

Analyst: Paul Sham

Main Board Listing – Research

國藥控股股份有限公司

Sinopharm Group Co. Ltd [Stock Code: 01099]
Joint Global Coordinators and Joint Sponsors : China International Capital Corp HK Securities Ltd
UBS AG

Joint Bookrunners : China International Capital Corp HK Securities Ltd
UBS AG
Morgan Stanley Asia Limited

Sector : Pharmaceuticals

Business : Distribution for pharmaceutical and healthcare products

Total share offer: * <u>545,679,150</u> shares (25.0% of the enlarged share capital) Public Offer: 54,568,000 shares (10%) Placing: 491,111,150 shares (90%) Greenshoe: 81,851,873 shares <i>*All 545,679,150 shares are New Shares</i>	<u>Business of Sinopharm</u> Sinopharm is the largest distributor of pharmaceutical and healthcare products in China in terms of revenue in 2008, commanding a market share of 10.8%. Pharmaceutical distribution is the principal business of Sinopharm, which accounted for 93.6% of total revenue in 2008. The Company has 25 self-operated distribution centres in 19 provinces, municipalities, and autonomous regions across China. It distributes 46 of the 50 international top-selling pharmaceutical products and is one of the three licensed nationwide anaesthetics distributors in China, commanding about 90% of the PRC market share in this segment. Sinopharm also operates other businesses such as retail pharmacy, manufacture and sales of pharmaceutical products, chemical reagents and laboratory supplies. In terms of the number of retail stores at year-end 2007, Sinopharm is one of the top five pharmaceutical retailers in China.
Price: HK\$12.25 – HK\$16.00 per share Market Cap: HK\$26,738 million – HK\$34,923 million Pro forma fully diluted FY09E PER: 28.05x – 36.64x Adjusted NTA per share: HK\$4.13 – HK\$5.04 Staffing: 14,449 (as of 31 st May 2009)	
HK Public Offer period: 10 th September 2009 – 15 th September 2009 Receiving bank: Bank of China (Hong Kong) Limited Bank of Communications Co., Ltd. Share registrar: Computershare Hong Kong Investor Services Ltd. Listing date: 23 rd September 2009	

This report has been prepared solely for information purposes and we are not soliciting any action based upon it. Neither this document nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which we consider reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein, while its group companies may from time to time have interests in securities of the company or companies mentioned herein.

**Shareholding Structure after Listing**

Sinopharm Industrial Investment Co., Ltd – owned as to: 51% by China National Pharmaceutical Group Corporation (CNP GC) 49% by Fosun International (00656.HK)	72.0%
CNP GC	0.5%
The National Council for Social Security Fund of the PRC (NSSF)	2.5%
Public Investors	25.0%
	100.0%

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$7,417 million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$14.13 each, being the midpoint of the indicative price range).

	HK\$ million
For expanding and improving the coverage of the distribution network in the eastern, central and north-western regions of China	3,337
For upgrading the logistics facilities	742
For upgrading and integrating the information systems and electronic commerce platform	742
For expanding the retail pharmacy operations	742
For purchasing imported pharmaceutical products from foreign suppliers	1,854

Financial Highlights

	Year ended 31 st December			Five months ended 31 st May	
(RMB million)	2006	2007	2008	2008	2009
Revenue	23,737	31,110	38,187	15,007	18,048
Gross profit	1,990	2,550	3,035	1,213	1,438
Operating profit	480	789	1,172	509	703
Attributable profit	101	381	586	297	422
Gross margin	8.4%	8.2%	7.9%	8.1%	8.0%
Operating margin	2.0%	2.5%	3.1%	3.4%	3.9%
Net margin	0.4%	1.2%	1.5%	2.0%	2.3%

Revenue Breakdown by segment (% of Total Revenues)

	Year ended 31 st December						Five months ended 31 st May			
(RMB million)	2006	%	2007	%	2008	%	2008	%	2009	%
Pharmaceutical distribution	21,927	92.4%	28,997	93.2%	35,745	93.6%	14,018	93.4%	16,846	93.3%
Retail pharmacy	823	3.5%	836	2.7%	952	2.5%	389	2.6%	463	2.6%
Other business operations*	986	4.2%	1,277	4.1%	1,490	3.9%	601	4.0%	739	4.1%
Total	23,737	100.0%	31,110	100.0%	38,188	100.0%	15,007	100.0%	18,048	100.0%

*Other business operations consist of the (i) distribution and selling of laboratory supplies; (ii) manufacturing and distribution of chemical reagents; and (iii) production and sale of pharmaceutical products.

Strengths/Opportunities

- ✓ **Strong national distribution network led to higher market share** Sinopharm currently covers 19 provinces, municipalities and autonomous regions in China with 25 distribution centres. The outstanding distribution network of Sinopharm was reflected by its leading market share, amounting to 10.8% in 2008, which is followed by much smaller competitors namely Shanghai Pharmaceutical with a 4.8% share and Jointown with a 4.0% share.

- ✓ **Benefit from market consolidation** Despite fragmented nature in the PRC pharmaceutical market (with around 9,000 distributors in 2007), the industry is indeed undergoing rapid consolidation. The PRC government enforced GSP ("Good Supply Practices") certification in 2003 as the relevant standard for quality control in pharmaceutical distribution. Higher compliance costs associated with the GSP certification have forced out some of the smaller players. As a result, the total market share of the 10 largest distributors grew from 26.1% in 2003 to 34.5% in 2008, while that of the 11 to 20 largest companies decreased from 10.4% to 8.5% over the same period. The above fact suggested that larger distributors, in particular Sinopharm, which gained its market share from 4.3% in 2003 to 10.8% in 2008, have successfully ridden on the reshuffle wave of the industry.
- ✓ **Strong relationship with hospitals** In 2008, more than 80% of pharmaceutical sales in China were made at hospital pharmacies, rather than at unaffiliated retail pharmacies. Sinopharm covered 4,723 hospitals nationwide (about 36.4% of total hospitals in China, or 56.2% of the largest, most highly ranked class-three hospitals) as their direct-sales customers. We believe such client network creates a high entry barrier for competitors such as Jointown (the third largest distributor), which focuses more on non-hospital customers.
- ✓ **Improving margins** Benefiting from economies of scale and integrated logistics systems, Sinopharm's operating expense of as a percentage of its total revenue decreased from 6.4% in 2006, to 5.1% in 2008 and to 4.2% in the five months ended 31st May 2009. As a result, the operating margins increased from 2.0% in 2006, to 3.1% in 2008 and to 3.9% in the five months ended 31st May 2009 and the net margins increased from 0.4% in 2006, to 1.5% in 2008 and to 2.3% in the five months ended 31st May 2009.
- ✓ **Synergies arising from vertical integration** Sinopharm is one of the top five pharmaceutical retailers in China in terms of the number of retail stores at year-end 2007. Despite the revenue generated from the retail pharmacy segment is relatively small at the moment, we believe synergies can be enhanced among the pharmaceutical distribution, retail pharmacy and other business segments, e.g. providing reliable supply channels or producing private-label products for the retail drug stores, which can create efficiencies and cost savings for Sinopharm in the long run.
- ✓ **Subscribed by renowned cornerstone investors** Sinopharm has secured renowned cornerstone investors such as Bank of China (03988.HK), China Construction Bank (00939.HK), China Life Insurance (02628.HK), Government of Singapore Investment Corp, Och-Ziff Capital Management, Martin Currie Investment Management, Value Partners Limited (00806.HK) and China Chengtong (00217.HK), illustrating the investment value of the Company.

Weaknesses/Threats

- × **Valuation tends to be pricey** Given the recent IPO revival, Sinopharm is likely to price its shares at the high end of the indicative range. Based on the high-end offering price of HK\$16.0, the FY09E PE ratio of Sinopharm is 36.64x. The valuation is expensive, compared with other HK-listed pharmaceutical manufacturing companies, such as China Pharmaceutical (01093.HK, FY09E PE 7.58x), the United Laboratories (03933.HK, 9.21x) and Guangzhou Pharmaceutical (0874.HK, 15.9x). Sinopharm's valuation can only be marginally justified if we benchmark it against those high-growth Chinese retailers such as Belle (01880.HK, 23.0x), Tingyi (00322.HK, 28.7x) and Hengan (01044.HK, 27.3x).

Recommendation: Subscribe

**Important Disclosure / Analyst Certification / Disclaimer**

This document is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (BEA).

The research analyst primarily responsible for the content of this report, in part or in whole certifies that the views on the companies and their securities mentioned in this report accurately reflect his/her personal views. The analyst also certifies that no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. Information and opinions expressed herein reflect a judgment as of the date of this document and are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is not to be taken in substitution for the exercise of judgment by respective readers of this report, who should obtain separate legal or financial advice. East Asia Securities Company Limited and / or The BEA Group accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or further communication given in relation to this report.

At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA along with its affiliates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its associates, its directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company or companies mentioned in the report.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of, or located in, any locality, state, country or other jurisdiction, publication, availability or use would be contrary to law and regulation.