

Industry Report

China Merchants Securities (HK)
Hong Kong Equity Research

China/ Hong Kong Pharmaceutical & Healthcare

1H14 results preview: Expecting solid performance from leaders

- We believe leading pharma players will do well in their soon-to-be-reported 1H14 results, meeting or beating market expectations.
- Sector momentum will pick up in 2H14, re-capturing mkt interest.
- Short-term sector sell-down was not fundamentally-based; attractive Buy opportunities emerge for long-term winners: Sihuan, CSPC, Sinopharm, Dawnrays, Essex, Phoenix and iKang.

What's new/ Actions

We expect strong 1H14 earnings results for leading pharma players, thanks to 1) healthy demand growth, 2) better pricing environment, and 3) market under-expectations. We also expect growth rate to pick up in 2H14 on higher seasonal demand, limited ASP pressure as tenders continue to progress slowly, and leading domestic players gain in market shares against MNCs under rising government investigations and media scrutiny. Impending launch of the Shanghai-Hong Kong Stock Connect aka *Hugangtong* could also help boost investor interest in HK-listed China healthcare plays given average 20%-lower valuation and scarcity value in terms of limited overlaps or direct comparables.

Implications/ Our views

As market focus quickly turns to the latest company's management guidance for 2H14/FY14/beyond, we expect sector momentum to pick up in 2H14 on 1) seasonal uptrend fundamentally, and 2) valuation roll-over to FY15E PER at more attractive high-teens levels. It is also helpful when we see co management and investors increasingly adopt a LT view that the market remains in a fast multi-year expansionary phase.

Catalysts

Outperforming results. Better M&A progress/visibility. Milestones achieved.

Valuations/ Key risks

After an approx. 20%-correction since March, sector average has come down to attractive 23x/17x FY14E/FY15E PER vs. 29x/23x for A-shares.

Financials

Company	Ticker	Rating	Current Price (HK\$)	Target Price (HK\$)	Upside	EPS		P/E (x)		P/B (x)		ROE (%)	
						FY14E	FY15E	FY14E	FY15E	FY14E	FY14E	FY15E	
Sihuan	460 HK	Buy	4.86	5.50	13%	RMB0.15	RMB0.18	25.7	21.4	4.3	17%	17%	
Dawnrays	2348 HK	Buy	6.23	8.20	32%	RMB0.25	RMB0.32	19.8	15.5	3.3	16%	18%	
Essex	1061 HK	Buy	2.63	4.00	52%	HKD0.12	HKD0.14	21.9	18.8	5.3	24%	23%	
Phoenix	1515 HK	Buy	11.60	16.60	43%	RMB0.23	RMB.028	40.2	33.0	2.9	7%	8%	
CSPC	1093 HK	Buy	6.06	8.00	32%	HKD0.23	HKD0.29	26.3	20.9	4.0	15%	16%	
Sinopharm	1099 HK	Buy	22.60	24.40	8%	RMB1.13	RMB1.31	15.9	13.7	1.5	7%	7%	
iKang	KANG US	Buy	18.88	21.30	13%	USD0.50	USD0.71	37.8	26.6	3.8	10%	13%	
Sino BioPh	1177 HK	Buy	6.78	6.70	-1%	HKD0.28	HKD0.33	24.2	20.5	3.8	10%	10%	
Shineway	2877 HK	Neutral	12.98	14.00	8%	RMB0.97	RMB1.05	10.6	9.8	1.6	12%	12%	

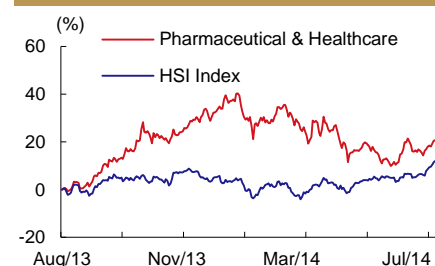
Source: Bloomberg, CMS (HK)

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OVERWEIGHT

Previous	OVERWEIGHT
HSI	24732
HSCEI	11119

Sector Performance



Source: Bigdata

%	1m	6m	12m
Absolute return	3.3	(7.4)	22.6
Relative return	(3.3)	(19.7)	10.0

Related Research

- 2H14 China Healthcare Equity Strategy-Crowded trade in reverse_Selective BOD (Overweight), 16 June 2014

China Healthcare 1H14 Preview

Expect strong 1H14 results for leading pharma players

We expect strong earnings delivery for leading pharma players in 1H14, and further pick up in growth momentum in 2H14 for the sector. Our top picks are long-term winners like Sihuan Pharma (460 HK, Buy, TP HKD5.50), CSPC (1093 HK, Buy, TP HKD8.00), Sinopharm (1099 HK, Buy, TP HKD24.40), Dawnrays Pharma (2348 HK, Buy, TP HKD8.20), Essex Biotech (1061 HK, Buy, TP HKD4.00), and Phoenix Healthcare (1515 HK, Buy, TP HKD16.60). On the other hand, we think upside is largely priced-in for Sino Biopharm (1177 HK, Buy, TP HKD6.70) and Shineway Pharma (2877 HK, Neutral, TP HKD14.00).

Strong 1H14 results are expected to be driven by 1) solid demand increase, 2) better pricing environment, and 3) market under-expectations. Specifically, we expect results outperformance vs. consensus estimates for Sihuan, Dawnrays, CSPC, Sinopharm, PHG, and CMS (867 HK, NR).

Momentum will pick up in 2H14

Further momentum in 2H14, due to 1) growth acceleration as industry enters higher seasonality in 2H13; 2) easy YoY comparison, 3) MNCs under increasing government and media scrutiny, benefiting domestic players; 4) limited pricing pressure as pharma tender progress delays; 5) rapid development of private hospitals boosts sector growth; and 6) sector valuation rolling over to FY15E PER at attractive high-teens levels.

We further believe that the launch of Shanghai-Hong Kong Stock Connect aka *Hugangtong* (trial run officially starts 11 Aug 2014) should favour HK-listed pharma stocks thanks to 1) Cheaper valuation (H-share/23x FY14E PER is 20% lower than A-shares/29x), and 2) Scarcity value (not too many overlaps or direct comparables between H and A-share names). We note that Sihuan, CSPC, Sinopharm, SBP, and Shineway are on the List of Eligible Stocks for Southbound Trading.

Short-term sector sell-down was not fundamentally-based

We believe recent sector sell-down was mainly due to 1) profit-taking ahead of interim results reporting season, which kicks off mid-next week but concentrate towards end of August, and 2) market sentiment shift in favour of cyclical stocks like banks vs. non-cyclical stocks like pharma. We view such slowdown to be temporary that presents attractive buy-on-dip opportunities for our top picks.

Note that yesterday we saw especially significant share price drop in CSPC (-13% in the morning session, -2.6% at closing) and Pioneer Pharma (1345 HK, NR) (-8% at closing) which was later confirmed by company management to be non-fundamentally based.

In conclusion, we believe sector is fundamentally sound in terms of 1H14 results and downside is limited. For a risk-averse investor, we would suggest buying after results are released and sell-side analysts have finished revising their estimates/views based on the latest company guidance.

Key rationale for our top-picks

- Sihuan Pharma (460 HK, Buy, TP HKD5.50): 1) Continued strong sales performance thanks to flexible sales model and mainly exclusive drug portfolio, 2) Strong M&A strength and execution, and 3) Direct beneficiary of new tenders.
- CSPC (1093 HK, Buy, TP HKD8.00): 1) Average 30% multi-year growth target on-track, 2) competitive product offerings and sales performance, and 3) attractive drug pipeline taking the US FDA approval path.
- Sinopharm (1099 HK, Buy, TP HKD24.40): 1) Largest pharma distributor with less than 20% mkt share (vs. >30% in US/JP/EU), 2) Above-market growth driven organically and by M&A, and 3) Below-sector valuation.
- Dawnrays Pharma (2348 HK, Buy, TP HKD8.20): 1) Strong sales performance on hep-B drug Entecavir and hypertension drug Amlodipine, 2) New sales-driven growth strategy, and 3) Attractive below-sector valuation at high-teens levels.
- Essex Biotech (1061 HK, Buy, TP HKD4.00): 1) Top eye Rx drug leader in China growing to become one-stop-shop for eye care, 2) Expanding product offerings and account penetration, and 3) Premium valuation given high entry barrier in biotechnology expertise and CFDA Class 1.1 drug status.
- Phoenix Healthcare (1515 HK, Buy, TP HKD16.60): 1) Direct beneficiary of latest Healthcare Reform focus in public hospitals, especially focused in the attractive Beijing market, 2) Upside in operating efficiency of existing hospitals under management, and 3) Further M&A execution.
- iKang Healthcare (KANG US, Buy, TP USD21.30): 1) Top medical exam center operator in China with strong brands and leading market shares in top-tier cities/regional markets, 2) Strong profit growth thanks to greater scale economies and product mix improvement, and 3) Fast market share expansion organically and via M&A.

Company	Ticker	Rating	TP (HKD)	300714			1H/2Q14E		FY14E		FY14E	
				Price (HKD)	Upside	Rev (m, reporting curr)	EPS (reporting curr)	Rev gth	EPS gth			
Sihuan	460.HK	Buy	5.5	4.86	13%	3,251	0.08	27%	19%			
Dawnrays	2348.HK	Buy	8.2	6.23	32%	508	0.12	16%	33%			
Essex	1061.HK	Buy	4	2.63	52%	199	0.05	24%	21%			
Phoenix	1515.HK	Buy	16.6	11.6	43%	497	0.09	22%	80%			
CSPC	1093.HK	Buy	8	6.06	32%	2,367	0.06	8%	40%			
Sinopharm	1099.HK	Buy	24.4	22.6	8%	95,052	0.54	21%	14%			
iKang	KANG.US	Buy	USD21.3	USD18.88	13%	142	0.25	41%	52%			
Sino Biopharma	1177.HK	Buy	6.7	6.78	-1%	2,562	0.05	28%	25%			
Shineway	2877.HK	Neutral	14	12.98	8%	1,255	0.44	13%	8%			

Source: CMS(HK), Bloomberg

Investment Ratings

Rating	Definition
OVERWEIGHT	Expected to outperform the market index by > 10% over the next 12 months
NEUTRAL	Expected to outperform or underperform the market index by 10% or less over the next 12 months
UNDERWEIGHT	Expected to underperform the market index by >10% over the next 12 months

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