

EARNINGS REVIEW

Sinopharm Group Co. (1099.HK)

Neutral

Equity Research

In line with expectations: Finance costs weigh on earnings growth**What surprised us**

Sinopharm reported in-line FY13 results, with revenue/NPAT Rmb166.9bn/ Rmb2.25bn, +22%/+14% yoy and +1%/-1% vs our estimates. 2H13 GP margin jumped to 8.13%, +23bps hoh or +20 bps yoy helped by a change in product mix and higher contribution from centralized EDL procurements from selected provinces. 2H13 adjusted EBIT margin of 3.34% was 30bps lower than 1H13 due to higher admin costs, yet 20bps up vs 2H12. Overall, 2013 EBIT margin was 9 bps lower than GHe. Finance costs were 6% more than GHe, at Rmb1.84 bn, with 2H12 finance costs up to 1.21% of revenue (vs 0.81% in 1H13, and 1.04% for 2013 GHe), mainly due to higher factoring costs as a result of higher cash conversion cycles, extended by 7 days.

What to do with the stock

Key management comments from analyst meeting: (1) revenue growth in 2014 to remain 3-5% higher than the market average, (2) continue to see high operating leverage while maintaining relatively stable gross margin, (3) finance cost is a big swing factor for earnings due to delayed cash payment from hospitals and uncertain interest rates. We therefore keep Neutral on the stock as we believe higher working capital replenishment might offset operating efficiency and cap share price upside. We trim our 2014-16 revenue forecasts by 1%/4%/7% and EPS forecasts by 3%/5%/4% to reflect revenue changes and a lower GP margin. **Valuation:** We lower our 12-m TP (based on 2014E-16E EV/GCI vs CROCI/WACC) to HK\$23.7 (from HK\$26.2), implying 18X 2014E P/E. **Risks:** Downside: higher finance costs and lower margin. Upside: further operational leverage.

Sinopharm 2013 results summary

(Rmb mn)	2H12 (Re)	2H13	YoY %	2012A (Re)	2013A	YoY %	2013E	YoY %
Revenue	69,225	86,800	25%	136,502	166,866	22%	165,338	1%
NPAT	1,015	1,098	8%	1,979	2,250	14%	2,280	-1%
GP margin	7.93%	8.13%	+20bps	8.05%	8.02%	(3bps)	7.89%	+13bps
OP margin	3.30%	3.58%	+28bps	3.41%	3.48%	+8bps	3.57%	(9bps)
NP margin	1.47%	1.27%	(20bps)	1.45%	1.35%	(10bps)	1.38%	(3bps)

Source: Company data, Gao Hua Securities Research.

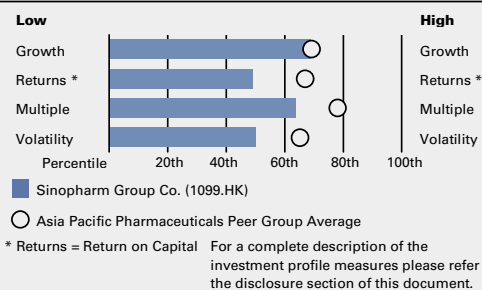
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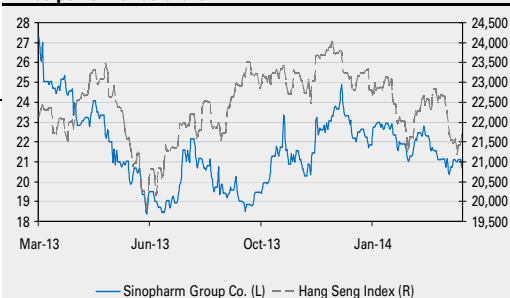
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Investment Profile**Key data**

	Current
Price (HK\$)	20.70
12 month price target (HK\$)	23.70
Market cap (HK\$ mn / US\$ mn)	53,163.7 / 6,852.0
Foreign ownership (%)	--

	12/13	12/14E	12/15E	12/16E
EPS (Rmb) New	0.88	1.04	1.24	1.49
EPS revision (%)	(1.3)	(2.6)	(5.4)	(3.5)
EPS growth (%)	6.6	18.7	19.6	20.0
EPS (dil) (Rmb) New	0.88	1.04	1.24	1.49
P/E (X)	20.1	16.0	13.3	11.1
P/B (X)	2.1	1.8	1.6	1.5
EV/EBITDA (X)	9.4	8.2	7.6	6.8
Dividend yield (%)	1.5	1.9	2.2	2.7
ROE (%)	11.6	11.7	12.8	13.9
CROCI (%)	39.3	14.5	14.3	14.5

Price performance chart

Share price performance (%)	3 month	6 month	12 month
Absolute	(8.0)	10.1	(24.2)
Rel. to Hang Seng Index	(2.4)	16.8	(23.2)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 3/24/2014 close.

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Sinopharm Group Co.: Summary Financials

Profit model (Rmb mn)	12/13	12/14E	12/15E	12/16E	Balance sheet (Rmb mn)	12/13	12/14E	12/15E	12/16E
Total revenue	166,866.1	197,405.7	229,845.8	265,467.1	Cash & equivalents	14,002.0	14,378.5	11,806.4	11,358.2
Cost of goods sold	(153,487.6)	(181,718.1)	(211,813.8)	(244,869.7)	Accounts receivable	55,966.1	66,208.9	77,089.1	86,854.4
SG&A	(7,565.5)	(8,851.5)	(10,191.1)	(11,558.2)	Inventory	16,702.3	19,774.3	23,049.3	26,646.4
R&D	--	--	--	--	Other current assets	3,043.0	3,043.0	3,043.0	3,043.0
Other operating profit/(expense)	288.9	341.8	398.0	398.2	Total current assets	89,713.4	103,404.7	114,987.8	127,902.0
EBITDA	6,728.5	7,862.4	9,068.9	10,431.3	Net PP&E	5,603.3	7,470.2	9,582.9	11,961.5
Depreciation & amortization	(626.5)	(684.4)	(830.0)	(993.9)	Net intangibles	6,310.5	6,140.8	5,971.1	5,801.4
EBIT	6,101.9	7,178.0	8,238.9	9,437.4	Total investments	1,164.9	1,317.7	1,485.9	1,671.1
Interest income	174.4	251.2	257.9	211.8	Other long-term assets	2,660.9	2,660.9	2,660.9	2,660.9
Interest expense	(1,834.8)	(2,301.2)	(2,505.6)	(2,615.9)	Total assets	105,453.1	120,994.4	134,688.7	149,997.0
Income/(loss) from uncons. subs.	138.8	152.8	168.2	185.2	Accounts payable	49,371.6	58,452.4	68,133.2	78,766.1
Others	40.2	50.0	50.0	50.0	Short-term debt	21,007.3	21,007.3	21,007.3	21,007.3
Pretax profits	4,620.5	5,330.7	6,209.4	7,268.5	Other current liabilities	462.3	462.3	462.3	462.3
Income tax	(1,040.8)	(1,202.5)	(1,402.9)	(1,644.9)	Total current liabilities	70,841.2	79,921.9	89,602.7	100,235.6
Minorities	(1,329.7)	(1,456.8)	(1,611.3)	(1,791.0)	Long-term debt	4,134.1	7,134.1	7,134.1	7,134.1
Net income pre-preferred dividends	2,250.0	2,671.5	3,195.1	3,832.6	Other long-term liabilities	1,866.5	1,866.5	1,866.5	1,866.5
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	6,000.6	9,000.6	9,000.6	9,000.6
Net income (pre-exceptionals)	2,250.0	2,671.5	3,195.1	3,832.6	Total liabilities	76,841.8	88,922.5	98,603.3	109,236.2
Post-tax exceptionals	0.0	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	2,250.0	2,671.5	3,195.1	3,832.6	Total common equity	21,815.5	23,819.3	26,221.5	29,105.9
EPS (basic, pre-except) (Rmb)	0.88	1.04	1.24	1.49	Minority interest	6,795.8	8,252.6	9,863.9	11,654.9
EPS (basic, post-except) (Rmb)	0.88	1.04	1.24	1.49	Total liabilities & equity	105,453.1	120,994.4	134,688.7	149,997.0
EPS (diluted, post-except) (Rmb)	0.88	1.04	1.24	1.49	BVPS (Rmb)	8.49	9.27	10.21	11.33
DPS (Rmb)	0.26	0.31	0.37	0.44					
Dividend payout ratio (%)	29.7	29.7	29.7	29.7					
Free cash flow yield (%)	5.6	(3.8)	(3.4)	0.9					
Growth & margins (%)	12/13	12/14E	12/15E	12/16E	Ratios	12/13	12/14E	12/15E	12/16E
Sales growth	22.9	18.3	16.4	15.5	CROCI (%)	39.3	14.5	14.3	14.5
EBITDA growth	24.8	16.9	15.3	15.0	ROE (%)	11.6	11.7	12.8	13.9
EBIT growth	25.5	17.6	14.8	14.5	ROA (%)	2.4	2.4	2.5	2.7
Net income growth	14.0	18.7	19.6	20.0	ROACE (%)	14.1	13.3	13.3	13.6
EPS growth	6.6	18.7	19.6	20.0	Inventory days	36.1	36.6	36.9	37.0
Gross margin	8.0	7.9	7.8	7.8	Receivables days	106.1	112.9	113.8	112.7
EBITDA margin	4.0	4.0	3.9	3.9	Payable days	104.9	108.3	109.1	109.5
EBIT margin	3.7	3.6	3.6	3.6	Net debt/equity (%)	38.9	42.9	45.3	41.2
					Interest cover - EBIT (X)	3.7	3.5	3.7	3.9
Cash flow statement (Rmb mn)	12/13	12/14E	12/15E	12/16E	Valuation	12/13	12/14E	12/15E	12/16E
Net income pre-preferred dividends	2,250.0	2,671.5	3,195.1	3,832.6	P/E (analyst) (X)	20.1	16.0	13.3	11.1
D&A add-back	626.5	684.4	830.0	993.9	P/B (X)	2.1	1.8	1.6	1.5
Minorities interests add-back	1,329.7	1,456.8	1,611.3	1,791.0	EV/EBITDA (X)	9.4	8.2	7.6	6.8
Net (inc)/dec working capital	(7,460.6)	(4,234.1)	(4,474.5)	(2,729.4)	EV/GCI (X)	1.6	1.4	1.3	1.2
Other operating cash flow	8,195.7	(152.8)	(168.2)	(185.2)	Dividend yield (%)	1.5	1.9	2.2	2.7
Cash flow from operations	4,941.3	425.9	993.7	3,702.8					
Capital expenditures	(2,013.2)	(2,381.6)	(2,773.0)	(3,202.7)					
Acquisitions	(154.4)	0.0	0.0	0.0					
Divestitures	0.0	0.0	0.0	0.0					
Others	(1,898.8)	0.0	0.0	0.0					
Cash flow from investments	(4,066.4)	(2,381.6)	(2,773.0)	(3,202.7)					
Dividends paid (common & pref)	(600.7)	(667.8)	(792.8)	(948.2)					
Inc/(dec) in debt	6,000.0	3,000.0	0.0	0.0					
Common stock issuance (repurchase)	3,226.2	0.0	0.0	0.0					
Other financing cash flows	(5,216.8)	0.0	0.0	0.0					
Cash flow from financing	3,408.7	2,332.2	(792.8)	(948.2)					
Total cash flow	4,283.7	376.5	(2,572.1)	(448.2)					

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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Reg AC

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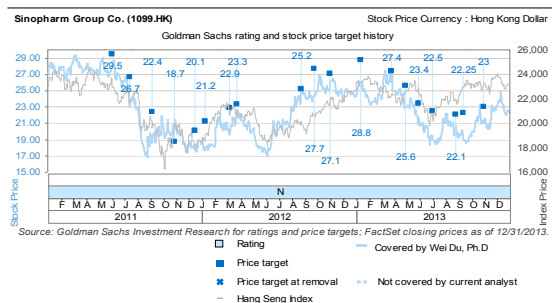
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