

Strong growth momentum regained, reiterate Buy...

Strong recovery, reiterate Buy with a PO of HK\$26.50

Sinopharm reported solid 2Q13 results, with top-line growth of 27% vs. 14% in 1Q13. The strong recovery was mainly due to robust industry growth and prescription drug sales growth from hospitals, as anticipated (refer [interim results preview note](#)). For the broader 1H13 period, Revenue/ Earnings grew 20%/ 20%, respectively. With Sinopharm regaining its strong growth momentum, we reiterate that the 1Q13 growth slowdown was an abnormality due to tight medical insurance budgeting control that should ease over the rest of the year. We are raising our EPS estimates and believe Sinopharm is well on track to deliver 21% FY13 growth, 3-5% above the industry.

Margin pressure in 2H13, but partly mitigated by lower costs

With concerns of a potential drug price cut and other on-going policy uncertainties, we lower our full-year Gross Margin by 15bps, to 7.90%. We expect this will be mitigated by lower SG&A costs, with greater scale and operational efficiency. We note, however, that irrespective of this increased efficiency, Sinopharm usually incurs more SG&A costs in 2H, and we ultimately forecast a lower OPM in 2H13 (consistent with the pattern observed in previous years). For FY13, we forecast an OPM of 3.70% with Financial Costs stable, with comparably cheaper funding from corporate bonds offset by a slightly higher Debtor factoring rate.

Valuation remains attractive

As the largest distributor in China, Sinopharm, trading at 17x/14x FY13/ 14 PE, is at an attractive ~15% discount to the healthcare industry average. Our HK\$26.50 PO is based on a 22x FY13 P/E. We believe this is justifiable by Sinopharm's robust earnings growth profile (2013-14E) of 20%. The closest peer group should be the domestic listed drug-distribution companies, which are trading at 21x 2013E P/E. We believe a premium for Sinopharm is reasonable, given the company's leadership position and investment grade scarcity of other alternatives in China healthcare.

Estimates (Dec)

(HK\$)	2011A	2012A	2013E	2014E	2015E
Net Income (Adjusted - CNY mn)	1,561	1,973	2,454	3,097	3,700
EPS	0.802	1.02	1.19	1.50	1.79
EPS Change (YoY)	31.5%	27.0%	16.4%	26.2%	19.5%
Dividend / Share	0.293	0.255	0.296	0.373	0.446
Free Cash Flow / Share (CNY)	-0.722	-2.40	1.76	2.26	2.67

Valuation (Dec)

	2011A	2012A	2013E	2014E	2015E
P/E	25.9x	20.4x	17.5x	13.9x	11.6x
Dividend Yield	1.4%	1.2%	1.4%	1.8%	2.2%
EV / EBITDA*	13.54x	9.03x	7.38x	6.00x	5.07x
Free Cash Flow Yield*	-4.05%	-13.71%	10.75%	13.82%	16.28%

* For full definitions of *iQmethod*SM measures, see page 5.

Equity | China | Pharmaceuticals
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Bank of America Merrill Lynch



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Stock Data

Price	HK\$20.75
Price Objective	HK\$26.50
Date Established	25-Jun-2013
Investment Opinion	B-1-7
Volatility Risk	MEDIUM
52-Week Range	HK\$18.06-HK\$28.10
Mrkt Val / Shares Out (mn)	US\$6,871 / 2,568.0
Average Daily Volume	5,258,995
BofAML Ticker / Exchange	SHTDF / HKG
Bloomberg / Reuters	1099 HK / 1099.HK
ROE (2013E)	12.8%
Net Dbt to Eqty (Dec-2012A)	28.0%
Est. 5-Yr EPS / DPS Growth	20.6% / 20.6%
Free Float	45.0%

Key Changes

(CNY)	Previous	Current
2013E Rev (m)	166,673.8	164,364.0
2014E Rev (m)	202,973.5	200,155.6
2015E Rev (m)	NA	241,656.4
2013E EPS (HK\$)	1.14	1.19
2014E EPS (HK\$)	1.37	1.50
2015E EPS (HK\$)	NA	1.79

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Refer to important disclosures on page 6 to 8. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 11308407

iQprofileSM Sinopharm Group Co. Ltd.

Key Income Statement Data (Dec)	2011A	2012A	2013E	2014E	2015E
(CNY Millions)					
Sales	102,225	135,787	164,364	200,156	241,656
Gross Profit	8,355	10,943	12,985	16,012	19,212
Sell General & Admin Expense	(4,887)	(6,298)	(7,152)	(8,649)	(10,370)
Operating Profit	3,636	4,863	6,082	7,638	9,141
Net Interest & Other Income	(616)	(985)	(1,178)	(1,431)	(1,718)
Associates	107	135	155	179	205
Pretax Income	3,128	4,014	5,059	6,385	7,628
Tax (expense) / Benefit	(725)	(934)	(1,164)	(1,469)	(1,754)
Net Income (Adjusted)	1,561	1,973	2,454	3,097	3,700
Average Fully Diluted Shares Outstanding	2,356	2,403	2,568	2,568	2,568

Key Cash Flow Statement Data

Net Income	1,561	1,973	2,454	3,097	3,700
Depreciation & Amortization	323	1,076	1,184	1,303	1,433
Change in Working Capital	(2,327)	(5,217)	(1,509)	(1,543)	(1,804)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	1,462	2,385	2,908	3,531	4,161
Cash Flow from Operations	1,019	217	5,038	6,388	7,490
Capital Expenditure	(2,721)	(5,983)	(516)	(576)	(644)
(Acquisition) / Disposal of Investments	(147)	(148)	2	0	0
Other Cash Inflow / (Outflow)	37	NA	(5)	(4)	(4)
Cash Flow from Investing	(2,831)	NA	(519)	(580)	(648)
Shares Issue / (Repurchase)	435	951	1,441	1,819	2,173
Cost of Dividends Paid	(570)	(493)	(614)	(773)	(924)
Cash Flow from Financing	302	1,223	(2,396)	(2,279)	(2,229)
Free Cash Flow	(1,702)	(5,766)	4,522	5,812	6,846
Net Debt	758	6,358	2,654	(2,295)	(8,182)
Change in Net Debt	15,862	2,231	(3,731)	(4,977)	(5,916)

Key Balance Sheet Data

Property, Plant & Equipment	5,363	6,399	7,062	7,791	8,593
Other Non-Current Assets	6,032	7,431	7,293	7,148	6,998
Trade Receivables	29,728	41,084	45,009	49,316	54,045
Cash & Equivalents	13,091	9,722	11,818	15,319	19,904
Other Current Assets	13,414	15,210	17,246	19,660	22,307
Total Assets	67,628	79,847	88,427	99,235	111,847
Long-Term Debt	5,182	5,192	4,672	4,205	3,785
Other Non-Current Liabilities	1,766	1,807	1,789	1,774	1,759
Short-Term Debt	8,667	10,888	9,799	8,819	7,937
Other Current Liabilities	31,624	39,217	43,656	48,821	54,378
Total Liabilities	47,239	57,104	59,917	63,619	67,859
Total Equity	20,388	22,743	28,510	35,615	43,988
Total Equity & Liabilities	67,627	79,847	88,427	99,235	111,847

iQmethodSM - Bus Performance*

Return On Capital Employed	10.4%	10.0%	11.2%	12.6%	13.3%
Return On Equity	11.4%	12.0%	12.8%	12.9%	12.4%
Operating Margin	3.6%	3.6%	3.7%	3.8%	3.8%
EBITDA Margin	3.9%	4.4%	4.4%	4.5%	4.4%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	0.7x	0.1x	2.1x	2.1x	2.0x
Asset Replacement Ratio	8.4x	5.6x	0.4x	0.4x	0.4x
Tax Rate (Reported)	23.2%	23.3%	23.0%	23.0%	23.0%
Net Debt-to-Equity Ratio	3.7%	28.0%	9.3%	-6.4%	-18.6%
Interest Cover	3.9x	3.4x	3.7x	4.0x	4.2x

Key Metrics

Analyst Exchange Rate	0.83	0.81	0.81	0.81	0.81
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* For full definitions of iQmethodSM measures, see page 5.

Company Description

Sinopharm Group Co. Ltd. is the largest distributor and a leading provider of supply chain services for pharmaceutical and healthcare products. It operates the largest national pharmaceutical distribution network in China, based on its 2008 revenue according to China Association of Pharmaceutical Commerce (CAPC). Its three major business segments are: (1) Pharmaceutical distribution, (2) Retail pharmacy and (3) Other business operations.

Investment Thesis

Being the largest drug distribution company in China, offering high-quality, value-added services, we believe Sinopharm is well positioned to benefit from the surge in healthcare demand in China and the coming wave of consolidation in the highly fragmented domestic drug distribution industry.

Stock Data

Price to Book Value	2.0x
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Operating cash flow improved

OCF was RMB 764mn in 2Q13, an improvement from RMB 111mn in 1Q13. We believe a large part of this is due to the seasonal pattern of cash collection by

distributors – chase for cash collection from hospitals in 4Q, slack in 1Q and return to normal in 2Q. Despite a 12-day increase in AR days compared to 1H12, we also note that the decreased inventory outstanding days and longer payable days are the real operational improvements that contributed to the improvement of OCF.

Table 1: Sinopharm Income Statement

(RMB mn)	2011A	1H12A	2H12A	2012A	1H13A	2013E	2014E	2015E
Total Sales	102,225	66,562	69,225	135,787	80,066	164,364	200,156	241,656
% change	47.7%	38.7%	27.7%	32.8%	20.3%	21.0%	21.8%	20.7%
Pharma Distribution	95,489	62,889	65,430	128,320	75,854	154,240	188,173	227,690
% of Total Sales	93%	94.5%	94.5%	95%	95%	94%	94%	94%
% change	47%	40.1%	29.3%	34%	21%	20%	22%	21%
Retail pharmacy	3,045	1,769	2,214	3,983	2,275	4,897	5,908	7,006
% of Total Sales	3.0%	2.7%	3.4%	2.9%	2.8%	3.0%	3.0%	2.9%
% change	78%	29.3%	32.0%	27%	28.6%	23%	21%	19%
Other business operations	3,691	1,904	2,525	4,429	1,938	5,227	6,074	6,961
% of Total Sales	3.6%	2.9%	3.6%	3.3%	2.4%	3.2%	3.0%	2.9%
% change	36%	9.3%	29.6%	20%	2%	18%	16%	15%
Total Costs of Sales	93,870	61,109	63,735	124,844	73,742	151,379	184,143	222,445
% change	48%	40.0%	28.0%	33%	20.7%	21%	22%	21%
Total Gross Profit	8,355	5,453	5,489	10,943	6,324	12,985	16,012	19,212
% change	43%	39%	24%	31%	16%	19%	23%	20%
% Overall GM	8.17%	8.19%	7.93%	8.06%	7.90%	7.90%	8.00%	7.95%
Other income	169	107	112	219	84	249	274	299
Dist and selling exp	(2,923)	(1,771)	(1,959)	(3,730)	(2,065)	(4,256)	(5,142)	(6,160)
% change	49.1%	34.4%	22.0%	27.6%	-25.1%	14.1%	20.8%	19.8%
as a % of total revenue	2.86%	2.66%	2.83%	2.79%	2.58%	2.59%	2.57%	2.55%
G&A exp	(1,965)	(1,209)	(1,359)	(2,568)	(1,347)	(2,896)	(3,506)	(4,209)
% change	27.2%	44.1%	20.8%	30.7%	-23.7%	12.7%	21.1%	20.0%
as a % of total revenue	1.92%	1.82%	1.96%	1.91%	1.68%	1.76%	1.75%	1.74%
Total Op profit	3,636	2,580	2,283	4,863	2,997	6,082	7,638	9,141
% change	51.0%	41.6%	25.9%	33.7%	-17.8%	25.1%	25.6%	19.7%
% op margin	3.56%	3.88%	3.30%	3.58%	3.74%	3.70%	3.82%	3.78%
Other income/ (exp), gains/(loss)-net	202	(9)	296	287	23	297	307	317
Finance costs - net	(818)	(620)	(652)	(1,272)	(777)	(1,475)	(1,738)	(2,035)
- Finance income	115	54	95	149	71	149	149	149
- Finance costs	(933)	(674)	(746)	(1,420)	(848)	(1,624)	(1,886)	(2,184)
Share of post-tax profits of associates	107	65	70	135	64	155	179	205
Profit before-tax	3,128	2,016	1,997	4,014	2,308	5,059	6,385	7,628
% change	30.4%	26.6%	30.1%	28.3%	14.5%	26.1%	26.2%	19.5%
Tax	(725)	(487)	(447)	(934)	(512)	(1,164)	(1,469)	(1,754)
% effective tax rate	23.2%	24.1%	22.4%	23.0%	22.2%	23.0%	23.0%	23.0%
Profit after-tax	2,403	1,530	1,550	3,079	1,796	3,896	4,917	5,874
% change	31.3%	27.1%	-35.5%	324.4%	17.4%	26.5%	26.2%	19.5%
% net margin	2.35%	2.30%	2.24%	2.27%	2.24%	2.37%	2.46%	2.43%
Attributable to equity holders	1,561	959	1,014	1,973	1,151.6	2,454	3,097	3,700
% change	29.1%	22.3%	30.6%	26.4%	20.0%	24.4%	26.2%	19.5%
% net margin	1.53%	1.44%	1.46%	1.45%	1.44%	1.49%	1.55%	1.53%
- MI	842	570	536	1,106	644	1,441	1,819	2,173
MI as a % of Profit after-tax	35.0%	37.3%	34.6%	37.0%	35.9%	37.0%	37.0%	37.0%
EPS (basic and fully diluted) in RMB	0.66	0.40	0.42	0.82	0.46	0.96	1.21	1.44
% change	24.2%	17.5%	30.6%	23.9%	15.2%	16.4%	26.2%	19.5%
EPS (basic and fully diluted) in HKD	0.80	0.49	0.52	1.02	0.58	1.19	1.50	1.79

Source: BoAML Global Research and Merrill Healthcare

Price objective basis & risk

Sinopharm Group Co. Ltd. (SHTDF)

Our PO of HK\$26.5 is based on 22x of FY2013 EPS estimate. We believe the 22x PE multiple is justifiable with Sinopharm's robust expected earnings growth (2013-14E) of 20%. The closest peer group should be the domestic listed drug-distribution companies, which are trading at 21x 2013E P/E. We believe a premium for Sinopharm is reasonable, given the company's leadership position and scarcity of other alternatives in the China healthcare sector for overseas investors.

Downside risks: (1) M&A activities significantly slow down and Sinopharm is not able to expand into new regions and more hospitals, (2) Financing costs (short-term borrowing and factoring) increase rapidly. and (3) government policies that severely cut drug prices and impose measures that could significantly slow down overall drug market sales growth and negatively affect the profit margins of distributors.

Link to Definitions

Healthcare

Click [here](#) for definitions of commonly used terms.

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I, Serena Shao, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Greater China - Healthcare Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	China Medical System	XCMSY	867 HK	Serena Shao
	Sinopharm Group Co. Ltd.	SHTDF	1099 HK	Serena Shao
	WuXi PharmaTech (Cayman) Inc.	WX	WX US	Serena Shao
NEUTRAL				
	Biosensors International	BSNRF	BIG SP	Serena Shao
	China Shineway Pharmaceutical Group Ltd.	CSWYF	2877 HK	Serena Shao
	CSPC Pharmaceutical Group	CHJTF	1093 HK	Serena Shao
	Mindray-ADR	MR	MR US	Serena Shao
	Sino Biopharmaceutical	SBMFF	1177 HK	Serena Shao
UNDERPERFORM				
	China Nepstar Chain Drugstore Ltd-ADR	NPD	NPD US	Serena Shao
	Shandong Weigao	SHWGF	1066 HK	Serena Shao
	The United Laboratories	ULIHF	3933 HK	Serena Shao

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt, Less Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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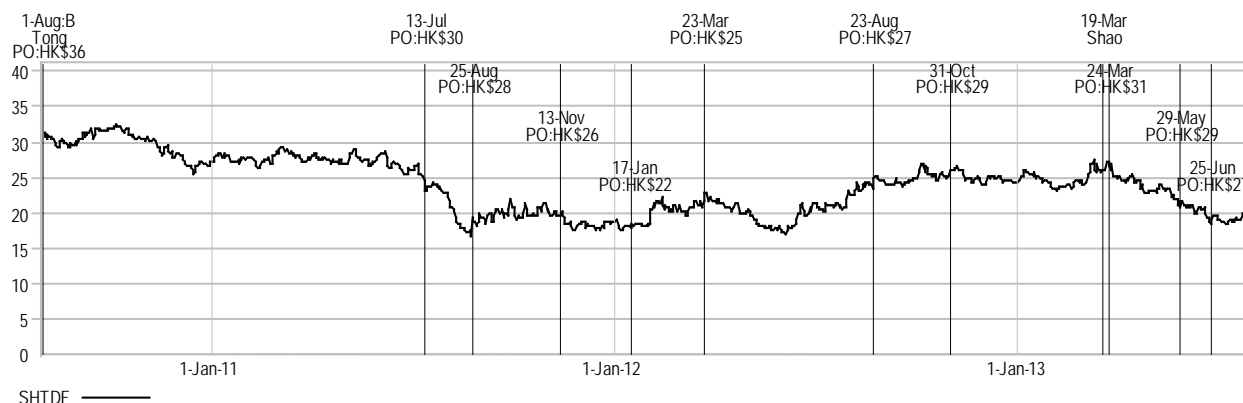
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26 August 2013

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SHTDF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR : No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of July 31, 2013 or such later date as indicated.

Investment Rating Distribution: Health Care Group (as of 05 Aug 2013)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	134	52.34%	Buy	103	76.87%
Neutral	59	23.05%	Neutral	48	81.36%
Sell	63	24.61%	Sell	39	61.90%

Investment Rating Distribution: Global Group (as of 05 Aug 2013)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1660	48.55%	Buy	1244	74.94%
Neutral	868	25.39%	Neutral	641	73.85%
Sell	891	26.06%	Sell	590	66.22%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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