

## Sinopharm Group Co -----Downgrade to NEUTRAL

### 1H13 results in line; management cautious on 2H13 outlook

EPS: ▼ TP: ▼

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- Sinopharm's 1H13 revenue grew 20.3% YoY with organic growth of ~17.3%; EPS grew 15.0% YoY with organic growth of ~12.7%, in line with consensus. MNC drugs accounted for ~46% of the drug distribution revenue (vs ~60% in 2012).
- Working capital remains under pressure. A/R days surged from 86 days in 1H12 to 98 days in 1H13, despite the four days improvement in A/P days. Management revised their guidance of working capital/revenue ratio from ~20% to 23%. They are cautious on the 2H13 outlook given the commercial bribery investigation, total reimbursement control policy implementation and NDRC drug cost investigation.
- We cut our EPS forecast for lower revenue growth and higher finance cost due to working capital pressure and expect Sinopharm to raise equity again in 2014/15 to maintain its target gear ratio, or on the average dilute equity interests by 3-4% per year.
- Downgrade to NEUTRAL. Our new TP of HK\$21.60 (from HK\$28.00) is based on 16x 2014E EPS, given ~15% EPS CAGR in 2013-15E.

increasing and thus the finance cost ratio (as a percentage of revenue) will be raising as well.

### Equity financing in 2014/15

According to our model, if the working capital requirement is higher than before, as the management guided, Sinopharm is likely to raise equity again in 2014/15, or on the average dilute equity interests by 3-4% per year. Therefore, EPS growth will be lower than top-line growth by at least 3-4%, without factoring the net margin erosion due to gross margin erosion and finance cost increase despite the minor operating leverage achieved.

### Downgrade to NEUTRAL

We cut our EPS forecast on lower revenue growth due to the sector growth deceleration and higher finance cost due to working capital pressure, and expect equity interests to be diluted by 3-4 % per year on the average. We downgrade our rating to NEUTRAL. Our new TP of HK\$21.60 (from HK\$28.00) is based on 16x 2014E EPS, given ~15% EPS CAGR in 2013-15E, in line with the sector average valuation. The major risks include margin pressure for drug price control and the market's negative reading on financial cost increase and operating cash flow volatility.

<b>Bbg/RIC</b>	<b>1099 HK / 1099.HK</b>	<b>Price (26 Aug 13, HK\$)</b>		<b>20.75</b>	
<b>Rating (prev. rating)</b>	<b>N (O)</b>	<b>TP (prev. TP HK\$)</b>		<b>21.60 (28.00)</b>	
Shares outstanding (mn)	828.34	Est. pot. % chg. to TP		4	
Daily trad vol - 6m avg (mn)	5.6	52-wk range (HK\$)		27.5 - 18.4	
Daily trad val - 6m avg (US\$ mn)	15.9	Mkt cap (HK\$/US\$ mn)		17,188.1/ 2,216.3	
Free float (%)	25.0	<b>Performance</b>		<b>1M</b>	<b>3M</b>
Major shareholders	Sinopharm Group (51%)	Absolute (%)	(3.9)	(4.2)	(17.3)
		Relative (%)	(6.5)	(0.3)	(26.0)
<b>Year</b>	<b>12/11A</b>	<b>12/12A</b>	<b>12/13E</b>	<b>12/14E</b>	<b>12/15E</b>
Revenue (Rmb mn)	102,225	135,787	161,592	191,960	228,941
EBITDA (Rmb mn)	4,096	5,429	7,024	8,123	9,375
Net profit (Rmb mn)	1,561	1,974	2,394	2,838	3,387
EPS (Rmb)	0.66	0.82	0.95	1.07	1.25
- Change from prev. EPS (%)	n.a.	n.a.	(4)	(7)	(9)
- Consensus EPS (Rmb)	n.a.	n.a.	0.94	1.13	1.36
EPS growth (%)	24.1	24.0	15.3	13.3	16.0
P/E (x)	24.7	19.9	17.3	15.3	13.1
Dividend yield (%)	1.2	1.5	1.7	2.0	2.3
EV/EBITDA (x)	3.5	3.7	2.6	2.0	1.6
P/B (x)	2.5	2.3	1.9	1.6	1.4
ROE (%)	11.4	12.1	12.3	11.6	11.5
Net debt(cash)/equity (%)	3.7	28.0	16.1	7.0	4.5

Note 1: ORD/ADR=5.00. Note 2: Sinopharm Group Co. Ltd. is a distributor and provider of supply chain services for, pharmaceutical and healthcare products. The Company operates in three segments: pharmaceutical distribution; retail pharmacy; other business operations.

[Click here](#) for detailed financials

### Cautious on 2H13 outlook

Management confirmed the impact of drug commercial bribery has been expanding, and are cautious on the 2H13 outlook given the total reimbursement control policy implementation and NDRC drug cost investigation. They maintained their previous guidance of outgrowing the sector average by 3-5 pp but hinted that sector growth will be decelerating—confirming our previous forecast.

### Working capital/finance cost remain under pressure

A/R days surged from 86 days in 1H12 to 98 days in 1H13, despite the four days improvement in A/P days. Management revised their guidance of working capital/revenue ratio from ~20% to 23%. They are also concerned that the discounting rate of A/R in the 2H13 will be

Figure 1: Sinopharm's 1H13 results highlight

(Rmb mn)	1H12(restated)	1H13	YoY
Drug distribution	62,716	75,854	20.9%
Retail pharmacy	1,942	2,275	17.1%
Others	1,904	1,938	1.8%
<b>Net Revenue</b>	<b>66,562</b>	<b>80,066</b>	<b>20.3%</b>
<b>Gross Profit</b>	<b>5,453</b>	<b>6,324</b>	<b>16.0%</b>
Other operating (expenses)/income, net	107	84	-20.9%
Selling and distribution	(1,771)	(2,065)	16.6%
G&A	(1,211)	(1,347)	11.2%
<b>Operating profit</b>	<b>2,578</b>	<b>2,997</b>	<b>16.3%</b>
Other gain/ (loss)	(9)	23	
Financial costs - net	(619)	(777)	25.5%
Share of results of associates	65	64	-2.2%
<b>Net Income</b>	<b>1,529</b>	<b>1,796</b>	<b>17.5%</b>
Minority income	570	644	13.0%
<b>Net profit</b>	<b>959</b>	<b>1,152</b>	<b>20.1%</b>
<b>EPS-basic/diluted (Rmb)</b>	<b>0.40</b>	<b>0.46</b>	<b>15.0%</b>
<b>Gross margin</b>	<b>8.19</b>	<b>7.90</b>	
Selling expense ratio	2.66	2.58	
Administration expense ratio	1.82	1.68	
<b>EBIT margin</b>	<b>3.03</b>	<b>2.88</b>	
Finance cost ratio	0.93	0.97	
Effective tax rate	24.14	22.19	
<b>Net margin</b>	<b>1.44</b>	<b>1.44</b>	
OCF	577	874	
Trade receivables days	86	98	
Inventory days	35	34	
Trade payables days	89	93	

Source: Company data, Credit Suisse estimates

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**Companies Mentioned** (Price as of 26-Aug-2013)

Sinopharm Group Co (1099.HK, HK\$20.75, NEUTRAL, TP HK\$21.6)

## Disclosure Appendix

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1099.HK	Closing Price	Target Price	
Date	(HK\$)	(HK\$)	Rating
23-Aug-11	17.50	30.00	O
15-Mar-12	21.60	28.00	
16-Mar-12	21.20		*
26-Mar-12	21.70	28.00	O
25-Jan-13	24.50	26.00	N *
26-Mar-13	26.05	30.00	O
29-Apr-13	22.90	28.00	

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**Method:** Our HK\$21.60 target price for Sinopharm Group Co is based on 16x 2014E EPS (earnings per share), given that we forecast 15% EPS CAGR in the next three years.

**Risk:** Key investment risks to our HK\$21.60 target price for Sinopharm Group include: 1) working capital commitments, 2) margin pressure for drug price control, 3) the market's negative reading on financial cost increase and operating cash flow volatility.

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