

## Company Report

### Shanghai Pharma (2607 HK)

#### A weak 2Q22 was expected

- 1H22 revenue/core net profit grew 6%/5% yoy, reflecting 2Q22 revenue/core NP grew 2%/7% yoy, in line with CMS est.
- Co. continued to shift toward innovative segments; the innovative investment/BD events should trigger an upward re-rating
- Current stock valuation remains attractive (9x FY23E PER). Maintain BUY with TP at HKD18.5

#### 1H22 results were impacted by Omicron restriction

Manufacturing sales was flat at RMB6.1bn in 2Q22, largely due to Omicron disruptions partly offsetting by steady sales of 60 key products (up 12% yoy in 1H22). Distribution growth grew 3% yoy to RMB49bn in 2Q22. Co. attributed the soft growth to less patient visits during COVID restrictions. This also resulted in soft retail which declined 15% yoy to RMB1.8bn. But Co. believes its distribution franchise was further strengthened after the Omicron wave given its important role in medical supplies and epidemic prevention. 1H22 overall GPM down 0.3ppt to 13.1% mainly due to adverse VBP impacts (manufacturing GPM down 0.7ppt). We reckon this trend to persist given ongoing VBP policies. 1H22 OCF turned negative to RMB556mn cash outflow (vs. RMB2,171mn cash inflow in 1H21), due to longer A/R days (from 93days to 111days) as a result of slower collection of A/R from hospitals during pandemic.

#### Innovative segments remained on a positive trajectory

Co. continued to invest and revamp its R&D pipeline (1H22 R&D expenses largely remained at ~6% of manufacturing sales). Co. now has 50 IND- or clinical-stage new drug pipelines, o/w 42 innovative candidates and 8 improved new drugs. Co. also leveraged its collaboration with Yunnan Baiyao to further expand its footing in Chinese herbal medicines. In addition, Co.'s rare disease platform, SPH Ruier, is better positioned to succeed in this market, supported by its rich rare disease pipeline. We believe these investments in innovative segments should continue enhancing its innovative transformation outlook.

#### Maintain BUY with TP unchanged at HKD18.5

We maintain financial forecast for FY22E/23E unchanged. SOTP-based TP also remained at HKD18.5. We believed its healthy B/S and its capital allocation capabilities should drive re-rate opportunities. **Investment risks:** VBP, R&D risk, COVID-19, etc.

RMB mn	2019	2020	2021	2022E	2023E
Revenue	186,566	191,909	215,824	228,665	249,982
Growth	17.3%	2.9%	12.5%	5.9%	9.3%
Adj. net profit	3,449	3,792	3,875	4,074	4,586
Growth	12.7%	9.9%	2.2%	5.2%	12.6%
EPS (RMB)	1.22	1.34	1.37	1.19	1.24
DPS (RMB)	0.44	0.48	0.42	0.39	0.43
P/E (x)	8.1	7.5	6.8	8.1	7.8
P/B (x)	0.7	0.6	0.5	0.5	0.5
ROE	9.8%	9.9%	10.4%	7.1%	7.5%

Sources: Company data, CMS (HK) estimates, our adj. net profit has been adjusted for one-off income/expenses and SBC, price as of Aug 30, 2022

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#### WHAT'S NEW

1H22 earnings update

### BUY

Previous	BUY
Price (Aug 30, 2022)	HKD11.2
12-month Target Price (Potential up/downside)	HKD18.5 (+64%)
Previous	HKD18.5

#### Price Performance



Source: Bloomberg

%	1m	6m	12m
2607 HK	1.4	(18.8)	(24.4)
HSI	1.1	(12.6)	(23.1)

#### Sector: Pharmaceutical & Healthcare

Hang Seng Index (Aug 30, 2022)	19,949
HSCEI (Aug 30, 2022)	6,840

#### Key Data

52-week range (HKD)	10.6-17.8
Market cap (HKD mn)	64,377
Avg. daily traded value (HKD mn)	39.6
BVPS (HKD)	23.6

#### Shareholding Structure

Shanghai SASAC	35.5%
Yunnan Baiyao	18.0%
BlackRock	1.8%
Free float	44.7%

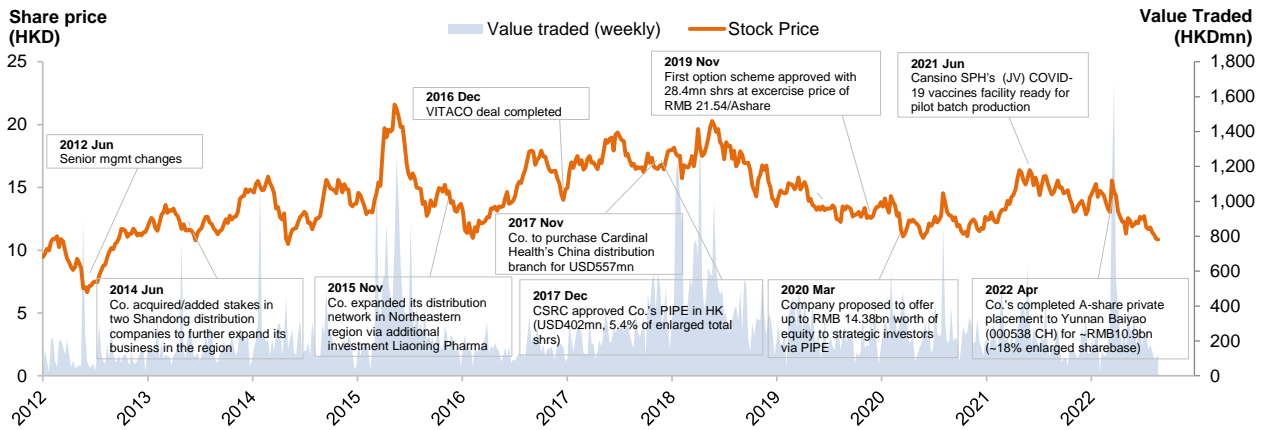
Sources: Company, Bloomberg

#### Related Research

1. Shanghai Pharma (2607 HK) – Challenging 2Q22E due to COVID lockdown (BUY) (May 19, 2022)
2. Shanghai Pharma (2607 HK) – GPO weighs on 3Q21 results (BUY) (Nov 3, 2021)
3. Shanghai Pharma (2607 HK) – Solid 1Q21 results to continue to support re-rate (BUY) (May 5, 2021)
4. Shanghai Pharma (2607 HK) – Resilient FY20 results; an overlooked defensive play (BUY) (Mar 28, 2021)

Focus charts

Figure 1: Stock performance and events of SH Pharm



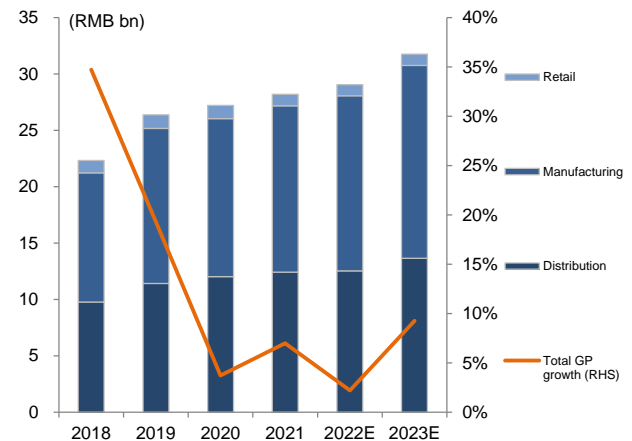
Sources: Bloomberg, CMS (HK)

Figure 2: 12m performance of SH Pharm (2607 HK), CR Pharm (3320 HK) and Sinopharm (1099 HK)



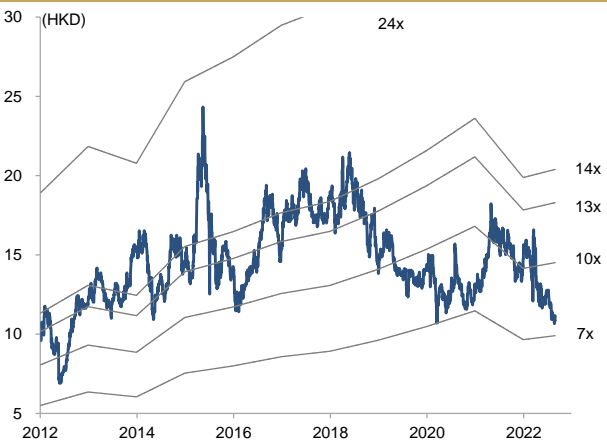
Source: Bloomberg

Figure 3: Gross profit breakdown by segments



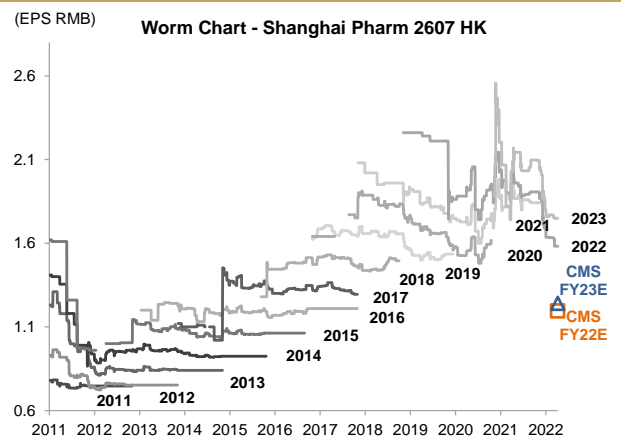
Source: CMS (HK) estimates

Figure 4: PER band



Sources: Bloomberg, CMS (HK) estimates

Figure 5: Adj. EPS consensus worm chart



Sources: Bloomberg, CMS (HK) estimates

## Valuation

Figure 6: SOTP Valuation

(RMB mn)

### Gross profit

Pharma manufacturing	17,420
Pharma distribution & retail	14,651

### Total SG&A

Pharma manufacturing	(14,767)
Pharma distribution & retail	(9,051)

### NOPAT

Pharma manufacturing	2,057
Pharma distribution & retail	4,340

### Valuation

Pharma manufacturing (13x NOPAT)	26,735
Pharma distribution & retail (9x NOPAT)	39,063

Less: net debt 7,012

Less: minorities valuation (10,756)

Equity value 62,053

# of shares (mn) 3,696

**TP (HKD) 18.5**

Source: CMS (HK) estimates

## Financial Summary

### Balance Sheet

RMB mn	2019	2020	2021	2022E	2023E
Cash and cash equivalents	15,716	19,576	20,138	36,684	38,784
ST investments	4,624	2,720	2,253	2,253	2,253
Inventories	24,877	24,088	27,104	30,033	32,836
Other current assets	52,874	61,178	67,000	71,418	77,517
<b>Total current assets</b>	<b>98,092</b>	<b>107,563</b>	<b>116,494</b>	<b>140,388</b>	<b>151,390</b>
Property, plant & equipment	11,901	12,228	13,398	14,192	14,915
Other assets	10,411	10,449	13,833	13,833	13,833
Intangible assets	16,617	18,945	19,710	18,605	17,570
<b>Total non-current asset</b>	<b>38,929</b>	<b>41,623</b>	<b>46,941</b>	<b>46,630</b>	<b>46,318</b>
<b>Total assets</b>	<b>137,026</b>	<b>149,186</b>	<b>163,436</b>	<b>187,018</b>	<b>197,708</b>
Accounts payable	47,936	49,935	55,058	60,067	65,672
ST bank loans	23,764	20,139	22,515	22,515	22,515
Income taxes payable	717	1,478	1,693	1,693	1,693
Other current liabilities	2,191	16,581	12,559	12,559	12,559
<b>Total current liabilities</b>	<b>74,608</b>	<b>88,133</b>	<b>91,824</b>	<b>96,833</b>	<b>102,438</b>
Long term debt	9,134	1,184	7,158	7,158	7,158
Deferred taxes	810	832	999	999	999
Other liabilities	3,089	4,295	4,388	4,388	4,388
<b>Total non-current liabilities</b>	<b>13,033</b>	<b>6,312</b>	<b>12,545</b>	<b>12,545</b>	<b>12,545</b>
<b>Total liabilities</b>	<b>87,640</b>	<b>94,445</b>	<b>104,369</b>	<b>109,378</b>	<b>114,983</b>
Minority interest	7,727	9,386	9,707	10,756	11,933
Common equity	41,659	45,355	49,359	66,884	70,792
<b>Total equity</b>	<b>49,386</b>	<b>54,741</b>	<b>59,066</b>	<b>77,640</b>	<b>82,725</b>

### Cash Flow Statement

RMB mn	2019	2020	2021	2022E	2023E
PBT	6,262	7,175	8,144	7,497	8,404
Depreciation and amortization	2,042	2,119	2,119	2,311	2,312
Operating profit before chg. in WC	9,813	13,088	13,531	11,266	11,909
Funds from other operating activities	(2,388)	(1,780)	(3,564)	(2,338)	(3,297)
<b>Cash from operating activities</b>	<b>4,367</b>	<b>8,257</b>	<b>6,580</b>	<b>5,460</b>	<b>4,941</b>
Capital expenditure	(2,128)	(3,010)	(4,119)	(2,000)	(2,000)
Purchase intangible assets	(625)	-	-	-	-
Net assets from acquisition	(2,452)	(2,046)	(1,039)	-	-
Interest received	234	288	388	322	587
Others	621	3,062	(1,246)	-	-
<b>Cash from investing activities</b>	<b>(4,350)</b>	<b>(1,706)</b>	<b>(6,016)</b>	<b>(1,678)</b>	<b>(1,413)</b>
Bank borrowings	1,706	1,689	4,332	-	-
Common dividends (cash)	(1,595)	(1,251)	(1,364)	(1,194)	(1,428)
Net proceeds of issuance of equity	-	-	-	13,958	-
Others	-	-	-	-	-
<b>Cash from financing activities</b>	<b>(907)</b>	<b>(2,673)</b>	<b>47</b>	<b>12,764</b>	<b>(1,428)</b>
<b>Net Cash - beginning balance</b>	<b>16,605</b>	<b>15,716</b>	<b>19,576</b>	<b>20,138</b>	<b>36,684</b>
<b>Net change in cash</b>	<b>(890)</b>	<b>3,878</b>	<b>611</b>	<b>16,547</b>	<b>2,100</b>
<b>Net Cash - ending balance</b>	<b>15,716</b>	<b>19,576</b>	<b>20,138</b>	<b>36,684</b>	<b>38,784</b>

### Profit & Loss Statement

RMB mn	2019	2020	2021	2022E	2023E
<b>Revenue</b>	<b>186,566</b>	<b>191,909</b>	<b>215,824</b>	<b>228,665</b>	<b>249,982</b>
Cost of sales	(160,685)	(165,067)	(187,947)	(199,313)	(217,910)
Gross profit	25,881	26,842	27,877	29,352	32,071
SG&A expenses	(17,561)	(17,597)	(18,461)	(19,551)	(21,498)
<b>Operating profit</b>	<b>6,970</b>	<b>7,589</b>	<b>7,428</b>	<b>7,693</b>	<b>8,254</b>
Interest income	234	288	388	322	587
Interest expense	(1,423)	(1,412)	(1,518)	(1,780)	(1,780)
PBT	6,262	7,175	8,144	7,497	8,404
Income tax	(1,432)	(1,570)	(1,869)	(1,687)	(1,891)
Minority interest	(750)	(1,104)	(1,148)	(1,050)	(1,177)
<b>Net profit</b>	<b>4,081</b>	<b>4,501</b>	<b>5,127</b>	<b>4,760</b>	<b>5,336</b>
<b>Adj. net profit</b>	<b>3,449</b>	<b>3,792</b>	<b>3,875</b>	<b>4,074</b>	<b>4,586</b>
<b>EPS - diluted (RMB)</b>	<b>1.22</b>	<b>1.34</b>	<b>1.37</b>	<b>1.19</b>	<b>1.24</b>
DPS (RMB)	0.44	0.48	0.42	0.39	0.43

### Financial Ratio

	2019	2020	2021	2022E	2023E
<b>Growth (yoy)</b>					
Revenue	17.3%	2.9%	12.5%	5.9%	9.3%
Gross profit	19.3%	3.7%	3.9%	5.3%	9.3%
Operating profit	29.0%	8.9%	-2.1%	3.6%	7.3%
Adj. net profit	12.7%	9.9%	2.2%	5.2%	12.6%

### Margin

Gross margin	13.9%	14.0%	12.9%	12.8%	12.8%
EBITDA margin	4.8%	5.1%	4.4%	4.4%	4.2%
Operating margin	3.7%	4.0%	3.4%	3.4%	3.3%
Adj. net profit margin	1.8%	2.0%	1.8%	1.8%	1.8%

### Efficiency

Inventory days	57	53	53	55	55
Trade receivable days	102	104	102	103	103
Account payable days	109	110	107	110	110

### Financial ratios

Current ratio (x)	1.3	1.2	1.3	1.4	1.5
Quick ratio (x)	1.0	0.9	0.9	1.1	1.1
ROA	3.0%	3.0%	3.1%	2.5%	2.7%
ROE	9.8%	9.9%	10.4%	7.1%	7.5%
Net gearing	34.8%	3.2%	16.1%	-9.0%	-11.0%

Sources: Company data, CMS (HK) estimates

## Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
HOLD	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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