H Funds	m	6,864	7,696	8,874	10,331

All figures in Rmb unless noted.

Source: Company data, Macquarie Research, November 2018

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand

Outperform – return >3% in excess of benchmark return
 Neutral – return within 3% of benchmark return
 Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield, which is currently around 9%.

Macquarie – Asia/Europe

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Mazi Macquarie – South Africa

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
 Neutral – return within 5% of benchmark return
 Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
 Neutral (Hold) – return within 5% of Russell 3000 index return
 Underperform (Sell) – return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low-medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Asia/Australian/NZ/Canada stocks only

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / epowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 30 September 2018

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	51.56%	59.51%	45.05%	46.88%	67.86%	46.70%	(for global coverage by Macquarie, 3.70% of stocks followed are investment banking clients)
Neutral	33.20%	28.92%	37.36%	47.70%	25.00%	42.73%	(for global coverage by Macquarie, 2.04% of stocks followed are investment banking clients)
Underperform	15.23%	11.57%	17.58%	5.42%	7.14%	10.57%	(for global coverage by Macquarie, 0.47% of stocks followed are investment banking clients)

002294 CH vs CSI 300, & rec history



(all figures in CNY currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.
 Source: FactSet, Macquarie Research, November 2018

12-month target price methodology

002294 CH: Rmb40.06 based on a PER methodology

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