

### COMPANY UPDATE

## YiChang HEC ChangJiang Pharmaceutical (1558 HK)

Deeping Hospital Penetration Drives Fast-growth At Kewei; Expect More Drug Asset Injections In 2019-20

Despite a high base in 1H18, we believe the company will sustain the strong growth in 2H18 and 2019, given deepening hospital penetration at Kewei and rapid sales expansion of Ertongshu. In 2019-21, we expect continuous drug asset injections from HEC R&D centre, which include 20-30 US/EU-qualified generics and 3-5 self-developed innovative drugs. Current valuation includes zero value for the company's drug pipeline. Maintain BUY and target price of HK\$68.99.

#### WHAT'S NEW

- Asset injection.** YiChang HEC ChangJiang Pharmaceutical (HEC Pharma) has proposed to buy drug assets, which include six generic drugs, from HEC R&D centre for Rmb505.2m.
- Profit alert.** HEC Pharma announced a positive profit alert with over 110% yoy growth in 1H18.

#### STOCK IMPACT

- Injection of six US and EU-qualified drugs just the start.** The total payment process is divided into two stages: a) prepayment of Rmb252m after closing the deal; and b) milestone payment of Rmb252m (Rmb42m for each drug) upon receiving CFDA approval. The six generic drugs are Esomeprazole Enteric-coated capsules, Olmesartan tablets, Clarithromycin (tablets and sustained release), Levofloxacin tablets and Moxifloxacin tablets. The six drugs were previously approved by the US or EU FDA. Therefore, these drugs are waiting for marketing approvals in China under the fast track review channel.
- US and EU ANDA-approved drugs are regarded as BE-equivalents** once they are approved by the CFDA. This means that they will be treated as having the same quality and pricing levels as the originator's products. Although there are many drugs in the Levofloxacin, Moxifloxacin and Clarithromycin markets, the market size at Rmb1.5b-3.0b each provides enough room for more entrants. Riding on its superior quality and supportive policy tailwind, we expect HEC will gradually take market share from foreign originators and domestic players.
- HEC Pharma targets to gain 100 generics approvals in China and overseas by 2020.** We expect 20-30 generic to be successfully registered in China through "export drug conversion", and be injected into HEC Pharma thereafter.

#### KEY FINANCIALS

Year to 31 Dec (Rmbm)	2016	2017	2018F	2019F	2020F
Net turnover	941.5	1,601.6	2,448.5	2,956.4	3,505.0
EBITDA	487.7	778.3	1,174.3	1,394.8	1,663.8
Operating profit	460.3	752.5	1,125.4	1,335.7	1,593.7
Net profit (rep./act.)	380.6	647.1	962.6	1,142.2	1,362.4
Net profit (adj.)	380.6	647.1	962.6	1,142.2	1,362.4
EPS (fen)	84.4	143.2	213.0	252.8	301.5
PE (x)	41.4	24.4	16.4	13.8	11.6
P/B (x)	6.4	5.6	4.5	3.6	2.9
EV/EBITDA (x)	31.0	19.4	12.9	10.8	9.1
Dividend yield (%)	0.9	2.0	2.7	3.4	4.1
Net margin (%)	40.4	40.4	39.3	38.6	38.9
Net debt/(cash) to equity (%)	(45.7)	(30.9)	(26.4)	(46.3)	(47.8)
Interest cover (x)	67.4	181.5	293.6	348.7	416.0
ROE (%)	16.5	24.6	30.4	28.8	27.7
Consensus net profit	-	-	848	997	1,226
UOBKH/Consensus (x)	-	-	1.14	1.15	1.11

Source: HEC Pharma, Bloomberg, UOB Kay Hian

### BUY

(Maintained)

Share Price	HK\$41.40
Target Price	HK\$68.99
Upside	+66.6%
(Previous TP)	HK\$64.47

#### COMPANY DESCRIPTION

Chinese pharmaceutical company focusing on the manufacture and sales of anti-influenza drug Kewei, the dominant efficacy of which makes HEC the largest influenza drug seller in China's prescription market. In addition, HEC holds a highly underrated pipeline covering both generics and innovative drugs, from hepatitis to diabetes and oncology, covering both generics and innovative drugs, from hepatitis to diabetes and oncology.

#### STOCK DATA

GICS sector	Health Care
Bloomberg ticker:	1558 HK
Shares issued (m):	225.8
Market cap (HK\$m):	18,713.7
Market cap (US\$m):	2,384.5
3-mth avg daily t'over (US\$m):	13.2

#### Price Performance (%)

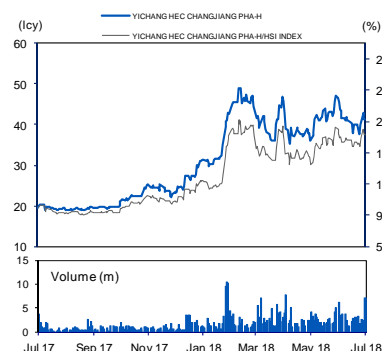
52-week high/low	HK\$49.05/HK\$18.88			
<b>1mth</b>	<b>3mth</b>	<b>6mth</b>	<b>1yr</b>	<b>YTD</b>
(11.9)	(11.7)	31.8	128.7	51.4

#### Major Shareholders

-HEC Pharma Co.	50.04
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FY18 NAV/Share (Rmbm)	7.82
FY18 Net Cash/Share (Rmbm)	2.07

#### PRICE CHART



Source: Bloomberg

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- **Esomeprazole enteric-coated capsules (埃索美拉唑镁肠溶胶囊)**. HEC Pharma has obtained marketing approval (NDA) for the injection formulation in May. The company will further add the oral-taken formulation to complete its gastrointestinal drug portfolio.
- Esomeprazole is a second-generation proton pump inhibitor (质子泵抑制剂), targeting gastroesophageal reflux disease and peptic ulcer. As per XianDa, Esomeprazole reported sample-hospital sales of Rmb3.2b in 2017 with a CAGR of 10% in 2015-17. AstraZeneca (the originator Nexium) is the market leader with over 80% share, while Sino Biopharma is second with a 12% share. We expect HEC Pharma's Esomeprazole capsule and injection to achieve peak sales of Rmb1.0b in total.
- **Olmesartan (奥美沙坦酯片)** is an angiotensin II receptor blocker (血管紧张素 II 受体阻滞剂) to treat hypertension. This drug is developed by Daiichi Sankyo under the "Benicar" trade name. Xianda reported sample-hospital sales of Rmb368m in 2017, with CAGR of 21% in 2015-17. The Olmesartan market is dominated by Daiishi and Beijing Wansheng, with market share of 74% and 20% respectively.
- **Clarithromycin (克拉霉素)** is a macrolide antimicrobial to treat mild to moderate bacterial infections. Xianda reported sample-hospital sales of Rmb765m in 2017, with flat revenue growth in the past three years. The market is evenly controlled by three participants, namely Abbott (28%), BaiSaiLuo (30%) and Hengrui (27%).
- **Levofloxacin (左氧氟沙星)**, founded by Daiishi, is a leading fluoroquinolone (喹诺酮类) antibacterial used for treatment of bacterial infections. According to sample-hospital sales data, the product recorded sales of Rmb3b in 2017 (tablet: Rmb700m; solutions: Rmb2.3b). The Levofloxacin market is led by Daiichi Sankyo and YangZiJiang, with a 30% market share each.
- **Moxifloxacin (盐酸莫西沙星)**, founded by Bayer, is another leading fluoroquinolone antibacterial used for treatment of bacterial infections. The product reported sales of Rmb3.8b in 2017 (tablet: Rmb 600m; injection: Rmb3.2b), with a remarkable CAGR of 20% in 2015-17. The originator Bayer is the largest player with 64% market share, while NanJing Youke is second with a 30% share.
- **Kewei and Ertongshu will maintain strong growth in 2018-20**. The outstanding 1H18 net profit (over 110% yoy growth) was mainly due to strong Kewei sales riding on the influenza outbreak in 1Q18. In 2019-20, we expect HEC Pharma to maintain ~20% net profit CAGR on the back of: a) Kewei's deepening penetration into tier II and III hospitals, on top of the newly-developed OTC sales channel; b) Er Tong Shu sales to reach Rmb330m in 2020 (2017: Rmb40m) thanks to a new endocrine sales team and the drug passing BE qualification.

### EARNINGS REVISION

- We raise our 2018-19 net profit forecasts by 10% and 4.4% respectively, given better-than-expected Kewei sales in 1H18.

### VALUATION/RECOMMENDATION

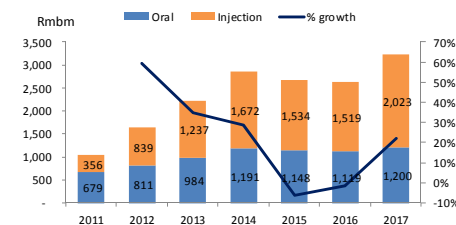
- **Maintain BUY**. Our new target price of HK\$68.99 is based on SOTP valuation, comprising: a) 15x 2019F PE for existing drugs, representing 0.54x PEG (net profit CAGR of 28% in 2017-20); and b) HK\$22.4 per share for its near-term drug pipeline.

### TENDER PRICE FOR ORIGINATORS AND GENERICS

(Rmb)	Original	Generics	Diff +/-
Clarithromycin Sustained-release/tablets (0.25g*8)	55.34	4.65	50.69
Levofloxacin tablets(0.1g*10)	31.6	3	28.6
Moxifloxacin injection (400mg)	246	214	32
Olmesartan medoxomil tablets(20mg*7)	45.4	32.61	12.79
Esomeprazole Magnesium Enteric-coated Capsules (20mg*7)	76	65	11

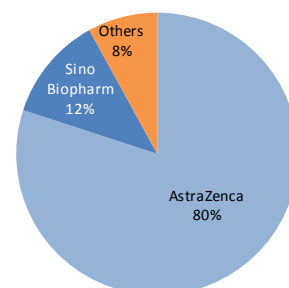
Source: XianDa, UOB Kay Hian

### ESOMEPRAZOLE SALES



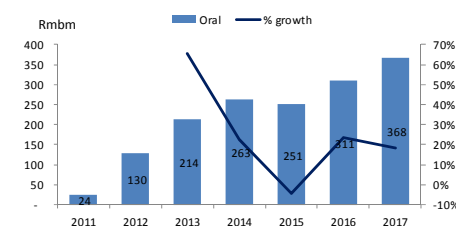
Source: XianDa, UOB Kay Hian

### ESOMEPRAZOLE MARKET COMPOSITION (2017)



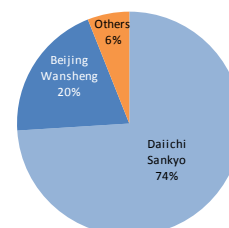
Source: XianDa, UOB Kay Hian

### OLMESARTAN SALES



Source: XianDa, UOB Kay Hian

### OLMESARTAN MARKET COMPOSITION (2017)



Source: XianDa, UOB Kay Hian

### PROFIT & LOSS

Year to 31 Dec (Rmbm)	2017	2018F	2019F	2020F
<b>Net turnover</b>	<b>1,601.6</b>	<b>2,448.5</b>	<b>2,956.4</b>	<b>3,505.0</b>
EBITDA	778.3	1,174.3	1,394.8	1,663.8
Deprec. & amort.	25.8	49.0	59.1	70.1
EBIT	752.5	1,125.4	1,335.7	1,593.7
Net interest income/(expense)	(4.3)	(4.0)	(4.0)	(4.0)
<b>Pre-tax profit</b>	<b>748.2</b>	<b>1,121.4</b>	<b>1,331.7</b>	<b>1,589.7</b>
Tax	(121.8)	(182.6)	(216.9)	(258.9)
Minorities	20.7	23.9	27.4	31.5
<b>Net profit</b>	<b>647.1</b>	<b>962.6</b>	<b>1,142.2</b>	<b>1,362.4</b>
Net profit (adj.)	647.1	962.6	1,142.2	1,362.4

### BALANCE SHEET

Year to 31 Dec (Rmbm)	2017	2018F	2019F	2020F
Fixed assets	670.2	821.3	912.1	992.0
Other LT assets	1,037.1	1,000.4	956.0	903.5
Cash/ST investment	887.2	954.1	2,058.2	2,615.8
Other current assets	1,181.4	1,525.5	1,644.7	1,938.6
<b>Total assets</b>	<b>3,776.0</b>	<b>4,301.3</b>	<b>5,571.0</b>	<b>6,449.9</b>
ST debt	10.0	10.0	10.0	10.0
Other current liabilities	630.7	452.7	886.9	768.0
LT debt	10.0	10.0	10.0	10.0
Other LT liabilities	64.6	64.6	64.6	64.6
Shareholders' equity	2,807.8	3,535.1	4,398.1	5,427.4
Minority interest	252.8	228.9	201.5	169.9
<b>Total liabilities &amp; equity</b>	<b>3,776.0</b>	<b>4,301.3</b>	<b>5,571.0</b>	<b>6,449.9</b>

### CASH FLOW

Year to 31 Dec (Rmbm)	2017	2018F	2019F	2020F
<b>Operating</b>	<b>640.1</b>	<b>492.9</b>	<b>1,537.3</b>	<b>1,044.7</b>
Pre-tax profit	748.2	1,121.4	1,331.7	1,589.7
Tax	(121.8)	(182.6)	(216.9)	(258.9)
Deprec. & amort.	43.8	85.7	103.5	122.7
Working capital changes	(30.1)	(531.5)	319.1	(408.8)
Other operating cashflows	0.0	0.0	0.0	0.0
<b>Investing</b>	<b>(779.9)</b>	<b>(186.6)</b>	<b>(150.0)</b>	<b>(150.0)</b>
Capex (growth)	(200.4)	(200.0)	(150.0)	(150.0)
Investments	(107.5)	0.0	0.0	0.0
Proceeds from sale of assets	0.0	0.0	0.0	0.0
Others	(472.0)	13.4	0.0	0.0
<b>Financing</b>	<b>(185.1)</b>	<b>(239.3)</b>	<b>(283.3)</b>	<b>(337.1)</b>
Dividend payments	(180.8)	(235.3)	(279.3)	(333.1)
Issue of shares	0.0	0.0	0.0	0.0
Proceeds from borrowings	0.0	0.0	0.0	0.0
Loan repayment	0.0	0.0	0.0	0.0
Others/interest paid	(4.3)	(4.0)	(4.0)	(4.0)
<b>Net cash inflow (outflow)</b>	<b>(324.9)</b>	<b>67.0</b>	<b>1,104.1</b>	<b>557.6</b>
<b>Beginning cash &amp; cash equivalent</b>	<b>1,212.1</b>	<b>887.2</b>	<b>954.1</b>	<b>2,058.2</b>
Changes due to forex impact (Rmbm)	0.0	0.0	0.0	0.0
<b>Ending cash &amp; cash equivalent</b>	<b>887.2</b>	<b>954.1</b>	<b>2,058.2</b>	<b>2,615.8</b>

### KEY METRICS

Year to 31 Dec (%)	2017	2018F	2019F	2020F
<b>Profitability</b>				
EBITDA margin	48.6	48.0	47.2	47.5
Pre-tax margin	46.7	45.8	45.0	45.4
Net margin	40.4	39.3	38.6	38.9
ROA	19.6	23.8	23.1	22.7
ROE	24.6	30.4	28.8	27.7
<b>Growth</b>				
Turnover	70.1	52.9	20.7	18.6
EBITDA	59.6	50.9	18.8	19.3
Pre-tax profit	65.1	49.9	18.8	19.4
Net profit	70.0	48.8	18.7	19.3
Net profit (adj.)	70.0	48.8	18.7	19.3
EPS	69.6	48.8	18.7	19.3
<b>Leverage</b>				
Debt to total capital	0.6	0.5	0.4	0.4
Debt to equity	0.7	0.6	0.5	0.4
Net debt/(cash) to equity	(30.9)	(26.4)	(46.3)	(47.8)
Interest cover (x)	181.5	293.6	348.7	416.0

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