

**China**
**HOLD** (no change)

Consensus ratings\*: Buy 15 Hold 3 Sell 2

Current price:	Rmb18.55
Target price:	Rmb20.00
Previous target:	Rmb20.00
Up/downside:	7.8%
CGI / Consensus:	
Reuters:	601607.SS
Bloomberg:	601607 CH
Market cap:	US\$6,725m
	Rmb47,357m
Average daily turnover:	US\$28.24m
	Rmb200.3m
Current shares o/s:	2,842m
Free float:	64.0%
*Source: Bloomberg	

**Key changes in this note**

- FY19/20/21F revenue increased by 4.6%/5.4%/5.0%, respectively.
- FY19/20/21F net profit increased by 1.4%/1.0%/0.7%, respectively.
- FY19/20/21F EPS increased by 1.4%/1.0%/0.7%, respectively.



Price performance	1M	3M	12M
Absolute (%)	1.9	2.1	-6.3
Relative (%)	1.1	2.2	-18.8

Major shareholder	% held
Shanghai Shangshi	33.6

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# Shanghai Pharmaceuticals-A

## 3Q19 results beat expectations; still less attractive than its H shares; maintain HOLD

- The 3Q19 results were higher than market expectations, and we are overall positive on the Company's fundamentals.
- We fine-tuned our forecast numbers. We raised our 2019/20/21F net profit forecast by 1.4%/1%/0.7%, respectively, and keep our Target Price of Rmb20.0 (13x 2019F P/E, 1sd below its historical average, comparable to our H-share target multiple, which is also 1sd below the average).
- The current AH spread of ~45% is at a historical high (Figure 1), making SPH's A shares less attractive than its H shares. Maintain HOLD.

### Better-than-expected 3Q recurring bottom line; good SG&A control and cash flow management; pressure on gross margin

- Reported 9M19 net profit was Rmb3.399bn, up 0.8% yoy, accounting for 77.6%/79% of our and the Street's 2019F full-year estimates. If non-recurring items are excluded, net profit increased by 19.6% yoy to Rmb3.07bn. On a quarterly basis, 3Q19 net profit (excluding non-recurring items such as fair value changes and impairments) was Rmb975m, up 44.8% yoy, better than expectations.
- Overall, we note robust revenue growth for each segment, while the gross margin saw some slight pressure. Control of SG&A expenses was good, and finance cost fell 5.5% yoy in 9M19. Cash collection was also well managed, with operating cash flow amounting to Rmb2.93bn, up 69% yoy. Days receivable remained stable at 90 in 9M19 (vs. 89.6 in 9M18).

### Manufacturing segment continued to show solid growth

The manufacturing segment delivered 24.05% yoy revenue growth in 9M19 to Rmb17.7bn; the gross margin was 57.54%, down 0.1ppt from 9M18. Strong revenue growth came from the fast ramp-up of 60 key products, whose sales came in at Rmb10.15bn, up 31.2% yoy. We believe the Company's more stringent cost management of raw material procurement and manufacturing centralization largely mitigated gross margin pressure from drug price cuts. Going forward, we expect the manufacturing gross margin to gradually decline by 0.2 ppt each year (previously we projected a flat gross margin).

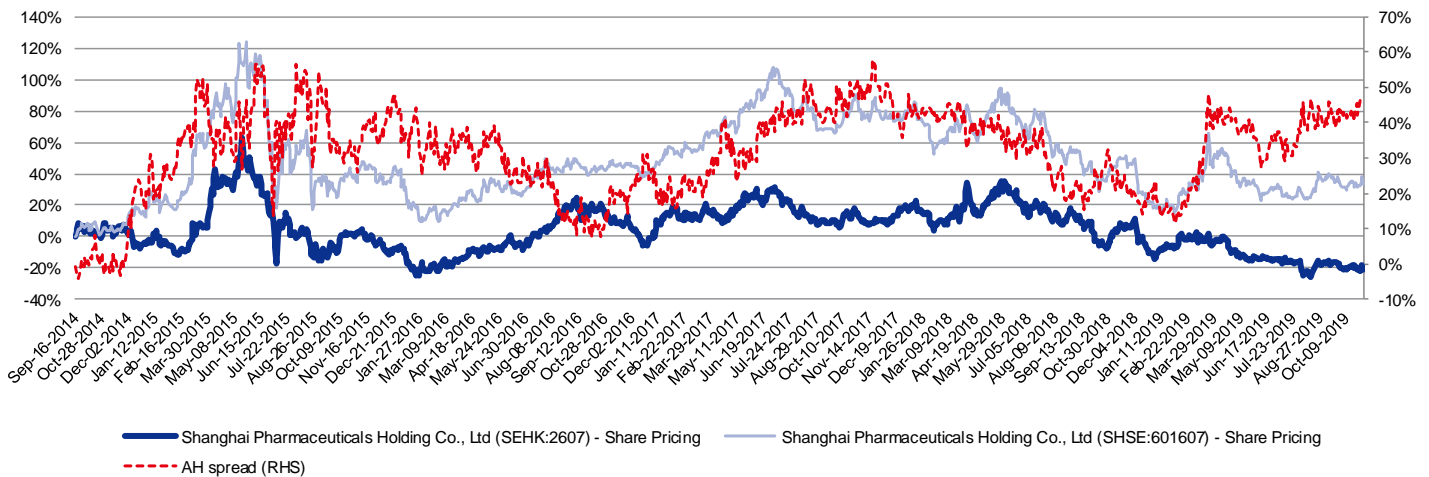
### Distribution gross margin pressure can be largely mitigated in the future

The distribution segment delivered sales of Rmb122.2bn, up 18.6% yoy, and the gross margin was 6.4%, down 0.27 ppt from 9M18. The 3Q19 topline growth rate was 14.1% yoy, which was lower than 1H19's 21% because of the consolidation of Cardinal China and Liaoning Pharmaceutical Foreign Trade in 1H18. We think the distribution segment's organic revenue growth, which came from the industry's organic growth (high single digits) and SPH's M&A (i.e. market consolidation driven by the "two-invoice system") remained solid. Looking ahead, despite foreseeable margin pressure from the 1) more stringent industry-wide medical reimbursement standards and more stringent prescription requirements for physicians; and 2) the Group Purchase Organization (GPO), we think gross margin pressure can be mitigated by 1) better-than-expected Cardinal China synergy; 2) continuing industry consolidation under the "two-invoice system"; and 3) increased direct sales percentage and product mix changes.

**Financial Summary**

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue (Rmbm)	130,847	159,084	185,404	206,896	226,889
Operating EBITDA (Rmbm)	5,550	6,650	7,734	8,355	9,022
Net Profit (Rmbm)	3,521	3,881	4,443	4,954	5,551
Normalised EPS (Rmb)	1.31	1.37	1.56	1.74	1.95
Normalised EPS Growth	10.1%	4.3%	14.5%	11.5%	12.1%
FD Normalised P/E (x)	14.17	13.22	11.87	10.64	9.50
DPS (Rmb)	0.38	0.41	0.47	0.53	0.59
Dividend Yield	2.05%	2.22%	2.54%	2.83%	3.17%
EV/EBITDA (x)	10.35	10.99	10.03	9.23	8.86
P/FCFE (x)	NA	NA	NA	21.45	NA
Net Gearing	4.8%	27.9%	33.4%	28.7%	29.9%
P/BV (x)	1.47	1.35	1.25	1.15	1.06
ROE	10.7%	10.6%	10.9%	11.2%	11.6%
% Change In Normalised EPS Estimates			1.44%	0.97%	0.65%
Normalised EPS/consensus EPS (x)			1.03	1.03	1.04

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**Figure 1: SPH's historical AH spread**


SOURCE: Capital IQ, CGIS Research

**Figure 2: CGIS research revenue projections**

Year ended Dec 31	2016A	2017A	2018A	2019F	2020F	2021F
(Rmbm)						
Manufacturing	10,334	14,987	19,462	23,744	27,305	30,855
Distribution	104,865	116,150	139,445	161,756	179,549	195,708
Retail	5,113	5,640	7,202	8,354	9,524	10,762
Net off internal sales		(6,508)	(7,847)	(9,320)	(10,402)	(11,408)
Others	453	578	823	870	920	972
Revenue	120,765	130,847	159,084	185,404	206,896	226,889

SOURCE: Company, CGIS Research

**Figure 3: 3Q19 P&L**
**Note: 3Q results calculation: 9M results (Chinese GAAP) minus 1H results (HK GAAP)**

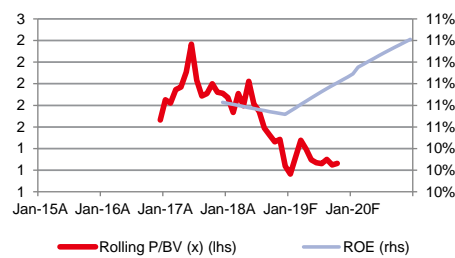
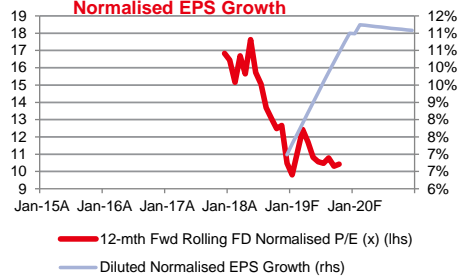
Rmbm	3Q2018	3Q2019	YoY	9M2018	9M2019	YoY
Revenue	41,723	48,042	15.1%	117,602	140,617	19.6%
COGS	(35,769)	(41,315)	15.5%	(100,987)	(120,941)	19.8%
Gross profit	5,954	6,727	13.0%	16,615	19,676	18.4%
Selling expenses	(2,696)	(3,033)	12.5%	(7,914)	(9,463)	19.6%
Admin expenses	(595)	(696)	17.0%	(2,944)	(3,618)	22.9%
Shares from JV& associates	190	272	43.4%	542	804	48.1%
Operating profit	2,852	3,270	14.6%	6,299	7,398	17.4%
Finance cost	(439)	(325)	-26.0%	(1,072)	(1,130)	5.5%
Others gains/losses	(762)	(1,382)	81.4%	(472)	(1,263)	167.8%
Pretax	1,651	1,563	-5.3%	4,756	5,005	5.2%
Tax	(149)	(269)	80.5%	(799)	(960)	20.2%
Net profit	1,502	1,294	-13.9%	3,957	4,044	2.2%
MI	164	181	10.8%	585	645	10.3%
Profit to shareholders	1,339	1,113	-16.9%	3,372	3,399	0.8%
Recurring profit to shareholders	673	975	44.8%	2,566	3,070	19.6%

SOURCE: Company, CGIS Research

**Figure 4: Earnings revision**

RMBm	FY19F			FY20F			FY21F		
	old	new	Change	old	new	Change	old	new	Change
Revenue	177,250	185,404	4.6%	196,305	206,896	5.4%	216,041	226,889	5.0%
Gross profit	24,872	25,135	1.1%	27,422	27,669	0.9%	30,285	30,558	0.9%
Operating profit	7,249	7,328	1.1%	7,905	7,982	1.0%	8,640	8,718	0.9%
Net profit	4,380	4,443	1.4%	4,906	4,954	1.0%	5,515	5,551	0.7%
EPS(RMB)	1.54	1.56	1.4%	1.73	1.74	1.0%	1.94	1.95	0.7%

SOURCE: Company, CGIS Research

**BY THE NUMBERS**
**P/BV vs ROE**

**12-mth Fwd FD Normalised P/E vs FD Normalised EPS Growth**

**Profit & Loss**

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
<b>Total Net Revenues</b>	<b>130,847</b>	<b>159,084</b>	<b>185,404</b>	<b>206,896</b>	<b>226,889</b>
<b>Gross Profit</b>	<b>16,239</b>	<b>21,694</b>	<b>25,135</b>	<b>27,669</b>	<b>30,558</b>
<b>Operating EBITDA</b>	<b>5,550</b>	<b>6,650</b>	<b>7,734</b>	<b>8,355</b>	<b>9,022</b>
Depreciation And Amortisation	(884)	(1,249)	(1,437)	(1,521)	(1,584)
<b>Operating EBIT</b>	<b>4,666</b>	<b>5,402</b>	<b>6,298</b>	<b>6,834</b>	<b>7,438</b>
Financial Income/(Expense)	(668)	(1,008)	(1,398)	(1,394)	(1,367)
Pretax Income/(Loss) from Assoc.	552	648	1,031	1,148	1,279
Non-Operating Income/(Expense)	655	302	354	390	434
<b>Profit Before Tax (pre-EI)</b>	<b>5,205</b>	<b>5,343</b>	<b>6,284</b>	<b>6,978</b>	<b>7,785</b>
Exceptional Items					
<b>Pre-tax Profit</b>	<b>5,205</b>	<b>5,343</b>	<b>6,284</b>	<b>6,978</b>	<b>7,785</b>
Taxation	(1,147)	(887)	(1,208)	(1,341)	(1,496)
Exceptional Income - post-tax					
<b>Profit After Tax</b>	<b>4,058</b>	<b>4,456</b>	<b>5,076</b>	<b>5,637</b>	<b>6,289</b>
Minority Interests	(537)	(575)	(633)	(683)	(738)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Preference Dividends (Australia)					
<b>Net Profit</b>	<b>3,521</b>	<b>3,881</b>	<b>4,443</b>	<b>4,954</b>	<b>5,551</b>

**Cash Flow**

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
<b>EBITDA</b>	<b>5,550</b>	<b>6,650</b>	<b>7,734</b>	<b>8,355</b>	<b>9,022</b>
Cash Flow from Inv. & Assoc.					
Change In Working Capital	(2,547)	(8,950)	(5,624)	(1,538)	(5,244)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	210	355	410	447	494
Net Interest (Paid)/Received	(668)	(1,008)	(1,398)	(1,394)	(1,367)
Tax Paid	(904)	(887)	(1,208)	(1,341)	(1,496)
<b>Cashflow From Operations</b>	<b>1,641</b>	<b>(3,839)</b>	<b>(86)</b>	<b>4,529</b>	<b>1,408</b>
Capex	(515)	(1,990)	(1,700)	(1,450)	(1,450)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(1,679)	(7,788)	(881)	(621)	(555)
<b>Cash Flow From Investing</b>	<b>(2,194)</b>	<b>(9,778)</b>	<b>(2,581)</b>	<b>(2,071)</b>	<b>(2,005)</b>
Debt Raised/(repaid)	22	0	0	0	0
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	(1,245)	(1,022)	(1,169)	(1,339)	(1,494)
Preferred Dividends					
Other Financing Cashflow	4,385	17,675	(1,652)	(500)	(500)
<b>Cash Flow From Financing</b>	<b>3,161</b>	<b>16,653</b>	<b>(2,820)</b>	<b>(1,839)</b>	<b>(1,994)</b>
Total Cash Generated	2,608	3,036	(5,488)	619	(2,590)
<b>Free Cashflow To Equity</b>	<b>(531)</b>	<b>(13,617)</b>	<b>(2,667)</b>	<b>2,458</b>	<b>(596)</b>
<b>Free Cashflow To Firm</b>	<b>116</b>	<b>(12,609)</b>	<b>(1,269)</b>	<b>3,852</b>	<b>770</b>

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**BY THE NUMBERS... cont'd**
**Balance Sheet**

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Total Cash And Equivalents	14,842	18,695	13,207	13,826	11,236
Total Debtors	36,530	48,015	50,517	59,436	61,142
Inventories	17,270	25,024	32,058	31,776	38,150
Total Other Current Assets	1	1,544	1,544	1,544	1,544
<b>Total Current Assets</b>	<b>68,642</b>	<b>93,278</b>	<b>97,327</b>	<b>106,582</b>	<b>112,072</b>
Fixed Assets	9,386	11,008	11,962	12,547	13,081
Total Investments	0	0	0	0	0
Intangible Assets	8,092	14,199	14,808	15,252	15,684
Total Other Non-Current Assets	8,224	8,395	8,950	9,562	10,237
<b>Total Non-current Assets</b>	<b>25,702</b>	<b>33,601</b>	<b>35,720</b>	<b>37,361</b>	<b>39,002</b>
Short-term Debt	13,792	22,031	21,000	21,000	21,000
Current Portion of Long-Term Debt					
Total Creditors	35,838	45,321	49,233	56,332	59,167
Other Current Liabilities	2	1,358	1,358	1,358	1,358
<b>Total Current Liabilities</b>	<b>49,632</b>	<b>68,710</b>	<b>71,591</b>	<b>78,689</b>	<b>81,525</b>
Total Long-term Debt	2,959	9,620	9,000	8,500	8,000
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	2,078	2,116	2,116	2,116	2,116
<b>Total Non-current Liabilities</b>	<b>5,037</b>	<b>11,736</b>	<b>11,116</b>	<b>10,616</b>	<b>10,116</b>
Total Provisions	0	0	0	0	0
<b>Total Liabilities</b>	<b>54,669</b>	<b>80,446</b>	<b>82,707</b>	<b>89,305</b>	<b>91,641</b>
Shareholders' Equity	34,031	39,014	42,288	45,903	49,960
Minority Interests	5,645	7,420	8,052	8,736	9,474
<b>Total Equity</b>	<b>39,676</b>	<b>46,433</b>	<b>50,340</b>	<b>54,638</b>	<b>59,434</b>

**Key Ratios**

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue Growth	8.3%	21.6%	16.5%	11.6%	9.7%
Operating EBITDA Growth	21.7%	19.8%	16.3%	8.0%	8.0%
Operating EBITDA Margin	4.24%	4.18%	4.17%	4.04%	3.98%
Net Cash Per Share (Rmb)	(0.71)	(4.56)	(5.91)	(5.52)	(6.25)
BVPS (Rmb)	12.66	13.73	14.88	16.15	17.58
Gross Interest Cover	6.98	5.36	4.50	4.90	5.44
Effective Tax Rate	22.0%	16.6%	19.2%	19.2%	19.2%
Net Dividend Payout Ratio	28.1%	30.0%	30.0%	30.0%	30.0%
Accounts Receivables Days	95.42	96.99	96.99	97.25	96.99
Inventory Days	53.64	56.18	65.00	65.18	65.00
Accounts Payables Days	105.5	105.9	106.0	106.3	106.0
ROIC (%)	11.9%	12.4%	10.2%	9.9%	10.3%
ROCE (%)	8.83%	8.03%	7.95%	8.31%	8.62%
Return On Average Assets	5.34%	4.94%	4.98%	5.08%	5.19%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

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We are transferring the rating mechanism from “BUY, SELL, HOLD” to “ADD, REDUCE, HOLD”. Please refer to the definitions below.

**Explanation on Equity Ratings**

**ADD** : The stock’s total return is expected to exceed 10% over the next 12 months.

**REDUCE** : The stock’s total return is expected to fall below 0% or more over the next 12 months.

**HOLD** : The stock’s total return is expected to be between 0% and positive 10% over the next 12 months.

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