

3SBio Inc. (1530 HK)

More catalysts to come

3SBio's 1H19 revenue grew 21.6%, adj. net profit grew 28.7% (excluding one-off stock options). 3SBio has multiple short-term catalysts, which may accelerate its sales growth onwards. Maintain BUY with new target price of HK\$17.70.

- Inline topline with improving margins.** 1H19 revenue was up 22% YoY with TPIAO surging 42% YoY, Yisaipu up 13% YoY and EPO (EPIAO and SEPO) up 5.8% YoY. TPIAO became 3SBio's largest source of revenue, contributing 45% of total revenue. 1H19 GPM improved 2.4ppts to 82.7% thanks to higher proportion of high-margin products. R&D cost was up 48% YoY 1H19, accounting for 10.0% of revenue. Admin expense ratio increased from 6.2% in 1H18 to 18.2% in 1H19 due to one-off expenses of options granted on 2 Feb 2017 and award shares under the ESOP by Sunshine Guojian. Excluding one-off items, adjusted net profit was up 28.7% YoY.
- Significantly benefit from NRDL revision.** New NRDL was released on 20 Aug. Yisaipu and EPO both saw expanded reimbursement coverage for additional indications, namely psoriasis indication for Yisaipu and oncology indication for EPO. We believe sales of Yisaipu and EPO will accelerate thanks to better reimbursement coverage. Bydureon and Byetta are in the list of 128 drugs for price negotiations. We believe these two drugs are very likely to be included into the NRDL, which will largely drive the penetration of Bydureon and Byetta among diabetes patients. In addition, we believe TPIAO will continue strong growth momentum by further substituting IL-11 which still took c.73% market share in 2Q19, according to data from IQVIA.
- Blockbuster approval expected in 4Q19E.** NMPA has completed technical reviews and on-site clinical trial inspections for inetetamab (anti-HER2 antibody), which may become the first domestic anti-HER2 antibody in China to be approved in 4Q19E. 3SBio has submitted application to NMPA for approval of pre-filled aqueous injection of Yisaipu in July 2019. The pre-filled formulation is more convenient for injection and could help to further extend the product life cycle for Yisaipu.
- Attractive valuation and maintain BUY with new TP of HK\$17.70.** We lift FY19/20 revenue forecasts by 2.5%/ 7.3%, benefiting from the updated NRDL. We raise SG&A and R&D cost ratio forecasts and trim FY19/20 adj. net profit forecasts by 11.5%/ 11.4%. We expect revenue to grow 21.5%/ 23.7% YoY and adj. net profit to grow 29.3%/ 20.7% YoY in FY19/20E. 3SBio currently trades at 17.6x FY20E P/E. Valuation is attractive. **Catalysts:** 1) GLP-1s' inclusion into NRDL, 2) earlier-than-expected launch of new products, 3) stronger-than-expected product sales, 4) successful IPO of Sunshine Guojian on China sci-tech innovation Board.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	3,734	4,584	5,567	6,881	8,207
YoY growth (%)	33	23	21	24	19
Adj. net profit (RMB mn)	870	1,003	1,297	1,565	1,873
Adj. EPS (RMB)	0.34	0.39	0.51	0.62	0.74
YoY growth (%)	34.2	15.1	29.3	20.7	19.6
P/E (x)	31.6	27.5	21.2	17.6	14.7
P/B (x)	3.7	3.2	2.9	2.5	2.1
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	12.6	14.8	10.0	14.1	14.4
Net gearing (%)	26.3	16.9	7.4	Net cash	Net cash

Source: Company data, CMBIS estimates; Note: Adj. net profit excluded options and award shares.

BUY (Maintain)

Target Price	HK\$17.70
(Previous TP)	HK\$16.70)
Up/Downside	+43.7%
Current Price	HK\$12.32

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Stock Data

Mkt Cap (HK\$ mn)	31,231
Avg 3 mths t/o (HK\$ mn)	72.2
52w High/Low (HK\$)	16.42/ 8.21
Total Issued Shares (mn)	2,535

Source: Bloomberg

Shareholding Structure

CS Sunshine Investment	18.60%
Decade Sunshine Limited	23.61%
JP Morgan Chase	7.06%
Free float	50.73%

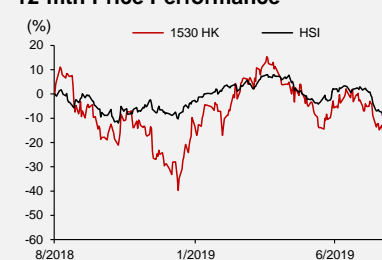
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-4.7%	4.3%
3-mth	-3.3%	1.8%
6-mth	7.5%	17.1%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

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Figure 1: 1H19 results changes

	1H18 RMB mn	1H19 RMB mn	YoY Change
TPIAO	841	1194	42.0%
Yisaipu	442	501	13.2%
EPIAO	339	336	-0.9%
SEPO	87	116	32.4%
Licensed in products and others	257	225	-12.5%
Others	207	272	31.1%
Revenue	2,174	2,643	21.6%
COGS	(427)	(458)	7.3%
Gross profit	1,747	2,185	25.1%
Other income and gains	118	68	-42.0%
Selling and distribution expenses	(823)	(999)	21.4%
Admin expenses	(134)	(481)	258.2%
Other expenses and losses	(224)	(319)	42.1%
Operating income	683	454	-33.5%
Non-operating items	0	0	N/A
Net finance costs	(73)	(48)	-34.4%
Share of losses of associates	(7)	1	N/A
Profit before tax	603	407	-32.5%
Income tax expense	(93)	(95)	2.9%
Attributable to non-controlling interests	4	10	139.6%
Net profit	514	321	-37.5%
Adjusted net profit	514	662	28.7%
Gross margin	80.3%	82.7%	+2.3ppt
Operating margin	31.4%	17.2%	-14.2ppt
Adjusted net margin	23.7%	25.0%	+1.4ppt

Source: Company data

Figure 2: CMBIS estimates changes

	2019E			2020E		
	Old Rmb mn	New Rmb mn	Change	Old Rmb mn	New Rmb mn	Change
TPIAO	1,985	2,372	19.5%	2,434	2,906	19.4%
EPIAO	718	769	7.1%	732	858	17.2%
SEPO	251	228	-9.1%	301	255	-15.3%
Yisaipu	1,343	1,256	-6.5%	1,612	1,472	-8.6%
Licensed-in products, CMO and others	714	487	-31.8%	799	609	-23.9%
302H	50	0	N/A	150	281	87.2%
304R	0	0	N/A	0	0	N/A
Others	370	455	23.0%	385	500	30.1%
Total revenue	5,432	5,567	2.5%	6,413	6,881	7.3%
COGS	(953)	(984)	3.3%	(1,118)	(1,224)	9.5%
Gross profit	4,479	4,583	2.3%	5,295	5,657	6.8%
Other income and gains	79	75	-5.6%	79	68	-13.5%
SG&A expenses	(2,396)	(2,790)	16.4%	(2,870)	(2,956)	3.0%
R&D and other expenses	(438)	(601)	37.4%	(530)	(802)	51.3%
Operating profit	1,724	1,266	-26.6%	1,974	1,967	-0.4%
Net finance income / (expenses)	22	(123)	650.3%	52	(104)	N/A
Share of profit of associates	(5)	(4)	-18.4%	0	0	N/A
Income tax	(279)	(182)	-34.6%	(336)	(298)	-11.3%
Minority interest	3	(0)	N/A	1	(0)	N/A
Net profit	1,466	957	-34.7%	1,766	1,565	-11.4%
Adjusted net profit	1,466	1,297	-11.5%	1,766	1,565	-11.4%
Gross margin	82.5%	82.3%	-0.1ppt	82.6%	82.2%	-0.4ppt
Operating margin	31.7%	22.7%	-9ppt	30.8%	28.6%	-2.2ppt
Adjusted net margin	27.0%	17.2%	-9.8ppt	27.5%	22.7%	-4.8ppt

Source: Company data, CMBIS estimates

Figure 3: DCF valuation

	2019E	2020E	2021E	2022E	2023E
	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn
Net profit	957	1,565	1,872	2,166	2,389
Depreciation and amortisation	358	376	393	411	428
Net interest income after tax	103	87	63	32	(3)
CAPEX	(250)	(250)	(250)	(250)	(250)
Change in working capital	(298)	(278)	(269)	(58)	(162)
FCF	871	1,500	1,809	2,301	2,402
Terminal value					26,339
	871	1,500	1,809	28,641	28,741
Discount factor	1.00	0.89	0.79	0.70	0.63
		1,334	1,432	20,173	18,012
Corporate value	40,951				
Debt & Preferred Stock	3,424				
Bank deposit and pledged cash	2,772				
Equity Value	40,299				
Number of shares	2,534				
Value per share (Rmb)	15.90				
Value per share (HK\$)	17.70				
Risk free rate	3.6%				
Beta	1.1				
Risk premium	10.3%				
Cost of equity	14.4%				
Cost of debt	5.0%				
WACC	12.4%				
Terminal growth rate	3.0%				

Source: Company data, CMBIS estimates

Figure 4: Sensitivity analysis

		WACC						
		10.9%	11.4%	11.9%	12.4%	12.9%	13.4%	13.9%
Terminal growth rate	1.5%	18.30	17.30	16.30	15.40	14.60	13.90	13.20
	2.0%	19.30	18.10	17.10	16.10	15.20	14.50	13.70
	2.5%	20.40	19.10	17.90	16.90	15.90	15.10	14.30
	3.0%	21.60	20.20	18.90	17.70	16.70	15.80	14.90
	3.5%	23.00	21.40	19.90	18.70	17.50	16.50	15.60
	4.0%	24.60	22.80	21.20	19.70	18.50	17.30	16.30
	4.5%	26.50	24.40	22.50	20.90	19.50	18.30	17.20

Source: Company data, CMBIS estimates

Financial Summary

Income statement						Cash flow summary					
YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E	YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	3,734	4,584	5,567	6,881	8,207	EBIT	1,170	1,304	1,266	1,967	2,300
Cost of sales	(676)	(877)	(984)	(1,224)	(1,484)	Depreciation and amortization	252	324	358	376	393
Gross profit	3,058	3,707	4,583	5,657	6,723	Change in working capital	(246)	(243)	(298)	(278)	(269)
Other income and gains	71	80	75	68	75	Income tax paid	(130)	(263)	(182)	(298)	(357)
Distribution expenses	(1,333)	(1,691)	(2,063)	(2,490)	(2,921)	Others	28	29	(4)	(0)	4
Administrative expenses	(315)	(317)	(727)	(466)	(547)	Net operating cash flow	1,074	1,150	1,140	1,766	2,071
R&D expenses	(257)	(363)	(557)	(757)	(985)	Capex	(138)	(247)	(200)	(200)	(200)
Other expenses	(53)	(112)	(45)	(45)	(46)	Acquisition of subsidiaries	-	-	-	-	-
Operating profit	1,170	1,304	1,266	1,967	2,300	Change in available-for-sale	(346)	612	-	-	-
Share of profit of associate	(14)	(8)	(4)	-	3	Other	(159)	(771)	(5)	19	51
Net finance cost	(120)	(74)	(123)	(104)	(75)	Net investing cash flow	(643)	(406)	(205)	(181)	(149)
Exceptional	66	274	-	-	-	Change of Debts	(839)	(1,191)	129	64	62
Pre-tax profit	1,102	1,496	1,139	1,863	2,229	Net proceeds from shares/ CB	2,320	19	-	-	-
Profits tax	(178)	(218)	(182)	(298)	(357)	Dividend paid	-	-	-	-	-
Minority interest	11	(0)	(0)	(0)	(0)	Other	(164)	(218)	(168)	(173)	(176)
Net profit	935	1,277	957	1,565	1,872	Financing cash flow	1,318	(1,390)	(39)	(109)	(114)
Adj. net profit	870	1,003	1,297	1,565	1,873	Net change in cash	1,749	(645)	897	1,476	1,808
						Cash at the beginning of the year	678	2,399	1,793	2,689	4,166
						Exchange difference	(28)	39	-	-	-
						Cash at the end of the year	2,399	1,793	2,689	4,165	5,974

Balance sheet						Key ratios					
YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E	YE Dec 31	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	8,477	9,402	9,294	9,168	9,025	Sales mix (%)					
Fixed asset	1,760	1,792	1,812	1,819	1,811	Yisaipu	27.1	24.2	22.6	21.4	19.8
Intangible assets	2,254	2,299	2,178	2,055	1,929	TPIAO	26.1	36.4	42.6	42.2	41.6
Goodwill	3,924	4,089	4,089	4,089	4,089	EPIAO & SEPO	22.9	19.6	17.9	16.2	15.1
Other non-current assets	540	1,222	1,214	1,205	1,197	Licensed-in products and others	13.4	10.1	8.7	8.8	8.9
						Others	10.4	9.7	8.2	11.4	14.5
Current assets	5,276	4,438	5,499	7,404	9,635	Total	100.0	100.0	100.0	100.0	100.0
Cash	2,399	1,793	2,689	4,166	5,974	Profit & loss ratios (%)					
Account receivable	1,783	2,178	2,235	2,544	2,837	Gross margin	81.9	80.9	82.3	82.2	81.9
Inventory	377	385	492	612	742	Net margin	25.0	27.9	17.2	22.7	22.8
Available-for-sale investments	705	-	-	-	-	Adj. net margin	23.3	21.9	23.3	22.7	22.8
Other current assets	13	82	82	82	82	Effective tax rate	16.1	14.6	16.0	16.0	16.0
Current liabilities	2,196	1,656	1,584	1,834	2,108	Balance sheet ratios					
Borrowings	1,087	570	632	732	852	Current ratio (x)	2.4	2.7	3.5	4.0	4.6
Trade and other payables	970	959	825	976	1,130	Trade receivables turnover days	87	103	112	99	90
Other current liabilities	138	127	127	127	127	Trade payables turnover days	42	90	81	44	42
Non-current liabilities	3,928	3,277	3,345	3,309	3,251	Inventory turnover days	180	172	158	163	165
Borrowings	1,047	425	493	457	399	Net debt to total equity ratio (%)	26.3	16.9	7.4	Net cash	Net cash
Convertible bond	2,272	2,299	2,299	2,299	2,299	Returns (%)					
Other non-current liabilities	609	552	552	552	552	ROE	12.6	14.8	10.0	14.1	14.4
Total net assets	7,630	8,907	9,864	11,429	13,301	ROA	6.8	9.2	6.5	9.4	10.0
Minority interest	233	2	293	293	293	Per share data					
Shareholders' equity	7,397	8	9,571	11,137	13,009	EPS (RMB)	0.37	0.50	0.38	0.62	0.74
						Adj. EPS (RMB)	0.34	0.39	0.51	0.62	0.74
						DPS (RMB)	-	-	-	-	-
						BVPS (RMB)	2.9	3.4	3.8	4.4	5.1

Source: Company data, CMBIS estimates;

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